The McElvaine Investment Trust

www.avaluefund.com

Annual Report
2012

The McElvaine Investment Trust ("the Trust")

The McElvaine Investment Trust is a RRSP eligible fund. The Trust was formed on September 27, 1996 with the following philosophy:

1. Highly satisfactory longer-term performance can be achieved by focusing on companies selling below net asset value.
2. The purpose of an investment vehicle is to make money not to own stocks. This is an important distinction because it means the Trust will only invest when presented with an attractive situation.
3. As there are few good ideas, there are times when concentration may be helpful.

There are 4 different series of the Trust. You may refer to the current offering memorandum for a detailed discussion of each Series, but very simply:

Series A:	Was established in March 2009 and pays a 1% service fee.
Series B:	The majority of our investors, including Tim, currently own these units.
Series F:	Was established in January 2008 to allow investors with advisors to hold their units in fee for service accounts.
Series X:	Formerly called Series A units. These units may no longer be purchased.

Performance Summary as of 31Dec12

The McElvaine Investment Trust[7]
Series B

Year (Period)	Pre-fee Return (1)(2) Series B Units	Net Return (1)(3) Series B Units	Index (4)	Average Cash Balance (5)
2012	19.4%	18.3%	7.2%	18%
2011	-12.3%	-13.4%	-8.7%	10%
2010	2.8%	1.8%	17.6%	6%
2009	19.1%	18.1%	35.1%	17%
2008	-47.8%	-48.8%	-33.0%	6%
2007	1.0%	0.6%	9.8%	9%
2006	15.1%	11.9%	17.3%	11%
2005	22.9%	17.2%	24.1%	13%
2004	11.3%	8.6%	14.5%	23%
2003	36.5%	28.2%	26.7%	14%
2002	5.4%	5.0%	-12.4%	5%
2001	37.2%	28.0%	-12.6%	2%
2000	24.6%	19.2%	7.4%	9%
1999	38.8%	29.5%	31.6%	26%
1998	21.3%	16.6%	-1.6%	27%
1997	16.8%	12.8%	15.0%	59%
16 Year Compound	10.8%	7.5%	7.0%	
$100 invested Jan97 is now		$316	$296	

Notes:

(1) The “Pre-fee Return” and “Net Return” information includes distributions reinvested in additional units.

(2) “Pre-fee Return” is our estimate of the increase in the asset value of the Trust during the period after the deduction of all expenses, other than the management fee and performance incentive fee, and applicable GST. The Pre-fee Return gives you the best indication of how the Trust’s investments have performed. However, the “Net Return” is a better indicator of the returns actually earned by investors.

(3) “Net Return” is our estimate of the increase in the net asset value of the Series B units during the period. The Net Return for each series of units will differ since the fee and expense structure for each series units differs.

(4) As the Trust invests primarily in Canadian securities, we have compared its performance to that of the S&P/TSX Composite Total Return Index. This index tracks changes in the share price of the largest companies (by market capitalization) listed on the Toronto Stock Exchange (and includes the return from reinvested dividends). These companies represent a broad range of industries. The Trust may often invest in small-cap and mid-cap companies that are not included in the S&P/TSX Composite Total Return Index, and therefore, other indices may also be appropriate comparisons for the Trust.

(5) “Average Cash Balance” is our estimate of the average of the month-end cash and short-term bond balances held by the Trust. We have included this to allow you to assess how the Trust was invested in order to generate the returns shown. For example, the 1997 Pre-fee Return of 16.8% was earned while the portfolio was on average only 41% invested.

(6) This Performance Table excludes the three months from 27Sep96 to 31Dec96 (start-up period). During this period, the Trust returned 3.1%

(7) It is important that you understand that performance is yesterday’s news and you should be careful about using it as a guide to tomorrow. The figures above are unaudited and in many circumstances, our estimates.

