June 2010

"Patience is also a form of action" — Auguste Rodin

Performance	June 2010	Q2 (April 1 – June 30, 2010)
STEINBERG VALUE EQUITY FUND	-0.36%	*
STEINBERG HIGH YIELD FUND	-1.53%	*
S&P TSX	-2.11%	-5.5%
S&P 500	-3.94%	-11.4%
MSCI World	-3.71%	-12.5%

*Inception: May 31, 2010

Our outlook remains unchanged. Given the risks that exist, we need to remain patient and wait for share prices to become cheap enough before we step in.

As we have been stating over the past year, the greatest risk we see to future economic growth is the impact of government deficits, or more specifically, the efforts to reduce them. European governments, most recently the United Kingdom, are taking aggressive action through tax increases and spending cuts in order to satisfy an increasingly nervous bond market. Bond investors are focused on sovereign debt, and any country that is not addressing its deficit runs the risk of being unable to borrow (Greece). Portugal is the latest country to have its credit rating downgraded, resulting in higher borrowing costs. This is why most countries have been ignoring the pleadings of the U.S. administration and economists, such as Nobel Prize winner Paul Krugman, to maintain stimulus spending. These countries simply do not have the luxury of easy access to funding that the U.S still enjoys. However, given its fiscal situation, tax hikes and spending cuts even in the U.S. are inevitable.

All of the above will most likely result in subdued growth over the next few years. However, with the many risks that exist — including rising inflation, higher interest rates, deflation, the deterioration of bank finances, investors demanding higher risk premiums — the reliability of any forecast is suspect. With this in mind, our strategy is to err on the side of capital preservation. We recognize that we will likely underperform if the global economy returns to growth quickly, but given the risks, we prefer to wait for share prices to fall to a level where there is compelling value and an adequate margin of safety.

STEINBERG VALUE EQUITY FUND

As noted in the chart above, global markets fell sharply last quarter, and the decline gave us the opportunity to purchase two quality businesses that we believe are deeply undervalued – Aida Engineering and Royal Dutch Shell.

Aida Engineering

As we mentioned in our March letter, the Japanese stock market has been largely ignored by investors for twenty years. The result is that several outstanding Japanese companies are trading at a fraction of their intrinsic value. One such company is Aida Engineering.

Aida Engineering develops and manufactures specialized metal forming press equipment used by international manufacturers in the automotive, consumer electronics and industrial component industries. Founded in 1917, Aida is a global business with operations in 17 countries, including Japan, China, the U.S. and Italy. Its custom-built machines help clients improve quality and reduce costs. The company provides end-to-end solutions, which include installation, preventative maintenance and spare parts. Each machine is unique and requires AIDA Engineering expertise for ongoing service and support. There is little opportunity for competitors to service the equipment.

International sales are driving Aida's long-term growth. The company's global expansion began over ten years ago and international sales now account for over 25% of their revenue, with customers in 60 countries.

Aida has a track record of rising earnings and stable dividends, while remaining debt-free. Its financial strength has enabled the company to maintain its technological edge through investment in R&D, while not having to rely on capital markets to fund growth.

Aida's working capital (cash, receivables and inventory minus current liabilities) per share is greater than its price per share. This effectively means that the market is placing zero value on its profitable, dividend–paying business! While one never knows when the price of an undervalued investment will converge with its intrinsic value, a brilliant investor once said, "I always invest with a 100 year time horizon… and sometimes things work out early!"

Royal Dutch Shell

Royal Dutch Shell is one of the largest integrated oil and gas companies in the world. The recent BP oil spill impacted the whole sector, affording us the opportunity to buy a company that we have long admired, at a bargain price. Royal Dutch Shell has historically maintained a pristine balance sheet and, unlike Exxon, has preferred to use its excess cash to pay dividends instead of buying back shares (often at inflated prices). The company also has the financial capacity to make acquisitions, should opportunities arise. At the price we paid, the shares are cheap by almost any metric and the dividend yield is 6.7%.

We have witnessed huge market swings over the past decade, with investor sentiment often shifting daily. We note that during the month of May, the S&P 500 rose or fell by more than 1% on 13 out of the 20 trading days, ending the month down approximately 8%. On Thursday May 6, the market fell 3% "triggered by Europe's debt crisis" (Bloomberg). Two business days later, the market rallied 4% when investors thought the crisis was over. This level of volatility shows no signs of abating. As disciplined investors, we will continue to ignore the daily market "noise", taking advantage of this volatility to focus on our search for value.

STEINBERG HIGH YIELD FUND

"*A high income opportunity in a low yield world*"

BP 5.25% November 7, 2013

Our fund's first investment, a BP bond due in 2013, offers a very attractive yield of about 8%. The reason for the purchase was simple. BP has over $100 billion of assets and generates cash flow of over $20 billion per year. Total debt is only $25 billion. Even if the company had to pay $60 billion for the oil spill, it could cover the total amount with 3 years of cash flow! Since we purchased the bond, the price has rallied, as the sound fundamentals of BP's finances have overcome irrational fears of bankruptcy.

In this low interest rate environment, with such a high level of volatility, there are many opportunities to pick up yield. Our research effort is focused on uncovering those situations that offer yields well above current rates, while sticking to our focus on capital preservation.

Sincerely,

Lorne Steinberg