TRAPEZE
CAPITAL CORP.

FEAR OF FLYING

Statistics show overwhelmingly that flying is a much safer way to travel than by automobile. Not to mention you get to your destination more quickly. Yet most people fear flying more than driving themselves. Statistics don't seem to matter. It's how you "feel" about it. Planes go up and down. They're very, very big and very fast and more complex than cars. Someone else controls them. And when the rare accident occurs, it's newsworthy and ugly.

So it is with investing. Statistics don't matter to most people. It doesn't matter that investing in stocks over time is proven to give the best return. So that getting to your ultimate destination—a better life, a happier retirement, security for the next generation too—is sacrificed from the irrational fear of investing in the proven best asset class. Because, like planes, stocks go up and down, they are more complex than other asset classes, someone else controls them—company managements or pilots of portfolios, such as us. Stocks don't provide "a return certain" although a statistically much better uncertain one. And sometimes stocks crash, and it's newsworthy and ugly. So the popular received wisdom is: let's get to where we want to go, more slowly, less effectively. We need to sleep nights. Damn statistics. Damn retirement. Damn the kids. Damn reality.

It is also received wisdom that risk and reward are positively correlated—the more risk incurred, the higher the potential reward. Nobel prizes have been granted for work substantiating this theory. It seems to make sense. Though, even Al Gore won a Nobel for an unsubstantiated theory that seems to make sense but is probably bunk.

T-bills—government-backed securities which offer essentially guaranteed maturity values—provide very low returns. At the opposite end of the spectrum, venture capital, where success is rare (hence risky), can offer unusual but outsized returns—like all or nothing.

The Only Way To Travel

Paradoxically, the least risky asset classes for the short term turn out to be the most risky for the long term, providing the lowest returns over an extended time.

Over time the lowest returning asset class is cash. Placing money under the mattress may feel less risky because you know you can't lose while everything else may be temporarily declining. However, even if "cash is king", it is desirable only in the very short term since it's proven that *all* other asset classes beat it over time. History shows us that, in increasing order of returns, you'd be better off in commodities, T-bills, long-term government bonds, real estate, large stocks and, finally, small stocks. These days, with issuers of so-called triple A rated Asset Backed Cash Obligations defaulting to holders, cash is more like the court jester than king.

Since the 1920s, inflation, on average, has taken about 3% of our purchasing power each year. Cash is actually trash, with T-bills returning a meager 3.7% per year, just slightly outpacing inflation. Before taxes. Long-term bonds returned 5.4%, large cap stocks a substantially better 10.5% and small stocks a whopping 12%. Imagine, if on top of being less risky, flying was also much cheaper than driving.

Bumpy Ride

So if, over time, we're that much better off in stocks than in all other asset classes, why are we continually brainwashed as to their extreme riskiness? It's because stocks *feel* riskier. Because, in the short run, stocks fluctuate more than other asset classes making most people *feel* a sense of risk taking. Now, of course, some stocks do fall and never recover—the true definition of risk, permanent capital impairment.

Unlike most other asset classes, stocks trade in a computerized auction market. With fluctuating bids and asks. Moment by moment. Sometimes pushed one way or another, meaningfully, by news, on big buying or selling. Fluctuating. Volatile. Short term. An opportunity for mispricing.

All other assets fluctuate too. But most, not nearly to the same degree. The most ubiquitous asset is housing. And you'd better believe house prices fluctuate too. Especially these days. Mostly down. And most people who shun margin to buy "risky" stocks seem to be able to endure excessive mortgage leverage on their houses, which unlike stocks don't enjoy earnings and dividends, are not easily tradeable and essentially depend on inflation and demographics to provide a gain.

Heck, we know firefighters, parole officers and bailiffs who think stock investing is risky.

