WORTH THE WAIT

Value investing is usually about waiting—often for an unwarranted and trying period, while momentum investing (indeed, the term itself may be an oxymoron) is about riding the latest hot stock and group, and then on to the next, value be damned. For us, good values are the imperative. Values are created when stocks are mispriced—too low compared to their fair market values. This happens because stocks are underappreciated, misunderstood, shunned, neglected or off the radar screen. And, it takes time for them to be appreciated and more time to be discovered. Undesirable opportunities for momentum players needing instant gratification. Value investing requires patience. Momentum players are, by definition, impatient and often don't take sufficient account of value. The late Bill Sams, renowned U.S. Portfolio Manager, put it best when he said that value investors are depressed 80% of the time and euphoric only 20%, while momentum investors are euphoric 80% of the time and spend the other 20% looking for a job.

Bottom line, the stocks in our portfolios are cheap. Good values all—we believe they will perform and gratify, and be well worth the wait.

Heading Up

The September '09 quarter for our growth accounts was respectably higher despite a poor August—a better September made up for it. And since the bottom of the Panic on March 9, our growth accounts are up significantly, ahead of the overall market, which itself has enjoyed the strongest recovery in the last 45 years. Some recovery from the outsized decline we suffered in the Panic. At the bottom of the market in March, stocks had suffered the worst decline since 1932 and a negative return for 10 years, the worst 10-year period since the early 1800s. September past was the one-year anniversary of the demise of Lehman Brothers and Bear Stearns, of Merrill Lynch being forced into Bank of America, Wachovia into Wells Fargo, and of Fannie Mae and Freddie Mac and AIG collapsing from the crunch. And GM on its way to bankruptcy. All leading to the Panic in March. And, paradoxically, what proved to be one of the most significant market lows in history.

While confidence has improved, there is still lots of concern. The Panic of March has morphed into mere worry. Panics crush stocks, even the good ones, as everyone rushes for the exit. Trampling even value investors. But mere worry is good for markets. It tells us there is still upside ahead. The Hulbert survey of market timing investment newsletters has recently been bearish, a contrary indicator, not consistent with a market top. John Aitkens of TD Newcrest, a favourite strategist, says, “The huge stock price gains from the March lows tell you the market was cheap in March, rather than telling you the market is expensive today.”

The worry derives from some continuing bad news—U.S. unemployment still high at 9.8%, foreclosures still high. And from lots of imponderables—will there be an economic double dip, deflation or inflation, how high will interest rates rise, will the U.S. dollar tank, will U.S. fiscal deficits rise to unmanageable levels from health care reform, the war in Afghanistan, tensions with Iran?

But the market thrives on worry and imponderables, because they keep liquidity high and values attractive.

What We Know

We know that the recession is over and that Q3 '09 should show positive growth. We know that industrial production (the sharpest fall since 1946) is picking up, to replenish depleted manufacturer and retailer inventories (the steepest decline since 1949). We know initial U.S. jobless claims are at their slowest rate of decline since January. Recent job growth in Canada has been surprisingly strong. We know that housing inventories are shrinking, on their way to normalcy. We know that interest rates are historically low and that housing is exceedingly affordable. We know that house prices are stabilizing. We know that productivity is high and the U.S. dollar low, encouraging U.S. competitiveness and exports. And that, accordingly, the U.S. trade deficit has been shrinking. We know the U.S. savings rate has risen to its highest since '98. We know there is a high amount of liquidity on the sidelines in the U.S., some $9.6 trillion, earning nothing, available to fuel consumption and investment. Stock market gains since the March lows have contributed to a $2 trillion increase in net worth. Leading indicators are up 6 months in a row. Lower gas prices recently have helped the consumer too. U.S. retail sales for September posted the first monthly increase in more than a year. But we also know consumers are still worried. We know there is still $400 billion of the $780 billion U.S. stimulus package still to be spent. We know that corporate earnings have bottomed and are now surprising on the upside (in fact, the highest percentage of positive surprises in almost two decades) with comparisons easily beat. We know that the demand from the faster growing emerging countries, especially China, India and Brazil, will continue to stimulate world growth, especially as they encourage their domestic demand.

