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 bluntstock 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) 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 76.0¢. 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 Second Quarter
Value Contrarian Equity Fund

Dear Partners,

> **Canadians old enough to have experienced inflation before, also know that reducing inflation is not painless… it takes an economy running cold to push inflation down.**
>
> **William Robson**
> **CEO C.D. Howe Institute**
> **July 21, 2022 Globe Mail**

> **The global economy is undergoing a series of major transitions… the long era of low inflation, suppressed volatility and easy financial conditions is ending.**
>
> **Mark Carney**
> **Former Bank of Canada/**
> **Bank of England Governor**
> **Aug 24, 2022**

> **Today, the inflation rate is higher than interest rates. Back then, (1979-1981 period) interest rates were higher than inflation rates. We have a long way to go. Inflation has to come down or interest rates will go higher. 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.**
>
> **Henry Kaufman**
> **Former Chief Economist**
> **Salomon Brothers**
> **Jan/Aug 2022**

The central bank, determined to rein in inflation, has begun its most aggressive campaign of interest rate increases since the late 1970's. This shift is inflicting pain on both equity and fixed income investors of all stripes.

Wall street journalist, Nick Timiraos, recently summed up the realities of the post pandemic new world economy. Specifically, in 2022, we are witnessing the stalling or reversal of three forces that pushed inflation and interest rates down significantly since 1981.

The three forces which have historically acted as deflationary catalysts:

1) Globalization: Worldwide competition drove prices lower for many goods.
2) Labour markets: Excess cheap labour.
3) Energy/Commodity prices: Overinvestment and fracking technology has led to excessive production, and lower prices.

The pandemic stock market lows of March 2020, in all likelihood, also represented the ultimate lows in the 40 year interest rate cycle (0.5%).

For the record, interest rates peaked in the 1980-81 period at approximately 20 percent. For the last 40 years (1980-2020), investors had positive tailwinds of near continuous falling interest rates working in their favour. One cannot count on this trend going forward.

Investors should not be surprised if the next 10 years bring rates up, not to the 20% level, but to more historical averages (4-6%).

Bank of Canada Governor Tiff Macklem, and Fed Chairman Powell have recently given investors ample warning of higher interest rates in the fight against inflation.

Perhaps the best investors can hope for is that the Fed overreacts with excessive rate hikes, crushing inflation faster than expected. Under this scenario, a severely weakened economy would permit a faster shift to interest rate cuts. A worse case scenario would be if inflation fell "temporarily", with an accompanying rate cut, and then inflation came roaring back. A "sucker cut" in interest rates, in this case, would only stall an eventual stock market recovery.

Nonetheless, we expect this bear market to be a slow grind, not a 90-day, or one-year affair [ie: over-and-done with "quickie"].

Second Quarter Performance

For most of us, buying and selling at the right moment (AKA: market timing), isn't going to happen regularly enough to beat the market.

Jeff Sommer
Wall Street Journal Columnist
August 28, 2022

In a bull market, positive psychology induces aggressive behaviour. Aggressive behaviour leads to higher prices. Rising prices encourage rosier psychology and further risk-taking. This upward spiral is the essence of a bull market…
This is the race to the bottom. This is why it's often said that "the worst of loans are made in the best of times."

Howard Marks
Oaktree Capital
May 26, 2022

Raging bull markets are examples of mass hysteria. In order for this to occur, however there has to be some factor that activates investors' imagination and discourages prudence.
Thus, special attention should be paid to an element that almost always characterizes bull markets: A new development, invention, or justification for the rising stock prices. (i.e.; crypto/blockchain/electric vehicles/SPAC's/Tech innovation. Often businesses with no hope of near-term profitability)

Howard Marks
Oaktree Capital
May 2022

Your Fund ended the second quarter with a net asset value of $3,741.78 per unit, a decrease of $461.93 from the December 31, 2021 net asset value of $4,203.71 per unit (after distributions). **Year to date [June 30th], your Fund returned: -10.9%.**

During the quarter, the S&P500 and the NASDAQ entered bear market territory. The resource led TSX avoided the same fate. But that won't last forever. A bear decline will just occur later in the cycle for the TSX.

The "momentum" investing trade came to a screeching halt in early 2022. "As long as markets/stocks go up, that's a profitable strategy" - now no longer worked! As we have brutally experienced in 2022, markets don't always move up!

Moreover, whatever investors had to own and was an obvious Covid winner, has tended to fall the most.
Think: Zoom, Peleton, Shopify, Netflix, etc… As one astute market observer chimed in: "consensus and popularity are rocket fuel on the way up and poison on the way down."

From the January 3rd, 2022, (S&P500 peak) through June 16th, the S&P500 fell 23.6%, below the 20% definition threshold that denotes a "bear" market.
But from its June 16th bottom, the S&P500 then proceeded to gain 17.4% by mid-August, an incredible 2-month bear market rally!

