

## 2008 Annual Report December 31<sup>st</sup>, 2008

### Performance

To December 31<sup>st</sup>, 2008 the performance of the **HughesLittle Value Fund** and **HughesLittle Balanced Fund** was as follows:

	<b>Value Fund</b> <i>(non-RSP)</i>	<b>Balanced Fund</b> <i>(RSP)</i>
Pre-Distribution Unit Price	\$ 8.09	\$ 8.31
2008 Distribution	\$ 0.10	\$ 0.43
Post-Distribution Unit Price	\$ 7.99	\$ 7.88
One Year Return since Inception	- 27.6 % - 11.3 %	- 23.6 % - 4.9 %
Three-Year Annualized Return	- 4.1 %	- 1.5 %
Three-Year Annualized Return S&P/TSX	- 4.8 %	
Three-Year Annualized Return S&P 500 CDN\$	- 6.9 %	

*Notes: The Value Fund commenced operations June 30<sup>th</sup>, 2005 at a unit value of \$10.00.  
The Balanced Fund commenced operations August 31<sup>st</sup>, 2005 at a unit value of \$10.00  
Performance results are net of investment management fees and Fund expenses.*

HughesLittle is a little more than three years old. While still a short period we have obviously experienced wildly different economic and stock market conditions over this time. With the full benefit of hindsight we'd like to review how 2008 has revealed what's going well and a few decisions that have not gone so well.

In 2006 our unit prices were up nearly 20 percent, followed in 2007 by modest gains in the low single digits. North American stock markets in 2006 were up on average by a mid-teens percentage followed by flat results in 2007.<sup>1</sup> Starting mid 2007 and right through 2008 many sectors of the economy contracted, some severely. Worsening economic conditions, falling real estate prices, and severe financial asset quality problems (mainly in the U.S.), caused stock markets worldwide to fall: In 2008 the TSX was down 33 percent, the S&P 500 was down 23 percent, the S&P Euro was down 32 percent, and the world index S&P Global fell by 28 percent, all in Canadian dollars.

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<sup>1</sup> Indices results for 2006/2007 in Canadian dollars were: S&P TSX 17%/10% and the S&P 500 16%/-10%.

Our unit value declines can be grouped in two categories. The first group, and biggest contributor, includes about 90 percent of our companies that are weathering the economic and market conditions just fine, but experienced declining share prices. The second group includes a few mistakes we made.

As mentioned, about 90 percent of both Fund's common stock holdings have weathered the economic storms just fine - at least as well as we expected. In fact we expect for 2008 this group of companies made year over year percentage gains in operating earnings averaging in the low teens. This is on top of similar profit gains in the years prior. We view the 2008 profit gains especially, to be a good result in a tough year and one of the most meaningful performance measures in this report.

Most of our companies sell basic, required products and services worldwide. A large portion of our companies are leaders in two or three company industries. These companies are well managed, soundly financed, and for some time they have traded at share prices well below fair value. So even as market conditions worsened throughout 2008 we were not worrying about significant permanent value impairment through this period. For sure many of our share prices were down, but we had (and have) many more reasons to be buyers than sellers.

We consider one of our strengths to be an ability to focus on our companies and keep in perspective the constant barrage of economic and market noise. In 2008 this strength became a weakness. We underestimated how widespread and deep the impact of the U.S. financial asset quality problems would be. We underestimated how contagious investor fear became and how fast it spread, impacting the share prices of even healthy, reasonably priced companies.

By far the vast majority of the companies we hold today will come through this period as strong or stronger than they were. And their shares will surely rise back up to prices that reflect these companies' strengths and fundamental value. We cannot unfortunately say this about 100 percent of our companies. We own (or owned) a few that have suffered some value impairment. These are the sort of mistakes we try to avoid. These are judgment errors that cannot be blamed on a declining stock market.

In our 2006 Third Quarter report we talked about three killers of investment results. They are bad management, intense competition, and paying too high a price for a stock relative to its underlying value. Reflecting on 2008 we are adding two, albeit obvious, additional killers to our list: debt and complexity.

The potential impact of too much debt cannot be overstated. Debt is one of the few certainties in business. It always has to be paid 100 percent in full. And too much of it, too often, causes harm to otherwise perfectly good businesses.

Another killer is complexity. This one is subjective and probably related to our mental limitations more than anything else. Over the years our best investments have predominantly been in simple, straight forward businesses - ones that we can understand how and why they work. Alternatively, we have goofed more than once by talking ourselves into owning businesses we didn't sufficiently understand.

We discuss in detail in the enclosed Investment Review (clients only) our hits and misses for 2008 as well as some thoughts on 2009 at the end of this report.

<b>Portfolio Review</b>	<b>Value Fund</b> <i>(Non-RSP)</i>	<b>Balanced Fund</b> <i>(RSP)</i>
<b><i>By Asset Class</i></b>		
Canadian Equities	14 %	9 %
Canadian Income Trusts	8 %	9 %
U.S. Equities	53 %	34 %
Foreign Equities	22 %	16 %
Canadian Fixed Income	3 %	32 %
<b><i>By Industry</i></b>		
Business Services	38 %	22 %
Consumer Products	27 %	21 %
Financial Services	16 %	13 %
Oil & Gas	4 %	4 %
Consumer Services	12 %	8 %
Government of Canada (bonds)	3 %	32 %

During the fourth quarter we primarily invested in shares or units of existing holdings. Our one remaining Government of Canada bond also expired in the quarter and was replaced by two new Canadian investment grade corporate bonds earning higher yields.

