Lionridge
CAPITAL MANAGEMENT INC.

DISCIPLINE, DILIGENCE, EXCELLENCE

Quarterly Portfolio Manager Commentary — Winter, 2013

STRONG RESULTS FROM A DEFINED PROCESS

As at the close of 2012, I'm pleased to be able to report continued strong returns for you. Our Total Equity Portfolio has managed to beat its benchmark* by a wide margin since its launch at the end of March, 2011 (outperforming by 6.1% on an annualized basis, and 11% on a total basis**). This has been achieved by concentrating on the stocks of strong companies that are available at attractive prices, and working to avoid situations that can lead to permanent losses of capital.

A couple of questions that regularly come up in my conversations with you are, firstly, how can I achieve this kind of outperformance and, secondly, why is it that my portfolios don't contain a lot of the usual names that are seen in most mutual funds. It is the second question that contains the clue to answer the first – i.e. it is because I am not compelled to hold all of the popular companies that I am able to concentrate your portfolios on a select number of great investments.

The reason most money managers tend to hold small amounts of a large number of "popular" stocks is because these managers are held to short term benchmarks, and therefore play it safe by constructing portfolios that are designed to track the overall market. When I refer to these managers as "playing it safe", I mean that they are keeping their careers safe, but that has nothing to do with keeping your capital safe. Such portfolios can often be comprised of companies that are expensive, or have lousy balance sheets, or have unsustainable business models. These portfolios can often suffer permanent losses, but to these managers investing is a relative game; it is okay to suffer losses as long as everyone else is doing badly.

As an unabashed value investor, I believe one of my biggest advantages is my willingness and ability to ignore short term distractions and take a long term view. Part of this means avoiding stocks that the general market is overly enamoured with at a given time. This also entails being willing to let cash pile up in your portfolios when obvious buys are becoming scarce in the market.

So where are we at the start of this new year? There's been a lot of talk the last few years about the worldwide economic situation, and a lot of warranted concern. I have never believed in trying to incorporate economic forecasts into stock picking, as this can often lead to dangerous over-confidence and distract one from fundamentals. At the same time, if there are obvious signs pointing to potential problems one can't ignore them.

Despite the enthusiasm over the supposed resolution of the "fiscal cliff" in the U.S., the underlying structural issues have not been solved by the White House and Congress; the can has only been kicked a little further down the road. Problems in Europe are obvious and issues in Asia are evident. Accordingly, I have set up your portfolios with a view to them being very stable ships designed to weather some stormy seas. I have done this via a combination of the nature of the companies I've invested in, the prices I'm willing to pay for them, and the extra ballast of a large cash allocation.

Or to put it more simply, my current tactic can be defined by three words: "Defensive, Defensive, Defensive"! One of my favourite quotes by Warren Buffet is as follows; "Be fearful when others are greedy, and greedy when others are fearful". You can attend to the other parts of your lives and sleep well knowing that I'm vigilantly attending to the task of helping to protect your capital and grow it.

At your service,

Hardev Bains, LLB, MBA, CFA,
President and Portfolio Manager

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1120 – 200 Graham Avenue • Winnipeg, Manitoba Canada • R3C 4L5

T. 204.957.1802 • www.lionridgecapital.com

*Benchmark: 45% TSX Total Return; 35% S&P500 Total Return (Cdn $); 20% MSCI EAFE (Cdn $)