

# AEGIS Value Fund



Portfolio Manager's Letter  
Quarter Ended June 30, 2016

July 28, 2016

Dear Aegis Investors:

**Table 1: Performance of the Aegis Value Fund as of June 30, 2016**

	Annualized							Since A Share Inception*
	Three Month	Year-to-Date	One Year	Three Year	Five Year	Ten Year	Since I Share Inception*	
Aegis Value Fund Cl. I	17.89%	46.18%	8.05%	-2.78%	4.56%	4.99%	9.32%	NA
Aegis Value Fund Cl. A at NAV	17.80%	46.07%	7.81%	NA	NA	NA	NA	-8.18%
Aegis Value Fund Cl. A-W/Load	13.38%	40.54%	3.80%	NA	NA	NA	NA	-9.67%
Russell 2000 Value Index	4.31%	6.08%	-2.58%	6.36%	8.15%	5.15%	7.38%	1.06%

\* Aegis Value Fund Class I (AVALX) and A (AVFAX) Inception were 5/15/98 and 2/26/14, respectively.

Performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. The investment return and principal value will fluctuate so that upon redemption, an investor's shares may be worth more or less than their original cost. For performance data current to the most recent month end, please call us at 800-528-3780 or visit our website at [www.aegisfunds.com](http://www.aegisfunds.com). Performance data for the Class A shares with load reflects the maximum sales charge of 3.75%. Additionally, performance for the Class A Shares without load is shown at NAV, and does not reflect the maximum sales charge. If reflected, total return would be reduced. The Fund's Class I (AVALX) and Class A (AVFAX) shares have an annualized gross expense ratio of 1.53% and 1.78%, respectively. The Fund Class I and Class A's net annualized expense ratio, after fee waiver, is 1.50%, and 1.75%, respectively. Under the waiver, the Advisor has contractually agreed to limit certain fees and/or reimburse certain of the Fund's expenses through 4/30/2017.

The Aegis Value Fund delivered a second consecutive quarter of solid returns, outperforming the Russell 2000 Value benchmark by 13.5 percentage points. With the strong year-to-date performance, the Fund's one-year trailing return of 8.05 percent (I-shares) earned the Aegis Value Fund the distinction of being mentioned as a Category King in the Wall Street Journal. We are pleased that our gains so far in 2016 have served to offset a significant portion of the Fund's previous declines we experienced when our strategy hit a rough patch starting in mid-2014.

During the quarter, softening economic data out of the United States, which included a surprisingly weak May non-farm payrolls print, torpedoed investor expectations of a near-term rate hike. As the quarter came to a close, a surprise "Brexit" referendum result whereby the United Kingdom voted to leave the European Union instigated a period of increased equity market volatility and a world-wide investor scramble towards perceived safe havens as fear of an impending collapse of the European Union escalated. The United States once again appeared to be a destination of choice for capital, with the dollar climbing 2.5 percent against the Euro during the quarter and gaining 7.9 percent against the British Pound Sterling. Bond yields plunged, with the global pile of sovereign debt sporting negative yields surging to nearly \$10 trillion at quarter-end. The U.S. 10-year Treasury dropped a significant 30 basis points over the quarter to close June with a yield of just 1.47 percent, near the July 2012 all-time low. After vocally calling for as many as four 2016 interest rate hikes during much of the past year, Federal Reserve governors questioned their economic bearings and decided instead to keep interest rates flat for yet another quarter. Bank stocks struggled to gain traction, with European bank stocks delivering particularly worrisome losses as Eurozone dissolution fears took the STOXX Europe 600 Index of European bank stocks down by 13.1 percent. Shares of German bellwether Deutsche Bank plunged another 19 percent, compounding first quarter losses of 30 percent amid increasing fears of Eurozone bank insolvency.

Precious metals were strong beneficiaries of the renewed flight to safety. Gold advanced 7.2 percent during the quarter while silver did even better, soaring 21.2 percent. Gains in precious metals compounded strong first quarter returns and continued to drive the stocks of precious metals miners higher, lifting the NYSE Arca Gold Miner's Index by a robust 38.3 percent in the second quarter. The Fund was well positioned for this turn of events, holding 22.1 percent of Fund assets in 16 precious metals and mining companies at the start of the quarter. Gains in these positions added a cumulative 13.3 percentage points to second quarter Fund returns and were responsible for a significant portion of the Fund's outperformance of its benchmark.

