TRAPEZE ASSET MANAGEMENT

Seeking Attractive Values

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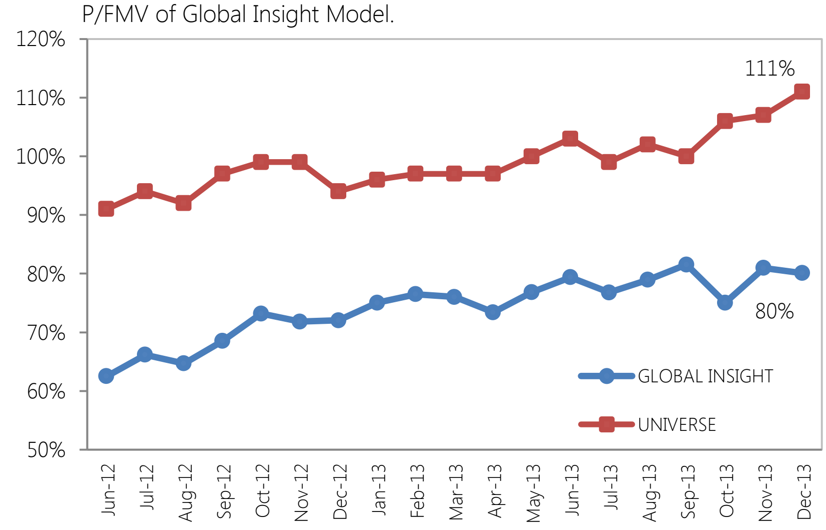
In our September musing, *Investing in a Fairly Valued World,* we wrote that for the first time since the financial crisis we view all major markets as fairly valued. We also wrote that this is not something that makes us too nervous as historically the subsequent 1 and 2 year returns from similar valuation levels are positive for the markets we examined. From September to December, the MSCI World Net Index appreciated 13.4%.

Chart 1. Median P/FVM of Global Large Cap Universe Vs. Median P/FMV of Global Insight Model.



While the market in general is not attractive by almost any valuation measure, the large cap holdings in our Global Insight Model trade attractively below our estimates of their fair market values (FMV). Chart 1 shows the median Price/FMV for our large cap Global Insight Model portfolio[1] compared to the median Price/FMV of our global large cap universe[2]. As of December 31, the median P/FMV for our universe of approximately 1,000 global large cap companies was 111% whereas the median P/FMV for our Global Insight Model was just 80%, a healthy discount to our estimated FMVs.[3]

[1] From an actual representative account managed by Trapeze based on our Global Insight Model.

[2] We have compiled a global large cap investment universe comprised of approx. 1,000 of the world's largest companies that meet a daily trading liquidity threshold of approximately $20 million.

[3] We estimate the FMVs for our global large cap universe using our proprietary valuation model, TVM™. The FMVs for the month-end holdings in the Global Insight Model are based on TVM™; however, values may deviate from TVM™ due to the analytical team's opinion about valuation inputs such as the expected growth rate or adjustments to balance sheet values, etc.

Table 1 compares three valuation metrics for our Global Insight holdings against our global large cap universe. All of these metrics are much lower for the Global Insight's holdings compared to the universe. We believe the Global Insight's undervalued positions are attractively priced and poised to outperform the broader fully-valued markets.

Table 1. Valuation Stats for Global Insight holdings vs. Global Large Cap Universe (as at December 31, 2013)

	Global Insight holdings	Global Large Cap Universe
Median forward P/E	12.8x[4]	14.8x
Median P/B	1.7x	2.1x
Median TTM EV/EBITDA	7.0x	9.9x
Median $US market cap	$18.0b	$19.5b

Hunting for New Bargains

New portfolio additions since Q3 2013 include Apache, Baker Hughes, China Mobile, China Unicom, Continental Resources, CST Brands, ENSCO, ING US, Juniper, Madison Square Gardens, Randgold Resources, Tesco, Total SA, TRW Automotive Holdings, Vivendi and Yamana Gold. We have since Q3 2013 sold Juniper and ING US as they reached our estimated FMVs. China Unicom and China Mobile have also been sold as sell signals were triggered in our TRAC™ trading system when they broke below floors.

Compelling ideas

All of the recent portfolio additions trade at discounts to our FMV estimates, three examples are as follows: Continental Resources is one of the largest oil producers from the Bakken formation and is the largest leaseholder across North Dakota and Montana with 1.2 million net acres. Disciplined capital allocation is expected to drive high netback production growth of approximately 40% in 2013 and 30% in 2014. A DCF-based analysis using management's guidance and current oil and natural gas prices indicates that the stock is trading at a 20% discount to its FMV of $130 per share. However, if commodity prices fell significantly it would obviously detrimentally impact the company's future results and valuation. Baker Hughes is a global provider of oilfield services and equipment, operating in more than 80 countries and employing almost 60,000 people. Ever-increasing demand for oil and natural gas has led to the development of technically challenging unconventional and offshore resources. The greater service intensity should boost margins and push multiples back to historic levels, implying a target price 30% higher than today. This cyclical recovery could potentially be delayed by a period of weak or volatile commodity pricing, which typically leads to constrained E&P budgets and lower revenue and profitability for Baker Hughes. The Dolan family controlled Madison Square Garden (MSG) trades at a 30% discount to our sum-of-parts valuation estimate. With stable cash flows from its media operations and large capital spending projects completed we see the company initiating a material share repurchase plan in the near term. Given the quality of MSG's assets and with ongoing media asset consolidation the company could be a natural target for an acquirer should the discount to FMV persist. As is the case with family controlled entities our key concern is board governance, namely the potential risk of acquiring trophy properties and the potential failure to pursue asset divestitures.

Conclusion

We view most major markets as fairly valued to slightly over-valued and our return expectation for equities is muted. A pause or small correction would not be a surprise; however, we do not see any macro-economic red flags that typically forewarn of a larger pullback. We expect our fundamentally undervalued equities to outperform the broader markets based on current valuation levels.

[4] Bloomberg earnings estimates.

About Trapeze Asset Management

Established in 1999, Trapeze Asset Management Inc. provides discretionary portfolio management for institutions and high net worth individuals, primarily through separately managed accounts. We are value investors seeking long-term capital growth by investing in securities with potential for above-average appreciation, while striving to avoid permanent loss of capital. We do so using fundamental research and proprietary methodologies.

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