My Commitment to Reporting

In the pages that follow I have tried to present the material I believe is important for you to assess the job I did. In other words, I have tried to put myself in your shoes and thought about what I would need to see to understand the performance of my investment. I hope I have done this in a fashion that neither trumpets my successes nor hides my warts.

You will find this report includes:

1. A general discussion of the issues affecting the Trust.
2. A specific discussion of the Trust including:
   i. a review of pre-fee returns to show you how the portfolio performed.
   ii. a reconciliation of pre-fee returns to your return to allow you to understand the expenses you paid and thus how the fund return became your return.
3. The Statement of Net Assets and Schedule of Investments for the Trust.

This report will not include a detailed discussion of our holdings. I have no intention of trying to sell you on each holding of ours. While the enclosed Schedules of Investments list the majority of our holdings, I believe a discussion of each not only has the potential to make me look quite foolish but also would not be in our best interests as partners. I do assume on these matters you trust my judgment and will hold me accountable each year for the collective performance of these individual decisions.

Finally, I work for you. If you believe there are items or issues I have not discussed but you would like to see covered, please let me know

Having said all of this, our lawyers and accountants say we need a disclaimer so here it is:

Warning Label
First and foremost, I caution you that all figures are my estimates. Secondly, I want to stress that all figures in the body of my report are unaudited. Audited Financial Statements have been sent separately to all partners. Finally, some of my comments could be considered predictions. While my statements are made with the best of intentions, history has shown I am often quite wrong.

To my Partners:

In last year's Annual Report, I concluded it was a good environment to be a value investor. What I meant was uncertainty was giving us opportunities to find interesting investments. Today the investment environment is tougher. The major difference is stock prices are higher today because investor perceptions have changed. The pendulum has swung from negative to optimistic.

When I think about perceptions and the influence of the media, I am reminded of the following old joke:

> *A little girl is walking down the street when a growling Rottweiler runs towards her. A woman grabs a stick and fends off the dog. Coincidently, a nearby newspaper reporter watches the entire incident and rushes over to help. Marveling at the woman's bravery, he decides to write an article. He tells the woman he is going to title it: Neighbour saves child from dog attack. The lady replies that she is visiting from the UK so the reporter responds that he will instead title the article: UK Tourist saves local girl. The woman adds that truth be told she is just temporarily in the UK on a university exchange but actually lives in Afghanistan. Next day the front page of the paper carries the headline: Local dog attacked by Terrorist.*

As stated, a year ago stock prices were lower but there was a lot of uncertainty. Today, investors feel there is less uncertainty and prices have risen. I would strongly argue that uncertainty does not equal risk. Risk depends solely on your margin of safety. In many ways, I find today's environment "riskier" than 18 months ago.

There is a lot to be positive about. Both housing starts and auto sales are up 50% from the 2009 lows. These are key drivers to the US economy. The major central banks are all providing substantial liquidity into the system. This contrasts sharply with the 1930s when monetary policy was tight.

The dark side of this wave of cheap money is that it acts as an "interest rate price control". Price controls distort decisions whether they are financial market, housing, spending or capital allocation related. Like a teenager with a new credit card, you just don't know when the cookie jar will be taken away. The effective structure of government investing "long" and borrowing "short" bothers me. This is a very unstable situation if perception changes.

The bottom line is I live in Victoria. The sunny days are wonderful and I enjoy them. During one of these days, I would be naïve to think there will not be rain sometime in the future. In the market today, we have had a sunny streak. It has served us well. As discussed in the following section, several of our holdings have either been taken over or their shares prices have reached our target prices. As a result, our cash level has risen somewhat. Having said this, there are enough unknowns out there that I am confident there will be moments of downpour. I realize the last 5 years have been difficult and I appreciate the support and patience you have shown. I remain confident in our approach and have the liquidity and experience to take advantage of any opportunities that arise.