What We Believe

We believe we are in a new bull market. The large-cap indexes have rebounded to around 90¢ on-the-value-dollar, and though many market mavens have called for an end to the new bull market, we don’t see it. The North American stock markets, and most sectors, remain undervalued and, importantly, “on buy” in our SVA™ work. We believe the world economy will continue to recover. That cautious banks and cautious consumers will become bolder with the ongoing recovery. That corporate earnings will "normalize" and continue to grow from the depressed level of the recession supporting what we believe to be an undervalued market going forward. We believe that the excessive level of money printing worldwide should lead to somewhat higher inflation, but not necessarily hyperinflation. That higher inflation and large fiscal deficits will lead to higher interest rates. And higher taxes, likely too, under the current U.S. administration. We believe that rising fiscal deficits and rising national debt could reach critical levels. Though the U.S. dollar may have intermittent rallies, we believe it should continue to be under pressure as the need for foreign borrowings increases and the dollar loses its esteem as the reserve currency. Foreign currencies have generally been strong, and those of the commodity producing countries particularly so. Australia and Norway just raised interest rates, concerned about an overheating of their economies. The Canadian dollar recently hit a one-year high of $.97 and then quickly dropped to $.93 after its central bank expressed concerns about the high Canadian dollar impacting exports as evidenced by a record $2 billion trade deficit for August. We believe there will be continuing turmoil in Afghanistan, Pakistan, Iraq and especially in Iran. We believe commodity prices should continue to rise, from increasing demand and supply constraints, and from the declining U.S. dollar in which they are denominated. We believe that oil and natural gas prices will rise and help our portfolios which currently emphasize that group. We believe gold and silver prices should continue higher from increasing Central Bank, investor and jewelry demand, and from tighter supplies.

We believe the market is a prospective indicator and that its strength is likely indicating a stronger economic recovery than anticipated. Indeed, also contributing to that recovery.

What We *Really* Know

Unlike momentum investors, for whom a stock is often merely quotations heading in a direction, what we, as value investors, *really* know is that an investment in a stock represents a fractional ownership of its business. We want those businesses to have good balance sheets, good managements, good returns on capital and prospects for growing earnings. And we want them to be seriously undervalued, to minimize risk, and to offer meaningful reward whenever they get closer to their fair market values. Even if it requires some waiting.

We think we *really* know that stocks, with the S&P 500 selling at 14x projected operating earnings for '10, are currently, by far, the best asset class for an investor. Bonds are no competition, with Fed funds at an insignificant zero to .25% and U.S. 10-year treasuries yielding only 3.5%. In fact, bonds are probably a short-sale with the threat of a lower dollar, higher inflation and continuing higher U.S. Treasury borrowing requirements. The U.S. Treasury knows it too, because it plans to lengthen the average maturity of its debt to 72 months from 49 months. Which is what you do if you expect interest rates to rise and your currency to weaken.

We *really* know that stocks are cheap—based on valuation, the economic outlook, liquidity and psychology. And that our stocks are *really* cheap. We *really* know that, even if what we *believe* is not correct, our stocks are still cheap and excellent investments. We *really* know that, over time, worried investors wanting to take on more risk for greater return will move from what they believe are risk-free assets—treasuries and the like—to the significantly better returns offered by stocks.

We *really* know that markets are often inefficient and that stocks are often inefficiently mispriced, either too low or too high, particularly in the less efficient Canadian market. If they are too low, as in the case of our current portfolio holdings, it is often because markets are generally poor, they are misunderstood, or they are underfollowed, in the latter case, as, say, St Andrew, where there has been no research coverage. And if our stocks are inefficiently priced, then our returns will likely be inefficient or sporadic as well, though with an upward bias. Over time, we *really* know most of our stocks should perform well, though we also *really* know some will underperform because we will have made a flawed appraisal or something unpredictable may occur.

We *really* know that, on an after-tax basis, returns from stocks are even that much better than bonds. Indeed, if there was ever a time to employ a modicum of leverage—buying cheap stocks, and perhaps higher yielding fixed income investments, using very cheap (now 2.25% on Canadian dollar debits and 2.75% on U.S. dollar debits), tax deductible margin debt, to earn a higher-return capital gain taxed at a more favourable rate—this is it. The sweet spot.

