TRAPEZE
ASSET MANAGEMENT

UNPOPULARITY CONTEST

It is often not easy to be value investors. Even before the U.S. stock market recently corrected violently from near all-time highs, many stocks were languishing. Clearly those in the commodity sector from the extensive commodity rout in energy, base metals, precious metals and food products. The Commodity Research Bureau's commodities index is back at the recession level of '09. The U.S. industrial sector is also down this year and looking attractive. Indeed, the resource heavy Canadian stock market is one of the worst performing in the developed world this year. Disinflation is in the air and central bankers, concerned about the potential for deflation, are in stimulative mode.

And yet, simple supply and demand economics would suggest that low commodity prices should increase demand and diminish supply. Many commodities are below their all-in cost of production which will discourage additional supply. And, we believe those forces will ultimately, hopefully sooner than later, cause commodity prices to start to rise again, helping the depressed shares of their producers. Oil prices are up over 20% from their recent lows. Value investors are often driven to what is temporarily unpopular and cheap, with less potential downside risk relative to upside potential. Trading off risk for patience. Looking not just at the stock market but at the market for stocks. Value investing 101.

Fighting Deflation

Central bankers everywhere are focused on the deflation signs and wish to have their currencies lower to stimulate exports and inflation. And this in a world of ultra-low interest rates in most of the developed countries. In the U.S., the rate on the 10-year bond is now at 2.16% compared to the dividend yield of 2.23% of the S&P 500. We believe the bull market in bonds is likely ending, especially if inflation picks up.

Global economic growth for 2015 is estimated by the IMF to be only 3.3%, with weak global demand. But the combination of low interest rates, currencies and commodity prices could ultimately be stimulative of growth, spurring inflation generally.

The Eurozone's growth was somewhat weaker in Q2 with slower growth in Germany and poor output in France, so the E.C.B. will continue its stimulative quantitative easing. And unemployment in the Eurozone dropped slightly to 10.9% in July. Japan is improving from its increased quantitative easing and the low Yen, contracting in Q2 less than expected. China, the second largest economy, which has seen its growth slowing from weaker exports and factory output, and where stock market volatility has been scary, just devalued its currency, lowered interest rates and its reserve requirement, and is likely to see further government policy easing to assist its economy and stimulate inflation.

While Canadian GDP growth was slower in the first half, clearly affected by low oil prices, the lower loonie should help with improved trade numbers. July exports were up 6.3%, the biggest monthly gain in many years, shrinking the trade deficit and improving the growth outlook. Annual inflation also rose in July to its highest level since December, also helped by the lower currency.

On the other hand, the strong U.S. dollar, up about 20% since mid-2014, is impeding U.S. companies with foreign exposure, and the potential for a Fed rate increase in September, or later this year, will not be helpful. Q2 annualized U.S. GDP growth of 3.7% was better than anticipated but helped by higher inventories which could be a drag on future growth. Housing, consumer spending, durable goods orders and employment are improving, though wage growth remains at multi-year lows. Household net worth is at a record high. Existing home sales were up 2% in July. July retail sales were higher, and automakers reported stronger than expected sales. Manufacturing weakened but the U.S. trade deficit fell in July as exports rose, notwithstanding the global growth slowdown.

Market Correction

The U.S. stock market was overdue for an outsized correction, but it likely won't result in a bear market. Positively, S&P 500 companies have strong balance sheets with $3.6 trillion in cash and marketable securities, to finance share buybacks, dividends, and to invest more when the opportunities are there. Earnings and dividends should continue to grow and, following the recent correction, the bull market should continue, particularly with attractive share prices, competitively low interest returns from bonds, high cash levels and bearish investor sentiment. And, insider buying has picked up, another positive indicator.

