TRAPEZE
ASSET MANAGEMENT

THE GREAT MIGRATION

We are value investors dedicated to creating portfolios for clients, whether growth (equities), income or a balanced blend of both, of undervalued securities with meaningful upside potential and a margin of safety to guard against permanent loss. For us, the bottom-up factors are the most compelling, but we are also mindful that we need to take account of the top-down macro factors. We know how the Crash of '08 and the accompanying recession created havoc for investors, including us, no matter how undervalued stocks were.

And these days, there are particular macro trends unfolding of which investors need to be aware. In fact, there is a great migration occurring, trends which will impact equity and fixed income performance significantly. These include: the attempt to reflate economies and emphasize more inflation—Japan, the reflater of the day, now targeting 2% inflation after suffering more than a decade of deflation; the beggar-thy-neighbour attempts by governments and central bankers to weaken their domestic currencies to make their exporters more competitive and profitable—again Japan, the current focus, as it strives to get the Yen lower; the revival of the U.S. housing market and U.S. banks more willing to make housing loans; the strengthening of the U.S. auto market and the desire of European auto makers to move operations to the U.S.; the shift from coal and nuclear for power generation to cheaper natural gas; the preference for hard assets such as commodities, precious metals and real estate over bonds; the significant recent movement by U.S. investors from bonds and cash to equities, January witnessing the biggest inflow into stock mutual funds since '96; the continued deleveraging by U.S. consumers and businesses and even by state and local governments; the significant creation of wealth from improved housing and stock prices; the improved consumer and investor psychology from the creation of that wealth; and, importantly, the great migration from fear to confidence.

The virtuous circle that we have talked about before, migrating from the vicious circle we all endured in the '08 recession. Rising wealth begets spending power and confidence. Strength begets strength.

Our View Of The Potential

As noted in previous letters, we believe we have anticipated the potential for these positive migratory trends. The competitive devaluation of currencies to revive languishing economies, including Fed policies to keep the U.S. dollar weaker and help U.S. exporters. The affordability and improvement in housing and its impact on wealth and employment. Our aversion to bonds and preference for stocks in a reflationary world. The massive liquidity on the sidelines ($2.7 trillion in U.S. money market funds alone as of this January) earning nothing, fuel to drive consumption and investment in equities. The cash hoards of corporations for acquisitions, stock buybacks and higher dividends to drive share prices higher. Rising S&P 500 dividends uniquely higher than the 10-year treasury yield.

A shrinking pool of equities, from buybacks, LBOs, M&A transactions (the highest amount in January since '05) and the paucity of new offerings (in 2012, 28% below 2007). At the end of Q3 '12, 300 billion total shares were outstanding for S&P 500 companies, the lowest since mid '09. Shrinking supply and increasing demand.

Short-Term Correction

The Dow Jones Industrials just topped 14000 for the first time since '07, and the S&P 500 closed above 1500 for the first time in more than 5 years. Interestingly, while the Dow and S&P 500 are at ceilings in our TRAC™ work, the NASDAQ and S&P/TSX are at floors. Recent insider selling has been high and an extraordinary amount of general selling took place before the end of '12 from investors wanting to lock in capital gains before the higher tax rates in effect for '13. Stocks generally are now approaching fair value and our technical indicators suggest the market is short-term overbought and due for a bull market correction of, say, 4%-8%. To protect we raised a little cash, maintained some short exposure on individual stocks and bought index puts (where authorized, and if you have not given us authorization we strongly suggest you contact your portfolio manager to discuss doing so) in an attempt to mitigate a decline in the broad market, particularly while put option premiums (i.e., insurance) are relatively cheap from current low market volatility (i.e., complacency). We believe that after a near term correction the markets could see new highs, from earnings improvement and multiple expansion and that the TSX could outperform the S&P 500 particularly as hard assets and more cyclical assets are embraced once again.

