BACK IN BLACK

May was another strong month for the Fund, which again managed to move ahead with the markets. Positive performance was broadly based within the portfolio, though we note that performance was exceptionally strong for several of our top investments. We gained 9.7% on the month vs. a blended benchmark gain of 3.5%. The really good news is that the strong month puts the Fund in positive territory year-to-date to the tune of 8.8%, despite three of our four benchmark indices still being down on the year (the TSX being the lone outlier with a gain of 6.4%). Furthermore, the Fund's net asset value per unit stands at a new high $16.64, meaning that every one of our investors has made money, which is the whole point of the exercise.

We really don't have any new macro opinions to ruminate on this month. We are fortunate to have not acted on several of our contrarian views yet (i.e. shorting oil, agriculture) while some that we have acted on are starting to pay off (i.e. shorting gold). Often, momentum can carry on for a long time before the market realizes the thesis is flawed; lots of money was made on uranium and zinc on a flawed theory that there was a shortage coming before the market figured out this wasn't going to be the case. Here are some recent thoughts we have been tossing around the office:

- **Oil:** Unfortunately, we just find ourselves unable to jump on this bandwagon. The argument for peak oil (the theory that we have seen peak oil production and that annual supply will fall from here, causing significant shortages in supply) continues to gather steam. However, we are also concerned about our own version of peak oil, whereby US oil imports peaked three years ago, and demand is expected to decline for the foreseeable future. While emerging markets are more than picking up the demand slack, a US-spawned global recession could end that temporarily, while energy efficiency is likely to continue unabated. Already we see SUV sales in free fall and Hybrids in take-off mode. If oil remains high after Hybrids become dominant you could see a further shift from Hybrid-Electrics to All-Electrics (and don't worry about the power grid, you will only be charging twice a week for three hours at a time, and overnight when grid demand is at its lowest). That being said, we have to admit that we were embarrassingly wrong when two years ago we stated that we believed that oil was now in a cyclical range of $30.00-$90.00 (oil was at $70.00 at the time), we now believe that range to be $60.00-$180.00 (the marginal cost of production at current exchange rates to the historical top of 3x that amount).
- **Natural Gas:** We have never really had very strong views on this commodity, which has been on fire this year. However, having owned a few junior natural gas names, we are getting more familiar with oil's poor cousin. While the market seems to have reason to take oil higher, we can't see any reason for gas to follow suit. Natural gas storage numbers are nearing all-time highs, and supply growth is as high as it has been in recent history as new technology is opening up huge shale gas fields. Meanwhile, in response to last year's weaker prices, the big boys such as Encana have been holding production back. Finally, gas surpluses overseas are encouraging exports of liquefied natural gas to North America where prices are high despite over-supply. In other words, we are awash in natural gas, with seniors holding back production and juniors filling the non-existent supply-demand gap. There are a few contrarians out there talking about

this while the macro guys are blindingly calling this year the year Natural Gas plays catch-up to oil. That being said, North America finds its Natural Gas supply-demand/storage-production growth factors as bearish as they have been this decade. Natural Gas could realistically fall from a current level of over $11.00 to $5.00-- seriously.

- **Fertilizer:** Depending on who you talk to, known reserves of the various nutrients range from 600 years to 3000 years. This is not oil.
- **Gold:** The problem with gold is that it is the “buggy whip” of the commodity markets. Marginal cost of production for what mankind actually wants (jewelry) would argue for $300. With financial, futures, currency and ETF markets opened up to the retail investors, there are better ways to hedge inflation/play a falling U.S. dollar than gold. Gold as an inflation hedge has outlived its usefulness now that those inflating commodities/currencies are so easily investable.
- **US Consumer:** Retail stocks are cheap (we are avoiding the sector while revenue growth rates turn negative), restaurant stocks are expensive (we are shorting these), gas prices are up (see above), while home prices are collapsing. As we are fond of saying: there are other/easier places to make money.
- **The Fed:** At a 2% rate, is another 1/4 point going to make a difference? If this isn’t the bottom, its close. The Fed won’t be able to spur the economy, but maybe it can ease inflation through a stronger dollar.

The Fund has performed well, but it has come from a dark place (like the rest of the market). Therefore, the near 20% move we have had in the past two months has still left plenty of upside in our existing portfolio. We have recently completed a due diligence “sweep” of the portfolio and believe that our companies’ business prospects are good, and that their shares remain undervalued. While we continue to ferret out new opportunities, it will be difficult to find room for them in our fully invested portfolio. We are also maintaining our close to 35% short position largely because we think those securities will decline in value, rather than out of concern for the markets in general.

Yours Truly

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