We *really* know that panics are rare and that the current reflationary period, with liquidity and risk aversion so high, and the alternatives to equities so poor, is an ideal environment for stock investing. We *really* know the yield curve is extremely steep supporting financial institutions and the credit process.

We *really*, *really* know we want to maximize exposure to equities. Earnings are improving, liquidity is high, competition from bonds is low and economic recovery lies ahead. And stocks seem to have considerable upside momentum, refusing to correct materially despite considerable apparent bearishness.

We *really* know we should not be inhibited from overweighting the most attractive groups, as in the case of our current favourite group, energy, nor of seriously overweighting the most attractive individual stocks, currently Corridor Resources, Orca Exploration, St Andrew Goldfields, Sterling Resources, Kroger, Clorox, CVS Caremark, Aetna, Ruby Tuesday. Worth the weight.

We *really* know that, even if the economic recovery stalls, the return opportunity on the defensive, safe-dependable, blue chips we're adding now—Clorox, Kroger, CVS Caremark, and the like—should continue to grow, through thick or thin, and offer us significant return opportunity.

We *really* know that credit conditions have eased and allowed some of our beleaguered small-caps to finance themselves, including Petrolifera Petroleum, Etruscan Resources, Firstgold and Malaga. We are multi-cap value investors and, despite the decimation of small-caps in the Panic from their illiquidity, we will not abandon our philosophy to invest our clients' funds where we expect they'll be "treated the best." We don't buy smaller-cap companies because they might offer the biggest upside, but because, on an overall risk-reward basis, we believe they are better value—comparatively undervalued, offering more potential upside reward, with fewer, more analyzable, moving parts—downside protection. Unlike the period from 2000 to 2002 where our cheap small-cap longs rose while our overvalued large-cap shorts sank as the markets became rational, the recent debacle leading up to March of this year was a sheer irrational panic. We waited for some rationality to apply but large-caps fell well below fair value (more than 50% in the case of the S&P 500 and TSX) and small-cap stocks fell even further from indiscriminate selling. From peak to trough, the S&P/TSX Venture Composite Index (representing smaller-cap holdings in Canada) declined 80%, two-thirds of which took place in a 5-month period. That's panic we'd never witnessed before and hope to never again.

Our 10-year annualized return for our Long/Short Composite to the end of September '09, even with the awful drawdown in '08, is 14.2% in US$ (translated from CDN$) and 10.6% in CDN$. For many years, doing what we do, we seriously outperformed the North American market averages. In the decline leading up to March we seriously underperformed. Markets tend, over time, to regress to their mean. Doing what we do, we think we can regress to our mean again. Indeed, we *really* know we have to outperform to recover to our mean.

Our Kind Of Market—Cheap Small-Caps

Small and mid-cap stocks should not be confused with lower quality stocks no matter their price or capitalization. Witness all the so-called "blue chip" large-cap stocks that have been decimated, including Lehman Brothers, Bear Stearns, Merrill Lynch, AIG, General Motors, GE, Nortel. We appreciate, more than most, after an ugly year-and-a-half, that small-caps inhibit our ability to trade. But we believe we have come through a rare period of panic and that we should not abandon the philosophy that worked so well for so long—trading off liquidity for ultra-value—for lower risk and much higher return. So we continue our commitment to the high quality small-caps we hold, including Corridor, Orca, St Andrew, Sterling and Petrolifera, together representing about half of most growth accounts. Our 3-year targets for just these five companies suggest returns above 40% annualized which should justify any wait.

Though *Corridor Resources* has appreciated 150% from its March low, it still represents extreme value. It remains 72% below its '08 high mostly because smaller-cap Canadian resource stocks are still, on average, 60% off their highs and the price of natural gas is also way below its high. Based on current cash flow prospects and the value of its existing Hiram Brook proven and probable reserves, Corridor is undervalued. The stock should continue to rise from the recovery in natural gas prices and the continued drilling of Hiram Brook wells which should add to production, cash flow and reserves.

In early September the company announced improved flow rates from its first two wells fractured with a new propane technique. Both wells were boomers. And while it's unclear as to whether the initial high flow rates (about 4 times that previously experienced) were attributable to the new propane methodology or simply better geology, the results have the ability to make the company's economics even better. At the old flow rates, and assuming $6 gas (where the forward curve is now), the company's IRR on each new well drilled was an already respectable 19% per annum. The new flow rates push this substantially higher—and though thus far it's only been two wells with the enhanced flow rates, it could be a complete game changer.

