The McElvaine Investment Trust

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Annual Report

2015

The McElvaine Investment Trust

To my Partners:

It certainly has been an interesting first couple of months of 2016. Whether it is politics, economy, foreign affairs or weather: all have been unpredictable!

As it is often said, economic/financial forecasters make weathermen look good. The good news is as a value investor our focus is simply what we pay and what we get. For example, in the early part of 2016, we were able to buy shares of a large operator of barges, shipping operations and oil service vessels at a large discount to asset value. Management is very well regarded and has a large equity ownership. In addition, the company is repurchasing shares. Certainly, the oil service part of their business is weak but their history has shown them to be a great operator and consolidator. In other words, while the future is uncertain, I don't particularly view this investment as risky. Sometimes it is more fruitful to sow than to watch the weather.

The question is how does one, as an investor in the Trust, take the volatility that has come along with this environment. For example, in 2015 we had a strong first half and gave it all back and more in the back part of the year. I appreciate this type of volatility causes some apprehension.

For each of our holdings, I not only look at the value today but also have an estimate of what I think the intrinsic value will be in 3 years. While I have been doing this for some 20 years, I do acknowledge I am always surprised by how outcomes differ from my estimates. On the negative side, this has been primarily due to financial leverage. On the positive side, an owner focused company often does better than I expect. As you can imagine, this history has encouraged me to focus on less levered investments which have owner/operators.

As of the end of February, when I add up the price to my estimate of 3 year intrinsic value, I find the Trust in aggregate is trading at a wide discount to intrinsic value. The bad news is we would all be happier if the discount was not as wide. The good news is I have confidence the volatility has been more in the market prices of our holdings than the intrinsic value. This gives me comfort both as the portfolio manager and as an investor in the Trust.

I have often discussed ETFs in the past. I realize they are the flavor du jour. Like many things, what starts as a good idea quickly gets spun into rather dubious territory. For example, a S&P500 index fund or ETF seems reasonable enough. In contrast, investors in sector specific ETFs (such as say biotech or leveraged loans) are investing in something much closer to a Ponzi type scheme than a rational investment. The reason simply is investment fund flows drive the performance much more than the economic fundamentals of the underlying business. ETFs are by nature liquidity driven investments.

You don't want to own them if the tide is flowing out of the ETF sector. By contrast, in our fund, I am able to look at what we own and compare the underlying intrinsic value to where it is trading. This ensures an unreasonably valued position does not remain a component of our fund simply because it belongs to a certain sector. In other words, if one's investment approach is predicting future popularity of a group, ETFs are your baby. Buying an ETF thinking one is value investing is similar to buying a G-string bathing suit believing it will help avoid a sunburn. Only on the darkest days will the two come true!

Moving quickly to get the image of a G-string out of your mind, I do share others' comments the current environment has a lot of unknowns. If you have ever had new drivers in your home, you will recognize the inclination to have one foot on the brake and one foot on the accelerator at the same time. We see the same phenomena with governments today. Fiscal policy has the brakes on, while monetary policy is stepping on the gas. This approach causes lots of smoke, noise and lurching and perhaps is not the most effective way to get from point A to point B.

In addition, unlike the US, Europe never cleaned up its financial institutions' balance sheets. In many cases, it has exacerbated the problem by encouraging the banks to own sovereign debt. I worry more about another European crisis than perhaps a China hard landing or a Japanese blowup. Europe simply does not have the buffer to absorb stress. Our European holdings are relatively low. BHF Kleinwort Benson's takeover was completed in February 2016 leaving us with little invested in Europe. This is not to say we would not add investments in that area but at this time, more attractive ideas can be found elsewhere.

Our Return for 2015 – Series B Units

Our returns for the Series B units are as follows:

	-------------------------- Percentage change -------------------		
	The McElvaine Investment Trust	S&P/TSX with dividends included	Trust's average cash balance
2015	-9.8%	-8.3%	19%
$100 invested:			
01Jan13 is now (3 yrs)	$114	$115	25%
01Jan97 is now (19 yrs)	$360	$339	17%

Our approach is centered on four items. We invest when we have:

1. A competitive advantage when making the investment (such as a seller who does not care about the price they are getting);
2. Observable investment value that exceeds the share price at the time of purchase (no financial spreadsheet gymnastics involved);
3. A financial position ideally combined with strategic position that provides staying power;
4. A Board and management team that is owner focused.