Investor Conference

We will be holding our investor conference on May 15th at the Terminal City Club in Vancouver. As usual, I will start with a presentation on what we are up to in the Trust and then I would be delighted to answer any questions you may have. Our luncheon speaker will be Michael Ross. Michael's CV is as follows:

> ***Michael Ross**, a pseudonym, is a Canadian intelligence and terrorism expert and a former deep cover Mossad Operations Officer who served in the Near East, Africa and Asia for 11 years, and was the Mossad's Counter-Terrorism Liaison Officer to the CIA and FBI for two-and-a-half years. Ross is a graduate of Political Studies from Bar Ilan University and the Begin-Sadat (BESA) Center for Strategic Studies and studied Economics and International Trade at the London School of Economics. Ross is the author of the bestselling memoir, The Volunteer: The Incredible True Story of an Israeli Spy on the Trail of International Terrorists and a regular contributor to the National Post.*

I am sure you will find his comments enlightening. The invitations will be going out in early March so please let us know if you will, or will not, be attending.

We are unique

I believe we are unique in many ways:

1. We eat our own cooking. Our investments are in the Trust alongside yours. This is not a job to me.

2. Our process is not confusing. We have been clear that we are looking for "ABBA" stocks (Appendix A has a refresher if you wish) and I am not at all concerned if our portfolio make up differs substantially from any index. Our approach over time should provide not only superior performance but also will likely not be closely correlated to whatever else you may be invested in.

3. Our fee structure rewards performance. I do well when you do well. We have some ground to make up before any performance fees are generated which results in our MER being relatively low.

Acknowledgements

I continue to be blessed doing something I enjoy for people I like and respect. Given the number of investment alternatives available in the market place, I consider myself very fortunate to have your trust. Thank you.

Tim McElvaine
February 26, 2013

Our Return for 2012 – Series B Units

The Trust's return for the 12 months ending 31Dec2012 after all fees and expenses was +18.3%. By comparison, the S&P/TSX Composite Total Return Index (including dividends) for this same period was +7.2%.

Investment Returns versus Your Returns

To illustrate our performance, below I have broken out the details as a percentage of our 2012 opening Series B net asset value per unit. I should caution you that these figures are my estimates and are unaudited:

Returns from investments	19.7%
Operating expenses and related taxes	-0.3%
Return pre-management and pre-incentive fee	19.4%
Management fee	-1.0%
Incentive fee	0%
Taxes on fees	-0.1%
Net return to you	18.3%

Breaking down our returns from investments further, I estimate the impact (realized and unrealized) from various investments as follows:

Japan related:	8.3%
Housing related:	7.2%
Europe related:	2.0%
Everything else:	2.2%
Return from investments	19.7%

The Year in Retrospect

This business always is full of surprises. A year ago, few would have predicted the strength in housing or the new found optimism for Japan. Nevertheless both of these areas were top contributors to our investment performance in 2012.

The largest contributors to our Japanese return were our investments in Monex and Shinsei Bank. The bulk of our Japanese positions were purchased only 2 years ago. I have to say our holding period has felt like a lifetime to me! As I write this note, we have reduced our exposure to Japan and it currently is in the upper single digits. I am not a Japanese bull or bear; we just invested when the pricing was attractive.

Our housing-related exposure was split between the US and Canada. PRT and Interfor are both lumber related companies based in British Columbia. We made our PRT investment in 2009/2010 at an average cost of about $1.45 per share. PRT was taken over in December 2012 for $4.45 per share. We acquired Interfor in the fall of 2011 and early 2012 with an average cost of $4.50 per share and sold our last shares in late February 2013 at a little over $9. Our US positions consist of AV Homes and Howard Hughes Corp. We continue to hold both of these positions.

