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VERTEX MANAGED VALUE PORTFOLIO

Second Quarter Report, 2011

Yogi Berra once said: **"predictions are hard, especially about the future."** Worse, is that generally experts are no better at making predictions than the rest of us, and in fact they often make worse decisions due to overconfidence. Being experts in our own field – that is investment management - we must be extra vigilant in understanding the folly of our particular views of the future. Clearly, we must have an opinion, but it should be based on an understanding of history, and most importantly, the history of human behavior. History teaches us that humans can overcome almost any obstacle and move forward from the wheel to the internet, and it keeps getting better. Interestingly, despite all evidence to the contrary, we humans keep coming up with dire predictions of the future. Peak oil, peak food, peak water... hopefully, we've now peaked in "peak" talk, as it's become more than just a little tedious. Our society is so successful that we have extra cash to pay "experts" to come up with this garbage. Anyway, here's the thing – it has been documented many times that we underestimate the risks of things we like and overestimate the things we don't like. We all fear nuclear power but allow our children to ride bicycles. I won't go into the statistics on this one for it is truly alarming.

Moving on to investments and at the risk of boring you to tears (as our readers know I've been on this train for a while) investors are overestimating the risks to the USA (*don't like*) and are underestimating/overlooking the risks to Canada (*really like*). Let's look at the evidence:

> America is dealing with its worst economy in decades. The housing and mortgage finance bubble burst in late 2006. One out of every four mortgages is underwater and "official" unemployment is running at 9.2%. Debt is at $14 trillion. I'm sure the reader could come up with a dozen other popularized reasons for the end of America… it's a long list for sure. However, they are dealing with the issues. Americans have burned down their economy and are rebuilding it. US banks took the losses, recapitalized and sucked it up. The US dollar and stock market are both historically low reflecting the investor's view of the USA as a "has been" economy.

Now, contrast this situation with Canada:

> Canadians are now told that we're the best of the G7. Our banks are the best in the world, we're rich in resources which the emerging economies have an "insatiable" demand for and there's no end in sight… resources can only go up. Canada's stock market has been one of the best globally for the last 10 years and the Canadian dollar reflects this view as it's at a multi-decade high.

OK, now let's look at history and the evidence:

> The largest increase in global energy demand was the decades of the 1950s and 1960s. Global growth in demand was running in the high, single-digits and... oil fell in price over this twenty year period. Economics 101 teaches us that higher prices bring on more production, innovation and substitution which lead to lower prices. Today oil prices are high and global demand growth is a *lot* lower. High prices bring on production despite

slower demand growth than the 50s and 60s. Canada has without a doubt been in a sweet spot, shall we say for the last 10 years with high commodity prices, yet, our government is running large deficits out until 2015 and this is their own optimistic projection. One can only imagine what those deficits will look like when commodity prices fall, with commodities being the largest share of our GDP. Add to this that Canada is in a real estate boom that makes the USA housing story look like an amateur production. To top it off, Canadians have now surpassed Americans debt-per-capita at its 2007 peak.

Without making any predictions here, I believe (with the acknowledgement that “I believe” are the two most dangerous words in the English language) that evidence and history shows the CCC trade (China, Commodities, Canada) is more risky than investors think and that the USA is a lot less risky than investors perceive it to be. Global inflows to Canada could turn to outflows under different conditions. Stock prices, currencies and assets are reflective of investor consensus and we’ll only be surprised if the outcome is positive south of the border. Thus, the path for US assets seems to be either flat, as investors have placed their bets against America as a foregone conclusion, or up, on a positive surprise.

That said (if you’re still reading), our portfolio remains invested as it has been for the last two years in Property and Casualty insurance companies, Pharma, US Banks, and Canadian forest products… with the exception of Sino Forest, in case you were wondering. In addition to these sector holdings, Mattel still represents about 5% of total. I have been questioned about Mattel many times over the years, as to its inclusion in the portfolio. It has had many ups and downs since we’ve owned the stock. However, a stock like Mattel is a perfect example of how short even 10 years is with regard to an investment program. Mattel was originally purchased in 2000 at a price under $9 per share after Bob Eckerd from Kraft took on the role as CEO. Mattel trades today at $27.00 after paying us $5.18 in dividends over this period. Just simple math shows this investment has grown 3.5 times or generated a return of roughly 12.3% annualized without ever reaching more than 15X earnings. This should be highlighted, as it’s purely the company’s earnings that generated returns and not investor excitement pushing up its price-to-value. If we could find twenty Mattels life would be good indeed!

In closing, it seems the summer doldrums have set in early this year with some pathetic returns for the second quarter. Of course any quarter, or year for that matter, is meaningless as highlighted in the illustration of Mattel above. As always, give us a shout should you have any questions or would like to admonish your penman. We hope everyone is having a great summer.

PERFORMANCE (As at June 30, 2011, Class A shares)

Net Asset Value	3 Month	Year-to-Date	3 Year+	5 Year+	10 Year+	Since Inception+
$14.9768	-7.10%	-3.32%	9.72%	4.94%	6.69%	7.58%

+annualized returns

THE PORTFOLIO

The top 10 holdings by weight in the Vertex Managed Value Portfolio at June 30, 2010 are:

Fairfax Financial Holdings Ltd
International Forest Products Ltd
Mattel Inc
PartnerRe Ltd
Platinum Underwriters Holdings Ltd
Montpelier Re Holdings Ltd
Timberwest Forest Corp
Pfizer Inc
Ingersoll-Rand PLC
West Fraser Timber Co Ltd

ASSET MIX

Cash	0%	Canadian Equities	42%
Fixed Income CAD	2%	Foreign Equities	53%
Fixed Income USD	3%		

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