A SPECIAL NOTE FROM THE PORTFOLIO MANAGEMENT GROUP

AUGUST 27 2015

VALUE PARTNERS
INVESTMENTS

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VPI CANADIAN EQUITY POOL

The market had been trending downward since April and then turned sharply lower during the last week. The VPI Canadian Equity Pool is not immune to these market downturns; however, the volatility does create a number of opportunities for me as the Portfolio Manager, for the companies in which we invest, and an opportunity for you.

Buying great businesses with attractive earnings and dividend growth will allow our clients to create wealth and higher income over time. When the business fundamentals have not changed, yet the stock trades materially lower, that is an opportunity. This month alone I have been able to add $15 million to our positions in Bank of Montreal, TD Bank, and National Bank at prices that were over 10% to 20% lower than they were previously. That means our clients captured more of their future earnings and dividends at lower prices. That would not have been possible without the market downturn. There are also a number of great businesses that we do not yet own. We are continuously working towards owning the best businesses in the world, that have dominant market share, consistent earnings, and opportunities to grow. I want an opportunity to purchase those businesses at reasonable prices. These uncertain markets make that possible.

The energy sector has led the Canadian market downward and deserves some attention. The long-term fundamentals look extremely attractive for investors considering the world currently uses over 94 million of barrels of crude a day with current expectations for demand of over 97 million in 2017. Owning the right energy businesses will be a very lucrative investment over the long-term. The short-term supply and demand fundamentals are not as favourable, but will rebalance soon. Revenues for most of these businesses have fallen in half as a result of the collapsing crude prices. This downturn is a potential opportunity for our energy companies to grow their businesses by purchasing assets from distressed sellers. There are a lot of distressed sellers. Our companies can choose to be purchasers given their financial strength. Even if our energy companies choose not to grow their businesses at this time, they will be aggressively lowering their operating costs, which would not have been possible when commodity prices were higher. Shareholders will benefit from the lower operating costs over the next few quarters, regardless of the commodity prices. We continue to own three energy businesses that have the potential to provide excellent returns over the long-term. They each have the financial capabilities to allow them to whether the storm and become stronger businesses when the storm is over. The average price of crude oil in the 2nd quarter was $57 per barrel and it is currently trading at $38. Our energy companies will not only manage their businesses through this difficult environment, but they will be better businesses going forward as a result. Although the short-term losses may not be over, the long-term opportunity in this sector is simply exciting.

The VPI Canadian Equity Pool currently has 10% of its assets in cash. Our intention is to use that cash to acquire more shares from people that do not understand the true value of the shares but, more importantly, 90% of the assets are invested in businesses that are difficult to live without and pay a large and growing dividend stream. This is how the wealthiest people in the world invest and it is how I invest. In fact, all of my investable assets are in this pool because at Value Partners our money is invested alongside yours.

David Atkins

Portfolio Commentary

August 2015

MARKETS PLUNGE! WHAT TO DO NOW??

Despite coinciding with the last stretch of summer vacation for many, the recent drop in stock prices has probably not gone unnoticed. After an extended period of appreciation without meaningful interruption, world equity markets have suddenly taken back 2015's gains, with a slowdown in China's economy being tagged as the catalyst. Though we won't predict a v-shaped recovery from current levels, below are a few of the reasons that we'll likely be deploying available cash in the days ahead.

Valuations were reasonable (and are now more so)

At around 18x trailing earnings at the beginning of the summer, the S&P 500 was already trading well within its valuation range of the past quarter century. The recent drop in share prices has pushed this metric down sharply, making the cost per dollar of corporate income very attractive, especially for companies whose business are not significantly exposed to the difficulties in China and Europe.

The most important economy is doing fine

Employment, wages, home prices, and GDP are all rising in the US, despite the headwinds being felt overseas. Though the commodity-based parts of our economy are struggling, the fact that our largest trading partner remains on the upswing bodes well for our manufacturers and other exporters.

Monetary conditions are still supportive

Interest rates remain very low and it is likely that the US Federal Reserve's plan to begin tightening will now be put on hold. This backdrop is not only positive for corporate balance sheets and funding needs, it also limits the options for anyone looking for alternatives to stocks and dividend income. As well, the yield curve is steep (meaning that short term rates are significantly below long term yields) which is generally not a condition that precedes recessions.

Now is when we earn the right to higher returns

It is assumed that stocks will provide higher long term returns than guaranteed vehicles and, over the course of time, this relationship has been borne out. The reason equities offer the promise of greater performance, though, is due to the risk that must be assumed in their ownership. In other words, days like these represent the cost that we all must pay to reap the long term rewards of participating in corporate growth. History has shown that those who try to defy this law by jumping in and out of the market invariably become their own worst enemy. Dalbar's most recent survey found that the average mutual fund investor in the US generated an annualized return of 3.8% over the past 30 years vs. the 11.1% produced by the S&P 500 over the same period, mostly due to his inability to stay on plan during difficult periods. To avoid a similar fate, it's almost certain that today's best course of action will be to take none at all. By the way, the market's recent decline takes it back to the level it reached last October during its selloff over the Ebola scare … remember that? (me neither).

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DIXON MITCHELL
INVESTMENT COUNSEL

Global equity markets have been extremely volatile over the past few weeks and the downward pressure on prices seems to be accelerating. The TSX and S & P 500 have lost close to ten per cent of their respective values during the past three weeks. As well, with negative news being reported daily we understand the anxiety and discomfort that such an environment can cause.

As you are aware, we have been concerned about very high equity valuations, the substantial risk in markets and the possibility of a serious correction for some time. In our view, only the timing and the triggers were uncertain. Several factors are causing the "jitters": concern over a slowing Chinese economy, lackluster global growth, falling commodity prices and uncertainty over the timing of the U.S. Federal Reserve's first interest rate rise in almost a decade.

As prices rose many were convinced of substantial returns. Today we have purveyors of doom and gloom as prices fall. This is particularly true with respect to the price of oil. As always, our focus is on the long term fundamental merits of each company and their valuation. This discipline allows us to take advantage of opportunities when there is fear and reduce portfolio risk in times of greed.

We have capitalized on the recent market decline. In particular, we have purchased businesses in the energy sector as the price of oil has fallen far below its long term inflation adjusted price. We strongly believe that as a group our energy holdings have the potential to provide substantial returns over the next five years. In addition, the recent market weakness has provided us with the opportunity to initiate new positions and where appropriate "top up" existing investments to our target weightings.

Should equity prices continue to fall we will likely be doing more buying. Our stock selections are not immune from market downdrafts. As we invest in a weakening market we will undoubtedly experience short term paper losses. This volatility is to be entirely expected.

We have experienced similar environments in the past and have always preached "safety first". It is at times like these that the value of our approach becomes apparent. Our confidence is based on the underlying value and quality of the businesses that we own. We strongly believe that all of our investments are worth substantially more than their quoted market values. Just as importantly, because many of our companies are industry leaders and financially sound, their competitive positions and value continue to grow.

Vito Maida
August 24, 2015

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The complete holdings of the Pool are disclosed in its Statement of Investment Portfolio semi-annually. On a quarterly basis, the Pools disclose the top 25 holdings in the Summary of Investment Portfolio. Both these documents are available on our website at www.valuepartnersinvestments.ca.

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