Searching For Value

To be sure, as value investors, we want to continue to buy what's cheap and avoid what is not. We will continue to emphasize the cheap and growing energy group. Oil and gas prices are likely going higher over time. The golds are washed out and cheap too and bullion and the producers should start to reflect the inflation we expect. We pointed out in our last letter that the divergence in value between the large caps and the mid and small caps was at a historic extreme. The TSX Venture Exchange is still down 66% from the '07 highs, in fact back to '03 levels. We believe that this won't last and as investor confidence continues to strengthen investors will migrate down the cap chain to the ultra-cheap smaller caps narrowing the valuation gap, particularly with more inflation benefiting junior mining and energy stocks. Historically fear driven low priced small caps with high values can be the most compelling investment opportunities even though riskier from their volatility and illiquidity. The market continues to shun these. As value investors we are compelled to be contrarian.

The Big Picture

On the macro front, while Q4 U.S. GDP stalled, from government cuts, lower exports and less inventory growth, the economy is still making headway from improvements in factory activity, consumer confidence, retail and business spending and, importantly, housing and autos. House prices have risen by the most in 6 years and new home sales in January rose by 15.6% compared to only a 3% estimate. Houses for sale in the U.S. in January were at a 13-year low. Household debt payments are at their lowest since '83 as households have been deleveraging, and it is helping consumer spending. GM, Toyota and Chrysler all had blow-out

January sales growth. The N.Y. Fed's Empire State Manufacturing Survey was very strong in February, a likely indicator of improvement in the country. U.S. Corporate earnings have been better than expected, 70% of companies reporting beating estimates. Japanese corporate profits are expected to rise 40% in the next fiscal year and its Nikkei Index is up 30% since November.

Although January U.S. unemployment was still high at 7.9%, retailers and home builders are adding jobs, and job growth for November and December was revised upwards. As well, the November trade deficit fell 21% to $38.5 billion which will help lift GDP.

To be sure, problems still exist and will need to be addressed. Automatic spending cuts of $85 billion at the beginning of March without some political compromise. And then the debt ceiling issue. The rising U.S. federal debt, now at $16.5 trillion, higher than GDP. The rise in U.S. treasury yields, with the 10-year reaching over 2% even as the Fed reiterates it will keep rates low, continuing its $85 billion monthly bond and mortgage backed securities buying, and keeping short-term interest rates near zero until unemployment reaches 6.5%. Though recent Fed minutes revealing controversy that its continued level of purchases could raise inflation, unsettle markets and create losses for it. The restored payroll tax and higher gasoline prices leaving Americans with less to spend.

Even though eurozone confidence is returning, the eurozone economy is still struggling, contracting in Q4 '12. And the high euro-currency as a result of the European Central Bank reducing its reserves (in contrast to the Japanese and U.S. central banks increasing reserves) may have to be reversed and its interest rate cut from an already low 0.75%. Because of the recession in Europe, the IMF has lowered its forecast for world growth slightly to 3.5%, still a little better than last year. But, China should continue to grow strongly in '13 benefiting from a genuine massive migration of population from rural to urban areas, stimulating consumption. Chinese home sales and new home prices are rising and its PMI was stronger too, although the Chinese Central Bank has just started to tighten somewhat. Like the Japanese market, Chinese equities have rallied too.

Because of the high euro currency and the euro zone recession many companies, including Ford and GM, are planning plant closings, likely to migrate elsewhere. In a previous great migration Randall's grandparents fled Europe for North America searching for a better life. Now it's Ford and GM.

Our own Bank of Canada governor, Mark Carney, migrating to the struggling U.K. to head the Bank of England with the expressed intention of focussing more on growth than on inflation which is already above its 2% target. Reflation. Real assets.

Moving Up But Lots Of Room To Grow

The performance of our stocks since last June has been much more in line with our expectations and a better reflection of the underlying values of our holdings. Some stocks, such as Southwest Airlines and Office Max, ran up so close to our assessment of their Fair Market Values (FMV) that we sold the entire positions. We also reduced our Manitok weightings too, merely because it became a disproportionate size within our accounts, though it still continues to be our largest position with material upside potential ahead—our estimate of its FMV is still well above the share price and we expect the FMV to grow to more than twice the current share price over the next couple of years.

