



International Value Advisers, LLC
IVA Funds Update Call
September 6, 2011

Tara Hannigan: Good afternoon, and welcome to the semi-annual IVA Funds Update Call. We thank you for joining us. My name is Tara Hannigan, and I'm the director of mutual fund distribution. Our goals on this call are to update you on the funds and share our current investment thinking. Our portfolio managers, Charles de Vaultx and Chuck de Lardemelle, will spend about 30 minutes giving a brief update on the firm and explaining what they're seeing around the world today, and then we will open up the call to questions.

To update you on IVA as a firm, as of August 31, we had approximately \$17 billion in total assets under management, with our two mutual funds comprising \$12.1 billion of that total. Both funds remain closed to new investors.

Lastly, a quick note on performance. As of Friday, September 2, the IVA Worldwide Fund Class A (no load) was down 2.09 percent year-to-date while the MSCI All Country World Index was down 7.13 percent year-to-date. Since the Worldwide Fund's October 1, 2008 inception, the fund returned 13.60 percent on an annualized basis, while the Index returned 3.11 percent over that same time period. The IVA International Fund Class A (no load) returned 1.24 percent year-to-date while the MSCI All-Country World ex-U.S. was down 8.23 percent year-to-date. Since the International Fund's October 1, 2008 inception, it returned 13.35 percent on an annualized basis versus the Index return of 3.97 percent. For more robust performance information, you can visit our website at www.ivafunds.com.

And now, I will hand the call over to Charles and Chuck.

Charles de Vaultx: Thank you, Tara, for this introduction and for giving some performance data on both the Worldwide and International Funds.

Trying to be resilient as possible in down markets is one of our key objectives at IVA, not that we're narrow minded, it's just that our experience is, if you focus on limiting the downside, if you avoid the losers, gains will take care of themselves. So again, it's our strategy of winning by not losing.

Now, in this difficult month of August that just ended, our Worldwide Fund Class A (no load) was down 3.64 percent i.e. approximately half of the decline in the benchmark (the MSCI All Country World Index), which was



down 7.3 percent, while our International Fund Class A (no load) was down 3.29 percent i.e. only captured 40 percent of the 8.23 percent decline in the MSCI All Country World ex-U.S. Index. It was certainly not fun being down in August. In fact, quite a few of us at IVA invested additional monies into our funds and partnerships in late July/early August. So more than ever, we eat our own cooking, and I guess it did not taste too good in August.

Nothing new to report regarding our firm, IVA. Things have been pretty stable. We are pleased about the closing of our funds to new investors earlier this year. We were able to stem inflows to allow us to remain small and nimble, which helps in many markets, but especially when markets are volatile. We moved to our new office space in late March, five months ago now, and we're still in Midtown Manhattan. The new space is both very quiet and comfortable, and I think enjoyed by all of us.

Our commentary typically includes a discussion on both the outlook and valuation. Today, the outlook remains somewhat bleak, but valuation is pretty compelling in some parts of the world, and for some specific securities. So again, today is a good illustration of the contrast that can happen sometimes between the outlook and valuation.

In terms of economic outlook, our views have not changed, and we believe that economic growth around the world will be rather muted for many years to come. There may be, of course, some ups and downs as economic growth is never steady nor linear. I remember as a teenager the late '70s, its stagflation, its ups and downs, stop and go, which basically produced no or very little economic growth and for quite a few years. That weak economic growth that we foresee for many years to come is the natural consequence of the bursting of the credit bubble that took place in 2008 in the U.S. Many excesses during the bubble took place at the household level in terms of over-consumption and over-indebtedness. When households misbehave, it is a multi-year healing process of saving more than before, de-leveraging slowly, so that spells anemic consumption.

In terms of job creation, we have felt for many years that it would be difficult for the unemployment rate to truly come down in the U.S. Historically, the majority of jobs created result from the formation of small businesses, and we haven't seen one shred of evidence yet of such small businesses being formed, and at the same time larger companies are minting money - are highly profitable - but are not comfortable at this stage reinvesting and expanding.



In Europe, the economic outlook may be even more subdued than in the U.S. Europe is complicated; it's such a mosaic, with Germany doing quite well so far on one hand, and then other countries, such as Greece and Portugal, which are facing extremely harsh economic times. As long as deflationary policies are being pursued in Europe, the economic outlook is grim. Also hurting is the fact that banks remain, in our opinion, very under-capitalized in Europe, which would make it all the more difficult for them to grant new loans.

Chuck and I have been surprised by the resiliency of the euro, but are maintaining our 50 percent hedge in the Worldwide Fund and 40 percent in the International Fund against the dollar, as we believe that the Europeans may have to capitulate and start printing money themselves at some point. Also, Chuck and I would not totally exclude the possibility that the euro zone may implode or split up in different groups of countries, say a German axis with Austria, the Netherlands, maybe France, maybe Belgium, and then a Mediterranean axis on the other hand, with Italy, Spain, Portugal, and maybe Ireland.

We continue to believe that economic growth in emerging markets may be better than the U.S. or Europe for the next five years, but up to a point only. One, China remains a vast export-oriented economy and would be hurt if Europe and the U.S. grew slowly for an extended period of time. Two, China also had its own credit binge in 2009, and time will tell if the soft landing sought by the policymakers will or will not degenerate into a hard landing. If that were to happen, many commodity-related countries and markets, including emerging markets such as Brazil and Argentina, could suffer at least temporarily.

Now, a weak economic outlook does not necessarily mean that equities should be avoided at all cost. One, because corporate profitability has bounced back to very high levels over the past two years, and that also means that balance sheets of many companies have been restored and repaired. And also, it means that those big free cash flows being generated are extremely supportive of current equity valuation, especially since we think those high free cash flows may remain high for many years to come, at least in certain sectors of some specific companies.

Now let's talk quickly about valuation. Year-to-date, the S&P is down 8 percent. The Euro Stock Index is down 20 percent. In local currency terms, Japan is down 12 percent, Hong Kong down 15 percent. So indeed, valuation has become even more compelling. Japan is dirt cheap at roughly one times book value, four and a half times after-tax cash flow, and Japan



offers a dividend yield of 2.2 percent, which may not seem very high to us, yet is more than twice what the 10-year Japanese government bonds yield. And also it's a dividend yield that remains based on a dividend payout ratio that is still quite low. In other words, conceptually, Japanese companies could afford to pay much higher dividends if they so choose.

Also, Japanese companies sport very strong balance sheets, sometimes obscenely strong balance sheets with loads of cash. Europe is very cheap as well at 1.4 times book value and an average dividend yield of almost 3.8 percent. What is also intriguing about Europe is that quite a few companies there are very global in scope. Think about Nestle, with almost 40 percent of its revenues coming from emerging markets. Think about Total, the French-based yet global integrated oil company. Think about Sodexo, the French-based food catering company which has, I think, around 40 percent of its revenues right here in America, or a much smaller company such as Robertet in France, a flavors and fragrance company, which generates roughly 35 percent of its revenues also here in the US. Think about Diageo, the liquor company, and so forth.

So again, many of these companies are partially insulated from the problems of say, Greece, Portugal, and Ireland. Now, we do, in all fairness, own some more euro-centric companies in Europe, like Vivendi in France, and GDF Suez. And for that reason we are partially hedged on the euro, as I discussed earlier, and as we own a few percentages in euro-denominated corporate high-yield bonds.

Now, the good news in Europe is that the stocks of companies with good businesses, well capitalized businesses, have been a lot more resilient in the stock market than the stocks of more mediocre businesses and of undercapitalized financial institutions. That has helped our resiliency, but on the flip side, many of those stocks are not cheap enough for us to want to increase our positions in those stocks significantly.

The U.S. market is a little bit more expensive, trading at less than two times book, offers a dividend yield of 2.2 percent, yet those averages are quite misleading, as we believe we have a bifurcated market in the U.S. today with, on one hand, pretty cheap large-cap quality stocks. We would include Wal-Mart, Microsoft and quite a few others in that category. And then many quite expensive small and mid-cap stocks which we've avoided.

High yield markets have come down over the past few months, quite abruptly. We are starting here and there to see some things to investigate, but we still haven't really pounced yet. Our biggest exposure in terms of



individual high-yield corporate names remains the Wendel bonds, a French-based holding company, that now yield over 9 percent with nice maturities of 2016, '17, '18. Those yields in excess of 9 percent strike us as quite attractive for that credit.

Before I let Chuck give us some of his thoughts, let me, once again, paraphrase Peter Bernstein who said, more or less, to quote, "You cannot manage returns. You cannot make returns happen. All you can do is manage risk and the degree to which you expose your portfolio if things go wrong." I believe that the portfolio is well positioned today despite a very uncertain outlook. One of the possible outcomes of this financial crisis that's following '08 may be at one point the re-emergence of inflation down the road. It's already there in India, as well as in a few other countries. And if that were to be the case, just to be a "Nervous Nellie", sitting with all one's wealth 100 percent in cash, in U.S. dollars or euro or yen or in Treasury bonds, may not be the optimal strategy and may, in fact, prove to be quite costly.