In July, independent consultants estimated Corridor's shale gas potential in the lower Frederick Brook formation at a whopping net 59.1 TCF of gas-in-place. This naturally fractured, very thick shale resource could be one of the best in North America and is being looked at by larger players as potential joint venture partners who could bring capital and expertise to develop it. With the enhanced flow rates from the Hiram Brook and recent higher gas prices, Corridor is likely closing in on its ability to develop the Frederick Brook.

The company also has a potential valuable Salt Springs gas storage facility, a 2 billion barrel potential oil prospect in the Laurentian Gulf ("Old Harry"), and its Anticosti Island prospect. Old Harry alone, which could start drilling in a couple of years (after regulatory approval), also likely with a partner, could add significantly to the company's value. All worth the wait.

Orca Exploration has also recovered from its 52-week low, up over 80%, but it still trades at less than one-third of its growing $11 net asset value. The company's earnings should begin to ramp up over the next few quarters. In the meantime, Orca trades at only 4x 2010 estimated earnings. The company may seek opportunities to grow through acquisitions, but ultimately we expect its Tanzanian assets to be sold, much in the same way as its Chairman, David Lyons, maximized value for the shareholders of Pan-Ocean Energy. We'll wait patiently for this reward. Former colleague, money manager John Clark, once said, "A value investor can often wait 5 years, only to make his money in an hour."

Sterling Resources landed a farm-in partner for its Breagh field in late July selling one-third of its working interest in the Breagh field and surrounding interests for CDN$103 million. The net asset value thereby increased and is nearly double Sterling's current share price. Sterling remains undervalued, with significant exploration potential that could drive its underlying value even higher.

We are awaiting an imminent production announcement from *St Andrew Goldfields.* The company won its royalty dispute over its Holt property and, though it was appealed, the company will likely produce from Holt in 2011. Meanwhile, initial ounces will come from the Holloway mine and its Hislop open pit. We expect at least 85,000 oz in 2010 providing the company substantial free cash flow. Once Holt is added the company should produce 110,000 oz in 2011. With a cost of about US$500 per oz and tax pools over $160 million, its free cash flow should justify a substantially higher share price. Exploration success and higher gold prices could be an added bonus.

We've waited a long time for the payoff from St Andrew and now everything seems to be falling into place. Worth its wait in gold.

Petrolifera Petroleum raised $50 million in August to reduce a good portion of its debt and allow its capital spending program to continue. We participated in the issue at $.88 for a share and a half warrant too. The La Pinta-1 exploration well in Colombia, the producing Argentinian assets and the prospective Colombian and vast Peruvian properties justify a value over $3 per share.

After selling about two-thirds of our *Ruby Tuesday* position following the stock's nearly 800% climb from its March 9th low, the stock subsequently sold off and we began adding to the position again when our SVA™ work gave the buy signal. The shares trade at a very attractive 20% free-cash-flow yield. The company raised $65 million in July to repay debt and recently announced earnings ahead of expectations. Restaurant traffic growth is now positive and customer satisfaction is scoring very well. At 8x free cash flow, Ruby's fair value is about $11 today, and should rise to $18 in three years compared to its current $6.88 share price (a prospective 38% per year return). We continue to believe the shares are very undervalued and have been adding to the position on the most recent pullback.

Our Kind Of Market—Cheap Big-Caps

Interestingly, because stocks got so low in the Panic, lowest quality stocks outperformed 2-to-1 year to date. In this process, many high quality U.S. blue chips, including safe-dependable stocks, have become abnormally cheap relative to their fair market values and the overall market, trading at levels not seen for many years. And we have begun buying them because we *really* know their natural growth will continue, they will ultimately be reappraised higher, and though based on our 2-year targets they offer relatively lower prospective annualized returns of about 25% compared to our small-caps, overall returns could be higher if targets are reached sooner. In addition, we may be able to enhance returns by trading them using our SVA™ work. This cohort includes Aetna, Clorox, CVS Caremark, and Kroger. And we currently monitor a universe of other undervalued big-caps to add whenever they reach their "floors"—buy points in our work. For clients who have contributed new funds we have also added Johnson & Johnson, Burger King, Berkshire Hathaway, Becton Dickinson and Wal-Mart—all with prospective annualized 2-year returns above 20%.