Don't be fooled. The math is not working in your favour. With the 17.4% bear rally, you might think you have almost retraced the 23.6% negative return to June 16. Wrong!
The math shows that to regain your year 23.6% loss, you would need a positive return of not 17.4%, not 23.6%, but over a 30% positive return just to get back to +23.6%.

An important key to long-term success in the equity markets is very simple - **avoid loss**. It's all in the math.

During the second quarter, we completed 10 sells vs 2 equity buys. The portfolio was purged of any small, look-see positions, or names we would not want to hold during a severe bear market decline or add too.

Our cash levels at quarter end were approximately 16%. By September end, cash will be approximately 30% of our assets.

The rise in our cash levels has resulted from an important event in the life of Value Contrarian Asset Management.
Specifically, on July 29, I decided to focus my complete attention on one client - that being the Value Contrarian Fund.

As a result, **I resigned from managing all individual portfolio accounts**. Going forward, the sole opportunity to obtain my investment expertise will be through the VC Fund. As a result, many individual investors transferred cash into the Fund in July and August.

To both new and repeat VC Fund investors, I wish you a warm and prosperous welcome. As many already know, “I eat my own pudding”, so to speak.
My returns are your returns, as I remain a top 3 investor in the Fund.

So what’s the positive news? We are likely entering a very rich opportunity environment in the equity markets over the next 6-18 months. With interest rates continuing to climb, there will be lower asset values, but more bargain opportunities for your manager.

Unlike in recent sell offs/bear markets, this market downturn (in our opinion) will be a slow grind over many months. Something millennials and Gen Z have never experienced! Of course, there is always the prospect of some unexpected geopolitical surprise to hasten/magnify any market decline.

The duration of this bear market could be one of its defining elements. And don’t expect this bear to be over at the first drop in interest rates. This may only provide the fuel for further bear rallies.

We are patient long-term value investors waiting for our comfortable pitch.
Although hoped for, we never buy at the bottom, or sell-out at the top - we have our shopping list ready, full of opportunities in quality, high free cash-flow businesses, with solid shareholder-friendly management (at reasonable valuations).

OUTLOOK

The historical record cautions strongly against prematurely loosening (interest rate) policy… We must keep at it until the job is done.

Jerome Powell
Fed Reserve Chairman
August 27, 2022

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

Henry Kaufman
Former Chief Economist
Salomon Brothers
January 2022

The emerging nuclear deal with Iran is a strategic disaster which gives Iran a license to manufacture a bomb… The IDF (Israeli Defence Forces) and the Mossad have been instructed to be prepared for any scenario… We will be prepared to act to maintain Israel's security. The Americans understand this, the world understands this, and Israeli society should also know it.

David Barnea
Mossad Director
August 2022

It's highly unlikely that we have witnessed the bear market lows. The US Federal reserve has clearly stated that "our focus is on getting inflation back down to 2%". To reduce inflation amid a strong labour market, the Fed will have to raise rates high enough to slow (crush) economic activity. All that is code for a Fed induced recession.

Investors are all too familiar with the expression: "Don't fight the Fed."
Specifically, investors have come to learn that a period of falling interest rates is good for stocks and means rising valuations. Conversely, rising interest rates, as is the case in 2022 (especially if aggressive) are ultimately bad for stock prices and equity valuations. Enough said.

So what do we see as the potential scenarios playing-out over the next 6-18 months in the equity markets?

Scenario #1 - Best case: Bear bottoms 4th Qtr 2022
Scenario #2 - Hoped for: Bear bottoms 1st half of 2023
Scenario #3 - Worst case: Bear bottoms last half of 2023/or early 2024

In conclusion, one can't expect Jerome Powell and central banks to calibrate their interest rate levels (up or down) to perfectly, on demand, wipe out inflation. It's an art, not a science. Policy mistakes can be expected!

In all likelihood, they may either overdo their rate hikes, pause too early, or have inflation come roaring back in a few years after another energy or some other surprise shock!

The rate of inflation supposedly fell sharply in 1971-72 and again in 1975-76 before going ballistic in 1979. Interestingly, the price of crude oil went from under $3 a barrel to more than $39 between 1966 and 1980! Any future energy price surge, over $100, will likely be temporary.

In our opinion, the US Fed will likely err on the side of excessive rate hikes to crush inflation. Simply stated, they don't want to go down in the history books with mud on their faces, like former Fed Chairman Arthur Burns.

Burns presided over the Chairman's job in the early 1970s and was tarred by letting inflation spiral out of control. Instead, today [I believe] the Fed honchos want to go down in the history books as the slayers of inflation, as Chairman Volker eventually did by 1982.

Only time will tell if central banks today share Mr. Volker's inflation-killing resolve.

Respectfully yours,

Benjamin D. Horwood
Portfolio Manager
September 6th, 2022

Value Contrarian Equity Fund
Next Fund purchase
Date: September 19th, 2022
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.

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