A full list of the entire year's activity is in the attached Investment Review section (clients only). As of December 31<sup>st</sup>, the Funds owned eight Canadian companies (including two income trusts), four U.S. companies, and three companies based outside North America.

The Value Funds' top five positions make up 66 percent of the Funds' assets.

The Balanced Funds' top five positions make up 40 percent of the Funds' assets. The Balanced Funds' higher cash position resulted from a series of sale and buyback

transactions that were done to keep the Funds' book values within regulatory parameters. More specifically, no individual holdings' book value may exceed 10 percent of the book value of the entire Fund. Due to the sale of one holding at a loss (which lowered the book value of the Fund) we sold and repurchased shares of three holdings that had unrealized gains as well as a partial sale of shares in one large holding at year end.

The Balanced Funds' fixed income securities are entirely made up of Canadian Corporate bonds.

Clients can read a more thorough discussion of our portfolio holdings in the 2008 Investment Review. Prospective clients will have to call us to get a copy of this report.

### **Annual Distribution**

The Funds distribute their net income and realized capital gains to unit holders annually. The Funds do this so the Funds themselves do not pay tax.

This year's distributions are 10 cents per unit for the Value Fund and 43 cents per unit for the Balanced Fund. The Value Funds' distribution is dividend income only, no taxable capital gains. Distributions are automatically reinvested in additional units of the Funds for each unit holder (unless we are instructed otherwise for Value Fund unit holders only).

Enclosed for unit holders of both Funds is a confirmation of your distribution. Value Fund unit holders will also receive on or before February 28<sup>th</sup>, 2009 a T3 Supplementary. Both the Value Fund confirmation statement and the T3 Supplementary give a breakdown of the types of income that made up the distribution. The T3 Supplementary form is necessary for income tax purposes.

Unit holders in the Balanced Fund are not sent a T3 Supplementary because the distribution is non-taxable for RRSPs, registered plans, and RRIFs.

### **Fund Expenses**

The 2005 to 2008 Management Expense Ratios (MER's) for the funds were as follows:

	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
HughesLittle Value Fund	1.28 %	1.30 %	1.61 %	2.04 %
HughesLittle Balanced Fund	1.36 %	1.36 %	1.40 %	1.70 %

The MER reflects all expenses charged to the Fund throughout the year. These expenses include: investment management fees, audit, trustee, custodian, administration, and GST. Details of these expenses are disclosed in the Fund's year-end financial statements.

The MER is expressed as a percentage of the average assets within each Fund over an entire year. The performance results we report to you are after deducting these fund expenses. We expect the MER's to decline as the Fund's assets grow.

## Financial Statements

The Fund's auditors, Berris Mangan Chartered Accountants, will send audited Financial Statements for each Fund separately to all clients no later than March 31<sup>st</sup>, 2009. The audited financial statements include a complete list of each Fund's portfolio investments as of December 31<sup>st</sup>, 2008.

## 2009

Here's what we said last year:

*"We are, as usual, short on any grand predictions for the coming year. We'll continue to exercise diligence, patience and humility. We will say this: the companies owned by the Funds are predominantly solid and most are great value at current prices. We estimate about 40 percent of The Value Fund (30 percent of The Balanced Fund) is currently selling close to half-off of fair value. This makes us optimistic about our future returns."*

And you know what? Even in retrospect we wouldn't change a word of this. For us, it was the severity of the price declines in 2008 that were so unexpected. In many cases (financials, commodities, and autos aside), share prices leading into this decline were not high relative to fundamentals. It was how the stock prices of so many healthy companies went from good value to great value that was difficult to predict.

Although we've made minor changes to the portfolio and we are keen to generate better results this year, we have no reason to do anything drastically different going into 2009: (did we mention?) the companies owned by the Funds are solid and are great value at current prices. We estimate at least 60 percent of the Value Fund (50 percent of the

Balanced Fund) is currently selling at half-off of fair value or less. A few of our holdings we believe are worth many times their current share prices.

The economy will remain constrained in 2009 if unemployment continues to rise. Higher unemployment will clearly put an additional drag on many sectors of the economy and increase the *business risk* for many companies. For investors however, an increase in *business risk* can, but does not necessarily, increase *investment risk*.

As we've discussed in previous reports, investment risk (and returns) are largely tied to the share prices of the stocks we own. Currently for example, share prices are very low relative to the earnings our companies will produce over their lives - including conservative estimates for the next few years. So even though we may be in the midst of a recession many common share prices, including ours, over-discount that.

For well over a year now, our portfolio companies' share price performance has fallen well behind their corporate performance. Based on many years of investing experience in public companies, we know this will not last. Share price and corporate performance always converge over time. This gap however may be testing your patience. Fortunately though, this is a question of when share prices will rise back up to better reflect fundamentals, not if. Share prices will move back up in time, many sharply, and we are fully invested when it happens.

As always, we fully realize and appreciate that you have entrusted us with your financial assets. We continue to do our best to take proper care in the work we do for you. With our money invested along side yours, we are working hard to achieve much improved results.

Please do not hesitate to contact either of us if you have any questions or comments.

Kind Regards,

Joe Little  
January 16<sup>th</sup>, 2009

Mark Hughes