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February 7, 2014

Annual Letter 2013

Barrage Fund

Management Report

The Barrage Fund began operating on March 1, 2013. In its first year of operation, the fund returned 37.00% before fees and 28.48 % after fees. For the same period, the S&P/TSX has provided a total return of 9.92% while the S&P 500 rose 28.08 % in Canadian dollars.

During the year, the fund's assets were invested principally in the United States. A 3.2% appreciation of the U.S. dollar against our currency has had a positive impact on the fund's returns for the period.

Although 2013 was excellent for the Barrage Fund and the U.S. market in general, it is important to keep in mind that this represents only one year of performance. Since the main objective of the fund is to provide a net return greater than the major indices in the long run, its performance should be evaluated on the same basis.

Over time, the Barrage Fund will face different investment climates. We know there will be days of excessive enthusiasm for stocks, and this enthusiasm will eventually recede to irrational fear. Human nature is responsible for this cycle, which repeats itself continually.

Periods of widespread optimism complicate our task when valuations reach irrational levels. Despite overvaluation, prices may continue to rise for a lengthy period. A temporary under-performance compared to the market is often the price to pay for not participating in this madness. On the other hand, when a period of uncertainty arrives, value investors seize the opportunity to accumulate positions at a discount.

Although the portfolio probably suffered a temporary loss with declining markets, the deployment of capital to new opportunities created by this decline increases the long-term potential of the fund while reducing its risk. Barrage Fund’s unit holders should therefore monitor the fund’s performance with this perspective, being neither overly cheerful nor depressed by short term variations.

We continue to believe that the economic environment in Canada harbors several risks that could have a negative effect on the Canadian economy and stock market. The U.S. economy seems to be in much better shape. We are pleased to have access to many investment opportunities south of the border at an exchange rate that we believe is still favorable.

Our companies have solid financial positions, are well managed, and their long-term prospects are favorable. In addition, they are trading at relatively low levels. For example, the price/earnings ratio of the S&P 500 is trading at 16 times 2014 earnings compared to less than 11 times for the companies selected for the Barrage Fund. However, we believe that the quality of our businesses is higher than those which make up the S&P 500.

Some positions have been adjusted during the year at prices deemed appropriate and we will continue to act opportunistically. We believe that the current portfolio will provide attractive returns to unit holders while having a lower risk than the market.

The Fund's Risk and Volatility

It is generally recognized that investing in the stock market involves risk. However, there is no consensus among investors and academics as to the exact nature of this risk. Many investors directly associate the risk of investment in a stock to its volatility in the stock market. However, these are two different concepts even if they are sometimes correlated.

In our view, the risk of an investment is essentially bound to the risk of the company itself, rather than to the volatility of its share price. Whether private or publicly listed, a company always faces risks. These risks are important to us since they could undermine the return of our investment, regardless of short-term volatility.

The volatility of a stock could be compared to air turbulence experienced during a flight. Although it may cause concern to the passengers, it almost never prevents a plane from reaching its destination. It is clearly not practical for a passenger to leave the aircraft after takeoff, which is not the case with the stock market. If shareholders decide to sell a stock because its price drops after they purchase, without taking into account the performance of the company and its value, this could help to accentuate the fall. Such investors, rather than taking advantage of the situation, succumb to the forces of human nature that make most people poor investors.

Investors can benefit greatly from volatility in the stock market; it allows them to buy and sell businesses at favorable prices. As long as the underlying business is doing well, lower prices represent an opportunity to increase the investor's position in the company and sooner or later, market forces will influence the share price.

Our fund is less diversified than the majority of investment funds and should experience greater volatility over time. Due to our investment horizon, we do not consider this volatility a real risk to our clients. A person in need of short-term capital should simply not invest in stocks.

Portfolio Concentration

Several entrepreneurs have accumulated their wealth through just one or a limited number of companies. For such entrepreneurs, a greater knowledge of their companies, and the industries in which they operated, more than compensated for the risks associated with a high concentration of their assets. Andrew Carnegie, an important industrialist of the 19th century, summarized this concept as follows: "Put all your eggs in one basket and watch that basket." Though extreme, this quote conveys a concept that we strongly believe in, which is the concentration of investments in order to obtain higher returns.

Firstly, we fully agree with the merits of diversification. What we oppose is excessive diversification. We believe that the marginal benefit of diversification over a dozen stocks in a portfolio rarely outweighs the inconvenience caused by it. As the number of companies held in a portfolio increases, the less time we have to devote to each one. It would be disturbing to find that losses in the portfolio could have been avoided if we had spent the time necessary to understand and properly monitor each business.

Moreover, even if we could perform an in depth follow up of fifty companies, a second factor would contribute to restrict the number of stocks in the portfolio. How could we justify investing in fifty companies when we should be able to judge which ones are the best opportunities in this group? In theory, we should liquidate the less attractive securities to concentrate our assets in companies representing the top investment opportunities. It goes without saying that a person unable to determine the best opportunities available would benefit from a wider selection.

Our conviction leads us to seek a balance in terms of diversification. We favor a portfolio allowing us to enjoy the benefits of diversification without compromising our ability to generate superior returns.

Investment Horizon and Portfolio Turnover

The investment horizon is frequently used in finance when describing the investment style of a portfolio manager; long-term investing appears to be particularly popular. We believe that there is some confusion on this issue and we would like to clarify our position.

Generally, investment decisions at Barrage are evaluated based on the long term. We do not proceed by received wisdom but rather in response to the economic reality of a company and the impact of this reality on its share price.

As discussed in the semi-annual letter of 2013, there is often a difference between the share price and what we consider to be its value. This difference may persist for several years and may even temporarily increase. Although we can not know exactly when this difference will cease, we understand that the accumulation of earnings will sooner or later prevail over this difference. We are ready to wait to realize this value. What is critical is being right on the quality of the company and its ability to generate profits.

Obviously, we would prefer to see the price of our shares reach their value immediately after our purchase. Unfortunately, since we can not predict when there will be a readjustment, a rapid increase in price is often simply a matter of luck. In order to protect ourselves, we must assume that this adjustment will be spread over a long period, hence the idea of long-term investment. However, we must ensure that our businesses are able to create value for shareholders in the meantime. That way, we will be rewarded regardless of the time at which the market will eventually recognize this value.

The portfolio turnover is directly influenced by the performance of the stocks in the portfolio. The faster the difference between the price and value of our securities dissipates, the higher the rotation will be. Thus, higher returns usually result in a greater rotation.

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Administrative News

CIBC Mellon, the administrator of the Barrage Fund, is currently preparing the financial statements of the fund for the year 2013. Once this has been audited by the accounting firm KPMG, we will send you a copy. In this document, you will be able to view the fund's positions as of December 31, 2013.

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The fund has not made any distribution for the year 2013. Therefore unit holders do not need to pay taxes on the gains and dividends of the fund for the year 2013. Going forward, we will send you an estimate of the distributions before the end of each year for tax planning purposes.

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You will soon receive an invitation to the first annual meeting of Barrage Fund unit holders. We are planning to hold it in the spring and hope to see you there!

Sincerely,

Barrage investissement privé

Patrick Thénière

Rémy Morel

Mathieu Beaudry

Maxime Lauziere