Chuck de Lardemelle: Thank you, Charles. I will now describe briefly how our mutual funds are positioned as of Friday, September 1, 2011 and make some brief remarks about the current investment climate.

Currently, our overall equity exposure is roughly 72.5 percent in the Worldwide Fund and 70.5 percent in the International Fund. Our corporate high yield bond exposure is 6 percent in Worldwide and 5 percent in International. Our gold bullion exposure is slightly below 7 percent in Worldwide and 7.5 percent in International. We also own sovereign government bonds of short maturities, less than three years, for 6 percent of Worldwide and 8.5 percent of International. Our U.S. dollar cash levels, including cash held as collateral, are 8.5 percent in Worldwide and 8.5 percent in International.

In terms of geographic exposure to equities, for the Worldwide Fund, approximately 30.5 percent is invested in U.S. equities, 21 percent in European equities - that includes 14.5 percent in the euro zone, and 6.5 percent in Switzerland, the UK, Norway and Denmark. 20.5 percent is in Asian equities, with Japanese equities being 14 percent of the fund, and another half a percent is invested in South Africa.

As for the International Fund, approximately 38.5 percent of the fund is invested in Asian equities, with Japan being 26.5 percent of the fund, South Korea 6 percent. 31 percent is in European equities - 21.5 percent in the euro zone, 3.5 percent UK, 4 percent Switzerland, 1.5 percent Norway, and 0.5



percent Denmark. Less than a percentage point in equities is split between South Africa and South America. In both Worldwide and International, our emerging market exposure is mostly in Asia - South Korea and Malaysia being the bulk of the emerging market exposure and away from the BRIC - Brazil, Russia, India, China - countries.

Finally, our Japanese yen exposure is roughly 40 percent hedged in Worldwide and 50 percent hedged in International, while our euro exposure is approximately 50 percent hedged in Worldwide and 37.5 percent hedged in International. These hedges include our high-yield exposure.

Compared to our last conference call in March 2011, moves in both portfolios' asset classes have been muted. Allocation to equities is up in Worldwide by a couple points, driven by recent select opportunities in Europe; flat in International, with the main move being a switch away from Japanese equities (from 29 percent of assets at the time to 26.5 percent today) towards European names (from 27.5 percent to 31 percent.) High-yield allocation is broadly unchanged, while allocation to gold is up roughly 150 basis points in both funds.

The current investment landscape, in my opinion, is characterized by a golden age for corporate profits, a derelict global monetary system, and a current trend of deleveraging in Western economies. Let's start with the golden age of corporate profits. The profitability of corporate America continues unabated so far and remains astounding given the poor recovery of U.S. GDP following the Great Recession. The latest figures show post-tax corporate profits as a percentage of GDP at a peak since World War II, more than 50 percent above the post-World War II average of 6 percent and beyond the previous peak of 2006-2007. Fortunately, price to earnings ratios have greatly contracted so that market capitalization to GDP is closer to the long-term average of 90 percent in the U.S., pointing to reasonably decent valuations.

The current level of corporate profitability, however, seems likely to decline over time, perhaps steeply. While the data for Western Europe and Japan is more difficult to obtain, bottom up work tends to show that levels of profitability in those geographies are elevated versus history. In Japan, for instance, profits to GDP were 2.9 percent as of the second quarter of 2011, close to a multi-decade high of 3.1 percent reached in March of 2007. This is all the more remarkable since the Japanese yen has appreciated so much since 2007. That market, despite the strong rebound in corporate profitability, is still close to its multi-decade lows, trades below book value, and at roughly 45 percent of GDP. While Tokyo is statistically cheap,



however, we are exercising restraint as the economy is managed to maximize exports, not corporate profitability. We would like to see more corporate mergers and hostile takeovers, a focus on return on assets, and more accountability from managements, before we would increase our allocation to Japan.

A word on Europe later, but for now I will note that high quality global companies listed in Europe, such as L'Oreal, Nestle and others, do not strike us as dirt cheap, although they are reasonable. The European market has done an excellent job, unfortunately for us, in discounting leveraged companies, or companies exposed solely to the European economies and bidding up high quality global corporates listed in Europe.

Let me move on to the current global monetary system. The current derelict global monetary system is characterized by a huge East-West trade surplus, which would have been impossible under the gold standard. Forty years of a global currency regime, anchored in nothing has resulted in China sitting on over \$3 trillion of foreign exchange reserves, enough on paper to buy 20 percent of all listed corporates in America. These amounts so far have been used to fuel a debt binge worldwide. Since 1998, most Western economies have seen their total debt to GDP (government plus private) move up by roughly 100 percentage points. It has also allowed China to import ever-larger amounts of commodities to fuel an infrastructure building mania like no other, in my opinion. We have very little direct exposure to BRIC countries in both portfolios.

Our main hedge against paper currencies, our gold position, continues to deliver when volatility spikes, even though we must recognize this ultimate incorruptible money may now be expensive vis-à-vis the Dow Jones, M1 monetary aggregates, or money in circulation in the USA. Gold, however, in our opinion, remains away from bubble territory. It is still under-owned by institutions. Peaks in the gold price reached in January of 1980, a clear bubble in retrospect, would point to a price of gold at least two times higher than the current \$1,900 per ounce.

Finally, the age of deleveraging is upon us. These deleveraging cycles typically take a long time and are strong headwinds to GDP growth as demonstrated by Japan over the last few decades or the Asian tiger's post-1998. The deleveraging cycles are especially long in countries where demographics are not favorable, as is the case in Japan and Western Europe. A timeframe of 10 to 15 years for the U.S., maybe more for Europe, would not surprise me. And the question of how much debt is too much debt remains on the table. Public plus private debt in the Western world exploded

post-1998 and is now at very high levels in too many countries, even before most Western countries started funding their retirement obligations. And so markets, as is usually the case, have attacked the weakest in the herd, namely a few peripheral countries in Europe.

Portugal and Greece are past 200 percent total debt, which is public plus private debt, to GDP. Both have large current account deficits, which mean they are not self-financing, i.e. there is not enough savings within the economy, within the local populations, to self-finance the government deficits. Both countries are unlikely to become self-financing unless they pursue internal devaluations or painful structural reform, including wage and benefit cuts and large layoffs in the public sector. Both have very large negative net international investment positions. In other words, the net of foreign assets held by the Greeks versus Greek assets held by foreigners is a large negative vis-à-vis GDP, currently close to one time GDP.

Another way to look at the issue, a large number of saleable assets in Greece have already been sold to foreigners. Portugal finds itself in the same situation. Bottom line, both Portugal and Greece are insolvent, in our opinion. Their debts need to be restructured swiftly and forcefully or Germany and others have to agree to large and recurring fiscal transfers. German taxes sent to pay a Greek civil servant, that's not going to happen! Given the need for large-scale deflation in these countries, if they want to remain within the euro, 30 cents on the dollar may be necessary to give them enough breathing room. 50 cents may be a stretch, especially for Greece.

Italy, however, in my opinion is in a different situation. The current account deficit is minimal, so the country is self-financing. Private debt is low in Italy. The Italian banks have a large exposure to Italian government debt, but very little to no exposure to other troubled peripheral countries (Greece, Ireland, Spain, Portugal) and are not relying on wholesale funding. The fiscal situation in Italy is manageable with a budget very close to a primary surplus. The net international investment position of Italy, while negative, is very reasonable, pointing to large foreign assets to repatriate or large domestic assets to sell to foreigners.

Finally, Italy reformed its pension system long ago and needs very little effort to ensure its retirement funding, contrary to most other Western countries, including the USA. In other words, despite 120 percent government debt to GDP, Italy is in relatively good shape. The Italian crisis is mostly a liquidity crisis at this point, in my opinion. If I'm wrong and Italy is insolvent, then I believe most Western countries are as well.



Here is the glitch, however. The more Europe contributes to bailing out Portugal and Greece, the more Spain and Italy skid towards the moving red line between a liquidity and solvency crisis because Italy and Spain cannot afford to waste additional money on hopeless bailouts.

While equity valuations in Europe are starting to reflect the likelihood of a severe recession, the political process to a solution is fraught with danger and uncertainty. Currently, Europe is trying to implement a bailout fund akin to TARP, the EFSF - European Financial Stability Fund. Any news that the EFSF would be used to recapitalize European banks would be a move in the right direction rather than using the money to bail out Greece, Portugal or Ireland. The new rules of the EFSF would allow it, if ratified, to recapitalize European banks. In addition, the new IMF head, Christine Lagarde, is on the record pushing for a recapitalization of Europe banks as well. That is the way to go, in my opinion.