You will note our process does not involve macro forecasting or economic predictions beyond assuming reversion to the mean at some point. Investing is a messy business and our protection is in the price we pay.

Investment Returns versus Your Returns

To illustrate our performance below I have broken out the details as a percentage of our 2015 opening Series B net asset value per unit. I should caution you that these figures are my estimates and are unaudited:

Returns from investments	-8.3%
Operating expenses and related taxes	-0.4%
Return pre-management and pre-incentive fee	-8.7%
Management fee	-1.0%
Incentive fee	0%
Taxes on fees	-0.1%
Net return to you	-9.8%

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

Canadian investments	-7.6%
US	0.1%
Europe	-1.6%
Everything else	0.8%
Return from investments	-8.3%

The Year in Retrospect

The results above are net of currency hedging which was a modest negative in 2015.
As you may recall, over the last year or so we had sold most of our US holdings hence the small contribution in 2015.

In 2015, the Trust ended the year with taxable income which was allocated to all investors. While the distribution was relatively small, I appreciate it did cause confusion and apologize. The distribution is automatically reinvested in additional units. Commonwealth Fund Services (the record-keeper and fund valuator for the Trust) believed the best approach was to follow the reinvestment of the distribution with a reverse split effectively leaving the outstanding units unchanged. While in theory this makes a lot of sense, in practice it caused lots of questions. We are working with Commonwealth Fund Services to improve the reporting of the distribution.

I should add that the Trust has significant capital loss carryforwards. Not that this is something to be particularly proud of but nevertheless it will shelter the Trust from capital gains in the near term. The distribution mentioned above was due to the Trust's interest and dividend income exceeding its expenses.

Significant contributors to performance
Breaking out our performance by company:

Carmanah Technologies	4.8%
Kleinwort Benson (RHJ International)	1.7%
Rainmaker Entertainment	1.7%
Glacier Media	-6.1%
Dundee Corp	-2.6%
Anglo American	-2.4%
Everything else	-5.4%
Return from Investments	-8.3%

For the 2nd year in a row, Victoria-based Carmanah Technologies rose significantly on an improved outlook and the acquisition of one of its competitors. We sold a portion of our Carmanah holding in June which effectively took our "cost" off the table. Kleinwort Benson (formerly RHJ International) received a takeover bid which was completed in February 2016. Kleinwort had been a long time holding and while we made a modest profit, overall it was a disappointing investment. Glacier Media fell significantly due to the elimination of its dividend as its results were impacted by the weak commodity market. Dundee and Anglo likewise fell on a negative outlook for commodity based investments.

The Trust's expenses consisted primarily of custodial, legal, audit and other operating expenses which amounted to about 0.40% of net assets. In addition, our management fee was 1% of net assets bringing the total MER, with taxes, to something around 1.5%.

There was no performance fee paid on the B units. There continues to be a performance fee shortfall for the B units which will have to be made up prior to any performance fees being paid.

Where We Are Now

Below are some details on our portfolio at 31Dec15. Audited financial statements, including a statement of Investment Portfolio, have been mailed to you. As you know, my primary focus is always on the specific company and country allocation is somewhat of an afterthought. Nevertheless, our portfolio based on the country of the primary listing of the holdings breaks out as follows:

Canadian holdings	60% of net assets
US holdings	10%
European holdings	12%
Cash and Net Working Capital	18%

Our Canadian portfolio has tended to be smaller companies. Our holdings are as follows:

Rainmaker common shares and debentures	11% of net assets
Glacier Media	10%
Carmanah Technologies	9%
Caldwell Partners	5%
Blackberry	4%
Noranda Income Fund	4%
11 Other Canadian Holdings	17%

Early in 2016, we disposed of our common shares in Rainmaker and acquired additional debentures. At this time our entire investment in Rainmaker is in the convertible debentures.

I realize the most pressing question is simply why does the Trust have 11% of its assets in Rainmaker. I would expect our position will be smaller by the end of the year. One way this may happen is a portion (or all) of the debentures may be repaid. In late April 2016, Rainmaker will release in theatres its 2nd feature animated film. This film is based on the best-selling Sony game *Ratchet & Clank*. While the success of the film is uncertain, a significant amount of any Rainmaker proceeds will be escrowed for the benefit of the debenture holders. I will provide an update at the end of June.