**Guyana Goldfields (GUY.TO)** was the most impactful positive contributor to Fund performance in the second quarter, improving Fund returns by an estimated 2.53 percentage points as shares increased 104 percent over the quarter. We began to acquire Guyana shares in late 2013 at attractive multiples to future cash flow as we built positions in several metals and mining companies beaten down by relentlessly declining precious metals prices. At the time, Guyana was well known in the mining community as one of the world's premier undeveloped gold projects. Furthermore, Guyana was in a friendly mining jurisdiction and had a well-respected management team. We held the shares for roughly two years while the project proceeded to completion, which was accomplished on-time and under budget, significantly de-risking the investment. Initial gold production began in late 2015 with the first quarter of 2016 marking the company's first full quarter of production-derived financial results, which met projections and demonstrated robust economics. While we believed Guyana was capable of achieving additional production and operational efficiency improvements over time, we chose to sell after Guyana stock was bid significantly higher as gold prices spiked and the company was added to both the NYSE Arca Gold Miner's Index and the S&P TSX Composite Index in mid-June. With Guyana shares requiring a \$1,500-1,600 gold price to justify the market valuation, we believed other opportunities offered better risk/reward characteristics and chose to completely exit our position late in the second quarter. The sale of Guyana Goldfields was our largest disposition in the quarter.

In addition to selling Guyana, we took advantage of the dramatic increase in mining share valuations to take profits in other precious metals miners, realizing \$14 million in gross proceeds in the process. With political turmoil seizing Europe post-Brexit and central bankers around the world pushing rates to extraordinarily low levels, we thought it a prudent time to liquidate a portion of our precious metals mining holdings, which were becoming a bigger percentage of the portfolio on an almost daily basis. After these liquidations, at quarter-end we retained positions in 15 precious metals and mining companies comprising 21.0 percent of Fund assets. We believe our remaining precious metals mining investments are generally among the most undervalued in the sector today and are also likely to bolster Fund returns in any future scenario of increased inflationary pressures and financial instability.

As we exited some mining securities, we continued to allocate capital into the paper and forest products sector, purchasing shares in **Resolute Forest Products (RFP)**, **Interfor (IFP.TO)**, and **Bracell (1768 HK)**. We discussed our Resolute Forest Products investment case in our last Manager's Letter, which is available on-line at [www.aegisfunds.com](http://www.aegisfunds.com). We continued to add to our holdings of Resolute shares, our biggest single addition to the Fund in the second quarter, as Resolute dropped another four percent amid a slew of investor fears including the specter of burdensome future tariffs and quotas on Canadian lumber imports into the United States. Following expiration of the Softwood Lumber Agreement "SLA" in October of 2015, Canadian lumber producers like Resolute have come under renewed investor scrutiny given the uncertain outlook for Canadian lumber. We continue to believe that a new acceptable bi-lateral lumber agreement between the U.S. and Canada will eventually be reached. Furthermore, we believe anxious investors are overlooking several positive drivers among Resolute's multiple businesses, including increased newsprint, lumber, and pulp pricing as well as the ramp-up of new projects.

We also purchased Interfor, a \$750 million market cap North American lumber producer, at an attractive multiple of just 5 times estimated 2017 free cash flow amid SLA-related investor pessimism towards lumber. While Interfor is a Toronto-listed equity, investors didn't appear to be properly taking into account that the company produces approximately 70 percent of its lumber in the United States and that Interfor would likely be a significant net beneficiary of future import quotas or tariffs on Canadian lumber imports. Furthermore, given the lack of North American single-home construction in recent years, the longer-term outlook for lumber demand as construction rebounds to more normal levels appears bright. We executed entry into this investment with fortunate timing, as shares are already up nearly 40 percent from our purchase price.

We also increased our stake in Hong Kong-listed Bracell, a low-cost Brazilian producer of dissolving pulp, a cotton fiber substitute with a strong market in China. At the time of purchase, Bracell was an approximately \$400 million market cap company, with approximately \$200 million in debt, and was trading with an enterprise value of just 3.0 times trailing annual EBITDA. Furthermore, we believed EBITDA was likely to expand given the significant drop

in the Brazilian Real, which lowered costs even further. Our timing here was also fortunate as shortly after purchase the company received a takeover offer from its primary shareholder at HK\$1.78, a 90 percent premium to our average cost. While we are glad to see the shares higher so quickly, we believe the offer undervalues the company and we are currently contemplating our options with respect to our position, which totaled 0.6 percent of Fund assets at quarter-end. Overall, our holdings in paper and forest products companies comprised 9.0 percent of Fund assets at mid-year.

Tobacco leaf dealer **Alliance One International (AOI)**, the Fund’s largest position, continued to hold a few more surprises for its beleaguered investors. The company had been embroiled in an accounting restatement process following the discovery of inventory and receivables discrepancies that were likely fraud-related and confined to a Kenyan subsidiary slated for closure. Fortunately, in the second quarter, Alliance One managed to complete its forensic investigation and refile all historic financials, once again becoming current and importantly doing so without any further negative surprises. However, a few weeks later the company was once again tardy in filing its normal March year-end audited financial statements. This most recent short delay was likely the result of an overworked corporate accounting department and a highly cautious auditing team. While the audited statements were filed in early July, we believe the delay created additional investor angst, pushing shares down 12.3 percent over the quarter. While declines in Alliance One shares negatively impacted Fund returns by 0.9 percent, company performance remains on track with our expectations and since mid-year, shares have recovered a strong portion of second quarter’s declines.