Most of our holdings still trade at a fraction of our estimated appraised values, and as they grow their businesses they keep adding to their underlying values. So we should continue to benefit from the rise in underlying value and our anticipated narrowing of the mispricing gap.

As the market depresses large caps to our buy points in the anticipated correction we want to opportunistically add. In the meantime, if any fall for company specific reasons, we are prepared to take positions as we did in a few instances discussed below.

Our Top Holdings—No Migration Necessary

Energy stocks still make up our largest sector allocation. The group is undervalued, oil prices should hold around current levels, we are bullish on natural gas prices too after a multi-year swoon and we continue to hold and find individual stocks whose price discrepancies are wide compared to their potentially outsized growing FMVs.

In this group, *Manitok Energy*, our largest position, has enjoyed 100% drilling success. The run up in the share price has partially recognized the company's performance. Though the share price is now close to the likely reserve value (pending shortly), the cash flow should justify a much higher value as is typical for a company in the early stages of exploiting a reservoir of conventional oil. With production now in excess of 4,000 boe/d, providing a run-rate of around $60 million of annualized cash flow at current energy prices, the company still trades at merely 3x this cash flow.

Manitok's hypothetical free-cash flow yield (assuming it decided to stop growing and merely drill 3 sustaining wells per year) is still high at about 20%. However, the company is not expected to free cash flow as it will use all of its cash flow to drill at least one well per month for the next few years, in our view materially growing its underlying value. Assuming $85 oil, in just 3 years' time, Manitok should have annual cash flow of more than $1.80 per share, and at a valuation of 4-6x cash flow, the share price should then be 2-3x today's level.

Most of Manitok's wells have free-flowed oil to surface (i.e., without fracking), a testament to the quality of the reservoir. Continued drilling success in the next 3 years should more than double production and cash flow over that time frame. We also see few risks for Manitok other than the price of oil which we believe should remain at or above current levels for some time. And the margin of safety still appears considerable given the reservoir quality (12 successful wells out of 12 drilled), high return on capital (over 100% expected IRR on each well), minimal debt and attractive undervaluation.

St Andrew Goldfields posted yet another record quarter of production with 25,800 ounces in Q4 '12 and 95,600 ounces in 2012. Q4 earnings and cash flow were solid too. St Andrew's price is too low. At today's gold prices, operating cash flow should be about $0.13 per share for 2013 as production continues to grow. It trades at about 3.5x cash flow, has a solid balance sheet with nearly 10% of its market cap in cash (net of debt), and trades at a much lower net asset value and cash flow multiple than its peers.

Our 3-year target remains at over 3 times the current share price (at an 8x cash flow multiple and assuming what we believe to be reasonable gold price assumptions). Based on our production estimates, the company should have over $135 million of cash (over 75% of its current market cap) in 3 years, while then earning free-cash flow of about $0.13 per share.

Meanwhile, the entire gold sector is depressed—both large and small cap gold companies sitting at or near 52-week lows. Gold bullion itself has struggled to lift beyond its recent trading range. We believe this is attributable to a robust U.S. dollar, muted inflation figures, a recovering global economy and more buoyant stock markets (meaning less fear), and rising real rates—though they still remain at extremely low levels. But real rates should remain low for some time, inflation seems bound to rise given the sheer size of the Fed's balance sheet (now at an all-time high and continuing to balloon) and, most importantly, producers' marginal cost of production keeps rising—at or near the prevailing bullion price. The high costs should underpin gold prices, with production for the majors barely rising, limiting supplies, while increased Central Bank buying augments demand. With negative sentiment, and falling to a buy point in our work, gold bullion appears to be in the final stages of a capitulation.

