VALUE CONTRARIAN
ASSET MANAGEMENT

The greatest sign of appreciation you can show us is when you refer the V/C Fund to one of your friends or family members.

Kindly note, the Value Contrarian Equity Fund may only be purchased once monthly.

Last Day for September Purchase*
September 25, 2020

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2020 Second Quarter
Value Contrarian Equity Fund

* **Cheques must be received by Friday September 25, 2020**

VALUE CONTRARIAN
ASSET MANAGEMENT

2020 Second Quarter
Value Contrarian Equity Fund

Dear Partners,

Many investors have underestimated the impact of low yields on [asset] valuations… The reduction of interest rates to near zero has increased the value of investment assets and spurred a global bidding war that has raised their prices

Howard Marks
Oaktree Capital Management
August 2020

It's completely understandable why many people believe that [stock] markets are no longer tethered to reality because the performance doesn't correspond to their personal experience, which is one of job loss, economic hardship and personal despair.

Barry Ritholtz
Ritholtz Wealth Management
August 6, 2020

…. Companies that do have better technology, better earnings prospects and the ability to be disrupters rather than disrupted (i.e: Tesla) still aren't worth infinity. Thus, it's possible for them to become overpriced and dangerous as investments, even as they succeed as businesses (This was the case with the Nifty-Fifty growth stocks during the 1968 – 73 period, & Microsoft from 1999-2012)

Howard Marks
Oaktree Capital Management
June 2019

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Today, we are witnessing many unsettling Covid consequences regarding the financial system and global stock markets. Specifically, the continuation of the 10-year bull market that has been "propped up" by massive central bank intervention with numerous monetary and fiscal stimulus programs.

This has included printing a flood of new money, the launching of an array of stimulus programs, easy credit, interest rates near zero, and directly for the first time, government purchasing the debt of troubled companies. There is no doubt "easy money" has juiced up the value of stocks, bonds, real estate and other financial assets.

Nonetheless, don't be fooled. While the mega-cap growth and tech companies have done incredibly well in the pandemic, there is the other side to this coin. As of mid August, over half the S&P500 members are still below their levels when the market last peaked on February 19th. Yet, the S&P500 recently soared to record new highs!

The rationale for the lofty equity valuations of today remains the historically ultra low interest rates. Falling interest rates have the effect of making a stock's stream of future earnings more valuable, thus jacking up stock prices even further than a year ago when rates were higher.

Over the past eighteen months, the crash in fixed income yields, from 3% in September of 2018, to 0.50% on U.S. 10-year T-bonds this past summer, helps further explain the remarkably strong stock market recovery from the coronavirus triggered selloff in Feb/March. Once again, today it's all about T.I.N.A. - meaning, "there is no alternative to stocks."

Fund managers are now betting that policy makers will somehow manage to keep interest rates ultra low both longer and deeper than most expect, or at least until inflation lifts or unemployment subsides.

Down the road, trouble will eventually arise when the four-decade (1981-2021) secular bull market in bonds comes to an end, and interest rates start to rise again. But until then, enjoy the ride (bumps included).

Second Quarter Performance

> **…The skeptics seriously underestimate the ability of the technological leaders to grow, <u>and to pull up</u> the overall growth rate for the universe of common stocks. They [tech] grow every day, and so does their representation in the equity indices and in corporate America, <u>creating a virtuous circle</u>**
>
> **…I don't know whether these [tech] bullish arguments are absolutely correct or merely have gained luster thanks to their having driven the 46% gain of the S&P 500 over the last four months [April – July 2020].**

Howard Marks
Oaktree Capital Management
August 2020

> **"Time is the friend of the wonderful (high ROE) business, it is the enemy of the mediocre (low ROE) business."**

Warren Buffett
Berkshire Hathaway

Your Fund ended the second quarter with a net asset value of <u>$3,197.48</u> per unit, a decrease of <u>$32.08</u> from the December 31, 2019 net asset value of $<u>3,229.56</u> per unit (after distributions). Your Fund returns: -0.99% year to date.
(Note: By the end of August, your Fund moved into positive territory for the year: ____.)

Year to date at June 30, the TSX Composite index was down -7.47%, and the S&P500 was down -3.08%.

