VALUE CONTRARIAN
ASSET MANAGEMENT

2023
Full Disclosure

Over the coming years we want to advise investors that the Value Contrarian Fund **may** be **more volatile** than has been the case in the past. Here is our reasoning:

1) When your Fund is fully invested, we are subject to the full volatility of the financial markets. As we don't short stocks, **cash** is often the simplest, risk-free instrument to blunt stock market volatility.

2) Berkshire Hathaway, Warren Buffett's investment vehicle, represents approximately 20% of your fund's assets. We view this as a strong investment in all market conditions. Nonetheless, there will be years (like 2019 & 2020) where Berkshire underperforms the market and will impede your Fund's returns.

3) In general, a rising Canadian dollar and a weakening US dollar will also affect your Funds results, due to our significant U.S. holdings. Presently, the Canadian dollar is approximately 75¢. However, if over the coming years it rose to 85¢ or 89¢, this would add a stiff headwind to your fund's net results.

Predicting currency moves is about as easy as predicting the weather this time next year. Good Luck!

Benjamin Horwood

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2022 Year End
Value Contrarian Equity Fund

Dear Partners,

> **It's becoming clearer that inflation has peaked and we're closer to the end of the rate cycle than people were concerned we'd be… That's why markets are breathing a sigh of relief [and powering up!]**

Jamie Cox
Partner, Harris Financial Group
January 11, 2023

> **The historical record cautions strongly against prematurely loosening policy. We will stay the course, until the job is done.**

Jerome Powell
Fed Reserve Chairman
February 1, 2023

> **Most bankers – and most money managers – seem to be congenitally optimistic about the future. Among other things, it's in their best interests, as it helps them do more business. But this optimism certainly shapes their forecasts and their resulting behavior.**

Howard Marks
Oaktree Capital Management
September 8, 2022

> **No pain in the stock market – means less chance of the Fed lowering rates significantly in the near term.**

Ben Horwood
Fund Manager, Value Contrarian Equity
Feb 1, 2023

Higher rates in 2022 sapped the appeal of tech and other unprofitable ("show me"?) growth stocks because they lowered the future value of their projected earnings. Apple shares have fallen approximately 26.83%, Amazon has lost roughly 49.62%, and Microsoft has slumped around 28.69%.

The Canadian stock market was a relative winner in 2022, for the obvious reasons of its heavy exposure to the energy and commodity sectors. While we heard ample talk about bear markets, at no time in 2022 did the TSX Composite Index fall into bear market territory!

In short, 2022 has been what is known as a "stock pickers" market. Approximately 50% of actively managed large-cap mutual funds were on pace to beat their benchmarks in 2022 (according to a December 20 Wall St Journal article).

Going forward, perhaps, no longer can one invest in the 5 FAANG stocks and cruise to outperformance.

We have been witnessing over the past year possibly the most well telegraphed recession in a very long time. With inflation having likely peaked, and interest rate increases coming to an end, it seems the market bottom was made in October and the worst is over (until the next bear market, or surprise crisis/OMG event).

Today, the conundrum investors face on the economic outlook is real. The Fed is still raising short term rates, (bad for stocks & the economy) but on the other hand, the yield on the 10yr long bond has fallen from 4.25% to 3.5% (positive for stocks & the economy).

Will the stock market take its lead from rapidly falling long bond yields or higher & longer short term rates? If January 2023 is any indication, the market is being led higher by falling long term interest rates.

For the time being, there is a disconnect between the Fed and investors. Investors just don't believe the Fed will carry out its stated interest rate policy of "higher & longer". So far, investors and stocks have been winning this battle.

2022 Performance: (-2.72%)

Warren Buffett once said… "If interest rates are <u>nothing</u> [low], values can be <u>infinite</u>. If interest rates are <u>extremely high</u>, that's a huge [downward] gravitational pull on values."

Noah Solomon
Financial Post,
January 18, 2023

It seems to me that a significant portion of all the money investors made over this period (1982-2022) resulted from the <u>tailwind</u> generated by the massive drop in interest rates. <u>I consider it nearly impossible to overstate the influence of declining rates over the last 4 decades.</u>

Howard Marks
Oaktree Capital Management
December 13, 2022

If you ask Warren Buffett to describe the foundation of his approach to investing, he'll probably start by insisting that stocks should be thought of as <u>ownership interests</u> in companies … people who buy stocks should think of themselves as <u>partners of owners</u> … [Unfortunately] most people buy stocks with the goal of selling them at a higher price, thinking they're for <u>trading</u>, not for <u>owning</u>. This means they abandon the owner mentality and instead act like <u>gamblers</u> or <u>speculators who bet on stock price moves.</u>

Howard Marks
Oaktree Capital Management
Letter to Investors
November 22, 2022

The old saying from market veterans is that investors should take their cue from the long bond market – that's what the smart money pays close attention to.

Simply stated, falling 10yr bond yields are fighting the Fed's actions of raising short term rates! In our opinion, falling long bond yields are telegraphing that the worst of the 2022 bear market is over! But that does not mean the Fed will be rushing to lower interest rates once it finishes with rate hikes.