With the 20th anniversary of the stock market crash of '87 just passed, the possibility of a recurrence is once again in the news. Daniel Kahneman, Nobel laureate for his work in behavioural finance, points out that investors believe there's a 51% chance that the market could fall by a third in any given year. The true odds are closer to 2%. Perhaps even lower right now given the market's positive fundamentals. Investors live in fear of short-term declines when, in fact, they should be more concerned with inflation eroding their future purchasing power.

Flying Higher With Stocks

Over any 20 year period stocks have *always* outperformed all other asset classes. Over any 15 year period stock outperformance drops to 93% (although it would also be 100% if you exclude the '30s depression); over any 10 year period, 89%; over any 5 year period, 74%; and, for any 1 year period, 70%. Stocks are deemed risky because the underperformance during shorter-term periods *feels* prolonged while you're enduring it. If, over a 5 year period, stocks lag bonds 25% of the time, that temporary impairment may *feel* permanent. But we need to realize that over the longer term the probabilities of stocks outperforming are overwhelming given the 90% plus historical odds in our favour.

And we always need to keep in mind capital gains from stock investing are treated much more favourably than the income returns from cash or bonds or commodities and you don't even have to pay any tax until you actually sell the stock, therefore allowing you to compound your return on a pre-tax basis until sold. A big edge.

Flight Insurance

That's not to say we should not be concerned about short-term fluctuations. And at Trapeze, we do attempt to reduce temporary market fluctuations in various ways. Not an easy task. We're fighting probabilities that aren't in our favour. Lord Keynes, famous economist and investor said, "Investing is an activity of forecasting the yield over the life of the asset; speculation is the activity of forecasting the psychology of the market." At Trapeze, we try not to speculate. We're not psychologists. We're pilots. We invest. Not easy to forecast markets, but we believe our SVA™ work gives us the advantage of knowing where the markets usually inflect. So, by raising our exposure to shorts and/or raising cash when the overall market looks very vulnerable to a decline, we attempt to limit the volatility in our portfolios—the short-term risk.

Preventing permanent impairment—i.e., avoiding the clunkers—is more important for overall capital preservation. The rest takes care of itself. What is a stock anyway? An honest to goodness individual business whose fractional ownership interests trade publicly. Yet many people would feel safer buying a McDonald's franchise, with assets they can touch and smell, that trades by appointment, than stock in the publicly traded franchisor, McDonald's, which is traded instantly and quoted all day long.

There's an "edge" in stock investing. The wind is at our backs as economies, corporate earnings and, in turn, business valuations invariably, over time, grow. And we don't want to prejudice that "edge" and hurt our overall performance by buying companies that, heaven forbid, might not survive.

We know we'll inevitably make mistakes. Pilot error. It's the only thing we guarantee. So we diversify. Our philosophy is geared to minimizing risk. Value investing. Buy low, sell high. We're always trying to find a real bargain. Usually, buying stocks that have fallen and whose share prices are well below Fair Market Value (FMV). That does not mean we won't buy a stock at its high. Our definition of "low" is relative to what the shares are worth, not to whether the stock price has risen. We also want to avoid "value traps"—stocks that are cheap, but for a reason, because of poor fundamentals which will continue to depress intrinsic value.

Buy low. Simply purchasing stocks at a wide discount to FMV minimizes risk. The bigger the discount from true value the less likely the stock is to drop further. And conversely, there's usually above average upside whenever the market decides once again to fairly value the shares. Low risk, high reward. Counterintuitive, but perfect sense.

When our individual stock holdings give sell signals in our SVA™ work, we try to use these stop losses to minimize loss. An excellent company, *Lowe's Companies*, recently gave a sell signal so we eliminated the position. Better safe than sorry. Now that it is at the next "floor" we'll consider buying it again. When, however, a stock trades at a deep discount to its FMV, we may continue to hold the position notwithstanding an SVA™ sell signal. Because more often than not, we think that value will trump even though current psychology causes a temporary loss.

