# AEGIS **Value Fund**

**Portfolio Manager's Letter**
**Quarter Ended March 31, 2014**

April 21, 2014

Dear Aegis Investor:

The Aegis Value Fund (Class I) declined 1.46 percent during the first quarter, underperforming the 1.78 percent increase in the Russell 2000 Value Index, its primary small-cap value benchmark. Since the market bottomed on March 9th of 2009, through the end of the first quarter, the Russell 2000 Value Index has climbed a cumulative 257.7 percent, while the Aegis Value Fund has returned a cumulative 485.2 percent. Past performance figures for both the Aegis Value Fund and the benchmark Russell 2000 Value Index are presented in **Table 1**, below:

**Table 1: Performance of the Aegis Value Fund as of March 31, 2014**

| | | | Annualized | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Three Month** | **Year-to-Date** | **One Year** | **Three Year** | **Five Year** | **Ten Year** | **Since I Share Inception*** | **Since A Share Inception*** |
| **Aegis Value Fund Cl. I** | -1.46% | -1.46% | 14.06% | 13.37% | 36.15% | 8.86% | 11.96% | NA |
| **Aegis Value Fund Cl. A at NAV** | NA | NA | NA | NA | NA | NA | NA | -1.50% |
| **Aegis Value Fund Cl. A -With Load** | NA | NA | NA | NA | NA | NA | NA | -5.20% |
| Russell 2000 Value Index | 1.78% | 1.78% | 22.65% | 12.74% | 23.33% | 8.07% | 8.43% | 1.97% |

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

*Performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. The investment return and principal value will fluctuate so that upon redemption, an investor's shares may be worth more or less than their original cost. For performance data current to the most recent month end, please call us at 800-528-3780 or visit our website at www.aegisfunds.com. Performance data for the Class A shares with load reflects the maximum sales charge of 3.75%. Additionally, performance for the Class A Shares without load is shown at NAV, and does not reflect the maximum sales charge. If reflected, total return would be reduced. The Fund's Class I and Class A shares have an annualized expense ratio of 1.38% and 1.63%, respectively.*

In the first quarter of 2014, declines in Fund holdings of Tecumseh Products, Swift Energy, and WPX Energy most negatively impacted Fund returns. In addition, the Fund's lack of significant investment in financial sector stocks, which at quarter-end comprised nearly 40 percent of the Russell 2000 Value Index, also negatively impacted quarterly returns on a relative basis. In the first quarter, the Russell 2000 Value Index Financials Sector gained a weighted average 3.00 percent.

Declines in shares of **Tecumseh Products (TECUA (non-voting) & TECUB (voting))** most negatively impacted Fund performance, detracting approximately 1.34 percent from first quarter returns as shares of the global manufacturer of refrigeration compressors declined as at least two large shareholders sold shares. Investors have presumably grown dissatisfied with the pace and potential cost of Tecumseh's turn-around. Additionally, the company also recently announced it had not been able to secure the immediate sale of its Brazilian foundry assets, which many investors had been hoping would be a near-term catalyst for share price improvement. With significant manufacturing facilities today in Brazil and France, Tecumseh would face substantial restructuring costs should it attempt to optimize its global manufacturing footprint. Furthermore, Tecumseh fundamentals have experienced some deterioration recently as the company works to recover from a warranty issue involving the failure of a particular India-manufactured compressor model.

Despite the near-term troubles, we believe the recent declines in Tecumseh will prove to be temporary. The company, now trading at just half of tangible book value, continues to own what we believe are valuable and eventually disposable assets, such as land in Hyderabad, India, located in an area that has become a technology corridor. Moreover, Tecumseh may also still eventually monetize its Brazilian foundry. The company maintains a strong market presence in aftermarket commercial compressor distribution, and holds a dominant position in truck sleeper-cab air conditioning through its high-margin Masterflux line of battery-driven compressors. This year, the company should continue to benefit from the recent declines in the Brazilian Real and the Indian Rupee, resulting in an improvement in the competitiveness of the plants in these regions. Furthermore, Tecumseh's valuation has long suffered under a problematic dual-class share structure, which the company is now working to consolidate into a single class. The composition of the Board of Directors has also improved in recent months, and a talented new executive with turn-around experience has recently joined the company. We remain optimistic Tecumseh will recover, and have continued to increase our position as shares have declined. Tecumseh shares were the largest Fund purchase in the quarter, and, at quarter-end, Tecumseh A and B stock combined represented 4.8 percent of Fund assets.