Since March, there has been a frantic/speculative frenzy of retail investors <u>piling into the markets</u>. In certain respects, this has been reminiscent of the <u>1998-2000 dotcom bubble</u>. One of the most blatant manifestations of this speculative fervor has been the resounding success of the commission free trading app – "<u>Robin Hood</u>." Yes, day traders and retail investors are back in full force – <u>not a positive sign</u>.

Mystifying to most investors is the fact that since the end of March, the stock market has been on a tear, yet the economy stinks, and unemployment levels are off the charts.

Has the stock market decoupled from reality?

1) The economy most people experience is local, personal and not publicly traded. Dining, retail stores, personal care services and most small businesses are not a big component of the major stock indices.

2) As one observer wisely observed, "the U.S. economy is not the stock market and vice versa." The stock markets don't correspond to the actual hardship of mass unemployment and small business dislocation.

3) The major stock indices are dominated by the 5 big tech wonders (Amazon, Facebook, Google, Apple, and Microsoft). These five names represent approximately 25% of the S&P500 index. They also have benefited the most from the pandemic lockdown. It is these 5 stocks which are pulling the S&P500 index into positive territory for the year.

4) The majority of the companies in the S&P500 index have negative returns for the year – yet the index is actually up for the year. How so? Market capitalization explains why. Because stocks with the biggest market values (Apple, Microsoft, Google, etc…) carry the most weight/influence in the S&P500.

5) Simply stated, the beat-up sectors in the S&P500 index don't count for very much in the grand scheme of the index. Airlines, hotels, retailers, and restaurant chains. Although highly visible industries and of considerable significance to the real economy, they in reality are not overly significant to the capitalization-weighted S&P500 index. Apple and Microsoft each represent more than 5% of the index (10%+). While the whole airline industry represents a mere weight of 0.18 percent of the index! Department stores a mere 0.01% of the S&P500.
   You get the idea now!
   In other words, it's only a few sectors/industries which are doing much of the heavy lifting and driving the index higher (internet content/retailers software, consumer electronics.)

Thus, it is not hard to see why many people are totally mystified as to the spectacular rebound in the North American stock markets of late. Simply stated, it does not correspond to their everyday personal experiences.

The Value Contrarian portfolio remains essentially "Tech Light". Other than our holdings in Paypal, mobile payments ETF, Canadian software provider Lighspeed, IT provider CGI and Berkshire Hathaways' massive holding in Apple stock, we are not over represented in this sector.

On the surface, it would seem mystifying how the Value Contrarian Fund has produced superior returns this year with a tech/gold light portfolio. In essence, it's all about our investing discipline, strategy and quality businesses. And yes, it took a heavy dose of Pepto-Bismol to be buying into the travel, restaurant hospitality and hotel sectors during a Covid pandemic market selloff.

Our performance can be attributed to these three main factors:

1) Going into March, we were approximately 30% cash. This fact gave us huge firepower to buy during the depths of the March panic selloff. At its March lows, the Dow was back at levels last seen in 2016. While the TSX dropped to levels last seen in 2012. (Remember my term: "Phoney Bull Market"?)

2) This year, the bulk of our purchases were wisely made in March. In addition, the majority of our buys, while not in tech, were in high quality companies (high free cash flow, above average ROE and shareholder friendly management).

3) Many of our equity additions in March were in sectors crushed by the Covid pandemic, and thus subject to potentially a greater snapback. A good example is our position in Realogy, the largest franchisor of Century 21.

*(Please see attached VC Fund's March Covid purchases and subsequent gains to August 31rst.)

It is important for investors to realize another significant reason why stocks are flying today – that's because of something called P/E multiple expansion. For example, between 2012 and 2016 one could purchase Apple stock for 10-11x earnings. In other words, for every one dollar of Apple earnings, an investor paid $10-$11 in stock price. Today, Apple shares trade at approximately 35x earnings (P/E 35). For every one dollar of Apple earnings, today an investor would have to pay $35 dollars.

P/E multiple expansion is a nice gift. It's similar to cycling with the wind to your back. However, the flip side is multiple contraction! Rising interest rates and slowing earnings growth are important factors in P/E multiple contraction.