Down in the stock market trenches, 2022 did not produce a "killer" bear market – defined as a stock index "peak to trough" decline in excess of 40%. Rather, 2022 produced "garden variety" bear markets for both the Dow & S&P 500 indices, meaning declines between -20% to -30%. While the TSX index did not even enter bear market territory (a decline of at least negative 20%).

In short, the January to October bear market inflicted painful damage to the blue chip tech FAANG stocks, and some very serious damage to the high sales growth, but no profit SPACs & Fintech sectors. Additional sectors pummeled by rising rates included, housing/construction/and real estate.

Interestingly enough, more than half the stocks in the S&P 500 actively outperformed the index in 2022. The reasons were simple. 20%-30% of the Index is concentrated in 10 tech names, they suffered the larger declines, dragging the entire index down.

Going forward, it will be interesting to see if these 5-10 concentrated high profile tech names continue to wag the S&P 500's tail? Or, has the 2022 bear market cleared the deck for a new crop of stocks to lead the broad Index's forward over the next 5 years.

Your fund manager sidestepped the worst of the carnage as a result of:

1) New investors' monies brought our cash levels to 28%. This greatly cushioned the downside risks.

2) Berkshire Hathaway, our largest position, produced small positive returns for the year.

3) Our US Dollar assets were aided by a falling Canadian Dollar, $0.79 in January to $0.73 by December.

4) No major portfolio catastrophes! Yes, we had some good luck on our side in 2022.

5) Our sins were more of "omission", rather than sins of "commission".

During the final quarter of 2022 we added some tech names that one would not normally associate with the Value Contrarian Fund.

Specifically, we purchased the Krane Shares China Internet ETF. This vehicle holds a basket of 34 Chinese internet companies which are listed on the New York Stock Exchange.

From the Fall of 2021 to mid October 2022 these shares were decimated, falling 83% ($105 to $18). Our 30,000 shares were purchased at an average cost of $21.79.
The top holdings in this ETF include the following well known names: Tencent Holdings (10.8%), Alibaba (9.2%), Meituan (7.6%), Pinduoduo (6%), and JD.Com (5.9%) – amongst others.

The final straw pummeling this sector ETF occurred in late October, one day after President Xi secured a third term as leader of the Communist Party. For example, during one bad day for Chinese stocks in general, the NASDAQ Golden Dragon China Index, which tracks dozens of Chinese companies listed on the American exchanges, fell more than 14% to its lowest close since April 2013, erasing $73.4 billion of shareholder wealth. Thus, giving back all investor gains to April 2013 is a perfect example of my famous expression – "A Phoney Bull Market".

The markets obviously did not like that President Xi, and his less than shareholder friendly policies, would remain in power for the foreseeable future. In addition to the above political negative, for over a year, there was the threat coming from the SEC (Securities & Exchange Commission), of forcing Chinese companies to delist their shares off American stock exchanges. (Chinese authorities were refusing to give US Accounting inspectors full access to audit working papers of New York-listed Chinese companies – thus the U.S. delisting pressure tactics).

With the Krane China Internet ETF holding blue chip, low P/E, Chinese internet stocks – your manager pounced in mid October. Cathartic selling was occurring. But these massive multibillion dollar companies were not going to disappear, nor were they being technologically disrupted!

Instead, it was all about politics, and political pressure from both the Chinese government and the US Securities & Exchange Commission. Since late October, this ETF has doubled in value. A compromise regarding these audit issues was finally negotiated, while President Xi has taken some of the pressures off the Chinese high tech sector. We would not be surprised to see this stock quadruple off the bottom.

Unfortunately, the bear market of 2022, in our opinion, was not a "killer" bear market, and thus did not fully clear the deck of all the 2009-2021 excesses.

The question remains whether the next five year period is just a "Phoney Bull Market**" – like the experience of the Golden Dragon China Index, which by 2022, temporarily reverted back to its 2013 levels.

OUTLOOK 2023

While the extreme <u>froth</u> has been wiped off the market, <u>valuations</u> are still nowhere near their long-term averages.

Jeremy Grantham
Chief Market Strategist
Founder GMO LLC
January 28, 2023

I'm not going to try to persuade people to have a different forecast, <u>but our forecast</u> is that it will take some time and some patience, and that <u>we'll need to keep rates higher for longer</u>.

Jerome Powell
Fed Chair
February 1, 2023

For the Fed to begin cutting rates this year… one of two scenarios must materialize: a severe recession [ie: 8%-15% stock correction] or convincing evidence that inflation will fall back down to the central bank's 2% target [a goldilocks scenario] in the near future.

Jeremy Schwartz
Credit Suisse Senior Economist
February 2023

These days, there's a new kid in town. We call him the "interest rate kid". In his holster is the real threat of much higher interest rates than we have grown accustomed to. As the ever-insightful Howard Marks points out, "investors can now potentially get solid returns from credit instruments (ie: GICs/bonds/mortgages/ect.). Meaning they no longer have to rely as heavily on riskier investments to achieve their overall return targets".