Our macros pillars—TEC™ and TRIM™—our economic composite and market momentum indicators—helped us remain bullish in the face of the recent market correction, as neither triggered alerts. Our economic composite, as tested for the last 50 years, typically signals well in advance of recessions. And, while the S&P 500 fell right to the bottom of its TRIM™ line, it then inflected back up. Only in bear markets should one typically be overly pessimistic because the median corrective decline in bull markets has been about 6%, though, about every 2 years, a 10% or so decline takes place. The last decline in excess of 10% was nearly 4 years ago. With the markets fully valued and overdue for a setback, commodity prices having accelerated their decline recently, more signs from China of slowing growth and steep corrective days for the Chinese and other overseas markets, the U.S. and Canadian markets suffered a quick 13% pullback from their peak.

We continue to believe money will be treated the best in the stock market. At just below our assessment of its fair market value (FMV), the U.S. stock market has an earnings yield of about 6% versus 10-year bonds yielding about 2.16%. And, we are able to construct a portfolio of large-cap global equities with earnings yields well above the market's 6%. Apple, Ford and Celanese, three of our latest purchases have earnings yields of 8%, 11% and 10% respectively.

Unlike the large cap North American stock markets, the small cap resource stocks (and now the large ones too) have once again been stuck in a bear market. One that stemmed from the high commodity prices post the Great Recession and the ensuing oversupply of various commodities rather than economic weakness, making the declines from 2011 difficult to predict. Now though, in the same fashion that commodity prices overshot to the upside, we are seeing an even more pronounced overshoot to the downside. Unless we are in the midst of a global deflationary slowdown, which results in an even higher U.S. dollar, and a major global economic dislocation, then we see a major inflection underway. Lower commodity prices will cut supply, while demand continues to grow, somewhat from the lowered prices themselves, which should boost commodity prices in the months ahead, especially since some have fallen unusually below the costs of production. This ought to help support the stock market in general. Earnings for the S&P 500 have been flat to down slightly. But, without the energy sector whose weakness is masking overall strength, they're up about 9%.

Our All Cap Portfolios – Key Holdings

Our All Cap portfolios combine selections from our large cap strategy (Global Insight) with our best small and medium cap ideas. We generally prefer large cap companies for their superior liquidity and lower volatility. Importantly, they tend to recover back to their fair values much faster than smaller stocks, so they can be traded more frequently for enhanced returns. We continue to increase our large cap weighting. However, our small cap positions are cheaper, trading far below our fair value estimates, and therefore our All Cap portfolios still hold a significant position in small caps.

Our small cap holdings have remained extremely undervalued, mostly attributable to the extended commodity bear market. Now that gold and oil prices are trading at or below the all-in cost of production, a rebound should not be far off. Most of the oil producers and gold producers globally have all-in sustaining costs above today's low oil and gold prices. Normally, these commodities trade at a 30-40% premium to the industries' average all-in costs. Although we've witnessed prices below industry costs in the past, it's usually during periods of great economic dislocation and, even still, those periods are short-lived—typically lasting only several months.

Meanwhile, each of our small company holdings has recently had, or is about to have, a major positive transformational event which should assist in lifting their respective FMVs. Although these smaller, less liquid holdings, are potentially more volatile, the risk of permanent impairment appears minimal while upside potential remains high. We elaborate on these key holdings below.

Specialty Foods Group, a shareholding in a private company held in our taxable accounts, has been preparing to liquidate its assets through a wind-down. The company has placed $40 million (of its more than $50 million cash) in trust, earmarked to be distributed to shareholders, pending required Board approvals. Its remaining business line is performing very well and we expect it to be put up for sale later this year. The approval of the wind-down plan, including the distribution of cash held in trust, requires Board approval and the complicated corporate organization structure needs to be unwound before the remaining proceeds can be distributed. We expect a partial return of capital in the next few months with the balance by the middle of 2016. As at June 30th our carrying value rose again based on the third party valuation and, in our view, there still remains 10-30% upside to our carrying value, mostly dependent on the sale value of the remaining assets.