Bank losses in Europe are 200 billion euro if European government bonds are marked-to-market against a one trillion tangible equity base, or about a 20 percent loss. The new EFSF, if ratified, would be in excess of 400 billion euro, enough to subscribe to attractive mandatorily convertible preferreds. Indeed, I would expect that, if attractive enough in their conversion terms, those preferreds may attract private capital, as well. While in aggregate Europe looks okay with a total debt to GDP of around 165 percent versus 195 percent for the U.S. and 213 percent for the UK, a very dysfunctional political setup may lead to a situation getting out of control.

We own only one name in Italy at this point, while the bulk of our exposure is in France. Our European equities are, for the most part, noncyclical, with high dividend yields. Valuations with a five-year view are reasonably attractive. Unfortunately, the best businesses remain reasonably priced and do not offer very large discounts at this point.

In conclusion, on all these questions, we have few clear-cut answers because the future is as uncertain as ever, but we do have some views. By positioning the portfolio towards equities of stable, high quality businesses rather than government bonds, by investing in dividend paying equities rather than cyclical or indebted companies, by owning gold rather than U.S. dollar cash, you can infer that we believe the debasement of currency will eventually be the choice of politicians to repay debt, especially in the USA. We do not know to which degree paper currencies will be debased. We also believe a new monetary world order needs to see a substantial revaluation of Asian currencies vis-à-vis Western currencies over the next decade. Hence, we keep some of our cash balances in Asian currencies.



Finally, at their current valuations, equities over the long-term are, in our opinion, likely to preserve buying power, but whether or not they provide true absolute positive returns beyond inflation remains to be seen. High volatility is likely to remain a characteristic of markets in a deleveraging world.

Thank you very much for your attention. All of us at IVA are extremely grateful for your continued and unwavering support. This concludes my prepared remarks. I'd like to turn the call back over to the operator for the question and answer session.

Question: Thanks very much guys. I was just wondering, to what do you attribute the incredible outperformance of the International Fund relative to international markets?

Charles de Vault: I think it's because, even though the International Fund has had more in Japan and at the time suffered more than the Worldwide Fund as a result of that, although very short-term, the thing that has hurt the Worldwide Fund is some of the tech names we've bought. In particular we've had a pretty decent size position in Hewlett-Packard, which has come down a lot. Also, in the Worldwide Fund, nine, 10 months ago now, we initiated a small position shorting 10-year Treasuries. And again, it's a small position, but that has cost us a few basis points. I think that's the main reason. Can you think of another one, Chuck?

Chuck de Lardemelle: Sure. I think the question, though, is related to International versus the international market.

Question: Yes, yes, that would be very good, too.

Chuck de Lardemelle: And so I think there are a number of reasons. One, I think there are very few International funds that own some gold, and gold obviously is performing extremely well as a hedge against basically Ben Bernanke, and so that has been a positive on the performance of the Fund. Also, I think the stock picking has been strong, and that's in large part thanks to our seven analysts. So to give you a sense, in the month of August, if you were to take only the equities within the fund, they caught only 62 percent of the downside in equities for the month. And that's due in part, as well, to our positioning towards, non-cyclical, unlevered names, I think as well as our cash reserves.

Since March, our Japanese names, vis-à-vis the Japanese market, have done extremely well, again because we were very defensive. We did not own the



exporters, which tend to be more cyclical. And so the yen appreciating, for instance, has not hurt our Japanese names whereas it has hurt the Japanese market as a whole. But the fact that we owned non-exporting names in Japan for the most part explains a lot of the over-performance that we've had on our Japanese portfolio alone. So it's part the gold. It's part the cash. It's part very strong stock picking, and it's part, frankly, being positioned adequately for a low return world that we did expect, Charles and I, and therefore we restrained our exposure to cyclicals, and so all that's been paying off, I think, in the last few months.

Charles de Vault: Yes, you're right, Chuck. Sorry, Ben, I misunderstood your question. Also, not owning any of those European banks has been extremely powerful. Not owning anything in Brazil, not owning anything in the emerging markets, again avoiding the losers does wonders when it comes to compounding wealth. That coupled with good stock picking.

Question: Well, great job. And you've got to be at the top one or two in the category this year, I would think.

Charles de Vault: It's a cyclical business. Tomorrow's another day!

Question: Thank you.

Charles de Vault: Thank you.

Question: Hey, guys. Thanks a lot for the call, and great job. Couple quick questions, could you talk a little more about Hewlett Packard (HP) and what your views are now? And also, as kind of related, on Dell. And then really just on U.S. technology companies, how do you view sort of, the cash hordes that many of them have right now, and just maybe comment on that. Thanks.

Chuck de Lardemelle: Sure. Thank you. So on U.S. tech in general, there is a clear shift in tech towards maturity, and I think it's throwing a curveball to a lot of investors. Value investors may not be as comfortable owning tech businesses because there is very little backing by tangible assets. Growth investors are not interested anymore in the maturing tech companies. I think what we have, for us in the tech sector, it's about 18 percent of the Worldwide Fund, and so it's a very large exposure and indeed one where Charles and I are exercising a lot of restraint because you never want to have too much in one basket. The good thing about our 18 points in tech is the 18 points are not necessarily correlated with one another.



For instance, Cisco has more to do with telecom equipment at home, in companies, in government buildings, and Dell and Microsoft have more to do with the world of the PC, and whether the PCs are in terminal decline or not. For Dell I would say this. I think they do face very strong headwinds now. In the past, they were offsetting the average selling price falling by volume going up substantially, the volume of the number of PCs they were making basically. Now, with the tablets, that's eating into the PC market. I think, basically, laptop plus PCs account for about 300 million units being shipped every year, and tablets are already up to 50 million units. So that's slowing down the number of units in PCs and laptops, and that's going to hurt Dell.

Hewlett-Packard, I'm not sure HP is a tech company anymore, frankly. If you look at the main pockets of value within HP, it's services and it's printers. Both businesses should be somewhat resilient over the years and somewhat noncyclical. We were aware, when we made the investment, that the margins were very high and probably unsustainable, so we had an earnings power much closer to \$4 a share, which is where we stand now. What we did not expect was the huge multiple contraction that we've had. At the time we paid about \$40 a share. We thought the sustainable earnings power was around four dollars a share. At the time, the Street was at \$5.50. The possible management mistake that was made is that we made this a 2 percent position. When you know there are headwinds of that nature and markets are not necessarily aware of lower margins, it should have been a 1 percent position, so you are in a position to average down if the worst-case scenario shows up. But you're still at four-plus in earnings. Stock is at \$22, balance sheet is decent. We also knew that the new management was unproven. Unfortunately they've taken money, and instead of buying back shares, they've bought pricey software companies, and that was probably a cost of \$2 a share in intrinsic value.

Bottom line, it's very difficult at this point to get below \$30, in terms of worst-case scenario in the intrinsic value. And our intrinsic value is closer to \$50 a share if it's properly managed. So we're not giving up. Unfortunately, we're not in a position to average down because we're already full. And it's a reminder, as always, that you can make mistakes, or you should always be in a position where you're comfortable averaging down or at least not cutting your leg at the bottom. And we've always wanted to be diversified because you never know where the blowups are going to occur. So on all these names, we have very compelling valuations. You're right to point this out. And how that cash is being deployed is going to be key. Unfortunately for HP, they've gone and made pricey acquisitions.



It's the same at Dell. Microsoft has been more savvy in deploying their cash. They've bought back a lot of shares at the right time. They also made the Skype acquisition, which a year and a half earlier, they could have bought that for less than half the price. So it's not great, but they seemed to be a little bit ahead of other tech companies. Cisco is in a position where they could pay you or they could pay us, \$1 a share in dividends. And I do hope that the tech companies realize they're mature. It probably would mean a change in management because the managers that are currently in place are still very much focused on growth. They are from the old days, from the tech bubble, and so they are quite anti-dividend usually. Charles, any additional comments?

Charles de Vaultx: Maybe just say that, yes, I agree with Chuck that, with Hewlett-Packard, the mistake was the size of the position. I want to reiterate that, for those companies in particular, all those companies mentioned by Chuck, we do spend a lot of time on worst-case scenarios with the threat of the headwind caused by cloud computing and the widespread adoption of tablets. We have spent a lot of time with worst-case scenarios, and the worst cases that would come up are very close to the share prices of some of those companies. In the case of Microsoft, I take comfort in the fact that David Einhorn may be unhappy with CEO Balmer, yet believes that the company is very cheap. And also, if I'm not mistaken, I believe that Seth Klarman recently announced that he too had taken a stake in Microsoft. So that's where we stand.

Question: Thanks a lot, guys.

Question: Can you talk about the Swiss franc and if that's sustainable with what the Swiss are trying to do, and then talk about, as a U.S. shareholder, how that would affect our Nestle holding? Do I assume it went up in price partly when the franc went up, and then we had this fall today?

