VALUE CONTRARIAN
ASSET MANAGEMENT

2022
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 anchor 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) 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 78.8¢. 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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2021 Year End
Value Contrarian Equity Fund

Dear Partners,

> **The longer the Fed takes to tackle a high rate of inflation, the more inflationary psychology is embedded in the private sector – and the more it will have to shock the system. [Perhaps with even higher rates than expected]**
>
> **Henry Kaufman**
> **Former Vice Chair Salomon Brothers**
> **Jan 14, 2022**

> **There's nothing in the market variables that is telling me the Fed is behind the [inflation] curve. Be careful what you wish for [higher rates], because six months from now we'll be talking about a recession and inflation is going to be relegated to the back pages of the newspaper.**
>
> **David Rosenberg**
> **Rosenberg Research**
> **February 2, 2022**

> **Certainly, we prefer to act through international co-operation, but if necessary – we will defend ourselves, by ourselves [against Iran].**
>
> **Yair Lapid**
> **Israeli Foreign Minister**
> **December 2021**

During the first year of the 2020 pandemic, the yield on the 10-year U.S. treasury bond (0.93%) had dropped 94% from the 15.8% yield available in September 1981. Simply state, in 2021, the easy money environment and P/E multiple expansion contributed to the double digits returns on the major North American stock market indexes.

2021 started out with significant speculative froth. In vogue were investments such as crypto, SPACs, and profitless growth stocks. (i.e.: Lightspeed, Nuvei, Shopify, etc…)

FOMO – "Fear of Missing Out" was in full bloom during the year. Recently, my favorite local sushi chef was eager to talk about his picks in the "hot" Canadian oil sector. These are classic signs of speculative late market excesses! When your neighborhood sushi chef suddenly becomes engaged in the stock market frenzy, your managers "yellow flashing lights" are on high alert!

Beneath all the investor and market euphoria in 2021, dangers lurked like hidden icebergs. Specifically, "market breadth" was not robust. By this we mean it was a handful of stocks or a few sectors which led the index's higher for much of the year.

Much of the 2021 gains on the TSX Index were the result of two sectors, energy, and banks/financials. While in the U.S., by years end, 7 stocks made up approximately 27% of the SAP 500 Index. (Apple, Microsoft, Google, Amazon, Facebook, Tesla and NVIDIA). Not a healthy technical sign.

History has repeatedly shown that expensive stocks or markets are not the "catalyst" driving equities lower. Rather, expensive stock markets just make any eventual decline more pronounced, and reduce future expected investment returns.

In 2022, it still pays to remember some "old school" wisdom. In today's world, the basic human emotions of "fear" & "greed" are still in full force. These emotions and have yet to be conquered by any of today's new technologies, or free trading apps!

P/E multiple contraction, resulting from higher interest rates, will be the Achilles' heel of the stock market in 2022-2023. Thus, Apple may no longer trade at 35x earnings, but eventually 25x earnings.

Caveat Emptor.

2021 Performance - + 18.6%

This [stock market] isn't a fake companies bubble [i.e.: internet stocks 1995 2000], it's an order-of-magnitude overvaluation.

Erik Gordon
Prof-Michigan Ross School Business
February 1, 2022

[Fed Chairman] Powell was distinctly not willing to rule out more frequent [or] larger rate hikes.

Nathan Sheets
Chief Economist - Citigroup
January 28, 2022

When the Fed began raising rates in 1994, 1999, 2004, and 2015, inflation was near or below its desired level… The tightening was thus pre-emptive, [and] intended to keep inflation from going up rather than push it down. That gave the Fed considerable latitude about how fast [and far] to raise interest rates.
Today, inflation is [already] too high.

Greg Ip
Wall Street Journal
January 27, 2022

December 31, 2020 – $ 3,753 (NAVPS after distributions)
December 31, 2021 – $ 4,458 (NAVPS before distributions)
December 31, 2021 – $ 246.50 (Year-End Distribution per unit)
December 31, 2021 – $ 4,203 (NAVPS after distributions)

Your Fund ended the year with a net asset value of $ 4,203.71 per unit.

For calendar year 2021, the TSX Composite Total Return Index rose: +25%; the S&P 500: +28.7%, and the NASDAQ: +27.4%.

The era of investors buying profitless sales growth stocks, while racking up effortless stock gains has passed. Surging inflation and the prospect of numerous interest-rate hikes have dented the 2009-2021 bull market.