High On Energy

Just because a company's future prospects can't be predicted with certainty doesn't mean it's risky. All or nothing prospects imply excessive risk and are to be avoided. But, if the probability of a positive outcome is high, but only the magnitude of the outcome is uncertain, the investment is not necessarily risky. With *Corridor Resources* we think that's the case. We know from engineering studies that the company is sitting on a large amount of gas. But how much more is there? Its drilling success rates have been near perfect. With an 80% upside to its risk-adjusted net asset value, Corridor is an attractive investment. But continued drilling success could make the upside very high indeed, well above its current "risked value". And, if gas prices go higher, as we anticipate, and if exploration success comes from some of Corridor's non-core properties, the upside increases that much more.

Corridor and the many stocks we own aren't just cheap. Even the ones, such as Corridor, in the resource sector have attributes that distinguish them. We prefer companies with competitive advantages, a market position not easily displaced or assets that others covet. Important companies. That lowers risk too.

We believe Corridor's Frederick Brook shale play is being watched closely by others. Their McCully field likely has a meaningful one TCF of gas. And the company gets premium gas prices selling into the New England market. Contrasted with producers in Alberta, it's in low royalty jurisdictions, New Brunswick and Prince Edward Island. As it continues to grow, it could be an acquisition candidate. Not too soon we hope.

Petrolifera, trading at half of what we think it'll be worth in a year or two, also has an enviable land package. Over 7 million acres in Argentina, Peru and Colombia. Its drilling success rate is also remarkable. It even fortuitously hit oil in Argentina while drilling water injection wells to stimulate reservoir pressures. Pertrolifera trades well below its current net asset value and should continue to ramp up reserves, production (from low risk water flooding stimulation alone) and cash flow. Drilling in Peru, where the prospects are immense, is only a few months away.

Pacific Energy has two low risk offshore development oil fields, both in the US. And its Wyoming gas assets, we believe, should garner lots of attention once results begin to come in. Trading at half of its current net asset value, that could double over the next 3 years, the company is extremely undervalued. We've just added to our positions in Pacific Energy.

Orca Exploration is a virtual monopoly gas producer in Tanzania. No competition is the ultimate in risk reduction. The company is just months away from contracting all its natural gas reserves for a period that could extend up to 20 years, providing steady, predictable earnings with minimal capital expenditures. Orca just announced a successful development well in Tanzania capable of 55 mmcf/d which will take total field deliverability to 200 mmcf/d. It is currently negotiating to sell more gas to the growing Tanzanian power sector. Exploration success in Uganda, where it's looking for oil, should also provide upside.

If you speak with the *Connacher Oil and Gas* personnel, you'll hear the common refrain that their company has the best bitumen reservoir in the oil sands that any of them have ever worked with. Connacher's Pod 1 should enjoy a very long 25 year reserve life and the company has worked hard to derisk the future. It bought Luke Energy for its natural gas feedstock to support the steam process which enables the heavy oil to flow to surface, and acquired a US refinery to eliminate the exposure to typical heavy oil price spreads. Connacher just started flowing its oil. A low risk bargain which trades at a one-third discount to net asset value which it continues to grow.

Our oil and gas names have all lagged of late. While oil is up about 30% in the last 18 months, remarkably the TSX oil and gas index is actually unchanged. In Canadian dollar terms, oil is up a mere 5% in the last 18 months while operating costs have risen more. And, the new Alberta government royalty scheme has weighed heavily on the sector. We don't think this poor action in the overall oil and gas sector will endure. Natural gas prices have been weak but should ultimately move much higher in the face of the low level of drilling in Canada—only 60% of rigs are expected to be utilized this winter, down from the normal 90%.

We also expect the overpriced Canadian dollar to stabilize or even weaken somewhat against the US dollar. Canadian manufacturers are being squeezed with weakness in the US economy robbing them of sales there and globally.

With oil at lofty prices some see investing in oil stocks as risky. The reality is, the worldwide supply of oil has ceased growing while demand continues inexorably rising, limiting the risk of any material decline in oil prices.