Charles de Vaultx: Yes, you're right, it's a good question. I mean, personally, I have no idea if what the Swiss are doing is sustainable or not. I was at a conference in Switzerland a few months ago, and clearly the population, the business people are very upset by the strong Swiss franc.

Now, of course, in the case of many stocks in Switzerland, it's largely irrelevant because so many of the businesses there are global, whether it's a Nestle, a Schindler, some of the large pharmaceutical companies, some of the banks. Many of these are global businesses. Now, today, Nestle moved up obviously, but did not move up exactly as much as the Swiss franc



declined against the dollar. So we'll see better in the next few weeks, if it's what I perceive to be mispricing, is rectified.

Chuck de Lardemelle: I think it's yet another sign of the derelict global monetary system, where currencies are being pushed around, and a Central Bank has to come out and peg its currency to another. Now, is it sustainable? On paper it is. I mean, all the Swiss Central Bank has to do is buy as many euro as they want and sell the Swiss franc. So on paper it is sustainable, that peg of 120 is sustainable. How long the Swiss national bank wants to do that remains to be seen, but so far it has been taken very seriously by markets.

Question: Thank you. And I'd just ask, is the Swiss franc gold-based, or is it just always thought of as a safer currency?

Charles de Vaultx: No. I think a long time ago (was it 10-20 years ago?), the Swiss Central Bank had a fair amount of gold, but they have sold some of it. So it's ultimately -- you should view it as a fiat currency except that the country as a whole is well managed in terms of its fiscal policy, trade surplus and so forth. So even though some of the Swiss banks misbehaved a few years ago, it's a very solid economy.

Chuck de Lardemelle: And it's also important to note, I think, that our cash balances are in sovereign government bonds of foreign countries. We did not have Swiss francs because, one, we have a few equities in Switzerland, but also it was a bit too close to Europe for our taste in the sense that the banking system in Switzerland is very large and potentially very exposed to Europe. So we weren't sure how that would play out if indeed Western economies GDP cannot support all the debt. So from our standpoint, so far, so good.

Question: Yes, thanks very much, gentlemen, for the timely call. Charles, you particularly expressed a bleak outlook. And despite all of the -- your talk of valuation, most of what our clients look at is the macro backdrop, which really doesn't offer a whole lot of hope, given the paralysis of policymakers. And I wonder what you see as unleashing the upside for the markets if this kind of policy paralysis persists.

Charles de Vaultx: Well, I mean, I did use the word "bleak" maybe excessively. I mean, we don't like to wear our rose-tinted glasses. Bleak in the sense that, the idea of, three, four, five, six years of weak economic growth around the world is obviously not your typical expectation. Now, there is some good news, as I said, many companies are able to generate huge amounts of free cash flow despite this weak economy, year in, year out, and some of those companies are giving some of that cash back to shareholders. And then, the valuation.



And in the final analysis, I think the threat of inflation has to be taken seriously. If you remember the stagflation from the late '70s, the economy grew very weakly for many years. You had to avoid bonds most of the time, and well-selected stocks ended up doing better than some other investments, like bonds or cash. So again, I think just to accept being paid zero percent on cash doesn't strike me as the solution. I think Chuck finished his comments, reiterating our belief that volatility is here to stay, in our opinion. It's unnerving, yes, but it's also something that can be exploited. It's easier to buy low, sell high, when things move up and down like a yo-yo. There are some very well financed, very strongly capitalized companies in Japan, as we discussed, some in Europe.

So we believe that the Wal-Mart's of the world, the Microsoft's, offer decent values, and I think you know how to cope with your clients. I think the great paradox of investing is that people precisely confuse the outlook, the economic outlook, with what the stock market may do. I think its Marty Whitman from Third Avenue who somewhat crudely says something to the effect that he likes to buy securities "when the short-term outlook sucks." Oftentimes you see people get excited by promises of high growth in emerging markets, people making the mistake of equating high economic growth with good stock market performance. Sometimes the two go hand-in-hand, sometimes they don't.

We are value investors at IVA, and we believe that valuation is as important, sometimes more, as the outlook. I think I mentioned some of those high-yield corporate bonds in France yielding over 9 percent. Hey, if our credit analysis is right and those bonds are money-good, it's a good yield pickup over cash or German bonds. Chuck?

Chuck de Lardemelle: I have nothing to add. Thank you.

Question: Okay, thank you.

Question: Thank you both for your time. Got a number of questions-- you can hit these questions very quickly, if you don't mind. Let me start with Total. If the economic world begins to slow down, China, the U.S., from certain austerity measures, the problems in Europe, won't that affect a company like that who's dependent on the oil prices and so forth and the need for oil going around.

Charles de Vaultx: Yes, absolutely. I mean, if you look at many energy-related stocks, they seem to be discounting much lower oil or gas prices than current spot prices.



So the message from the stock market is that the economy will weaken around the world and that the underlying commodities will come down. Again, it's a matter of price. The current stock price of Total, we think is discounting a price of -- which may be as low as \$65 or \$70. And could oil prices reach that level again? Yes. I mean, they went all the way down to \$35 briefly in 2009, but we believe the replacement cost of oil is \$80, \$90 a barrel. We think that it's going to get harder and more expensive, longer-term, to find oil. So it's a very well capitalized company. You get paid while waiting. The dividend yield is approximately 7 percent, I believe, by now. So we are comfortable holding onto some of Total, yes.

Question: And would the dividend be secure if the oil price were to drop like that?

Charles de Vaultx: No. The dividend payout ratio is quite high, so the dividend may be cut a little bit, but I would not expect anything drastic. And the company is a pretty low-cost producer, so compared to other oil companies, the operating leverage is more muted. So when oil prices go up a lot, the operating free cash flow of Total does not go up as much as other oil companies, but also vice-versa on the way down. So the dividend is not totally secure, but I would not expect a meaningful cut.

Question: Okay, great.

Chuck de Lardemelle: And just to add something to what Charles said, you should also keep in mind that we have very little direct exposure to oil or commodities in general in the funds except for gold, which we view as a different commodity. Second, we have no exposure to China or the BRICs, no first derivative exposure to countries like Australia or Brazil that could really get hurt if commodities go down. Third, if indeed you have a recession in China and commodities go down, or if there is a global recession and commodities go down, we believe oil is substantially different from, say, copper or iron ore because, in the case of oil, China is about 15 percent, of total oil consumption in the world. And the number of cars -- whatever happens in China, the number of cars on the road in China is going to go up.

Conversely, if you look at iron ore, if you look at copper, if you look at zinc, China accounts for 40 percent-plus of the global consumption. And so there, if you have a recession in China, you could temporarily see oil come down, but you would see, in our opinion, copper and other commodities go down very substantially. So yes, Total by itself is a fairly large position. But within the larger portfolio, in terms of our exposure to oil, we would like to have more exposure to oil. It's a matter of finding securities that would



allow us to buy the oil at a very effective price. Maybe that comes in the next recession. I hope that provides some color.

Question:

Very good. Two other questions. I'll just go ahead and ask them both at the same time, if you don't mind. The problems in Europe right now and Greece - I think I saw one-year yields on Greece like 67 percent, if my reading is correct, also with Finland saying they want some collateral. So it's indicating that Greece is a real problem child, and they may be broken off. What I'm trying to ask, is the CDS risk that could be posed by the guarantees at banks and so forth, the exposure that banks have made to this. What do you think would happen if Greece were to default and they were separated, and had some effects on Portugal and the other Mediterranean, Club Med countries. And the last thing is -- and I'm really worried about the CDS exposure. The next question, gold stocks seem to be very undervalued in relation to gold. That's it.

Chuck de Lardemelle: I'll take the question on Europe, and Charles will take the one on gold. On the European CDSs, just to give you some sense of where we are in Greece, at least what we have been told officially, Greece has about \$350 billion of government debt. On top of that you have about \$70 billion or so, 50 to 70 billion of CDSs that have been written on the debt. But we're told that the net -- if you net out the positions, the net CDS market is only about \$10 billion. So the CDS market, it seems to be actually quite small and quite thin vis-à-vis the underlying bond. I think it is very important not because of Greece, but because of Italy. I think there is a game going on where, with very little money, you push up the CDS. The yields on government debt in Italy react, bonds go down, and the stock market goes down even more. So it's an easy game if you are able to short equities to push up the CDS a little bit. I am on the side of Soros on the CDSs. I think they are useless products. I think if you want to be short Greek bonds, borrow all the Greek bonds you want and short the bonds. You do not need an instrument like this that adds a layer of redistributing the risk around and fudging the issue and allowing, in some instances, manipulation of prices.