European returns were driven largely by RHJ and Bank of Ireland. Bank of Ireland was recently sold at a profit however we continue to hold RHJ. Our cost in RHJ is about €5.40 versus a current price of about €4.0. We acquired most of our position in 2010 and while I continue to feel we have a margin of safety, the market obviously disagrees. Part of the issue is RHJ has entered into an agreement to purchase a private bank from Deutsche Bank. This was negotiated in the summer of 2012 and is awaiting regulator approval. A number of investors oppose this move and would prefer RHJ distributed the bulk of its cash to investors. I met with RHJ's Chairman several months ago and concluded the agenda will be driven by the regulators decision on the Deutsche Bank transaction. This decision is expected in the spring.

The everything else category consists of a mix of investments. The two largest negative contributors to performance were Rainmaker Entertainment and Glacier Media. We have held both investments for many years. I have commented often on Rainmaker in our quarterly letters so I won't repeat myself here except to say over the last 5 years it has been an enormous negative to our performance. With a new management team, a recently released feature film (Escape from Planet Earth) and a financing, I am optimistic on its future. Glacier's poor performance I think has been driven by disappointment with the speed of its integration of various Postmedia properties acquired in late 2011. In addition, national advertising has been weak. I believe both in the soundness of the acquisition and the mgmt/owners of Glacier. Once again, like Rainmaker, in 2008 we had an opportunity to sell Glacier at a substantial profit. It currently trades below our average cost. While I continue to be comfortable with both these holdings, I do appreciate you may want to use an impolite phrase to refer to my astuteness.

The largest positive contributors in the everything else category included EGI Financial, The Caldwell Partners and Pacific Capital. EGI has been a longtime holding and while it trades over our cost, it has not performed particularly well over time. The board is good and I believe they are focused on shareholder returns. The Caldwell Partners instituted a dividend and the stock responded positively. Pacific Capital is a restructured US bank which was taken over early in 2012.

The Trust's expenses consisted primarily of custodial, audit and other operating expenses which amounted to about 0.30% of net assets. In addition, our management fee was 1% of net assets bringing the total MER, with taxes, to something around 1.40%. I believe this is significantly below the industry average.

Given our performance of late, there was no performance fee paid on the B units. There is a significant shortfall for the B units that will have to be made up prior to any fees being paid.

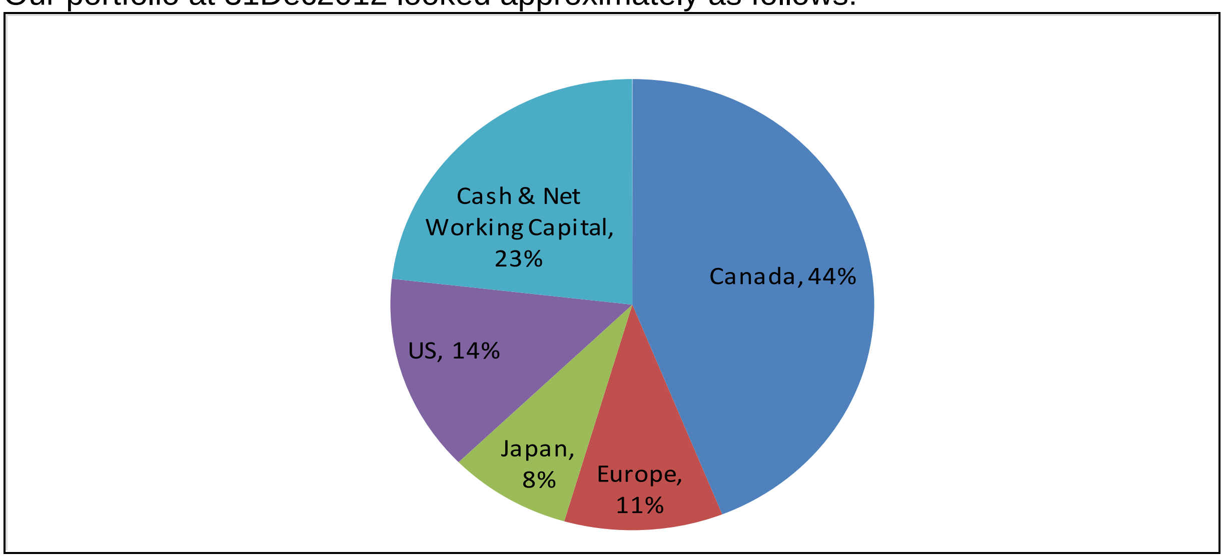
Where We Are Now

Below is the unaudited statement of net assets for The McElvaine Investment Trust. Audited financial statements, including a statement of Investment Portfolio, has been separately mailed to you.