***Furthermore, unlike in the past, there are no guarantees that the Federal Reserve will ride to the rescue with lower rates during the next market downturn.

According to one line of thought (Greg Ip – Wall Street Journalist), the Fed is so far behind the inflation "curve ball" that it needs to get interest rates up almost irrespective of the upcoming data. As a result, the Fed won't be holding the market's hand by committing to a particular path of rate increases. "This is a "recipe" for unpleasant surprises (larger individual rates hikes), more market volatility, and a risk premium in the form of higher bond yields…"

There is a looming dilemma the Bank of Canada and the U.S. Fed may eventually face. At some point, the Fed may have to choose between which specific problem to rescue:

1) A plunging stock market; or
2) Persistent inflation.

In other words, will the Fed, as it has in the past 30 plus years, come to the rescue of stocks and a falling stock market with lower rates, or;
Will the Fed make the tough decision and continue to raise or maintain rates, despite a weak/falling stock market, in order to win the battle against inflation.

David Rosenberg (see quote p.2) provides a differing view on the severity and duration of today's inflation threat. Only time will tell whether today's outbreak of inflation is "transitory", or something more entrenched.

Your Fund had a solid year of singles & doubles. We took profits early in our energy holdings. Not being overweight in the energy/commodity sectors did hold back your Funds returns for the year.

For the most part, our larger positions performed well. TD Bank (+39.2%), Berkshire (+28.9%), AON (+43.2%), Pershing Square (+17.4%), and CGI (10.7%).

We took advantage of the billion dollar + Definity – Insurance IPO for a quick gain of over 30%. Definity is one of Canada's largest property & casualty insurance companies.

Luckily, we did not have any major "blow-ups" in the portfolio. However, your manager was "early" investing in an ETF holding "bluechip" Chinese internet stocks.

Alibaba, Tencent, etc. were down over 50% from their record highs as a result of the Chinese governments crackdown on the tech sector and its freewheeling entrepreneurs. Add in rising interest rates, a slowing economy, and regulatory uncertainties, and now one can better understand the headwinds facing these Chinese stocks.

Our portfolio anchor (and largest position) remains Berkshire Hathaway, which had another solid year. With rising interest rates now underway, there has been a rotation away from "growth" and into "value" stocks, all to the benefit of Berkshire and its large insurance and financial portfolio.

Buffett, disciplined as ever, did not find any "elephant" sized investments to put its $150 billion of cash to use. Instead, Berkshire spent over $20 billion in the first nine months buying back its stock.

Buffett is a "supremo" allocator of capital, and very price sensitive when buying back Berkshire stock. No worries of him overpaying!

An interesting Berkshire fact. Apple stock represents approximately 50% of Berkshire's entire equity portfolio, and almost 25% of its market capitalization. Berkshire stock will thus suffer "guilty by association" should Apple's stock plunge in price.

Despite Buffet's rock-solid balance sheet, huge cash position, and stable of high-quality business, one must remember Buffet's following observations.

"Berkshire, three times since I took over, has gone down roughly 50%. Did I feel poor then? No, not at all… I knew it was going to be worth more over time. American businesses are going to be worth more over time… But if you think you can jump in and out or that you know the time to come in, then I think you're making a mistake. "(Feb 2017)

Finally, we own a significant core holding in Bill Ackmans, Pershing Square listed hedge fund. While the current asset value of Pershing was up +26.9% for the year, its stock price advanced only +18.7%.

From 2015 to 2018, Bill suffered a series of missteps with Valeant, Herbalife and JCPenny. Nonetheless, Ackman has sharpened his investment skills from this rough patch. Today, Pershing Square is a concentrated portfolio of quality, world class growing business. The Funds holdings include such names as Universal Music Group, Hilton Worldwide, Domino's Pizza, Lowe's hardware store, and Chipotle, amongst others. Simply stated, we are piggybacking off of Ackmans superior investing skills… at a discount!

Ackman relishes being a contrarian. In 2020, he famously made over two billion dollars on a Covid-19 short bet. While recently, he made approximately a billion dollars calculating that there would be a more than expected rise in interest rates.

Unfortunately, in our opinion, the 1.5% + 20% performance fee the Fund charges causes Ackman's vehicle to trade at a hefty discount to its asset value. Thus, we prefer to be buyers of Pershing stock at a 30%-35% discount. (The Fund normally trades at a 25% discount.)