I think, obviously the problem of Portugal and Greece is now on the table, and while the total government debt of these two countries is about 600 billion euro. Of that, about 300 billion is owned by the banks. If you take your haircut of 50 percent, you have 150 billion in losses. The IMF came around with 200 billion of projected losses on European banks recently. I think the ballpark is about right, 200 billion. Again, the tangible equity of the banking system in Europe is about a trillion, so that's about 20 percent. That system probably generates a little bit more than 100 billion a year of pre-provisioning income. So I don't see this as an insurmountable hurdle.



It's a big loss. There is a need to have confidence come back. And in order to do that, you would need an effective TARP-like fund. It's present in the EFSF, but here is the issue. You remember when the U.S. Congress refused to sign off on TARP. Well, just imagine what TARP would have been for Mexico, and then imagine that you have 17 Congresses that have to sign off on it. It's a mess. And it's such a mess that we have very little confidence that Europe will be able to step in front of the ball. Eventually it gets sorted out, but I think, there is a high risk of political upheaval and markets forcing the issue on the European countries.

So you have countries like Finland, Slovakia, saying we're not signing off on this. Finland says we want collateral, so Slovakia says we will be the last one to sign. That's going to happen in December. Well, markets move every day. In the case of Italy, one thing I did not mention is that Italy has a weighted average maturity of the debt of seven years. So it's not in a situation where, if yields stay high at 5.5, 6.5 percent for six months, it bankrupts them. Eventually you have to sort it out because, if interest rates stay beyond six percent for a long time, they have a very, very serious problem, and the liquidity becomes a solvency crisis. But before you refinance all your debt at six, you have some time.

And last but not least, there is a political game being played in Europe. The ECB, the European Central Bank, is trying to force countries like Italy, like Spain, to take very tough austerity measures. So they are waiting for the last minute in order to intervene on markets and do their QE1 basically. Also Trichet, which has made a number of huge blunders over the last few years, is going at the end of October. I think he doesn't want to turn his coat right now. And so he's trying to more or less hold off. But maybe by October, we have a new regime coming in.

Bottom line, it's solvable but it's not easy, and there are so many political questions. And last but not least, both Portugal and Greece, in my opinion, Ireland most likely as well, need some sort of very heavy restructuring. They will have a political choice to make. They can leave the euro and devalue, in which case they don't have to necessarily reform their bloated civil servant sector, public sector, or they can do the difficult thing, stay in the euro, and do what's called an internal devaluation, which is everything, all the prices within the economy fall by 10 percent to 25 percent. Latvia did it. Now, Latvia was two million people. Greece is 11 million people. Ireland is four million people. Portugal is 11 million people as well. So it's the size -- more or less the size of New York, I think. New York is eight million people.



But devaluation helps you for a year or two, but then you import a lot of inflation, and you're back to square one. And so that's it. Unfortunately, it's in the hands of politicians. Eventually I think it gets solved. Hopefully in between this current crisis and a solution, we have an opportunity to invest substantial amounts of capital in Europe if things are ugly for a few weeks or months.

Charles de Vault: Regarding your second question on gold stocks, obviously they have not gone up as much as gold, not only year-to-date but for many years now. Frankly, we are not surprised by this development. I think it's important to realize how expensive those gold stocks used to be 10, 15 years ago, especially the North American ones. And they traded at extremely high multiples of cash flows. And basically, I think the most overwhelming thing that happened was the advent of the gold ETF some, six, seven, eight years ago. Now investors around the world, be they retail investors, institutional investors, can quite easily invest in gold via the gold ETFs. And there's no longer a need to pay through the nose for those gold mining stocks.

For a few years, what also has hurt these gold mining stocks is that the production costs went up sharply because companies used to do high grading when the price of gold was low because production costs went up, such as, fuel, diesel and so forth. Some of the commodities, the Canadian dollar, the Aussie dollar, many others went up against the U.S. dollar. So again, the promised operating leverage that gold mining companies are supposed to offer does not always materialize. Finally, I want to remind you that quite a few gold mining companies are not pure gold companies. There may be some copper in there, either pure copper projects, such as the one Barrick Gold is buying. Or, because of Mother Nature, a lot of gold mining deposits are porphyry deposits, a combination of gold and copper. An obvious example is the Freeport McMoRan Copper and Gold mine in Indonesia.

Finally, let's not forget the issue of taxes. As the price of gold goes up, it becomes very tempting for various governments around the world to slap some gold mining companies with higher taxes, higher royalties. It's happened to some extent in Australia over the past year. It just happened recently, if I'm not mistaken, or it's being implemented in Peru, in Tanzania. There are some, of course, places such as Zimbabwe or Venezuela where some mines are being all or partially expropriated.

So again, there's a lot to be said for owning the real thing, which we have custodied at HSBC in midtown Manhattan, in New York, or almost the real thing via the gold ETF. Now everything has a price. Recently we've done some work to see if gold mining stocks had become cheap enough vis-à-vis



the metal. Our conclusion is that some gold stocks now traded at a 10, 20 percent discount to their intrinsic values. So we may be close to a point where we may or may not decide to swap a little bit of our gold into gold mining stocks.

Question: Thank you so much for your answers.

Charles de Vault: You're welcome.

Question: Yes, hello, two quick questions. First of all, I trust that you do not hold any U.S. banks. And second, could you expand on the issue of large caps generating all this free cash flow? Doesn't it come to a point where there's only so much free cash flow that you can generate in an environment that is so, so?

Charles de Vault: Well, regarding the -- do you trust that we don't own any U.S. banks. You're right, we don't. We've started to do some work, obviously, because many U.S. banks seem to be adequately capitalized, unlike European banks. So it's a matter of us being comfortable with the price. Now, obviously I'm talking about the common equity. Some banks have instruments that are higher up in the capital structure, preferreds or bonds, and we may have done a little bit in that sphere. Chuck, do you want to answer the questions on the free cash flow of those companies?

Chuck de Lardemelle: Yes. So that's absolutely right. I think the market has done a very adequate and interesting job of basically contracting the multiples, foreseeing that -- the growth is going to be much more muted, going forward, versus the '90s where you had leverage being added to the economy. Deleveraging means basically that your GDP growth is going to be very pedestrian. I don't think it's going to be as bad -- I hope it's not going to be as bad as Japan. I think in the case of U.S. corporations for sure, they'll all manage for shareholders. But you may see a type of economy where, every time the government steps off the gas, the growth slows down substantially or the economy goes back into a recession.

And what's interesting is, after Congress finally decided on deficits and so on and wanted to cut the spending, is really when the market came down. The interpretation for some was that we lost our triple-A rating, and that's why the market came down. That's not why. I think, the 10-year Treasury yields continued to go down substantially. I think the reaction was, hey, the main engine of growth over the last year and a half or so is just dying. Government spending is now going to be restrained. And so, of course, the free cash flow may not grow much from here, but it's still here.



And you're looking at a PE of less than 12 in the S&P 500, which indicates earnings yields of more than 8 percent. So at those prices, you don't need growth. The key question, I think for Charles and I, is really whether those types of margins are sustainable, what happens if the economy slows down or goes into a recession. When will we see those margins come down, I think that's the key question. We've noted in our remarks how unusually high the profitability of corporations is, but I think it's well discounted by a fairly low PE.

Question: Okay, thank you.

Question: Thanks for the call today. I think my question was just answered on the banks. I was wondering if you were starting to look at those. It seems like they've been put in the same category as some of the European banks. I guess the other question would be on the European side. What's it going to take for some movement there? I mean, is it just going to have to be a disaster over there before they finally capitulate? Well, what do you see as potentially being the catalyst and the speed of something happening? And then lastly, maybe just comment on emerging markets slowing, as well. Thanks again. Thanks for your work, as well.

Charles de Vault: I'll start. Very briefly you started talking about the U.S. banks. We do believe that many -- most of them are safe, so at the right price they could represent a legitimate investment as opposed to a speculation. There are, though, very complicating factors. The capital requirements are much higher than before, so in the future, the return on equity is bound to be a lot less than they have been in the past. Some of the banks, obviously, are subject to litigation. The reported book values are not reliable. Just to invest in a bank based on a discount to book value is not good enough. So we're doing more work on U.S. banks, but we'll be very cautious. And again, maybe in some instances going higher in the capital structure may or may not be a way to go. Chuck, regarding Europe - any ideas to what will?

Chuck de Lardemelle: No. Unfortunately, I think it's best summarized by being 17 countries trying to each adopt a TARP program. And bear in mind that one veto and the whole thing supposedly collapses. So unfortunately, they've been behind the curve for more than a year now, and the politicians don't seem to grasp that a solution might be much more towards recapitalizing the banks rather than throwing good money after bad.