THE MCELVAINE INVESTMENT TRUST
Statement of Net Assets
December 31, 2012, with comparative information for 2011

	2012	2011
Assets		
Investment portfolio, at fair value	$ 27,840,473	$ 37,585,975
Receivable from forward currency contracts	511,011	238,782
Options contracts	62,677	-
Cash and deposits	8,362,163	3,225,086
Dividends and interest receivable	61,436	52,052
	36,837,760	41,101,895
Liabilities		
Payable on forward currency contracts	99,046	78,598
Accounts payable and accrued liabilities	66,913	90,035
Redemptions payable	222,497	536,366
	388,456	704,999
Net assets	$ 36,449,304	$ 40,396,896

Our portfolio at 31Dec2012 looked approximately as follows:



As you know, my primary focus is always on the specific company and country allocation is somewhat of an afterthought. Looking at the portfolio as I do, you will see our largest positions at 31Dec2012 were as follows:

Glacier Media Inc.	11%	of net assets
RHJ International	9%	
EGI Financial	8%	
Interfor	7%	
Monex Group	7%	
8 Other Canadian Holdings	18%	
8 Other Foreign Holdings	17%	
Cash and Net Working Capital	23%	

As stated above, we sold the balance of our Interfor position in February 2013. Glacier, RHJ, EGI and Monex all have significant insider ownership. In many ways, an owner of these companies are managements' minority partner rather than simply an investor. I think this is a good position to be in.

Conclusion

We made up some ground in 2012. The Trust has some cash to take advantages of any turbulence as well as owns a number of inexpensive securities. As I approach my 50th birthday, I feel blessed with my relationships and as always, thankful for all your support.

McElvaine Investment Management Ltd.

ABBA Primer
or
What we look for when investing

ABBA is my snappy acronym for what we look for when making an investment.

A – Accident

If you're going to buy the best bargains you have to buy the things that other people are selling. ~Sir John Templeton

We deal in nightmares not dreams. We are looking for people who are selling for reasons other than price. Examples include:

- Sector, industry or a region people are avoiding
- Bad news such as dividend cut, downgrade, unexpected poor results
- Special situation such as a spinoff, emergence from bankruptcy or rights issue

B – Bird in Hand

Protect the downside. Worry about the margin of safety. ~Peter Cundill

We want to have a margin of safety based on our purchase price. We also consider what the stock may be worth in 3 years. Things we consider include:

- Replacement value
- Liquidation value
- Private market value
- Sum of the parts value

B – Brick House

To finish first, you must first finish. ~Rick Mears (Indy 500 4 time winner)

In the story of the Three Little Pigs, the pig with the brick house survives the wolf. There will always be wolves in business and our job is to look for cheap brick houses. Things we consider include:

- Balance sheet strength
- Free cashflow generation and capital requirements
- Market share, competitive positioning, relative cost of production

A – Avoid or at least understand Lola

If you've been playing poker for half an hour and you still don't know who the patsy is, you're the patsy. ~Warren Buffett

In the 1970s, the Kinks had a hit with the song Lola. It was a story about a young man who meets a woman named Lola in a bar. After a fun filled evening of drinking, dancing and snuggling, our hero is surprised to discover Lola is in fact a man not a woman. Similar to this story, we prefer to understand, prior to the “final act”, the motivation and interests of the Board and management. Things we consider include:

- Stock ownership of directors and management and Insider buying
- Management compensation program
- Independence of Board

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