Orca Exploration is undergoing a number of changes which we see as transformational events. Since the IFC (an arm of the World Bank) is investing $60 million toward Orca's $120 million expansion plans (terms are now being finalized), Orca is embarking on reworking 3 key wells and may drill offshoots or new wells if need be. This development work is being completed to significantly boost Orca's production and assist in filling the new pipeline that, after years of waiting, is just now being completed by the Tanzanian government. Orca provides over 90% of the natural gas to the country which generates over 50% of its power, yet brownouts are the norm in the country as the pipeline has been needed to deliver sufficient gas to power plants.

Meanwhile, the government has been in a better position to pay its obligations to Orca, thanks to the World Bank which has been providing aid to the government. TANESCO, the national power utility and Orca's primary customer, is meeting its current obligations to Orca and is reducing the arrears too. Orca's cash (it has no debt) and funds still owed by TANESCO, net of payables, amount to about 75% of the entire share price. With an estimated reserve value of over $11 per share, the combined value is about 4 times the share price. Because the value is so high relative to the share price and the World Bank is now involved, downside appears minimal. The company's long-life natural gas reserves, low operating costs and high netbacks should make the company of interest to potential suitors. Orca announced last fall that it had received unsolicited expressions of interest in all or parts of Orca's assets. As the uncertainties in the country dissipate, perhaps some of these discussions may advance.

St Andrew Goldfields has been assisted by the falling Canadian dollar which has boosted profit margins. Gold, in CAD, is about $1500/oz. The Taylor mine was given the go-ahead by the company to move toward production and only awaits government approval prior to starting production in a month or so. Taylor's initial results from its bulk sample were excellent showing 9 g/t. The company's overall reserves and resources jumped by 25% last year and recent drilling results are indicative of an even further extension of mine life. The existing mines continue to perform well allowing the company to suggest production will come in at the high end of original guidance for the year. And guidance for next year is 125-135k ounces, a material lift from 2015. At today's gold price, St Andrew should deliver free cash flow of over $25 million in 2016. With net cash in excess of $27 million and only about $90 million of EV (enterprise value—market cap plus debt less cash), the market continues to undervalue St Andrew at less than 4x free cash flow—on many metrics making the company the cheapest in its sector. The net asset value of the company, based on reserves only, at today's gold price, is more than $0.60 per share, twice the current share price. If gold prices rise back to normal—at a reasonable premium to the industry average cost of production, in line with the marginal cost of production—upside should be even higher.

Manitok Energy has now completed its major acquisition of land, including 1,800 boepd of production, in the Wayne area, near its Entice properties, and acquired the other half, that it did not already own, of the checkerboard sections at Entice—all from PrairieSky Royalty. The company had some production glitches—tie-in issues—over the last year which caused production to stagnate. These glitches are nearly fixed. Total production should be a corporate record high in excess of 6,000 boepd by year end. More importantly, the Entice discoveries gave rise to several new oil pools but the new wells have not been on line long enough to offset the impact from declining energy prices. Manitok also renegotiated its arrangement on the freehold land it leases from PrairieSky whereby the royalty rate was lowered to a flat 17.5%. The required drilling timelines were extended too, helping concerns that previous terms may have proved onerous for Manitok's balance sheet if energy prices were to remain low.

Our estimate of the value of Manitok, at today's oil price, is over twice the share price. Our previous, substantially higher valuation estimates are still achievable but depend on higher oil and gas prices. Other than production glitches, the key risk for Manitok has always been a severe decline in oil prices. If oil prices were to remain at less than $40 for an extended period, the company would likely need to reduce its debt. However, oil prices have already overshot, by a wide margin, the level at which they ought to trade based on supply and demand. Supplies should flatline now while ever growing demand should create a supply-demand deficit in the next several months. Manitok is capable of generating very high IRRs (internal rates of return) on their drilling at Entice and Wayne but needs somewhat higher oil prices, around $50, to do so. Once the commodity price normalizes, cash flows should ramp from the company's high inventory of drilling locations and justify a share price many times today's level. In the meantime Manitok is adding to its reserves, actively reducing costs, examining drilling commitments, and considering financing and merger alternatives which should all combine to bolster its balance sheet and provide faster growth.