And on top of that, you're running now into an end game in terms of politics, because usually when you have to make very tough decisions, it's better if



they are made within six months of the shock, because the population is more willing to make sacrifices at that time. We've just seen results of elections in Germany. Merkel did not win the elections. The odds that in one of those countries there is an election, where the government says, we will not provide money for the TARP, goes up exponentially. Also, Spain and Italy now have the right to bail out of the TARP because their funding costs are over the costs of providing money to the TARP, to the EFSF.

So the whole situation compounds and is difficult. Usually in those situations, though, common sense prevails at the end of the day. And our position for now is Italy is solvent. Portugal, Ireland, Greece are not. Spain we believe is solvent, but Spain is much more difficult because there is not much government debt, but there is a lot of private debt. And so far, the Spaniards, against all odds, are paying their mortgages because their mortgages are recourse, or the banks are lying to us. I don't know. But the key to Spain is how many bad loans are in the mortgages, and so far the mortgage defaults have been extremely low, supposedly because it's recourse. I don't know. It's difficult. And the clock is ticking.

Charles de Vaulx: I think your last question had to do with emerging markets. I presume it was banking related. We are not comfortable with what some of the Brazilian banks have done. Nothing fatal, but there's been somewhat of a mini-bubble, somewhat of a credit binge over there. We are very skeptical as to the health and the state of Chinese banks.

So it's going to be one country at a time, one company at a time, but we'll also have to be very cautious when approaching emerging market banks.

Question: Yes, quick question on French sovereign risk. You mentioned that Italy and Spain have a right to bail out of funding, the stabilization fund, because of their own high borrowing costs. This would appear to put a lot of pressure on the ability of France to maintain its triple-A standing, because if they lose it, I think they have to post cash collateral. In the past you have not worried about French sovereign risk. Have you changed your mind?

Chuck de Lardemelle: I think we worry about the ability of all Western countries to pay their debts over the long-term, especially when you add retirement obligations. Now, the EFSF is probably not the best way to deal with the problem in the first place. I think the best way to deal with the problem is to recapitalize the bank for preferreds and offer terms attractive enough that actually a lot of the recap is going to be done by the private sector. For instance, we certainly would look at a preferred where it's convertible at book, tangible book, and the convertibility ratio adjusts over the next three years where tangible book



goes, but it only edges down, and then the coupon of, say, 3 percent now that goes up to 7, 7.5 percent to really incentivize the banks to actually get the preferred to convert or raise capital to retire the preferred.

Unfortunately, politicians need to go through a learning curve, and it's both parties in a number of different companies. It's very complex. Is the rating of France at risk? Look, the U.S. just lost its triple-A rating, so yes, for France it's at risk as well. Is this the end of the world? When you look at Japan, when you look at the U.S., they lost their triple-A rating, actually the 10-year bond yields came down substantially because it was a sign of very low growth. So eventually will this happen - we shall see. I think it's not in the same timeframe, though, as Europe having to rally together and find a definite solution to an under-capitalized banking system. I think that's the most pressing issue.

Question: Okay. And quick related question, I'm baffled by the euro's resilience. How has it held up so well?

Charles de Vault: Well we are baffled as well. Again, let's not forget that it's a competition of who's the ugliest. So really, you look at the euro and it's bleak, but then again you look at the U.S. dollar, and I doubt if it's any better. I think one of our explanations is -- and I think we alluded to it -- that so far the Europeans have not printed money. The Americans have. And that may have to change at one point. Also, I talked about Europe being a mosaic of all sorts of countries. I remember, I think it was six, nine months ago, maybe in the Wall Street Journal, an article discussing all the European countries. If you aggregate the European countries in terms of their fiscal deficit or surplus, trade deficit or surplus, because Germany's so strong in aggregate, Europe as a whole looks healthier at the government level than the United States. So that also may be part of the explanation.

Chuck de Lardemelle: That's right. So the current account deficit of Europe as well, on top of everything else, is about balanced, or Europe as a whole is self-financing. The interest rates on the euro are higher than they are in U.S. dollar, and I think Charles is right. To me, it is mostly the fact that the U.S. has chosen to print and to inflate the debt away. And at least verbally, at least so far, Europe has chosen austerity and deflation. And so with austerity and deflation, you have a strong currency. With money printing and inflation, you have a weak currency. Now, there is a potential for a very severe shock if the ECB changes its stance and says, for instance, "Enough with this. We're going to monetize Spain and Italy so you can attack all you want. It doesn't matter." If they do a Bernanke-like turnaround, that's when you would see the euro really take it on the chin, in my opinion. So the main



difference really is, Europe has chosen so far to repay the debt through austerity and deflation, and the U.S. through money printing and inflation.

Question: Good. Thanks for your help.

Question: Chuck and Charles, thanks for the call and your time. Let's see. Chuck, earlier you said that the future is as uncertain as ever. And so, as a result of that, we see prices where they are today. And as a long-term investor who has intentions of adding additional capital to your funds, I just wonder, with Peter Bernstein's thought in mind that you can only manage risk, you can't manage returns, is there greater risk in sitting on cash and averaging it into your fund over time, or is there greater risk in putting it all in right now?

Charles de Vaultx: And that's a great question. Now, our funds, I would argue are typically a lot less volatile than most of the other funds out there. I mean, I don't mind volatility on the way up, mind you. We certainly tried to be very resilient on the way down. So considering that we have much less volatility than most, I think that there's less of a need to dollar cost average for our fund just, mathematically speaking, if you will.

So I think it's a matter of comfort. One of the advantages of dollar cost averaging is that psychologically, de facto, you accept the notion that you will not pick the bottom. You will not pick the bottom, you will not pick the top. And so I think for some individuals or institutional investors, they get some peace of mind by knowing that there's a process. They will not catch the bottom, and it's okay. So I guess it really depends on your psyche or the psyche of your clients.

Question: Well, I'm comfortable with volatility. I am a long-term investor. And so I tend to think in chunks of, five years, 10 years, 15 years. And I just wonder, is it good enough right now?

Charles de Vaultx: Look. I mean, I made the point that some of us invested additional monies in late July/early August. Obviously, on those monies we're down. We did not buy at the bottom and I'm not sure if the bottom is in sight yet. Maybe you have to look at your alternatives. I mean, does the money stay in cash instead, in dollars?

Question: I mean, in this particular case, yes. The money's in cash, and it, I could use a year and a half. I could use two days.

Charles de Vaultx: I think that's truly your call. Again, it's a matter of comfort. I can't say more.



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- Question: And I'm not asking you to make my decision. I'm just -- from your perspective, having seen lots of different markets and looking at the opportunities today -- and understanding I'm a long-term investor. I'm not asking you to call the bottom. This is not a market timing question. But, from an expectation standpoint over the next 10 years, is one going to feel pretty comfortable if they put a fair amount of money to work in your fund today?
- Charles de Vaultx: I mean, I clearly have that expectation. Now again, for peace of mind, you may want to maybe put half now, half later. I'm not in your shoes, and it would be wrong for me to tell you how to go about it.
- Question: And in your personal case where you put money, when you made your comment earlier in the call, I took that to mean you're constantly putting money in the fund over time, more so than just sort of saying I'm taking the time to put it in.
- Charles de Vaultx: Yes. And despite what I've said about our fund not being volatile, but in my case, it's also a function of income. As I get paid my salary (or as a partial owner in the firm some dividends), more cash comes in my pocket than I can put to work. So that's the predominant reason as to how I do things.
- Question: Very good. Thank you.
- Charles de Vaultx: You're welcome.
- Question: Yes, just a follow-up to the gentleman's last question. First of all, thanks for stellar performance for many, many years through dramatically different market environments. It's a pleasure to work with you. But I have a question about your equity weighting. In the time that I've worked with you, you've never been afraid about having 40 percent of the fund in equities. Your current weighting is 72 percent. And I wonder what triggers you have for decreasing that equity exposure in the fund.
- Charles de Vaultx: Well, I think when we've had 40 percent in the past, and I'm thinking about the spring of '09, early summer of '09, you have to bear in mind that we had at the peak, close to 35 percent in high yield bonds, which we were using to get equity type returns. In fact, at the highest point, the average yield to maturity on those high-yield bonds was 11.5 percent. So just looking at the equities alone without adding the high yield bonds -- it's not offering the proper comparison. Again, it's one stock at a time what our comfort level is in terms of our understanding of the business. Do we trust management?



Obviously, in the case of Hewlett-Packard, we were skeptical, but had no idea that he would make that acquisition. Ben Graham in one of his books also articulated an idea which I think is of interest. He said, if at any given time you can put together a portfolio of truly cheap stocks, whether it's 20 names, 40 names, 50 names, and there's not even a doubt as to whether those stocks are cheap enough, he argued, Ben Graham, that if at that very moment the market as a whole -- whatever that means, the S&P or the World Market -- if the market as a whole is not cheap, there's a case to be made to keep 20, 25 percent, maybe 30 percent in cash or bonds. So I think all those factors play in. Chuck, do you have anything to add?

