

# **VERTEX MANAGED VALUE PORTFOLIO**

## **Second Quarter Report, 2007**

### **An Entitlement to High Returns**

Minus 1.97% year to date return. Oh sorry, my mistake, that was for the first six months of last year. This year we've improved by 20 basis points for a year to date return of minus 1.77%. There is a lesson to be learned from this...yes, there is. The lesson to be learned is that there's no lesson at all. Returns over such a brief interval are meaningless as was proved last year when the second half returned 20%. Returns can't be summoned on demand. Returns arrive in a most unpunctual fashion. The main reason for the negative year to date return has been a decline in the US dollar. 56% of your fund is in USD denominated securities and, in fact, had we published our returns in USD instead of CAD, our YTD performance would be very nicely positive. By the way, that's not an excuse; I only mentioned this to give the reader a better understanding of the variables affecting short term performance. I say short term performance as most short term shocks, like a massive shift in exchange rates, work themselves out over longer periods of time. I'm not going to talk a lot about your fund in this report for the simple reason that very little has changed over the last few years. The elevator story is this; your fund is invested in equities that are trading at price to value ratios much, much lower than the market with dividend yields much higher than the market, and has no exposure to commodities where I perceive most risk is concentrated today. I'd also mention there's nothing stopping me from taking 50% of our assets and buying metals and oil stocks except discipline and a knowledge of history. Believe me, it would be far easier to be with the herd and party like Paris Hilton every time the TSX hits new highs, really it would, but this party will end and people's life savings are at risk so I abstain.

As your fund is in excellent shape, I'd like to talk about something else this quarter and in this context the reader will gain a much greater understanding of what's going on in the Value Fund. This subject could best be described as an entitlement mentality to high returns. When I first entered this business, to convince an investor to purchase a money market mutual fund was quite an undertaking. Believe it or not, most people considered money market investing somewhat risky compared to Guaranteed Investment Certificates. Much more difficult was to convince an investor that it made sense to add a small allocation of equities to their largely savings bond and GIC portfolio even though it was demonstrably a superior investment strategy. This was a time when investors were pessimistic, skeptical and most of all fearful. People were more concerned about what they could lose than what they stood to gain by investing in stocks. This was 16 years ago and it turned out to be a fantastic time for investing in equities. It has been said that a bull market is born of pessimism with a dose of fear and ends in optimism with a sprinkling of euphoria. Where we are today I don't rightly know, however, taking a brief survey of public opinion it is definitely optimistic. Baring the tech meltdown and correlating TSX meltdown, stock markets have been very investor friendly for 15 years.

The melt down of 2000 - 2001 is over five years past and since those poor years (mostly forgotten) the Canadian market in particular has been on fire. The metals index is up 40% annualized for the last six years and an outsized 71% annualized for the last two years! The energy index is up 24% annualized for the last six years. This stuff actually makes the tech market mania look reasonable. To put all of this in perspective, money market securities (a surrogate in investment speak for a risk free investment) are yielding 4.5%.

Having said all of this, to achieve a rate of return above 7% when risk free assets are yielding a meager 4.5% is a large achievement and brings us to this point. Most investors today would consider 7% a substandard return and many would be laughing out loud upon reading that 7% is a reasonable expectation. In fact, many professional money managers kind of know this, yet in the context of today's outsized returns, have repressed memory syndrome. So we are in a world where risk free rates are sub 5% and expected returns without risk are double digit and I'm not talking about just 10%. One can get fired in Canada these days if only producing a 10% return! I know this from experience.

Now I'm not a pessimist but a realist. The world's capital markets have not reached a state of happy equilibrium where investments go in one direction only and risk is no longer linked to return. How many retirement nest eggs will be decimated when investors go back to an emotional state of fear and pessimism? I don't know but what I'm pretty sure about is yours won't. This fund is a completely different animal. We seek out opportunities where fear and pessimism are the rule. Those investors having been with us since inception know that we owned lots of banks in 1999 when they were unpopular - know that we bought aerospace firms just after 9/11 and bought insurance companies after hurricane Katrina and companies like Merck after the Viox panic - and now? How about the sub-prime mortgage companies - could you find an industry with more fear and pessimism? I love it. Would it be easier to be in Canadian denominated energy and material stocks? - of course - just as it would have been easier to be in tech stocks in '99.

Returns come in a most unpunctual fashion - they disappear unpunctually as well but also more rapidly than they arrive.

## PERFORMANCE

<b>Net Asset Value</b>	<b>Rate of Return (Class A)</b>					
	<b><u>3 Mos.</u></b>	<b><u>1 Yr.</u></b>	<b><u>2 Yrs.*</u></b>	<b><u>3 Yrs.*</u></b>	<b><u>5 Yrs.*</u></b>	<b><u>7 Yrs.*</u></b>
<b>\$14.7721</b>	<b>-2.11%</b>	<b>18.24%</b>	<b>8.25%</b>	<b>8.54%</b>	<b>9.94%</b>	<b>9.11%</b>

\*Annualized

Past performance is not indicative of future results  
All data are based on the Class A unit values

**THE PORTFOLIO**

The holdings in the Vertex Managed Value Portfolio at June 30th, 2007 include:

Fairfax Financial Holdings	Angiotech Parm.	Novastar Financial Inc.
Montpelier Re	Merck & Co.	QLT Inc.
BCE Inc.	CTS Corp.	Harleysville Group
Partner Re	Seamark Asset Mgmt.	American Home Mort. Inv.
Mattel Inc.	Sceptre Asset Mgmt.	Overstock.com Inc.
Level 3 Comm.	Odyssey Re	True Religion Apparel
IPC Holdings Ltd.	XL Capital Ltd.	Syntax-Brilliant Corp.

**ASSET MIX**

Cash	0%	Canadian Equities	26%
Fixed Income		Foreign Equities	49%
Canadian	17%		
Foreign	8%		

Vertex One Asset Management