Dynacor Gold Mines has now received approval for its larger mill, which took around 2 years because the government was busy enforcing rules against small noncompliant miners and millers. Construction is now underway. The new mill should be completed in early 2016, lifting earnings power to over $0.40 per share annually from $0.30—which the current mill expansion should allow it to earn assuming slightly higher gold prices. The company has been a miller of gold, not a miner, which leaves it much less susceptible to bullion price movements; however, the recent gold declines have reduced industry production and the existing mill is a multi-hour drive through the mountains for most ore suppliers. In Peru, overall gold production was down by about 18%. The commodity price decline contributed to reducing Dynacor's profitability as grades fell. Even though Dynacor's output actually expanded, it did not grow as much as expected which left costs somewhat out of line with expected volumes in the most recent quarter. As important, the company's own exploration properties could add substantially to the value of the company. It is spending $6 million this year to advance its Tumipampa project, mostly on the areas it considers to be development work, since the grades have averaged over 20 g/t, nicely above that required for having its own viable mine. An NI 43-101 report delineating an initial resource, likely in excess of 1 million ounces, is expected in the first half of '16. Some of the intercepts have been outstanding, with as much as 111 g/t discovered. We anticipate serious interest from other majors in the area in Dynacor's potential mine(s).

Dynacor has no debt and about US$13 million of cash, much of which will be used to build the new mill and fund its exploration program. The stock trades at only 5x its expected earnings run rate, ignoring the cash. Our view of the FMV is over double the share price, without the added volume from the new mill or any potential value from Tumipampa.

Corridor Resources should see transformational events ahead too. We expect the New Brunswick Liberal party's temporary ban on fracking to be lifted, hopefully in the next several months. New Brunswick's gas resource is immense and very meaningful to the downtrodden province, and other regions have shown fracking not to be deleterious. Corridor still needs a partner to prove up its huge Frederick Brook resource, which will be less difficult once the fracking moratorium is lifted.

At Anticosti Island, Quebec, stratigraphic cores assisted the third party engineers to boost the estimated shale oil resource by around 50% to over 30 billion gross barrels of oil in place. The Quebec government and Maurel & Prom, a mid-tier international oil company, are spending up to $100 million drilling on Anticosti Island. In 2016, wells will be drilled which will bring the first results and could bring this project to the fore. A partner is still needed for the Gulf of St. Lawrence Old Harry project, which has significant potential upside, but higher energy prices and some favourable political winds are necessary for this riskier project.

Meanwhile Corridor trades materially below its net asset value, and the company has projected $27 million of working capital (and no debt) for the end of 2015—over half its share price. The New England market, where Corridor sends its current production still remains undersupplied. The company has been receiving a premium for its gas of about $3 per mcf over prevailing gas prices which should remain in place for some years to come. And it has planned to shut in gas until the winter months in order to get even higher prices, some of which has already been pre-sold at significant premiums. The potential upside from Corridor's assets continues to be extremely high but we have certainly been waiting a long time for it to arrive.

Our top holdings in our All Cap portfolios also include large caps *Honda Motor, KKR, AIG* and *Hershey Foods* which are discussed below in our Global Insight portfolio review.

Our All Cap Portfolios – Portfolio Changes

In the last few months we added new positions in *Berkshire Hathaway, CST, Ford, Apple, Intel* and *Celanese*—all summarized in our Global Insight portfolio review below. We sold Google and Triumph after they ran up to TRAC™ ceilings, in line with our FMVs. We repurchased Triumph at a floor along with Corning, Micron, Porsche and Whole Foods Markets and sold each, along with IBM, Jacobs Engineering and Samsung, as all triggered sell signals falling below their respective floors, mostly from the recent market weakness. All then fell to a subsequent floor and we are evaluating each for potential repurchase, especially once the 30-day tax loss period expires.

Other material changes included the takeovers of Legacy and Powder Mountain by *Crescent Point* and *Canamax* respectively, both share for share exchanges. We continue to hold both as each are much stronger companies combined and the upside potential, especially from higher oil prices, remains high.