Mr. President, something that never existed… Now does not exist anymore.
[Israeli covert military operation – destruction of the Syrian secret nuclear reactor – September 2007]

Israeli PM to President Bush
Operation Orchard: The Mossad & Sayeret Matkal
YouTube Doc – July 24, 2015

In order to turn the market around to a more non-inflationary attitude, you have to shock the market. <u>You can't raise interest rates bit-by-bit</u>.

Henry Kaufman
Former Vice Chair Salomon Brothers
Jan 14, 2022

Geo-political shocks to the global financial system rarely, if ever, happen totally "out of the blue". Cataclysmic events/showdowns are usually telegraphed well in advance. Investors always need to pay close attention to these potential geo-political powder kegs. These warnings may occur over weeks, months or even years. Today (or in 2023), think - Israel & Iran, Russia/Ukraine or China/Taiwan.

In our opinion, the combination of rising interest rates, with an Iran/Israel conflict, could be the eventual one/two knockout punch to create the conditions for the next bear market. However, should an acceptable nuclear deal with Iran prevail, the payoff could be lower oil prices, and reduced military tension in the Middle East.

Today, western democratic powers don't usually engage in un-telegraphed military moves. It normally takes time to gather a consensus in a democracy. Moreover, only when democracies have been directly attacked, their backs are up against the wall, or a strategic allie has been invaded/attacked, will a western democracy get off its butt and make a military move.

Interestingly, no European/North American democracy has ever destroyed a nuclear reactor. However, there is one nation that is an "outlier" when it comes to destroying nuclear reactors.

The one democratic exception [we can think of] to the above military behavior, is the state of Israel, which in the past has destroyed two nuclear reactors in Iraq and Syria.

Israel, the size of New Jersey, with 9 million citizens [of which 2 million are Arab Israelis] is surrounded by dictatorships, autocrats, and supreme rulers/ monarchs for life. Neighborly relations in the Middle East are not normally a picture of "campfire Kumbaya" love. As people in the region like to say: "it's a tough neighborhood". In our opinion, this region is always one geo-political powder-keg "spark" waiting to blow!

The "starters gun" announcing the official countdown to the onset of the next bear market, likely commences this March/2022, with the first Fed rate hike. A big question, that only in hindsight can be answered: "Is the 40 plus year cycle (1981-2020) of steadily falling interest rates finally over?" History has shown that it can take anywhere from 3 months to a further 3 years (from the initial rate hike) before a final stock market peak has been reached.

The not so good news:

The "**cream puff**" ride of 2021 is over, especially for profitless growth stocks. Rising interest rates in 2022 will mean increased volatility and market corrections. And, there is always the possibility that the Fed overshoots, with more frequent or larger rate hikes than expected.

The good news:

Slowly rising interest rates and inflationary pressures may actually be positive for the Canadian stock market. The TSX commodity, energy, and banking sectors will likely continue to lead the way. Shopify has been dethroned from its #1 position as Canada's largest TSX listed company. The market is now saying – show me profitable growth, as opposed to, fast sales growth!

All the stars are aligning in 2022 for the TSX to finally outperform its tech laden southern neighbor. Canadian stocks represent solid value, trading below their five-year average valuation at about 14 times earnings.

Unfortunately, in the coming year, the gains in the TSX will likely not be broad based. Rather, the gains will likely continue to be concentrated in a few sectors, such as volatile energy & commodities. Thus, Canadian managers will have a tough time beating the market in 2022, unless they are "index huggers".

Barring a surprise "geo-political" event [i.e.; Israel/Iran], rising interest rates will cause further P/E multiple contraction on growth stocks, while favoring profitable value stocks.

Remember, opportunities present themselves in all markets! And don't forget to fasten your seatbelts!

Respectfully yours,

Benjamin D. Horwood
Portfolio Manager
February 1, 2022

Year - End Management Note

> **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, an appreciative thanks to all the Value Contrarian staff in 2021. Special thanks to Chiraz for continuing to make the VCFund move to National Bank as smooth and seamless as possible. Chiraz is truly the "**Queen of Audits**" at VCAM. She expertly guides us through our annual "never-endum" period of financial & regulatory audits. [Deloitte/SGGG/PSB BOISJOLI/AMF/FINTRAC]. **Regulators/Regulations gone wild**!!

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

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.