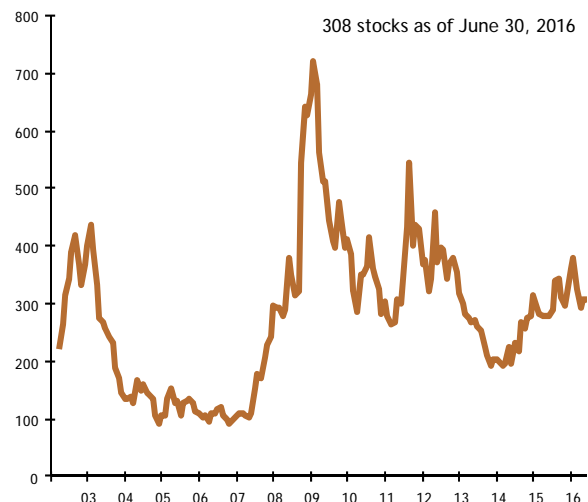
While preservation and growth of capital is a complex job even during the best of times, today is a particularly unsettling time to be an investor. Navigating hard-earned capital through the current global macroeconomic environment is not an easy undertaking, particularly with today’s record high sovereign debt levels, increasing levels of money printing, taxation and political authoritarianism, as well as an ever growing tangle of unpredictable economic regulations. These worrisome trends have resulted in a hostile environment for capital formation and have significantly increased the odds of low-probability/high-impact “black swan” market events in the future. With interest rates plunging to near all-time lows, investors worldwide are generally bidding up anything with a yield. Valuations in Treasuries, high-grade bonds, dividend paying utility equities and real-estate investment trusts have all climbed dramatically and today valuations look very stretched. We are steering well clear of these sectors of the investment universe, which we suspect are likely to offer a material amount of future pain for today’s income investors who may be focusing more on yield than on current fundamentals. Should interest rates begin to ascend, we believe many of these investors are unfortunately likely to see their portfolios eviscerated.

**Figure 1:**  
Aegis Value Fund, S&P 500 Index, and Russell 2000 Value Index Historical Price-to-Book Ratio



Source: Aegis Financial Corp and Bloomberg (Data from 9/30/1998 to 06/30/2016)

**Figure 2:**  
Number of Stocks Selling Below Tangible Book Value (Market Cap. Greater Than \$70 Mil)



Source: U.S. public equity market statistics from Stock Investor Pro (Data from 4/30/2002 to 06/30/2016)

More broadly, with the S&P 500 trading at a multiple of approximately 19.5 times trailing earnings, well above its multi-decade averages, U.S. equity market valuations today do not appear particularly undervalued. When viewed on other valuation metrics, U.S. equity multiples appear priced for perfection. In May, Goldman Sachs Global Investment Research calculated the median stock was at the 100<sup>th</sup> percentile on Enterprise Value (corporate debt plus market value of the equity) to sales relative to its historic valuation over time, the 99<sup>th</sup> percentile when measured on Enterprise Value to EBITDA, and the 83<sup>rd</sup> percentile when calculated on price-to-book value. The Wall Street Journal recently reported that the market's Shiller P/E ratio, which compares the price of a company's shares to the 10-year average of its earnings, was above 25 times in early July, well above its historic average since 1870 of just 17 times. High starting valuations have historically implied lower future returns. In a 2012 research paper, hedge fund manager Cliff Asness demonstrated that when Shiller P/E ratios were above 25 times historically, annualized 10-year future returns were an anemically low 0.5 percent. These statistics all clearly imply that it is time to be cautious.

After recently paring back several positions that had reached full valuation, Aegis Value Fund cash levels have climbed to 13 percent, providing the Fund with flexibility as we navigate through today's unusual environment. While we are holding cash levels today that are a little higher than we've held in recent history, we also realize that in today's environment of massive worldwide quantitative easing and increasingly negative interest rates, cash may not prove as protective in preserving capital as it has in the past, given the increasing potential for accelerating inflation and currency devaluations. This is one of the reasons we continue to hold on to precious metals-related investments.