Microsoft, for example, suffered a major P/E multiple contraction from 2000 until 2011. During this period its stock went nowhere. From over 35 P/E, Microsoft's P/E dropped to 9.6x in 2011; great company, higher earnings, but a slower growth rate from 2000-2011. Easy come easy go!

Going forward, you will probably grow tired of hearing me repeating this, but, in this high P/E market environment, investors must be psychology prepared for occasional market corrections/pullbacks of 5%-10%-18%. Don't confuse corrections with a bear market decline. These are two different beasts.

Two to three years down the road, we would not be surprised to see the Dow at ___?___. (see p6 for our Dow prediction)

OUTLOOK

> **There isn't an interest rate [i.e. fixed-income product] anywhere in the world that looks attractive once you take inflation into account. That makes just about everything else seem more appealing.**
>
> **David Vickers**
> **Russell Investments**
> **Financial Times**
> **August 7, 2020**

> **The priorities of the US Federal Reserve are clear: take the edge off shocking events, <u>even if it means inflating and distorting asset prices</u>.**
>
> **Michael Mackenzie**
> **Financial Times of London**
> **June 14, 2020**

<u>The Bad News</u>

The fact that the <u>same</u> high-tech names are once again <u>leading the markets higher</u> coming off the Feb/March 2020 bear market lows, (as was also the case coming off the Oct-Dec 2018 near bear market) is actually <u>not a positive technical sign</u>. Rather, in our humble opinion, this was a sign that a true end of cycle market bottom <u>was not reached on March 23rd, 2020</u>.

At the <u>true end of a business cycle</u> and stock market bottom, <u>all stocks are washed out</u>, including the mighty tech names (Amazon, Microsoft, Apple, Facebook, Google). Moreover, true end of cycle bear bottoms are not reached, peak to trough, <u>in a mere 42 days</u>. Rather, secular bear markets feel like <u>Chinese water torture</u>, lasting 12-24 or 36 months, before a final bottom is reached.

Perhaps, history may give investors a glimpse of what lies a few years ahead. More specifically, the era of the mighty "Nifty Fifty" stocks. These were the leading growth stocks of the late 1960's (also then trading at nosebleed P/E multiples) that were <u>eventually crushed</u> in the brutal bear market of 1973-1974. Their "invincible" business models (Coke, J&J, Merck, Philip Morris, Xerox, Polaroid, IBM, etc.) could not forever defy the laws of economic gravity, slowing growth, P/E multiple contraction, and finally the October 1973 Arab-Israeli war/oil embargo.

While today big tech does represent the future, and will continue to grow, however, the pace of tech stock market returns are likely to diminish as their growth continues but slows, and their price/earnings multiples move into nosebleed territory. This will give investors and the markets reason to pause, along with an eventual compression in sky-high P/E multiples.

The Good News

On a more positive note, we believe the coast remains clear for a few years to come. Or until assets/securities start to feel the effects of a significant rise in interest rates or a new financial crisis emerges. Sky high valuations by themself don't cause bear markets, rather it is rising interest rates or surprise events which crush corporate earnings.

Without a significant rise in interest rates over the short term, the broad stock index's could rise 5% - 15% above the record highs of February 2020!
Dow 33,000 – is a possibility.

At a certain juncture, (as was the case after March/2000 when Tech peaked) we would expect to see a pronounced rotation out of the five Tech "Wonder Stocks", into the more traditional "value" stock plays, such as Berkshire Hathaway and SNC Lavalin.

While these 5 Tech U.S. "Wonder Stocks" (23%+ of S&P500 index) have again been driving markets higher since the March pandemic lows (gold, commodities & Shopify in Canada), it will be "value" stocks which will extend the duration of this present stock rally.

Conclusions

Obviously, ultra low rates increase the likelihood of asset bubbles and speculative manias. Hopefully, investors will refrain from reckless behaviour in their quest for income and riskier higher yields. (Watch out for your friendly local stockbroker recommending higher yielding fixed income products, where you don't fully understand the risks).

Investors must be fully aware that "exuberant markets" can and do get ahead of themselves. Thus, don't be surprised by volatile markets. 10% - 18% corrections should be expected. The Brexit referendum of 2016 was a perfect example of a market pullback catalyst which did not end the existing bull market.