"Lenders and [equity] bargain hunters face much better prospects in this changed [new] environment than they did in 2009-21 [a period of ultra low rates]", according to Marks.

If you believe we are in a changed environment, then the equity leaders and strategies of the last thirteen years, "may not be the ones that outperform in the years ahead". Going forward, Tesla/Tech/FAANG investors may be sorely disappointed with "rear view mirror" investing strategies.

2022 was a year in which stocks were in an interest rate bear market. Nobody knows for certain if 2023 will turn into an earnings-driven bear market. The question remains, how much has the 2022 selloff discounted the coming "projected" earnings recession of 2023?

Our Educated Predictions For 2023:

1) Expect positive, low double-digit, TSX returns in 2023 [the post bear market snap back].

2) No new bear market lows. October 2022 being the lows of this first bear market. (In our opinion, the ultimate market lows will only occur during the next bear market – timing unknown)

3) ** When will the Fed lower rates? It's a game of chicken between the Fed and a booming stock market. Our guess is that when the markets correct 8-15%, this will give the Fed an opening to start lowering rates. Doing otherwise, will simply add fuel to the fire. No pain in the stock market – means less chance of the Fed lowering rates!

4) Going forward, dividends will play a much greater role in an investor's total returns. Buy dividends!

5) 10-year bond yields have fallen to under 3.5% today, from the October peak of 4.25%, thus propping up the equity markets. Our predictions are based on a 10-year bond yield below 4%, and a Fed that is near the end of its rate hike cycle.

6) Going forward, the dominance of mega-cap tech FAANG stocks in the indices, will be vastly diminished. For example, from 2000 to 2012, Microsoft's stock price languished for over 10 years, despite rising earnings (it's called P/E multiple contraction).

7) Despite geopolitical issues, China will be the place to make money in 2023. This is based on cheap valuations, and the post bear stock market "snap back" effect. Simply stated, the harder a sector falls from grace, the greater the eventual rebound.

8) Last year's winning stock markets will continue their positive streak. Thus, the TSX index will likely continue its outperformance in relation to the broad US indices.

9) Don't be surprised to see an 80¢-85¢ Canadian Dollar over the next 18–24 months, and the TSX making new record highs.

10) Wildcards as always: Middle East wars, Vladimir Putin exits/Ukraine verges on collapse or unexpected financial blow-ups.

As 2022 was not a "super" bear-market event (40%+ declines), and interest rates may linger higher & longer than expected, investors should not expect an outsized market snap-back similar to the 2009-2010 market recovery. Lest we forget, last year the TSX Index did not even enter into a bear market, unlike the Dow, S&P 500 and NASDAQ.

In conclusion, today's "uncertainties" are the catalysts which often create opportunities in the equity markets. Nonetheless, due to higher than normal historical valuations and a higher interest rate environment, we predict stocks will produce more subdued returns over the next 10 years than the previous 10 years.

The good news is that when the Fed eventually lowers rates, the Dow/S&P500/TSX indices will all make new record highs within the next 18-36 months.

Respectfully yours,

Benjamin D. Horwood
Portfolio Manager
February 1, 2023

Value Contrarian Equity Fund
Next Fund purchase
Date: February 20, 2023
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.

It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently.

Warren Buffett
Berkshire Hathaway

As we have always stated, we cannot promise any particular results, only that investments for your Fund will be selected based on **value not popularity**. We view our Fund shareholders as our partners, and we assure you that the protection and growth of your capital will continue to be paramount in our thinking.

We aim not to be the biggest but to ensure consistent performance, even if that means limiting the Fund's size or closing it to new investors in the future. We want to enjoy coming to work every day and view the Value Contrarian Fund more as a private partnership, where "membership has its privileges".

Secular or disruptive technological changes to an industry or company is what truly destroys shareholder wealth and keeps us up at night (think Nortel, Abitibi, Kodak or Blockbuster). Conversely, stock-market volatility or the fear and panic of a bear market are merely temporary but opportunistic events for the rational buyer. At the end of the day, "**price paid**" is what matters most when investing for the long-term. **"Price is what you pay, value is what you get".**

Being the third largest shareholder and the Manager of your Fund is certainly no guarantee of superior long-term results. But I do think one's comfort level is enhanced by having my financial interests aligned with yours. **Simply stated, your returns are my returns**.

Finally, much applause and thanks to all the Value Contrarian staff. There were significant changes to our business model and a lot of stressful moments in 2022. Specifically, on June 30th, VCAM exited all of our private client business. This technical and time-consuming conversion was smoothly handled by Chiraz, our operations manager. As always, Chiraz expertly (and with patience that I don't possess) guided us through the "thicket" of financial and never-ending regulatory hoops. 3 hats off to Chiraz!

I would also like to welcome aboard our McGill student, Domenico Marti, as a full time employee commencing in May. With Dom, "Please take care of it" are requests that certainly can be executed with confidence. Gen Z to the rescue!

We would like to thank our shareholders for the trust you have placed in us during this volatile past year. And again, **thanks for your referrals – much appreciated – keep them coming.**