Uncertainty presents opportunities for those willing to turn over enough rocks to be able to distinguish between short-term uncertainties and long-term risks. Unemployment and deflation uncertainty, anathema to grocers, is a short-term phenomenon that we have recently sought to exploit. This uncertainty has driven sentiment towards U.S. grocers to near cycle lows as evident by the group's trough multiples and near 52-week low share prices. We recently initiated a position in *Kroger*, undoubtedly the best run U.S. grocer thanks to its organic growth history, which has created a store culture unmatched in food retailing. Given its diversified store base, both geographically and demographically, Kroger is able to effectively compete against Wal-Mart. The higher food costs and lower unemployment we perceive in the coming years will provide considerable tailwinds for Kroger's earnings and improve investor sentiment. At today's valuation we can afford to wait. We forecast $2.50 per share of annual earnings in

2 years even if there is minimal inflation and little improvement in employment. At 14x earnings, Kroger's fair value is roughly $32 today and expected to be $37 in two years for a potential 27% annualized rate of return including the dividend.

We also recently bought *Clorox*—the U.S. consumer products supplier of name brands such as Clorox, Ajax, Liquid-Plumr, ArmorAll, Pine-Sol and Glad for 13x earnings, though it almost always trades right around our fair market value, now about $78 or 18x earnings, and growing by at least 9% per year. And we collect a 3.4% dividend while we wait. So, at a minimum, we should get the growth rate of 9% plus the dividend yield of 3.4% for an aggregate 12.4% per year. Should the stock revert back up to fair market value in short order, as it should do from this very unusual occasion where the share price has detached so far from reality, then we will enjoy a considerable capital gain. Our 2-year expected rate of return is 31% per year.

We still hold a position in *Aetna*, which in our view is the best run national health insurer with the best plan designs and top underwriting standards. Yet even though Aetna still meets our required rate of return, trading well below our fair market value appraisal (trading at 8x 2010 free cash flow versus our 14x fair value assessment), we recently sold one-third of our position as our SVA™ work gave us a sell signal indicating at least temporary potential weakness in the stock. But the undervaluation is extreme and provides a margin of safety offsetting uncertainties regarding healthcare insurer profit margins from President Obama's healthcare reform. We are encouraged that the U.S. government may not include a "public-plan option" as part of its proposed healthcare reform. That increases our confidence in our fair market value assessment of Aetna which we still expect to garner at least 8% operating margins (versus 11% 2004-2007) or $4-$5 of annual earnings per share. Aetna's fair value is in the mid-$50s today and we expect it to grow to the mid-$60s in three years versus its current $26.65 share price. A 37% annualized return. Merely by waiting. We are anxiously awaiting the opportunity to buy back the shares we sold when the SVA™ work provides a buy signal. We continue to be attracted to the U.S. healthcare space and also hold a sizable CVS Caremark position. In the case of CVS we recently added to our position on a pullback to an SVA™ buy point. CVS also offers a potential 2-year annualized 28% rate of return.

We recently divested our entire *McKesson* position (other than in the Trapeze Value Trust where we sold call options against our position, earning options premium which effectively reduces our cost—a conservative strategy we'd like to employ more widely for clients) because, after the stock's recent appreciation, upside relative to our fair market value no longer met our hurdle compared to other opportunities.

A "Short" Wait

We have one short-sale position, recently initiated—overvalued mobile handset manufacturer, *Palm*. Unlike our Kroger and Clorox investments, we are shorting a highly uncertain and extremely high risk business that is exceedingly expensive. For those that haven't seen the Bell or Sprint advertisements, the perennial second-tier Palm recently rolled out a new mobile handset called the Pre. Sell-side analysts and industry commentators have championed the new device propelling Palm's shares over 500% (to $18.09) since the beginning of the year. We are not wagering that the Pre is a flawed device, rather that the odds of success are stacked against

Palm and, even if wildly successful, the company was more than fairly priced. Competition is fierce from incumbents such as Research in Motion (Blackberry) and Apple (iPhone). Plus new entrants fueled by Google's mobile platform as well as others with proven vendor relationships (Nokia and Motorola) have pre-Christmas launches pending. Increased competition should limit handset shipments and lower Pre's already reduced selling price. Sprint recently lowered the Pre's price by 25% only 4 months after its launch while Palm lowered sales volume guidance for its upcoming quarter. Perversely, the stock remained within 10% of its 52-week high when we shorted it and sentiment was hugely bullish. Our short-term target for the stock is $11.