Glacier Media has also been a difficult investment. While it has had its operational challenges, the biggest negatives have been a reassessment from CRA and a levered balance sheet. Glacier continues to de-lever both through operational cashflow and asset sales. When complete, I believe the result will be a very cash generative set of businesses run by good people. I should add I am on the board of both Rainmaker and Glacier.

Carmanah has risen to become a large position primarily due to appreciation of the stock price. By way of background, Carmanah designs, develops and distributes energy efficient (solar) LED solutions for infrastructure. For example, their lights are used on buoys, offshore windmills and to light pathways and parking lots without access to power.

My interest in Carmanah was peaked when John Simmons (CEO) and the Board backstopped a rights issue. The Trust acquired rights and established its position at the same time. In 2015, Carmanah's operations improved, it acquired a competitor and strengthened its balance sheet via a share offering.

We continue to own a large position as the balance sheet is strong, the industry has a tailwind, management is focused and large shareowners, and most importantly, the stock is not expensive.

In the 2nd half of 2015, we added to our US portfolio and our holdings at 31Dec15 included:

VOYA Financial	4% of net assets
Leucadia National	4%
4 Other US holdings	2%

We sold half of our VOYA position in the early part of 2015. Subsequently, the share price weakened over concerns on both interest rates and its exposure to oil company debt. You may recall, we acquired VOYA when it was divested from ING Groep as part of their restructuring. VOYA is primarily an asset manager and provider of retirement management services however it continues to have a legacy life insurance and annuity business. The shares continue to trade at a significant discount to book value, its operations are industry leaders, it is focused on returning capital to shareowners, and management are large shareowners.

In the late fall, we started to purchase shares of Leucadia National. Leucadia has a number of businesses but the most significant one is the investment bank Jefferies Group. Without a doubt, some of their businesses including Jefferies are challenged at the moment. The shares trade at a large discount to tangible book, the balance sheet is reasonable and the board and management are large owners. Leucadia has also recently repurchased shares.

Our overseas portfolio at 31Dec15 consisted of the following:

Kleinwort Benson (RHJ International)	7% of net assets
Symphony International	3%
3 Other European Holdings	2%

As mentioned, we tendered our remaining shares of Kleinwort to a takeover bid and received cash in late February. While we made a small amount of money, on a time weighted basis it was a poor investment. While the balance sheet remained our source of a margin of safety, operations never obtained the expected results.

Symphony International's structure is confusing. Simply put it is a publicly traded private equity business focused on Asian businesses but listed in the UK and trades only in US dollars! Their largest holdings include Minor International (one of the largest restaurant and hospitality companies in Thailand and the Asia Pacific) and IHH Healthcare (operates 49 hospitals throughout the Middle East and Asia and has a 10% ownership position in one of India's largest healthcare providers). Symphony came on my radar screen a couple of years ago when they did a rights issue backed stopped by insiders. Symphony has net cash at the holding company level, trades at a significant discount to net asset value, has a modest catalyst with a (weak) sunset clause and most importantly, has significant insider ownership.

Our conference – May 11th

Our conference will be on May 11th at the Terminal City Club in Vancouver. If you have not received an invitation, please let us know. We got pretty full last year and have added additional seating for this year. I would encourage you to let us know early if you would like to attend.

We will get underway at 11am with a presentation by Michael Ross on the Middle East. You may recall Michael was the ex-Mossad operative who spoke to us a couple of years ago. At that time, he warned us Syria was going to be a mess. As I write this, Michael is gallivanting around in Nigeria and I look forward to hearing his views. On the assumption Michael has not spoiled your appetite, his talk will be followed by a buffet lunch and then my presentation. It should be an interesting event and I look forward to seeing you then.

Conclusion

I hope my discussion has given you a sense of what I am up to. The key takeaway I want to leave with you is on a price to intrinsic value basis, our fund is cheap.

As always, we are open for business and appreciate any additional investment you may make and any referral you are able to provide. Please email us at info@mcelvaine.com if you are interested in receiving an investor package.

Most importantly, many thanks for your trust and support. I realize there are many investing alternatives and I appreciate your confidence.

Warm regards,

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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.

We currently offer 2 different series of the Trust. You should refer to the current offering memorandum for a detailed discussion of each Series, but very simply:

Series B: The majority of our investors, including Tim, own these units.
Series F: There is no management fee and only a performance fee.
Series F is only available via financial advisors.

Further information is available at our website:

www.avaluefund.com