And, we added an income position, a secured debenture in *Enerdynamic Hybrid Technologies* (EHT) to our All-Cap accounts as well. The bond yields 18% and has a 2-year maturity, though we believe it will be redeemed by the company in January—the earliest time the company can repurchase it. The company is now a combination of a Welland, Ontario based solar company and a Luxembourg based manufacturer of prefab structures. These two companies have been working together for some time and decided to combine, especially since the U.S. government wanted to procure substantial contracts and required more transparency into the shareholder base. Because the share price was depressed, and the company did not wish to dilute itself, and wanted to finance relatively quickly, EHT issued its debt with a hefty coupon. We also received bonus common shares at a favourable price as part of the financing. The company is expected to generate at least $35 million in pre-tax profits over the next 12 months and stands to win contracts for schools, housing, health care centres and military shelters, from various jurisdictions around the world.

When we see an opportunity to buy an income security, especially a secured one (this is a $20 million dollar bond secured against over $40 million in existing assets), with an equity-like return, we are pleased to purchase it, even in equity accounts.

Global Insight (Large Cap) Portfolios – Key Holdings

Through July 31, our Global Insight Long/Short composite (our entirely large cap portfolios) is up 4% (USD) and 12% (CAD) annualized since inception June 1, 2012, net of all fees. A complete description of the Global Insight Model is available on our website. Our target for our larger-cap positions is more than a 20% return per year over a 2-year period, though many may rise toward our FMV estimates sooner should the market react to their undervaluations sooner. Or some may be eliminated sooner if they decline and breach TRAC™ floors. Since inception, our long positions have performed as expected. The realized gains on our "longs" have been above 20% annualized. The overall performance has been inhibited by risk management tools (cash, shorts, puts) and unrealized losses from resource companies.

At less than 70 cents-on-the-dollar versus our FMV estimates, our Global Insight holdings appear to be the cheapest, in aggregate, since we began the large cap only model over 3 years ago.

Fiat Chrysler Automobiles' earnings growth and earnings multiple should benefit from several near term catalysts. Operating momentum continues to accelerate while the recently released Q2 results handily beat expectations thanks to much stronger North American margins. The company also continues to reduce debt and, in turn, lower interest expenses. The shares trade at more than a 20% discount to our $18 per share appraisal value.

Insurer *AIG* also posted recent operating results which were above expectations, primarily driven by ongoing improvements in its core P&C underwriting. The company is nicely levered toward higher interest rates while the shares remain undervalued at roughly 80% of adjusted tangible book value.

Priceline.com, a more recent addition, had Q2 results which were solidly above expectations driven by strong bookings growth. Our estimated FMV is $1,500 and could expand faster than expected as the company's revenue growth should remain at or above mid-teens over the coming quarters.

KKR's share price has suffered, likely from the plunge in oil. Samson Resources, acquired by a KKR-led investor group for $7.2 billion in 2011, is reportedly planning to file for Chapter 11 bankruptcy. However, it's important to note that energy comprises just 7% of KKR's investment portfolio and, even with the decline in its energy holdings, KKR's total investment portfolio declined less than 1% in the first half of 2015. Elsewhere, KKR is firing on all cylinders—resulting in record economic net income during the second quarter. Our valuation remains just over $30 per share.

As we have written for some time, we expect 2016 to be a breakout year for *Honda*. Sizeable upfront expenditures are set to pay dividends as new vehicle models begin to roll out over the next two years. Barring a severe slowdown in key Asian markets, we see Honda's 2016 earnings per share jumping to approximately ¥334, an increase of over 20% from 2015. Our FMV estimate for Honda is approximately ¥4,800 which equates to 1.3x book value.

SAP SE, the world's largest provider of enterprise software and software-related services, is transitioning its business model from one built around a traditional hardware/software sales cycle to one focused on cloud and SaaS (Software as a Service). We believe that SAP's cloud and SaaS vision is more focused than its competitors. Evidence of accelerating momentum came in the most recent quarter, with cloud revenue/billings growing at over 30%. Our FMV is approximately €74.