Clearing Security

Outside the oil and gas sector *Allen-Vanguard* is our single largest position. It operates in the defense business where earnings should grow even if the economy weakens. The company just acquired its major competitor, Med-Eng, which should catapult combined revenues to over $500 million in the next fiscal year. In a recent Versant Partners' report, analyst Neil Linsdell argued that the transaction transformed the company into "the pre-eminent supplier of must have equipment" and "the global leader in providing integrated solutions to counter the threat of bombs and IEDs [Improvised Explosive Devices]." The counter-terrorism products and services they provide include bomb jammers, bomb squad training, remote operated vehicles (robots), containment systems, area denial systems (barricades) and personal protection equipment. Homeland security is becoming big business and, unfortunately, is starting to impact everyone's homeland. Contracts for Crew 3, the next generation of IED jammers, should begin to be awarded soon which could provide Allen-Vanguard with upwards of an incremental $500 million in annual revenue by 2010. Even without that, we expect the company's FMV to grow to almost 3x today's share price over the next 3 years.

We have added to our *CompuCredit* position. A new recent ugly leg down in the financial sector took CompuCredit to new lows. At less than 4x next year's depressed earnings we think the stock price has overcorrected. The company operates mostly in the subprime credit card market, and the US housing downturn doesn't directly impact it since it doesn't make mortgage loans and most of its customers are not homeowners. Competition in CompuCredit's markets has diminished over the years and its proprietary servicing and debt collection skills should provide the company with an enduring competitive advantage. The company has excess liquidity to pursue opportunities the current environment might present. Worth more than three times today's share price, the company's valuation remains extremely compelling. Its organic growth and inherent high profitability should also act to continue to drive FMV substantially higher over time.

The Gold Club

With around 20% of our portfolios in gold stocks we're somewhat protected against various exogenous risks—risk of a continued US dollar decline, of rising inflation, of a sudden calamity. And bullion has been making 27 year highs. Maybe from those concerns. Even with the metal at 27 year highs, none of the producers is coining it. The stuff is tough to find. Capital intensive. Costly to produce especially with rising energy and labour costs. Not only is labour costly, it's hard to come by. Many jurisdictions are inhospitable. We don't invest in Venezuela or Ecuador. We hold gold stocks principally because the supply/demand fundamentals are so favourable. There's simply a shortage of the stuff. So bullion should still go higher. And, we've been able to find gold companies whose stocks represent good value.

Our largest gold holding, *Etruscan*, is trading at less than net asset value and we believe that its growing FMV warrants a double in the share price over the next 3 years. Etruscan's assets are predominantly in the Birmian trend in West Africa which enjoys similar characteristics to Nevada's Carlin/Cortez belt in the '90s, but with the Birmian trend stretching over an even larger area. Etruscan has operated in the region for many years and now has claims over 20,000 sq km, likely making it the region's largest landowner. The mines that Etruscan currently has in production and development alone justify our 3 year projection, but should the company have further exploration success on its prospective gold properties, or within subsidiary Etruscan Diamond's enormous gravel package, the upside could be even greater.

Several of our companies, including *High River Gold* and Etruscan, recently raised equity capital which we believe has temporarily set back their prices. Read temporarily.

Fly American

While value investing is our overarching constant theme, we do embrace themes and look for cheap individual businesses in a particular group that should be favourable and popular. That's why we like resource stocks. Energy and Gold. Big secular plays.

We have usually been heavily invested in US stocks and now we think, despite the apparent current slowdown, the US is shaping up to be a very desirable place to invest, particularly in US multinationals that will benefit from the lower greenback with the ability to exploit the fast growing global economy and repatriate foreign earnings into higher US dollar reported earnings.

Thanks to co-pilot, analyst Anthony Visano's insightful work, we recently added *Office Depot*. It, and the other big box stores in its space, including competitors Staples and OfficeMax, have major competitive advantages over smaller companies. Staples, the largest in the office supply field, has had high and stable returns on capital for years. These top three should continue to grow for years because their combined market share in the US is only 10%.