When compared with the Russell 2000 Value benchmark, the Fund has recently held an outsized portion of its assets in oil and gas exploration & production companies, and energy service firms. Performance of our selections within the energy sector was mixed this quarter, despite the strong improvement in underlying industry fundamentals, as record-breaking cold winter weather depleted gas inventories and drove gas prices higher. On the positive side, gains in land-driller **Patterson Drilling (PTEN)**, the Fund's strongest performing position, improved Fund returns by 0.83 percent in the quarter as shares rose in anticipation of an improving market for drilling services. The Fund's investment in **EPL Oil & Gas (EPL)** also experienced gains as the company entered into an agreement to be acquired by Gulf Coast competitor Energy XXI at a healthy premium, driving Fund returns 0.61 percent higher. However, the Fund suffered losses on our holdings of **Swift Energy (SFY)** and **WPX Energy (WPX)**, which each negatively impacted Fund returns by approximately 0.70 percent. We exited our investment in Swift Energy at a loss after receiving indications that the drill program was failing to generate sufficiently economic reserve additions to justify the capital expenditures, leaving us increasingly concerned about the underlying quality of Swift's acreage, particularly given its high levels of debt. While WPX also suffered share price declines in the quarter, we believe fundamentals actually improved at the well-financed company as gas prices moved higher. In our estimation, WPX shares remain materially undervalued relative to the company's acreage position, its reserve base, and its production. We currently anticipate a recovery in WPX share prices as the year progresses.

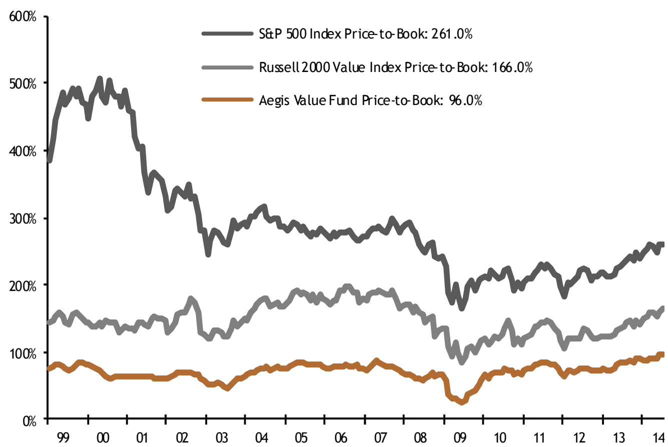
Recently, attractive investment prospects in the financials, utilities, and health care sectors meeting our stringent risk-reward criteria have been limited, and as such, we hold few positions in these areas when compared to the Russell 2000 Value benchmark. Within the financials sector in particular, our 11 percent weighting is significantly lower than the 40 percent financials weighting within the benchmark. Relative Fund performance has been suffering in the last couple of quarters as the prices of many financial sector equities have been climbing. Investors have recently become more optimistic on banks, believing that the economy is strengthening sufficiently to enable the Federal Reserve to stop its program of money-printing and interest rate suppression, and are betting on increasing interest rates and bank net-interest (profit) margins. Certainly banks are better capitalized today, with the Federal Reserve reporting recent stress-test results showing banks had doubled aggregate capital since 2009.

Despite the increased capital levels, however, we have avoided the banks. We continue to view most banks as highly-levered, highly-regulated businesses with low margins and opaque financials. Regulatory burdens and direct government competition in such lending areas as home mortgages and student loans have suppressed bank profit margins, particularly at smaller financial institutions. With Fed-reported loan delinquency having already reached a 27-year low of just 0.87 percent of loans in December, we see limited opportunity for further improvement on the credit front, particularly in a scenario of higher interest rates. We question the economy's capability for resilience in the face of a significant increase in interest rates, as any increase would almost certainly spike delinquencies and reduce consumption among today's highly leveraged borrowers. Furthermore, we question the resolve of the Fed to increase interest rates in light of the high level of government debt. Increased government involvement in banking appears to be a far more likely scenario, with risk that banks may be increasingly coopted to invest in low-return Treasuries and other securities to facilitate the servicing of the ever-increasing Federal debt load. Given our concern over banking sector risks, our holdings within the financial sector continue to be primarily non-bank insurance companies.