Confectionary giant *Hershey* beat earnings expectations recently while it maintained its 2015 earnings goals. Driven by its strong brand and ongoing innovation, the company continues to post strong pricing within its key U.S. chocolate business. The stock trades at a 20% discount to our appraisal value.

Leucadia National—a conglomerate that owns investment dealer Jeffries and a collection of other assets—had a slow first quarter but its Jefferies unit posted strong Q2 results, up 50% sequentially. With the shares trading at a material 25% discount to its sum-of-the-parts valuation, we continue to believe the market is overlooking the company's long history of outstanding capital allocation.

We also continue to hold insurers *Prudential* and *MetLife.* Both have performed well despite low interest rates, volatile financial markets, and regulatory headwinds. Each trade at more than 20% discounts to our estimated FMVs.

Global Insight (Large Cap) Portfolios – Portfolio Changes

In the last few months we added new positions in *Berkshire Hathaway, CST, Ford, Apple, Intel* and *Celanese*—all summarized in our Global Insight portfolio review below. We sold Google and Triumph after they ran up to TRAC™ ceilings, in line with our FMVs. We repurchased Triumph at a floor along with Corning, Micron, Porsche and Whole Foods Markets and sold each, along with Samsung, IBM, and Jacobs Engineering, as all triggered sell signals falling below their respective floors, mostly from the recent market weakness. All then fell to a subsequent floor and we are evaluating each for potential repurchase, especially once the 30-day tax loss period expires.

In the period, new additions—all at floors and at least 20% below our FMV estimates—include the companies detailed below.

We are once again very comfortable holders of *Berkshire Hathaway*. Excluding cash and public securities, the world-class collection of operating assets owned by Berkshire are valued at approximately 6x pre-tax earnings or more than a 20% discount to our FMV estimate. The business hasn't really suffered but the share price fell about 17% from its high of late last year while the FMV has continued to ascend.

China Unicom has benefited from improved cost controls translating into mid single-digit bottom line growth. Lower capital spending, combined with the upcoming tower transaction, where Unicom should experience the most relative cash injection, positively impacts our appraised value. Our FMV estimate is $19. We sold our position in the company last quarter after it ran up to our FMV estimate; however, the severe market downturn in Chinese stocks pushed the stock down to a floor, well below our estimate of its FMV, where we repurchased it.

21st Century Fox unfortunately sold off right after we bought it as media companies were reporting poor results. With mid-teens growth expected for the next twelve months for Fox's Sports, News and international cable networks, we estimate this segment is worth more than the entire share price and we are getting the Movie, TV production, Broadcasting and equity investments for free. Our sum-of-the-parts valuation is $40.

Normalized earnings of rental giant *Hertz* should begin to shine through in the back half of the year. The company should demonstrate improved cost controls while operating in an improved industry pricing environment. Additionally, corporate actions, including a division spin-off and improved governance, should lead to a higher earnings multiple. Our appraised value is $27 per share.

Ford Motor, as with GM, declined as investors became increasingly concerned about slowing Chinese auto demand. China represents very little in our appraisal of Ford's overall value. We were encouraged by the recently reported quarter as Ford posted strong results across nearly every segment. This positive momentum should continue over the next few quarters as earnings should be driven by strong North American profitability driven by the revamped F-150. Our FMV estimate is $20.

Fueled by strong merchandise sales and profitability, gas station operator *CST Brands* handily beat recent quarterly estimates. The company is creatively expanding square footage growth by selling its fuel distribution business and some service stations to its MLP. The former Valero subsidiary is attractively priced relative to our sum-of-the-parts value, which is above $45.

We just repurchased shares of *Apple* near the recent low on its sharp selloff—market corrections can be painful while they unfold, but they provide opportunities to purchase great businesses below their FMVs. We parted with our shares last November at about $109, when the stock ran up to a ceiling in our TRAC™ work. We just bought it back at about $104. In the interim period, our estimate of Apple's FMV has risen along with the company's earnings. The iPhone continues to be a juggernaut, the Apple Watch has shattered smart watch sales records, and its stalwart lineup of MacBooks and iMacs continues to grow despite overall declines in the PC market. Shares trade at a discount to our FMV estimate of $130.