We will continue to seek out other overvalued short-sale opportunities, particularly as the market rises to fair value.

Glad We Waited

Etruscan Resources and *Firstgold* were the last two of our holdings where we were concerned about the company finances and, thankfully, both found financing opportunities. Etruscan raised $43 million from Endeavour Financial (a resource based merchant banker) leaving Endeavour with a 54% stake in the company. The deal allows Etruscan to pay down debt, remove most of its costly hedges and breathing room for its operations at its Youga mine, now finally running closer to its target capacity. Firstgold has had an offer from Northwest Non-Ferrous International Investment Company, the subsidiary of a Chinese mining conglomerate, to acquire 51% of its shares and all its debt obligations. The transaction is expected to close by mid-December, finally allowing a critical path to proceed for its Relief Canyon mine in Nevada to start production early in 2010.

There were several other positive material changes for other smaller holdings recently. *Malaga* completed a rights issue (in which we participated) providing the funds to double its production from its current 250 t/d to 500 t/d by next spring, justifying a value 5 times its current share price. The resulting increased cash flow should allow the company to drill off its considerable tungsten veins, likely driving the value even higher.

At the end of September, *Cano Petroleum* announced a merger with Resaca Exploitation. The combined entity will have greater scale and the two companies are highly complimentary, both being secondary and tertiary recovery operators with mature, long-life oil production. We did sell some shares on the immediate and substantial increase after the announcement though we believe the true value is much higher and ought to be realized as the combined entity shows substantial growth over the next couple of years—the proven reserve value alone is 3 times the current share price. And higher oil prices should increase that value.

Canoro Resources had a senior management change with Robert Wynne, the former CFO of Pan-Ocean, taking over as CEO of Canoro. We welcome a reenergizing of the company whose share price still languishes at less than one-quarter of its reserve value.

TG World Energy settled a lawsuit with its partner and can now move more freely ahead with its drilling plans. In the meantime, the company still trades for less than the cash on its balance sheet. Combining the cash per share with our conservative appraisal of TG's business, we value it at over 3 times the current share price.

Income Accounts—Paid While You Wait

Finding quality income investments with meaningful yields is becoming challenging because bonds—which fluctuate in price too—at these historically low rates should probably generally be avoided. The debt of high quality, well-known corporations is yielding annual returns of only 4%-6%. Which is why we are looking at lesser known companies.

We added the 10.5% Secured Notes of gold miner *Jaguar Mining* in the quarter just ended. We purchased the debt at a roughly 10.3% yield to maturity, which was extremely attractive relative to the company's 14x interest coverage, 10x asset coverage and considerable equity market value ($900 million) relative to the $85 million debt issue. It was the only debt of the company and maintains a first claim on the company's Brazilian assets. Subsequent to our purchase, Jaguar announced a new 4.5% convertible debt issue of which some of the proceeds will be used to retire our Notes in mid-November at $105 giving holders a premium over par.

We still think the royalty trust, *Pizza Pizza Royalty Fund*, and high dividend paying (12.5%) *Student Transportation of America* are both solid holdings with double-digit current yields and the potential for strong capital gains over the next 3 years as each trades well below fair market value today (hence the high yields). And each provides recession proof necessaries—food and school busing.

There are also some higher yielding, yet safe, U.S. corporate bonds which we're now analyzing given the ascent of the Canadian dollar which is removing much of the risk of exposing ourselves to U.S. dollar based income assets—to date we have not wanted to offset any U.S. bond gains with a depreciating U.S. dollar.