Despite domestic equities trading at generally full valuations, we believe the Aegis Value Fund can continue to grow and preserve capital primarily through a strategy of careful investment in heavily researched opportunistic special situations. As can be seen in [Figure 1](#), stocks in the Aegis Value Fund at quarter end traded at just 67.7 percent of book value. This is a significant valuation discount to the broader equity markets and is evidence of our continued efforts to avoid the overvalued portions of the market and pare down positions where price has increased faster than intrinsic value. Through diligently recycling the capital into new deep value holdings, we work to ensure that the portfolio remains invested in stocks offering risk/return characteristics that we believe are among the strongest in the market today. Fortunately, there continues to be a reasonable universe of cheap stocks to choose from. As can be seen in [Figure 2](#), the number of stocks on our discount-to-book watchlist, while down sharply from early 2016, remains elevated. We stand ready to take advantage of investment opportunities that any future bout of market weakness may provide.

Thank you for your continued trust in us. Employees and our families have in excess of \$20 million invested in Fund shares. We continue to carefully monitor the investments for emerging risks. Should you have any questions, our shareholder reps are available at (800) 528-3780. You are also welcome to call me personally at any time at (571) 250-0051.

Sincerely,

A handwritten signature in black ink that reads "Scott L. Barbee".

Scott L. Barbee  
Portfolio Manager  
Aegis Value Fund

**Please see the following for important information:**

*The Aegis Value Fund is offered by prospectus only. Investors should carefully consider the investment objectives, risks, charges and expenses of the fund. The Statutory and Summary Prospectuses contain this and other information about the fund and should be read carefully before investing. To obtain a copy of the fund's prospectus please call 1- 800-528-3780 or visit our website [www.aegisfunds.com](http://www.aegisfunds.com), where an on-line prospectus is available.*

Mutual fund investing involves risk. Principal loss is possible. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in smaller and mid-cap companies involve additional risks such as limited liquidity and greater volatility. Value stocks may fall out of favor with investors and underperform growth stocks during given periods.

*The Fund's top ten holdings are Alliance One International Inc., WPX Energy Inc., Resolute Forest Products Inc., Delta Apparel Inc., Alaska Communications Systems Group Inc., McDermott International Inc., Alamos Gold Inc., Coeur Mining Inc., Endeavour Mining Corporations., and Geodrill Ltd. As of June 30, 2016, the stocks represent 10.3%, 7.3%, 6.1%, 4.8%, 4.7%, 4.4%, 3.7%, 3.6%, 3.5%, and 3.2%, of total Fund assets respectively. Fund holdings are subject to change and should not be considered a recommendation to buy or sell a security. Current and future portfolio holdings are subject to risk.*

**Price to Book:** A ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share. **Book Value:** A company's common stock equity as it appears on a balance sheet. **EBITDA:** Earnings before interest, taxes, depreciation, and amortization expense. **S&P 500 Index:** An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. **Russell 2000 Value Index:** measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. **The Russell 2000 Index:** measures the performance of the small-cap segment of the U.S. equity universe and is constructed to provide a comprehensive and unbiased small-cap barometer. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. **Cash Flow:** A revenue or expense stream that changes a cash account over a given period. **Discount to Book Value:** A company's stock trades at a discount to book value when its market capitalization is less than the book value. **Price-to-Earnings:** A valuation ratio of a company's current share price compared to its per-share earnings. **Basis Point:** One 100th of one percent. **Enterprise Value:** The market capitalization plus debt, less cash. **The NYSE Arca Gold Miners Index (GDM):** a modified market capitalization weighted index comprised of publicly traded companies primarily involved in the mining of gold and silver in locations around the world. **The S&P/TSX Composite Index:** the Canadian equivalent to the S&P 500 market index in the United States and contains stocks of the largest companies on the Toronto Stock Exchange (TSX). The index is calculated by Standard and Poor's, and contains both common stock and income trust units. **STOXX Europe 600 Index of European Bank:** is capitalization-weighted index which includes European companies that are involved in the bank sector. The parent index is SXXP. The index was developed with a base value of 100 as of December 31, 1991. **Shiller P/E ratio:** was popularized by Yale University professor Robert Shiller, is a valuation measure, generally applied to broad equity indices, that uses real per-share earnings over a 10-year period. The ratio uses smoothed real earnings to eliminate the fluctuations in net income caused by variations in profit margins over a typical business cycle. **Free cash flow (FCF):** represents the cash that a company is able to generate after laying out the money required to maintain or expand its asset base.

*The Wall Street Journal (WSJ) ranking is based on Lipper data. However, the WSJ only considers the largest class of a Fund in their "pool" of Funds for any particular category, whereas Lipper counts every class of a Fund as a separate ranking entity. Because the number of Funds in the WSJ ranking category may be smaller than the Lipper category, the WSJ ranking for the Fund may be higher than the Lipper ranking. Past performance is not indicative of future performance.*

Lipper Analytical Services, Inc. is an independent mutual fund research and rating service. Each Lipper average represents a universe of Funds with similar investment objectives. Rankings for the periods shown are based on Fund total returns with dividends and distributions reinvested and do not reflect sales charges.

An investment cannot be made directly in an index.

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