Office Depot is run by CEO Steve Odland, formerly of Autozone. He's a proven cost cutter who understands how to best capitalize a company. Earnings power is approximately $3 per share, though is currently masked by large investment spending on remodels, new systems and distribution centres. In two years we expect the earnings power to be visible. Even if sales growth were somewhat anemic, the company has enough levers to push earnings higher. The business should be fairly resistant to any economic slowdown with no inventory risk from perishable goods.

Short-term problems and an accounting glitch have caused the stock to fall nearly 50% in the last year. Looking into '08, Office Depot's margins should improve thanks to back office improvements, increases in private labeling, more direct sourcing and a reduction in investment spending. The company is worth 14x forward earnings yet trades at only 9x. That implies an FMV today 50% higher than the current share price rising to over twice today's share price in 3 years. Its peers, Staples and OfficeMax, trade at 50% and 30% premiums, respectively. Even if the US slips into recession in '08, earnings per share should still be at least $1.70, which would imply a fair value 20% above the current price. Moreover, the company is an excellent leveraged buyout candidate, potentially offering financial buyers a healthy IRR.

US assets are becoming more attractive. TD scoops Commerce Bancorp. Other US acquisitions by international acquirers will naturally follow. Depressed prices, low interest rates and a low dollar make these acquisitions inevitable. With lower condo prices in Florida and elsewhere, low mortgage rates and a low US dollar, look for foreign investors, including lots of Canadians and Europeans, to pick up bargain vacation properties. Canadians are getting into cross border shopping big time, notwithstanding the border delays.

Fly Me To The Moon

We see little risk in our holdings—neither in their businesses nor in their valuations. But certain kinds of stocks *are* risky. Start-ups have a high reward potential but they also come with a tremendous amount of risk—too many unknowns and unproven business models. Cyclicals are risky because they fluctuate even more than your usual stock and when they look the best, at the top of the cycle, is the time they are the riskiest. Companies with excess leverage are at risk of permanent impairment if business worsens and they can't service their debt. Like many financials today. Certain industry groups are risky if profits are hard to come by due to heavy competition, low barriers to entry or high capital requirements. We avoid companies where we believe cash flow returns won't exceed the company's cost of capital. We also avoid investing in jurisdictions where the political risk is high. And, of course, we're always wary of overvalued companies whose prospects might look exceptional but can't be justified by their lofty share prices. The Mile High Club. *First Solar*, at a whopping 125x next year's earnings. So we're short it but hurting as it rises to unsustainable levels. There's no solace in big caps over small caps these days either. Ericsson, Capital One, Wachovia, Citibank, Merrill Lynch, Time Warner and other big caps have dropped big time with big write-offs including many who've written off their big time CEOs.

Friendly Skies

The US economy is clearly slowing led by the worst housing downturn in many years. It may end up in a recession. In the meantime, however, the declining US dollar allows US companies to be more competitive providing a lift to exports and a diminution to the trade deficit.

More important, years of above average coordinated global growth continue to lie ahead as China, India, Brazil and other developing economies are growing strongly.

Since WWII the modern role of our central banks has shrunk the duration of the time spent in recession to only 18% versus rates almost double prior to that. In more recent years the rate has fallen even lower. Soft landings were previously wishful thinking, but between the strength of the global economy and the levers of central banks, a downturn in the US and Canada could be much less steep than might otherwise have been the case.

Interest rates should stay low in the US because of the subprime mess and the slowdown and stay low everywhere else, Canada included, because no one wants its currency higher. Lower house prices are a double-edged sword—bad for owners and a constraint to consumer spending—but they make houses more affordable for those who don't have one or want something grander. "Everyone is born short a house," quips star money manager Bill Miller.

Incomes and employment have been holding up quite well even as spending declines, so the savings rate is increasing in a country which heretofore had a deplorable savings rate. Savings go somewhere—into fixed income and maybe equities—i.e., high savings rates are good for markets.