After the 2008-2009 financial crisis, it took more than six years before the interest rate cycle started its long march upwards (U.S. rates started to increase in December 2015, peaking in early fall 2018). Low rates are here for now!

There likely remains a few more years before rate increases could sabotage the present stock market party. Unfortunately, we can't predict the future. We can however, reflect on the lessons of history, and apply discipline when it comes to our capital allocation. "Price is what you pay. Value is what you get."

Respectfully yours, **

Benjamin D. Horwood
Portfolio Manager
September 4th, 2020

Value Contrarian Equity Fund
Next Fund purchase date:
Call today: 514 – 398-0808

P.S. Do visit us at our web site: **www.valuecontrarian.com**

**We're often asked: "When is the best time to invest in the Value Contrarian Fund?" Although there is no best time, since it is impossible to time the market, a preferable entry point is when the Fund has produced a month of negative returns or a year of underperformance. Unfortunately, human nature prefers the exact opposite.

Overall, long-term shareholders in the V/C Fund benefit from a sinking stock market, the same as a regular grocery shopper benefits from declining food prices. So when stock markets plummet – as they will from time to time – "neither panic nor mourn". It's good buying news for your Fund.

2020 VC Fund March Bear Purchases

Individual Stock Returns March - Aug 31/2020

#UNITS	PRODUCT	COST PRICE	PRICE NOW	% INCREASE
12,000	**A&W REV RYLTS**	$ 21.067542	28.20	**34%**
5,000	**CANADIAN NATURAL RESOURCES**	$ 20.42	25.72	**26%**
10,000	**CGI INC**	$ 73.416	91.62	**25%**
15,000	**KNIGHT THERAPEUTICS**	$ 5.23	6.21	**19%**
5,000	**LIGHTSPEED INC**	$ 17.18	45.30	**164%**
1,000	**MAGNA INC**	$ 45.65	63.52	**39%**
2,036	**PEMBINA PIPELINE CORP (PPL)**	$ 38.55	32.30	-16%
10,000	**QXM -CI FA MORN NAT BK QUE ETF**	$ 15.84	19.51	**23%**
2,000	**RESTAURANT BRANDS**	$ 49.06	70.67	**44%**
40,000	**SNC LAVALIN GROUP**	$ 20.94	23.08	**10%**
US.	US.	US.	US.	US.
2,500	**AON PLC**	USD 151.95	199.99	**32%**
1,000	**AMERISOURCEBERGEN CORP**	USD 75.03	97.03	**29%**
1,000	**BERKSHIRE HATHAWAY**	USD 175.00	218.04	**25%**
350	**BOOKING HOLDINGS INC**	USD 1,225.49	1,910.45	**56%**
2,500	**DISNEY WALT COMPANY**	USD 91.39	131.87	**44%**
4,500	**GENERAL DYNAMICS CORP**	USD 118.352	149.35	**26%**
10,000	**INGERSOLL-RAND INC**	USD 19.75	35.06	**78%**
12,500	**HILTON GRAND VACATIONS**	USD 14.54	21.91	**51%**
250	**IHI-ISHARES US MED DEVICE ETF**	USD 185.51	303.89	**64%**
2,500	**IPAY - ETFMG PRIME MOB PAY ETF**	USD 38.01	56.39	**48%**
4,500	**PAC - GRUPO AEROPOR DEL PAC**	USD 56.45	77.48	**37%**
1,250	**PAYPAL HOLDINGS INC**	USD 87.01	204.14	**135%**
45,000	**PERSHING SQUARE HOLDINGS LTD**	USD 14.66	27.80	**90%**
1,250	**PSCH-INVESCO S&P HEALTH CARE**	USD 94.64	133.26	**41%**
74,000	**REALOGY HOLDINGS CORP**	USD 4.10413	11.08	**170%**
4,550	**TRIMTABS ALL CAP US ETF**	USD 29.21000	42.53	**46%**
100	**VBK-VANGUARD SM CAP GROWTH ETF**	USD 124.75	218.53	**75%**
250	**VHT-VANGUARD HEALTH CARE ETF**	USD 140.05	207.47	**48%**
12,500	**WYNDHAM DESTINATIONS INC**	21.9050304	28.99	**32%**