In the last few quarters we marked down to market the prices of a number of our income positions. Most of our income positions are not publicly listed and as the prices of comparable high-yielding income securities were falling, we marked our income securities down in price too, to comparable yields. As well, the rough economy and very poor capital markets impaired the assets of some of the businesses. With material positive changes anticipated, we should be able to mark positions back up as asset values rise or as positions approach maturity (most mature over the next 2 years). The only security subject to further markdown in both the second and third quarters was *Richards Oil and Gas* debentures.

Lately, there have been positive material changes for the businesses of most of the other income holdings.

Specialty Foods Group is enjoying very strong year-to-date earnings and has considerable cash on hand relative to our debenture which is the only debt outstanding. *St Andrew's* anticipated production should bring in enough free cash flow to easily retire all our 12% debentures at maturity in December 2010. As well, we believe the company is likely to beat its earnings hurdle triggering an extra 10% bonus payment under the terms of the debenture. The warrants held by the debentureholders, exercisable at $.44, are also now in the money. *Avcorp Industries* just completed its financing which should fully fund its business and afford the breathing room until the larger contracts kick in over the next couple of years. The *First Metals* and *Blue Note Mining* reorganizations were completed and we received cash and freely tradeable shares (plus new debentures in the case of First Metals). The *High River Gold* takeover bid allowed Severstal Resources, its majority shareholder, to boost its stake to 62%. We're confident that our small debt portion, due in 2011, will be paid off in full at maturity. *Lanesborough REIT* continues to sell assets, the proceeds of which are freeing up capital to be used to repay our debentures due next February. *Arctic Glacier Income Fund* just settled a lawsuit with the U.S. Justice Department for much less than the market expected which doubled the unit price.

We think our income portfolios, which have a current income yield of about 10% per year, should also provide a few percent per year of capital gains over the next 2 years as most recover to par at maturity, for a potential 15%-20% total annual return from our income holdings.

Waiting Calmly

Because of the inordinately low returns currently available on income securities, we think, as a preferable alternative, accounts seeking lower risk investments could currently consider an equity component of the defensive, safe-dependable U.S. stocks that are now unusual bargains. We can now buy world-class companies such as Kroger, CVS Caremark and Clorox—all of which have decent growth rates (the latter two at double digits) and reasonable dividend yields—with a margin of safety as they trade below market multiples whereas each normally trades at a premium. We think each of these, and others that are similar, should provide a 20%+ annual rate of return over the next 2 years—an unusual opportunity to get blue chip and growing companies at 75¢, or less, on the dollar, especially so since the overall market has now recovered to about 90¢ on the dollar.

These safe-dependable businesses grow relentlessly as evidenced by their underlying fair market value growth throughout the current recession. Their share prices fell less and therefore recovered less, thus far.

The icing on the cake are the tax implications. Bonds yielding 4%-6% leave an investor with a paltry 2%-4% after-tax, versus profits on stocks which are subject to capital gains taxes rather than income taxes, with nearly 80% of the gain as an after-tax return. In other words, the after-tax return on, say, Clorox could be over 20% per year over the next 2 or 3 years, well above the meager after-tax return that can be earned safely on bonds.

The Virtue Of Patience

Successful stock investing requires patience. Value investors trade off risk for patience. The biblical figure, Job, could have been a value investor. In the past we've held individual stocks that provided little return for lengthy periods, even as the business prospered, only to make a large gain from some market event—the company being "discovered" or taken over. Patience is especially required in the case of lesser known names, such as Orca for example, a very low risk investment which trades "by appointment", but which we believe could be a triple just to reach its current fair value, not even accounting for future growth. It has long life reserves, increasing production profile, no debt and is cheap on every metric including expected cash flow and earnings and net present value. All one needs to do is wait. Hopefully for a more attenuated period given the recent market recovery and our belief in its continuation.

Herb says he feels most comfortable feeling lonely and holding what's unpopular. And having to wait for recognition. Therefore, natural gas. St Andrew. Republicans. Narrow neckties. *His* Nobel Peace Prize.

The famous speculator of the 1920s, Jesse P. Livermore said, "… I've found that the big money was never made in the buying or selling, the big money was made in the waiting."

On the other hand, Herb believes it's much easier for his younger colleagues at Trapeze to wait. At his age, he's afraid he may end up as a waiter.

Herbert Abramson and
Randall Abramson, CFA
October 30, 2009

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