Chuck de Lardemelle: Well, obviously our equity weight is a function of valuation, but also our diversification. If we find opportunities in a new geography where we're not exposed, in a new industry where we're not exposed, we're probably more willing to invest. If we were to find three new names in technology tomorrow, those would be very small weightings because we're already large in technology. Our current equity weighting is on the high side, maybe. It's also a very defensive portfolio - very few cyclicals, high dividend yields especially in Europe. So an equity weight alone doesn't give you the whole picture.

I would say that we're probably less exposed with 72 percent equities today than we would be with 60 percent, which were mostly cyclicals with leverage. And indeed, I think I mentioned the catch of the downside during the month of August, which was 62 percent for equities alone in International and 72 percent in Worldwide. The difference is accounted for by Hewlett-Packard, the fact that Hewlett-Packard fell down so much and is only owned in the global fund. But you can see that our equity allocation today is actually extremely defensive, not the weight but the type of equities we own.

Question: Gentlemen, forgive me, but I am relatively new to all this. Could you explain the different strategies again? Maybe you explained before -- between the International and the Worldwide, and apparently the International has done much better than the Worldwide.

Charles de Vault: Yes. I mean, in a nutshell, some investors out there like to do their own asset allocation, and they want to decide for themselves how much they should have in the U.S., in International, in bonds and so forth. And so those investors basically would like us to offer a pure International Fund, a fund that invest strictly outside the U.S. Our preference, if you will, is to manage a global fund where we roam around the world and decide where we think the best values are.



Question: I've lost you already.

Charles de Vault: The Worldwide Fund is the fund that can invest both in the U.S. as well as outside the U.S. So the International is strictly non-U.S. The Worldwide is non-U.S. and the United States. And so we, Chuck and I, decide how much should be in the U.S. and how much should be outside the U.S.

Question: Well, I thought in the International, you said it's non-U.S., but then you have money in the U.S., don't you, in the International?

Charles de Vault: No, only cash. The cash is invested in commercial paper in U.S dollars. We tried to make sure that the International Fund is as international and non-U.S. as possible. Again, we wanted -- now, you made the observation that, as of late, year to date the International Fund has done better than the Worldwide. Yes, but that keeps changing, over the past two and a half years, it's been the other way around. So sometimes one does better, sometimes the other does better. It really has to do with how you like to invest, whether you want to do your own asset allocation or whether you'd give us, with our Worldwide Fund, the flexibility to choose how much should be in the U.S., and outside the U.S.

Question: Right. Okay. And you're heavily in equities and bonds?

Charles de Vault: We have around 70 percent in equities, so as Chuck just commented, yes, it is predominantly equities, but today those are, we think extraordinarily safe equities, with very strong balance sheets, very few cyclical names, no banks in Europe, no banks in the U.S., at least in terms of equity. We also own some gold, which sometimes acts as a hedge. Sometimes when the market goes down, gold goes up, so sometimes gold can be inversely correlated to equity markets. And sometimes it does not act as a hedge.

Question: Well, do you have a view on what the rest of the world is going to do vis-à-vis the United States?

Charles de Vault: No, we have no idea. We don't do any forecasting, so we have no clue. We're value investors, so we invest based on where we find the best values. The short-term valuation has little predictive power in terms of what the markets will do. A cheap market can be even cheaper or the other way around. So we don't have the foggiest idea as to what markets will do and which ones will do better than others.

Question: Right. Well, thank you very much.



Charles de Vaultx: Thank you.

Question: Yes, thanks for taking the call. Your comments on the Japanese small caps, are you still interested in those and finding names? And then, have you found any names in Indonesia? Thank you.

Chuck de Lardemelle: Well, I mean, yes. By and large, in Japan, the smaller the company, the cheaper they are. So the best bargains in Japan are among smaller names while, in the U.S., we tend to find the best bargains among ultra-large companies. Now in Japan, we want to exercise restraint. We have decent-size positions both in the Worldwide and International Fund. If we were not willing to exercise as much restraint, we could easily buy more of many of the securities we own there already, so no, there's no urgent need for us to find new names, be they small or large, in Japan.

Now, when we find something that's intriguing, we'll do the homework because, you never know. We can substitute one name for the other, or we can do the work now and maybe in the future, if we get more comfortable that corporate governance improves in Japan, maybe there'll be a time for us to start buying that name on which we did the work today. Indonesia, we haven't looked at anything to my knowledge. I don't think there are that many stocks that are large enough for us to invest. The market has done quite well. I think as of yesterday it was up year-to-date, so I'm not sure that we would find that many great bargains today in that market. I think our time is better spent looking elsewhere.

Question: Good afternoon, gentlemen. Thank you for spending so much time with us today. So with some markets down, the S&P down 15 percent-plus from the high, and down 6 percent year-to-date, it also appears that multiples are contracting and the world seems to be taking a risk-off point of view. Would you consider reopening the funds for a period of time, or perhaps starting a new fund to take advantage of some new opportunities? Thank you.

Charles de Vaultx: I mean, opening a new fund would be very unlikely because that fund would – if that new fund were to invest in large-cap U.S. names or Japanese names or high-yield bonds, all the ideas that would go in that fund are ideas that should go first and foremost to our existing fund and their shareholders.

Now, we did close our funds earlier this year because of capacity constraints. We don't want to get too big. So if our assets under management were to come down because of redemptions, or if, which would be not good, if our performance was negative, yes, we would consider reopening the funds, but



we're not contemplating that at all at this stage. Even though the funds are closed, and I talked about how flows have been stemmed, we still have slight positive inflows as we speak, even though my understanding is that many international and global funds over the past month or so have been experiencing some redemptions. But it has not been our case.

Question: Hi, gentlemen. Thank you for taking my question. I'm curious to find out the reason, why is it that you prefer to stay away from the BRICs considering the fact that there's so much growth out there? Is it due to political or geopolitical, that is, or transparency risks? Could you please elaborate on that? Thank you.

Charles de Vaulx: It has to do, first and foremost, with price. As value investors, we pay tremendous attention to the price, and we will not pay high multiples for dreams of growth. Now, sometimes, mind you, the growth materializes, but growth does not always translate into good stock market performance. Let me try to give you one example - the airline industry. I think that industry's been up and running for, what, 80 years or so, and there's been tremendous growth in the airline industry worldwide for 80 years. Yet by and large, if you aggregate all the airline companies around the world over the past 80 years, and I don't think, as a whole, much in the way of profits has been delivered. So again, high economic growth does not always translate into good stock market performance.

I think it was a year or so ago that our friends at Tweedy Browne talked about or mentioned a study made by a University of Florida professor, Jay Ritter, and I think he did it in 2004. And his thesis -- Jay Ritter's thesis was precisely that high growth does not always translate into good stock market performance. So, if you Google -- you can probably find that study on the Internet. I always like to tell the story of the United States in the late 19th century, early 20th century, as maybe the most successful emerging economy ever, tremendous growth rate, tremendous growth, so much so that, by World War I, America became the leading economic superpower. Guess what? Do you think stocks did that well during that timeframe? Not quite.

In fact, my history books suggest that some of the biggest stocks didn't do quite well because most of them went bankrupt, the canals and railroads, in particular. And of course, in good American fashion, we made sure that it was mostly the BRICs that owned those securities. So again, think of China. What is available in the stock market in China, by and large -- there are exceptions -- is not to our liking. It's these big capital-intensive business models where you run the risk of cost overruns, of over-capacity. And then many businesses where you run the risk of government interference. When



there's too much inflation in China, it's very tempting for the government to tell China Mobile, "Hey, tough luck, you can't raise your fees this year." So I think there are all these issues as well.

Now, the way we have played going back 18 years now, growth in emerging markets has been oftentimes more indirect than direct. We've understood early on in the early to mid '90s that China lacked commodities, that they would need a lot of commodities. Chuck gave some numbers earlier. And so when commodity prices were low, copper, palladium, sugar and so forth, we bought those things, or related securities, ultimately as an indirect way to play high economic growth in China and India. But I would make the case that some Japanese companies today are increasing business in China, either exporting to China or through their own operations and subsidiaries in China. So you can get partial exposure to high economic growth indirectly. We don't own, unfortunately today, Remy Cointreau, the French-based cognac company, but my understanding is that some 25 percent, or maybe more of their earnings now, come from China.

So I hope that my answer helps.

Question: Yes indeed. Just the one example, you mentioned Total earlier on. There are several companies on Russian exchanges, and actually some of them I believe are traded in London as well, such as TMKBT, that do provide something, in my opinion, that you were describing in terms of correlation with oil. So your take on that would be that you'd assume that they're overpriced for the valuation, for the cash flow that they're generating?

Charles de Vault: No. I mean, I don't know that specific situation, but I'll be commenting in general. Many years ago we did own a tiny position, maybe 0.2 percent, in Yukos Corp.