Inflation should pick up as the prices of imports rise, but will be tempered by the lessened demand for goods and services from a slowing US economy, especially housing and housing related, and from lower prices of commodities mostly priced in declining US dollars everywhere else in the world and from the pressure for productivity improvements everywhere outside the US to offset rising local currencies.

The US trade and current account deficits should finally start to decline to a more respectable 5% of GDP. In fact the US trade deficit in September fell to $56.5 billion, its lowest level in 28 months as the falling dollar pushed American exports to an all-time high.

The budget deficit may be exacerbated initially as tax receipts come under pressure from the slowdown and from write-offs (i.e., lower earnings and stock losses) but ultimately should increase as the economy restrengthens and tax receipts improve—too late for President Bush, but ultimately good for Mrs. Clinton or Mr. Giuliani. And very good for markets.

Plain and simple, the lower dollar is making US exporters more competitive. It has also made foreign travel for American tourists much more expensive but a bargain for visitors to the US. Wouldn't the ultimate irony be that all of this current dislocation and discomfort is setting the stage for an incipient boom period? On the other hand, in Canada, Europe and Japan and other countries dependent on exports some slowdown is inevitable. We're already hearing ugly stories in Canada about depressed auto sales and tourism declines. Look for the loonie to adjust downward even if it has to be helped by the Bank of Canada lowering rates.

With the market recently at record highs many fear we're vulnerable to a significant decline. But if GDP and corporate earnings continue to rise, shouldn't the stock market too? Earnings are the key driver of the markets in the long run, though in the short run, P/E ratios, driven primarily by inflationary expectations and interest rates, dictate the market's level. In the last 50 years earnings are up about 34 fold and, surprise, the stock market is also up 34 fold (7.4% per year excluding dividends).

Psychology can affect the short term. In the bubble of '99/'00 investors took the markets excessively high in a frenzy of optimism. Today we have a respectable wall of worry to climb.

Gravity also comes into play. A correction greater than 10% normally occurs every 2.5 years—the market gets ahead of itself and needs to return back to its earnings trend line. But the US market has not had a correction of more than 10% in almost 5 years. That doesn't necessarily mean we're going to get one any time soon, but based on our SVA™ work, it simply means we've been tracking up from a lower break point without hitting a "ceiling" yet for the overall market.

The market is currently more than 25% undervalued. With the economy slowing US interest rates have declined and should stay low. US inflation could clearly increase with record crude oil prices, rising food prices and higher imports from a lower dollar. Gold, another inflation barometer, is setting recent highs too, perhaps foreshadowing a lift in general prices. Oh no, dare we mention *stagflation* again in yet another of our letters? However, being so undervalued, the market could withstand some interest rate impact from moderately higher inflation. The bull market lives.

Some Turbulence Ahead

Back in '00 we saw significant risk in the market indexes. At the same time, stocks in general were reasonably priced. Confused? The Value Line, 1700 of the largest US stocks equally weighted, was trading at 12x earnings, while the market capitalization weighted S&P 500 and the Nasdaq 100 (skewed by the largest companies) were trading at substantially higher, unsustainable, valuation levels. Today, the Value Line has adjusted back up to a more reasonable 18x earnings while the S&P 500 has fallen to a very reasonable 14x. Some world-class companies are trading at cheaper valuations and greater discounts to FMV than we've seen in years (Walgreen, Wal-Mart, UnitedHealth Group, Medtronic, and Harley-Davidson).

Yet, today, with the bull market in North America almost 5 years old, we are again seeing some of the excesses in certain areas, particularly in tech stocks. The Nasdaq tacked on 25% from its April low. Stocks with good fundamentals, like Research in Motion, Apple, Baidu.com, Amazon, First Solar and others are trading at excessive and risky valuation levels. Seat belt time.

Short Flights

We continue to find short sale candidates to protect against an unforeseen downturn. For certain, as in '00 (our best performance year ever), shorting can protect against an anticipated market decline when our work suggests a bear market is underway. Shorting should help provide a less volatile return experience by mitigating short-term risk. And we still believe we can profit from short sales of very overvalued or, best of all, "bad" companies, even in an up market.