Overall, the domestic equity market turned in its seventh straight quarter of positive returns. The broad-based, large-cap S&P 500 Index increased 1.81 percent in the first quarter, while the small-cap Russell 2000 Index climbed 1.12 percent. From the market low on March 9th, 2009, through the first quarter of 2014, the S&P 500 Index has increased a cumulative 208.3 percent, while the Russell 2000 Index has climbed an even greater 266.3 percent. With the S&P 500 having now run for close to three years without a 10 percent correction, speculative behavior appears to be on the ascendency. Aggregate margin debt in February hit an all-time high level of $465.7

**Figure 1:**

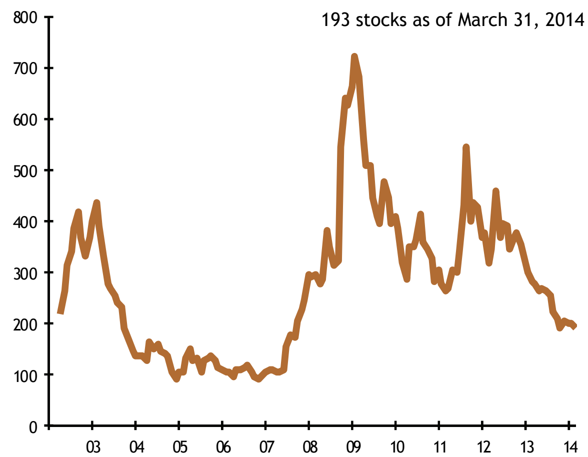
**Aegis Value Fund, S&P 500 Index, and Russell 2000 Value Index Historical Price-to-Book Ratio**




*Source: Aegis Financial Corp and Bloomberg (Data from 9/30/1998 to 3/31/2014*

**Figure 2:**

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




*Source: U.S. public equity market statistics from Stock Investor Pro (Data from 4/30/2002 to 3/31/2014)*

billion, well ahead of the previous peak of $381.4 billion in 2007. Margin debt as a percentage of Gross Domestic Product (GDP) has also been approaching record highs. As 2013's broad market returns of 30-40 percent significantly exceed the rate of corporate earnings growth, valuation multiples have also been on the rise. At the end of March, the S&P 500 traded at 17.2 times 2013 earnings, and the Russell 2000 Index traded at an even higher 23.2 times 2013 earnings.

We believe certain sectors of the equity market have now become quite speculative. The Wall Street Journal recently reported that in mid-March, internet retailers traded at an average of 158 times earnings and 5.7 times revenues after gaining almost 90 percent over the previous 12-months, while biotech firms traded at 44 times earnings and 19 times revenues after annual gains of approximately 65 percent. Initial Public Offering activity has been surging, with a reported 222 transactions above $50 million raising $55 billion in 2013, the highest since a record 406 offerings raised $97 billion in 2000. While these momentum-driven sectors have blown off some steam in recent weeks, clearly the fear and anxiety prevalent in the years following the 2008 banking crisis has been dissipating, replaced by a renewed willingness to speculate.

Overall, valuations at the Fund have also been trending higher in recent quarters. At the end of March, stocks in the Aegis Value Fund traded at a weighted average 96 percent of tangible book value. As can be seen in **Figure 1**, while the Fund's valuation has climbed significantly from the bottom of the market in March of 2009, Fund holdings, on average, trade at significantly lower valuations than those of the broader market. At quarter-end, the Russell 2000 Value Index traded at 166 percent of book value, while the S&P 500 traded at 261 percent of book value.

As can be seen in **Figure 2**, as the equity markets have rallied, the number of stocks on the Aegis Value Fund watchlist has been declining in recent quarters. The month of March ended with 193 stocks on the watchlist, down from 204 stocks at the end of 2013. While the current number of watchlist candidates is still materially above the 100-150 names prevailing during the 2004-2007 trough, today's number is well below the 722 names on the watchlist at the peak of the financial crisis in February of 2009.

Given the rally in equities, we have been increasingly focused on risk management, prudently exiting holdings where prices have risen to levels that reflect and incorporate optimistic outcomes. So far we have been able to find a sufficient number of securities offering what we believe are adequate risk/return profiles to replace these names and maintain a diversified portfolio. While we are working diligently to find and profitably exploit the new opportunities that do still exist in the deep value universe, this work is becoming more difficult, given the run-up in valuations. Should equity prices continue to surge, Fund shareholders may see Fund cash levels rise in future quarters, as we may experience difficulty obtaining a sufficient number of "bargain-priced" securities to adequately reinvest sales proceeds.