Intel is another tech company we repurchased during its recent correction. We sold our shares of Intel in the middle of 2014 after they hit a TRAC™ ceiling and our estimated FMV. Since our sale, Intel's shares have declined by nearly 20%. In the meantime, Intel's transformation into a data center/Internet of Things company has shown marked progress. At the end of 2013, PC and PC-related revenue accounted for 66% of total revenues. We estimate that by 2017, less than half of Intel's revenues will come from its PC-related businesses. The upshot is that non-PC operating margins are significantly higher than its PC business—double in the case of its Data Center Group. Our base case FMV is $35. We believe there could be significant multiple expansion as more investors become aware of Intel's transformation.

In our Q1 2015 letter we wrote that we were close to selling our position in chemical company *Celanese* as it was approaching our FMV estimate. We sold it just days later. Shares then fell about 17% from our sale price, providing the opportunity to once again acquire Celanese at a 20% discount to its estimated FMV. Celanese's business should perform well as the economy continues to expand (its advanced materials products are used in vehicles and construction). One risk is China, which accounts for 20% of sales. However, most of Celanese's profits in China come through its acetate joint venture which does not have a high correlation to GDP growth. Our estimated FMV is above $75.

Income Holdings

After recently being as high as 2.4% and falling as low as 1.9%, the 10-year U.S. government bond now yields 2.16%. Rates have remained constrained by slower growth and disinflation around the world. However, higher rates likely are on the horizon. High-yield corporate bonds now yield about 7.4%. Our income holdings have an average current annual yield (income we receive as a percent of current market value) of about 9%. We continue to hold a number of undervalued income positions, a few trading well below par, but with value based on asset coverage which, we believe, justifies higher prices. And we continue to collect outsized interest income on these positions due to the depressed prices.

We look for income opportunities where interest 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). However, lower rates, particularly in high yield securities, have created a dearth of attractive opportunities. We continue to explore for opportunities, both via screening and our network of contacts, and patiently await better risk/reward parameters.

In the last few months we added just one position, Enerdynamic Hybrid Technologies bonds, which we discussed above in our All-Cap equity section. We eliminated our holdings in Dundee Office as its performance had been weaker than expected and other REITs became more desirable.

Of note, regarding our top income holdings: *Specialty Foods,* now an equity holding of a private company, held only in our taxable income accounts, is expected to return capital to us in the months ahead (see the reference under All Cap holdings above); *Sun Product* bonds (a private company held only in our taxable accounts) has solid earnings from its consumer staple business; *JAKKS Pacific's* convertible bonds rose from the possibility of a buyout; *Ruby Tuesday's* bonds have benefited from an uptick in same store sales and remain well covered by underlying real estate; *Advantex Marketing* debentures should benefit from the company's diversification of partners and merchants; *Brookfield Real Estate Services* continues to benefit from its steady royalties based on the increasing number of real estate agents in its network; *Telecom Systems* has increased in value as the company is exploring strategic alternatives for enhancing value; *Enerdynamic Hybrid Technologies* should have a material earnings lift from new contracts; *Northwest International Healthcare Properties REIT* bonds have benefited from the REIT's stable income stream especially now that it's merged with Northwest Healthcare Properties REIT; *Student Transportation* bolstered its balance sheet with a recent equity issue and remains at a discount to our estimate of its asset value.

Value Will Out

With central banks focused on growth and generating inflation, and their pedals to the metal, we believe the ultimate outcome will be inflationary growth, or even stagflation. But, inevitably, a boost for depressed commodities and the depressed share prices of their currently unpopular producers. A particular opportunity when the correction phase ends and the bull market resumes. Time to be contrarian. And patient value investors should clearly be rewarded.

Herbert Abramson and
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