We recently added *Goldcorp*, the lowest cost senior gold producer with the highest production growth, but which trades at a big discount to our FMV estimate. With the group at a TRAC™ floor and bullion likely near a bottom, the group and especially Goldcorp appear attractive.

Another gold holding, *Dynacor*, mills gold for gold miners in Peru, and its stable milling business does not really fluctuate much with the price of gold. While upcoming quarterly results may not be as strong as the last quarter which benefited from higher than normal grades, with excellent throughput and the ability to attract higher quality business from competition, we still expect at least $.05 per quarter of earnings, pricing it at just over 6x earnings or a 15% earnings yield. By fall we expect the company should be running a second larger mill which could expand earnings to over $0.25 per share annually.

The company has been delivering record results and if its own gold exploration properties now being drilled deliver promising results, that could also add substantial value. Based on milling alone though, the company should have a value closer to $2.50 per share, nearly double today's share price.

Orca Exploration's share price has been stuck between 60% and 80% of book value since June of last year. Hard to believe, since it traded near its FMV at more than twice its book value, briefly touching $7, in early 2011. Now at $2.33 the price appears to be totally disconnected from its more than $8 FMV (our estimate based on both the reserve value and value justified by its expected cash flows). Orca has long-life natural gas reserves, operates at low costs with high netbacks and the company's infrastructure, contracts and head start in the region could have appeal to the majors with nearby operations allowing Orca's assets to be monetized in the next couple of years.

However, Tanzania has been a mess over the last year. TANESCO, the national power utility, was not able to pay its bills and though it's doing so currently again it still owes Orca significant arrears. The country is struggling with power outages and the World Bank is on the case to help. Last summer the company agreed to general terms with the government on a revised production sharing agreement, but the specific terms have yet to be finalized. The language of the government's new proposed natural gas policy might seem threatening when it speaks of the gas belonging to the people, but a full read of the draft document suggests an overall healthy regulatory framework that has to date been absent.

Orca's gas remains in high demand due to the severe power shortages in Tanzania, the company's gas production generating over 50% of power in the country. We believe Orca's 70% discount to its reserve-based net asset value is unjustified. A Chinese sponsored group is expected to build a major pipeline which should allow a ramp-up of Orca's production and cash flow once completed. Other major energy companies have made massive gas discoveries close by, which has spurred government plans to better support gas-fired power generation.

Our valuation for Orca is over 3 times its share price. But the company's record earnings and cash flow have been overshadowed by the government uncertainties and the temporary deferral of exploration drilling of Songo Songo West until Orca's funding position is clearer. Still, Orca has a healthy balance sheet with sufficient cash which will expand once the national utility is in a position to pay its arrears which we expect should be over the next several months.

This was an eventful period for *Specialty Foods Group* (SFG). It repaid all of its debentures at the end of '12 leaving us with only the warrants which are exercisable into equity. Then it had disappointing news from Nathan's Famous that it would not renew its contract with SFG beyond March '14. Still, based on a third-party valuation we repriced the warrants from our cost, to more accurately reflect their higher value and they are still likely worth more than our carrying value. Moreover, the company just won an appeal by Nathan's of a legal claim SFG previously won against Nathan's for $6 million which, alone, should boost the warrants' value by more than 20%. The private company will likely milk its free cash flow until the expiry of the manufacturing/distribution contract with Nathan's, and then likely liquidate its assets, a scenario assumed by the third party valuation.

After trading it successfully earlier in the year, we bought *Apple* shares again in late December when the stock hit a TRAC™ floor. Investing in the company has since been controversial from concerns over flattening revenue growth rates, lower margins, the threat of increased competition, the lack of new product announcements, the drag from the cash laden balance sheet to mention a few issues. But our analysis shows that, even though the company's valuation implies shrinking profits, decent growth should continue for some time. We do foresee more regular updates to its products, enormous market shares in ever-growing end markets, a company that still has the best products (phone, tablet and PCs) in its fields, and, a hold on its user base, incumbency, from its apps, data (including iTunes) and cloud-based system.