We have made some recent adjustments to our short selling strategies. First, even though we have intentionally not had a heavy exposure to shorts in the last 4 years because of our bullish bias, our exposure was too high. The market has remained "on buy" and in a bull market during the whole period. Therefore, we lowered our exposure over the last few months to about 10% of the portfolio. Second, we only initiate shorts at ceilings in our work. This is done to maximize profit and minimize loss, placing us closer to a stop loss in our work. Third, we are limiting individual short positions to around 3% weightings and are tending to equal weight our short positions. This should help prevent the few losers from offsetting the larger number of winners. Fourth, we will attempt to make sure that even when we cover on a stop loss that we revisit and reshort each position at the next ceiling if we believe our original premise is still intact. Ironically, we covered a number of losing positions and were relieved as we watched them go higher but ultimately dismayed as we subsequently watched them decline without us.

Most important, when the next bear market does arrive we believe we will be able to anticipate it and to protect performance in a market decline. In '02, at the height of the last bear, we were 40% short which contributed materially to our performance in that year.

Income Autopilot

The majority of our holdings in income accounts are convertible debentures, bonds and preferred shares. Generally we prefer securities with a fixed maturity value. There's typically less fluctuation and companies are obliged to pay us back at fixed dates. We look for undervalued income securities where we can earn interest/dividends and, potentially, a capital gain too. To lower risk we look for healthy amounts of earnings to enable interest coverage and healthy balance sheets with good asset coverage too. No new positions have been added recently but we did eliminate two holdings: *Gateway* debentures, after it was announced the company would be acquired and the bonds moved up close to maturity value; and *Calgen* notes, after positive rumblings around litigation increased the value of the notes closer to our fair value estimates.

Navigating Risk

There will always be misperceptions regarding risk.

There's a perception, even among some of our clients, that what we do is risky. Perhaps it's our outsized historical returns or the fact that our portfolio holdings aren't household names. Or that performance fluctuates, as it has for us in the last 3 months. But we have had many periods over the years where we've suffered over a few months only to recover smartly, by sticking to our knitting. We don't believe our holdings are risky because they may be temporarily underperforming. In fact, as they get cheaper they are less risky. And more prospective. We try to minimize all risks, even hedging the US dollar decline for our Canadian and international clients where we hold US securities. With the Canadian dollar now at more than a 7% premium we've started to protect our US clients from a potential decline in the Canadian unit.

Along with other value investors, we maintain a long-term horizon in a short-term investment world. The media, consultants and human nature (our own included) push investors toward instant gratification. There's great pressure to perform every month, quarter and year. But when we invest in a stock it's typically with a 3 year or greater time horizon. We project earnings out 3 years, multiply by the anticipated earnings multiple, adjust for any hidden assets and arrive at a 3 year projected annualized rate of return. Often, our purchases are bargains just because the market does not perceive a recovery for the company's share price in the short run. But to us, if we can buy at a floor in our work where we believe the market has fully discounted the current negative news, the stock may actually lift before it is generally expected.

Come Fly With Us

Currently, we remain fully invested. Our holdings are cheap and attractive. Some of them, such as CompuCredit, have gotten cheaper and even more attractive. And, we'll continue to be on the lookout for other cheap and attractive positions. Low risk opportunities in currently by far the best asset class—stocks.

Hey, we're risk averse too. Despite our company name, we're afraid of bungee jumping, first dates and job interviews. But we embrace statistics. Reality. Flying conditions today are excellent. Lots of worry. Fear now. Lots of liquidity building on the sidelines. Low interest rates, a growing global economy and bargains galore in the US for foreigners, and locals too. Good visibility, but some occasional choppiness. We're not afraid of flying nor of stock investing. It's the only way to go.

Herbert Abramson and
Randall Abramson, CFA
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