Question: I'm so sorry that you did that.

Charles de Vault: No, it was tiny, but of course, sometimes it's hard to forget certain things. So in the specific case of Russia and even though some friends of mine tell me that things are getting better and this and that, we do worry, yes, in this case of Russia corporate governance, the rule of law, we worry. And now, if our funds were about trying to shoot for the moon, trying to get high returns, we would probably consider it. Our fund - it's for "Nervous Nellies." It's about not losing money, winning by not losing. So we're not ready to invest yet in places such as Russia.

Question: Thank you so very much for the answer. Thank you.



Charles de Vault: You're welcome.

Question: Yes, two questions for you. With all of this volatility, has there created an opportunity, and would you ever consider investing in or through closed-end funds? And secondly, is there a capacity and-or willingness to make direct loans to certain companies, especially if some of their bank funding is cut off?

Charles de Vault: I'll start with the first, and then Chuck, maybe you can answer the second question. Yes, of course, during bear markets, discounts on closed-end funds widen, and sometimes those funds become attractive enough. But, more often than not, within a closed-end fund, not everything is to our liking. You would have to accept within those closed-end funds other securities that you might not be keen on. So that coupled with the fact that some of these closed-end funds have pretty high expense ratios mean that, typically, we avoid them. But everything has a price, and in the past we have looked at closed-end funds. I think closed-end funds, everything being equal, have more appeal to us when it becomes virtually impossible for us to invest directly in a country. Just to give an example, but I can only tell you a story.

Back in 1994 in February, I remember I visited South Africa, got very intrigued by the stock market, and I had the choice of buying some -- I think a Morgan Stanley closed-end South African fund, trading at a 22 percent discount, or buying individual securities with no discount. And there were enough parts of the closed-end funds that I did not like -- I think there was Mittal Steel South Africa (formerly known as ISCOR) for one -- that I felt it was better just to build a portfolio of securities without a discount than the closed-end fund, and that strategy, at that time paid off.

Chuck de Lardemelle: In terms of the direct loans, we are allowed in our prospectus to do private placements. Direct loans would be extremely time consuming. They also raise all kinds of issues with pricing. So if it were ever to happen, it would be very small positions. And we would much rather invest in public securities, in bonds, and so on and so forth. But we do have that ability to do either direct loans or straight loans, secured loans. And indeed in our past life we have done such private placements, but always in a very tiny portion -- as a percentage of the assets of the fund if only because of valuation issues.

Question: Thank you.



Question: Gentlemen, thank you so much for the call and your time. You've put some great insights into Europe, and you've pretty much answered all my questions. But I guess just to come up with one final question in general over in Europe, I'm wondering if there's anything in particular that you're watching to see if the Europeans are making decisions that are going to make the situation go from bad to terrible, at which point you might sell or trim Europe. So what would come to mind, government bond yields in Spain or Italy, or if you see the European officials bailing out the countries instead of recapitalizing the banks like you've suggested. Thank you.

Chuck de Lardemelle: I think they can do much more than what they're doing now, so it's really I think -- if we see decisions, hopefully they'll be in the right direction towards recapitalizing the banks. What could happen, though, is that markets continue to push the issue. But I should mention probably that if you look at the Italian banks, for instance, the large profitable Italian banks tend to trade at 50 percent of tangible book. The less profitable banks tend to be some sort of mutual banks, trade at about 30 percent of tangible book, and there was no credit bubble in Italy. The only question at this point, at this price on the Italian banks, in my opinion: is Italy the country itself, solvent? Whether the government debt is money good? Because those banks, all of them, have substantial exposure to the Italian government.

Spain is more difficult, but the bottom line is, for those who are willing to speculate -- and we're not -- the banks, if you believe that they are going to make it, some of the banks are actually probably decent speculations because of the leverage embedded in the banks, and I call them speculations. And because of the inability of politicians to come together and put a decent solution on the table, that's why also I call them speculations.

So markets are discounting a lot, and frankly, as investors, this is a difficult time because so much is in the hands of politicians, and we are not political analysts. We can try to judge the value of businesses, but as far as deciding what the next election cycle is going to be, what the politicians will do, we are reluctant to have a view on that because we know it's not our expertise. Sorry I can't provide any more color on this.

Question: Thank you very much. That's a great answer.

Question: Hi, gentlemen, thanks for doing the call today. I really appreciate it. And you guys really spend a lot of time answering questions, far more so than most portfolio managers will do.



Just one follow-up question. Can you elaborate a little bit more on your notion of Greece, Portugal and Ireland doing an internal restructuring as opposed to, leaving the euro and doing an external restructuring?

Chuck de Lardemelle: Yes. So there are two, I think, or three possible courses of action. The first one is that France, Germany and others decide, hey, we're going to bail out our brothers. We're going to set up a fund. There is going to be a transfer from France, Germany and other countries to Greece, Portugal and others. That's the way it's set up in the U.S. In the U.S., you have Connecticut, New York and other states paying for Alabama, Mississippi and so on, on a recurring basis, so we send money to the federal government and we get X percent back but less than 100.

In Europe, more or less everybody gets back what they sent, and so there are no fiscal transfers. I think the fiscal transfers at this point are off the table. The Germans are not willing to do it. Most northern countries are not willing to do it. It's impossible politically, so that's out.

Chuck de Lardemelle: So the second solution is hey, they default, they devalue, they can get out of the euro, so the drachma is back on. The problem with that solution is that you have done no reforms in your country, so you still have a bloated civil servant or public sector. And because these are small countries, 11 million people for Greece, 11 million for Portugal, four million for Ireland, they would import a ton of inflation. So they devalue their currency but they have to import so many things to just live, that basically you have a ton of inflation, and fairly soon you're uncompetitive again.

And so devaluation, while easier from a political standpoint than tough restructuring, does not provide a solution. So that would be serial devaluations. You know, every three years they devalue again.

The last solution is a solution where they decide to stay within the euro. They default, and they do what's called an internal devaluation. There is one country that has done this successfully in the last few years, that was Latvia, so it's an eastern European country that was freed from the rule of the USSR in '91 or so. Now, the thing with Latvia is they had very little government debt, but they were pegged to the euro, and they decided -- it was about two or three million people -- to remain pegged to the euro, but they had to adjust because they were not competitive anymore. They had plenty of inflation, hot money in, now going out of the country, and they needed to become self-financing. They needed to adjust substantially. And they decided to do so.



And bear in mind, it was extremely painful. GDP was down 20 percent plus, but they did not default, and they remained pegged to the euro, and today they are back on track. So that's called an internal devaluation. It's when basically all your prices within your economy come down so that your economy becomes competitive again. It's very painful. Frankly, I could see Ireland doing something like this. They are able to grit their teeth and take it on the chin. Portugal and Greece, we shall see.

Question: So basically it's just a situation where they lower all their costs until they start attracting investment capital, so they lower their wages, lower everything else.

Chuck de Lardemelle: That's right, basically so they can export again. Because at the end of the day, I think the main metric you want to look at for those countries to decide, whether they can make it or not, is their current account deficit.

Question: Right.

Chuck de Lardemelle: The current account deficit, when you're in a deficit, it means that you don't have enough savings within your country to face your needs, and so you need to attract foreign capital. And that's the key because, if you don't need to attract foreign capital, as the case of Italy, they don't need to attract foreign capital, well, then you're self-financing. It's the case of Japan, as well. So Japan has a ton of government debt. But so far it's not led to a crisis because they were self-financing. In other countries with a lot less debt, you had a substantial government debt crisis because these countries were not self-financing. And for both Portugal and Greece, despite a very harsh recession, they still are in very large current account deficits, which tend to prove that their economies are just not competitive.

So the obvious answer would be, hey, let's devalue. But if you do that, you're going to import a lot of inflation, and you're back to square one within a few years. So you're left with very deep internal restructuring. That's one of the things I think about in the bailouts in Greece so far. We haven't seen pink slips to the public sector. So I would believe that the economy remains uncompetitive and the reforms are not the right reforms. They're taxing up and up and up. They are not collecting on those taxes, and they are not restructuring the public sector the way it should be.

And I'm not saying it's easy, and I'm not blaming anybody. It is what it is.

Question: All right. I really appreciate you spending the time to go over the details on that. Thank you very much.



Charles de Vaultx: You're welcome. Thank you.

Charles de Vaultx: Okay. Well, thank you so much for joining us. A replay of this call will be available until September 22. You can access the replay by dialing 1-888-266-2081, access code 1542145. We will also have a transcript posted to our website in about a week, so please visit us at www.ivafunds.com.

Thank you. Good night.

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IVA Worldwide Fund A (no load)	22.53%	17.32%
IVA Worldwide Fund A (with load)	16.43%	15.16%
IVA International Fund A (no load)	23.66%	16.22%
IVA International Fund A (with load)	17.46%	14.08%

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