Investors no longer appear to be paying for its growth potential yet growth, from China, iTV or other new products, or simply a continuation of the advancing smart phone market, lies ahead. At 7x earnings (excluding the cash on the balance sheet, which the company is under pressure to more aggressively distribute), the company is one of the cheapest in our large-cap universe. An astonishing valuation for a company with the second highest profits in the world. Our estimate of FMV is about $700 per share and rising which provides a potential return in excess of 25% per year over the next couple of years. Because the shares remain under pressure we may sell some soon based on an anticipated TRAC™ sell signal with the intention of repurchasing at the next floor, below $400.

Pivot Acquisition is a private IT outsourcing company. We have just elected to roll our 12% convertible debentures (held in our taxable accounts) into preferred shares with similar terms. Pivot's preferred shares will not be listed, so they remain subject to liquidity risk; however, we continue to receive a premium yield plus a favourable conversion privilege. And, the company expects to imminently list its common shares into which our preferreds convert. We expect a significant lift in our carrying value.

The company's profits continue to be strong with nearly $60 million of EBITDA expected in '13. It appears the company will list at a rather attractive valuation and our conversion privilege is at half of that value, allowing much potential upside ahead as the position seasons, though the liquidity will likely remain limited even as a public company with a small market float.

AIG's share price was about 50% of book value when we initiated our investment and, while the business and share price have performed well, the stock still trades for about 66% of book value. We still see upside ahead. The government's stake has been eliminated so the overhang of potential selling is gone. While the impact of asset sales and Hurricane Sandy in Q4 '12 temporarily restrained book value growth, retained earnings in 2013 could lift book value per share to around $65, well in excess of its share price. Costs are coming down, the company is shedding non-core businesses and meaningful share buybacks are likely to resume around midyear. If the price traded up to only 80% of book value over the next 2 years, we could have a return in excess of 25% per year.

Legacy Oil + Gas reported yet another quarter of record production and met its forecasted 2012 exit rate of 17,900 barrels of oil equivalent per day in November of 2012. Its netbacks are industry-leading, operating costs are declining and drilling has continued at a 100% success rate. We look forward to the fourth quarter and 2012 fiscal results to be released next month.

The company continues to create value and in the recently released 2012 reserve report, proven and probable reserves grew approximately 7% to over 94 million barrels of oil equivalent. Perhaps more importantly, after a dismal '11 due primarily to poor weather, Legacy's proved plus probable finding, development and acquisition costs improved dramatically in '12.

Despite the operational momentum, Legacy continues to trade at less than two-thirds of its net asset value. Its low valuation appears to be attributable to the general concerns about oil prices and the prospect of wide differentials in Western Canada where bottlenecks continue (though they have narrowed recently) as well as lower growth rates than some of its high-flying peers.

We sold about one-third of our position in reaction to a TRAC™ sell signal last June at about $6.80, repurchased shares in July at about $4.90 at a TRAC™ floor and just about 40% of our position at $7.16 on another TRAC™ sell signal. We are anxious to reacquire the position we just sold to raise our weighting now that the stock has fallen to a floor. Assuming $85 oil, we anticipate our FMV estimate could rise to over $18 per share in 3 years, a target which implies more than a 30% annual increase from today's levels.

Corridor Resources' low share price indicates investors have essentially given up on it. We expect it to have a resurgence. Corridor's projects/jurisdictions have been the subject of many positive press articles and government speeches recently. Natural gas fracking in New Brunswick is likely to be a non-issue, in fact new rules better regulating the industry were just released. And proper exploitation of the region's resources has become generally viewed as the province's financial salvation.

The Repsol LNG import facility in New Brunswick is expected to be reversed into a plant to generate LNG for export. It would then need to obtain gas in the area for supply, likely to include Corridor's 59 Tcf shale-gas-in-place Frederick Brook field, which in 2011 showed extremely promising results with gas shows in 8 separate zones over nearly 1,000 metres of depth, amongst the thickest gas shales in North America.

While the PQ government in Quebec has stopped shale gas drilling altogether, they appear favourable towards shale oil, particularly on sparsely populated Anticosti Island where Corridor has 19.8 billion barrels of oil equivalent resources in place and is seeking a joint venture partner.

And the Federal government and both Quebec and Newfoundland have been favourable towards Corridor's Old Harry project in the Gulf of St. Lawrence which has a potential 2 billion barrels of recoverable oil where it is also seeking a partner, likely after the completion later this year of the ongoing Federal environmental assessment.

Any one of these projects alone could provide material upside for Corridor. Meanwhile the company's reserves, infrastructure and land value are worth far more than the current market capitalization. While Corridor still needs partners to advance its mega projects, the company is debt free, makes a little cash flow, and should be able to attract partners on favourable terms for its 3 projects.

We believe the longer term risk-reward ratio remains extremely attractive. We also look forward to higher natural gas prices which would enhance value by providing higher cash flow and accelerate the development of its existing conventional gas assets.

MetLife, like AIG, has begun to recover as its fixed income holdings, a key source of its earnings, start to generate higher interest income. The market seems to be digesting the prospect of more government regulation. We are still surprised that this dominant international life insurance company trades at only 7x earnings and well below book value. Our FMV estimate is over 50% higher than the share price, and growing. The company has excess capital which it and key shareholders would like returned to shareholders via dividends or share buybacks. Like AIG, if the company merely recovered to 85% of its book value, the return would be in excess of 25% per year over the next 2 years.

Migrations In And Out

We have added positions in *Och Ziff*, *Goldcorp*, *Staples* and *Kohl's*, increased our *Southern Pacific Resources* and added small cap *Amarok* and *League Opportunity Fund* debentures. All trade well below our estimate of FMV.

Och Ziff, which we previously bought and sold in 2012, trades at 7x earnings, with a dividend yield in excess of 5% (excluding special dividends like the additional 6% that we just earned), and manages over $30 billion in lower-risk hedge funds non-correlated to the equity markets.

As mentioned above we also recently added Goldcorp.

While we exited Office Max which had a lower potential return after its move up closer to our FMV (a tad too soon, obviously, in light of its proposed merger with Office Depot), we added Staples which appeared attractive once it fell to a TRAC™ floor, well below our FMV, and we just sold the full position on its rally from the Office Max/Office Depot merger announcement. We continue to hold Kohl's, a leading mid-market department store chain across the U.S., which is even cheaper as it fell out of favour after reporting anemic comparable sales growth.

Like our other large-cap holdings we are looking for a potential return from each of these large caps in excess of 25% per year over the next 2 years as they recover to our determination of FMV. We continue to analyze many large companies, constantly reviewing the most undervalued stocks in our universe of about 1,000 global large-cap stocks.

We added to our Southern Pacific shares when the stock set back to book value, much too low in our view given the advances the company has made on its McKay oil sands project. STP is in the initial stages of commencing production, steam is being injected into the formation and 8 of the 12 well pairs are currently producing oil. Volumes are building slowly, as management conservatively manages the ramp, which is normal for a SAGD project. Although the company is in the "show-me" phase of the project, McKay remains on track to reach its design capacity of 12,000 bbl/d within 12 to 18 months of first oil, which occurred last October.

In the near-term, the market unfortunately appears focused on the threat of lower oil prices driven by excess supply and wide differentials due to a shortage of pipeline capacity. Investors seem to have ignored STP's trucking and rail marketing agreement which management believes should deliver mid-$40 per barrel netbacks. As volume builds and the project delivers, the significant discount to FMV is expected to narrow.

Amarok is a company launched by the founders of Manitok. Given Manitok's success, the company was seeing more than its share of other opportunities for thrust belt plays. The Manitok founders have chosen to conduct these non-Canadian opportunities in another vehicle, the first two Amarok projects being in Wyoming and Montana. We bought shares in an issue at $0.30 and foresee potential value of over $0.70 in the next 18 to 24 months as the company executes on its development assets.

Both Southern Pacific and Amarok fall into our small-cap basket where we seek to obtain more than 40% annualized returns over the next 3 years, a higher required return than for our larger cap holdings, to account for liquidity and volatility risks.

League, a private company, issued a convertible debenture due March '14, which pays 8%. Our interest in League was piqued by its hard asset protection—real estate assets backing our debenture—and a conversion privilege which is set at 75% of the price of the company's common share IPO which we expect prior to this summer.

Income Holdings

Though less liquid than government and investment grade corporate bonds, our income holdings are either higher-yielding corporate bonds where we believe the risk/return is favourable, often with potential for capital appreciation, or REITs and high dividend-paying common share equity positions which currently represent less than 20% of income portfolios.

Our holdings have an average current yield (income we receive as a percent of current prices) of around 8%. But the return could be higher, from anticipated capital gains as discounted positions increase to their maturity value, and from the conversion privilege (based on the equity value) of some of our convertible securities as their underlying stock prices increase. And, income portfolios could also benefit from a potential upwards revaluation in the undervalued shares held. As some of our holdings are equities (or debt convertible into equity) our estimates are subject to the inherent risks of equities generally.

Just as we constantly screen for equities we review a multiplicity of issuers in an attempt to find income opportunities where interest coverage and asset coverage are well above average (to mitigate potential risk of permanent loss) and the return relatively high (both from current income and the potential for capital gain).

Of note, regarding our top income holdings: *Advantex's* profits continue to grow as it expands its merchant base; *Radio Shack's* bonds, due in August, are well covered by the cash on its balance sheet; *Southern Pacific's* convertible debentures, where we just added to our position, are more attractive now as the price is lower while its McKay project is starting to deliver; Pivot Acquisition, mentioned above, is growing its profits smartly and working towards a liquidity event; *Smith & Wesson* bonds remain at a high price from the rise in the company's profits; Specialty Foods Group, as mentioned above, repaid all the bonds, and the warrants continue to provide potential upside; *NII Cap Corp's* bonds have been more volatile, and we increased our position after a decline, the price subsequently increasing only to fall back again recently, though they still trade well below the replacement value of the company's assets;

Dynacor debentures which mature this June, paid holders a 6% bonus payment as its EBITDA exceeded a predetermined threshold; *Brookfield Real Estate Services* continues to exact royalties on robust Canadian real estate sales; *Pinetree Capital* debentures have declined with the Canadian small-cap correction though they remain well covered by asset value; *Student Transportation* keeps delivering consistent earnings growth, though we lowered our weighting as the price advanced towards fair value.

Malaga redeemed all of its bonds when they came due in November. And we had three recent additions in our income accounts: *J.C. Penney* 6.875% bonds—though the company is in turnaround mode, it's led by former Target and Apple store executive Ron Johnson—the yield-to-maturity (2015) of 8.6% at the time of purchase appeared mispriced relative to its asset coverage of owned real estate and excess liquidity; *Ferro Corp.* 7.875% August 15, 2018 bonds—Ferro being a manufacturer of specialty chemicals where activists have been involved recently, which may expedite the planned expense reductions and potential asset sales—its bonds also appearing mispriced given its yield-to-call in 2014 of 13.7% at our time of purchase; and League debentures mentioned above (though not for RSP accounts as its non-Canadian assets made this private company's debt ineligible).

The Ultimate Migration

Money ultimately migrates to where it will be treated the best. That destination is not cash, nor bonds with paltry returns, especially in a reflationary environment. Interest rates are likely to rise and we believe the 31-year bull market in bonds is over.

We think from an asset allocation standpoint, equities are the place to be. The positive migration to them is here for a while and the dips should be an opportunity to add.

Herbert Abramson and
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February 26, 2013

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