We remain on the lookout for a number of emerging market risks. Globally, levels of indebtedness appear to be on the rise. The Bank for International Settlements recently reported that aggregate global debt has soared more than 40 percent to $100 trillion since the first signs of the financial crisis in mid-2007. Non-financial public market corporate debt in China has swelled from $607 billion at the end of 2007 to $1.98 trillion today, a tripling of debt in a little over 6 years. According to the Sunday London Telegraph's Ambrose-Evans Pritchard, nearly $620 billion of debt from Chinese businesses is dollar denominated, exposing these issuers to increasing financial stress in a scenario of Chinese Yuan depreciation. In the first quarter, the Chinese government refused to bail out Shanghai Chaori Solar Energy Science & Technology Company, allowing the company to be the first debt default to occur in the Chinese onshore bond market, and reversing the implied bond guarantee that had been presumed by the market after several previous investor bailouts. The change in precedent left investors questioning the strength of the Chinese economy, and as a result, many industrial commodities saw weakness, with copper dipping to a 4-year low. Fortunately, our Fund holdings of copper producers **Nevsun (NSU)** and **Amerigo (ARG.TO)** generate sufficient cash flow, even in a lower copper price environment, to provide the potential for a reasonable investor return. Nevsun, in particular, is a debt-free, cash-rich producer with one of the lowest copper production costs in the world. Nevertheless, we continue to monitor our exposures to the prospect of financial fallout from instability in China's debt markets.

Outside of China, the investment mood is clearly more optimistic, despite recent political tensions in Russia and the Ukraine. In Europe, stock prices of banks in the peripheral parts of the European Union (EU), previously considered un-investable wards of the state, have been soaring. Portugal's Banco BPI, for example, was up 56.25 percent in the quarter, while Italy's Intesa Sanpaolo SpA was up 37.97 percent. We also note that the Greek government, long considered a risky credit, was recently able to issue sovereign five-year notes at an astoundingly low 4.95 percent yield in a deal that was more than six times oversubscribed. European investors appear to have completely forgiven Greece despite the country having subjected holders of its debt to massive losses when Greece defaulted just two years ago. Yet Greece's sovereign debt as a percentage of Greek GDP has continued to climb, from 148 percent in 2010 to approximately 180 percent today. Greece is not alone. Yields on 10-year bonds in Ireland and Italy recently dropped to record lows of 2.85 percent and 3.11 percent, respectively, despite gross debt to GDP continuing to climb to 123.7 percent and 134.5 percent, respectively. We believe Eurozone investors are once again assuming significant risk and receiving very little interest in return. Should European bond yields surge higher in the future, peripheral banks are likely to suffer, and global financial pressures may increase.

Even in the US, while the federal deficit has shrunk, courtesy of one of the biggest tax increases on the American public in decades, the federal debt continued to soar higher, approaching $17.35 trillion today. While the federal deficit has trended lower, the federal budget may have yet to experience the full suppressive impact of higher taxes on revenue. Additionally, rising levels of entitlement outlays and a further deterioration of federal spending discipline appear likely to render the trend of recent deficit reduction temporary. The Federal Reserve also continues its money printing at a historically overwhelming rate, supporting further government deficit spending, despite the recent moves to "taper." While nobody can predict the future, as the Fed attempts to exit from its unprecedented policy stance and normalize interest rates, we believe the economy may experience more difficulty than many today expect. Consider that consumer spending growth is once again outpacing wage growth, implying that consumers are now again either dipping into savings or increasing debt. Corporate junk bond issuance is also getting sloppy, with aggressive "pay-in-kind" and covenant light loans now making a re-appearance.

Thoughtful investors must contemplate whether the current state of economic affairs is sustainable. With several years having passed since the previous downturn, and with fear now giving way to speculation in the financial markets, we believe it is prudent to work judiciously to position ourselves so that the Fund might be able to perform acceptably well in a wider variety of market environments. Today, many value investors consider cash holdings as the default tool for defensive positioning. Cash has certainly proven to be useful at preserving capital during the 2008 credit crisis, and could once again prove to be an attractive asset if the Fed ever finds the will to tighten the money supply. With valuations much higher than in the past several years, we believe the "opportunity cost" of holding higher levels of cash may be somewhat lower today.

However, we believe prudent investors must now also consider the possibility that cash may not be as protective to purchasing power in the future as it has proven to be in recent downturns. In certain potential future scenarios of inflationary acceleration, possibly driven by a "run" on hard-assets as overly indulgent Fed policy eventually leads to an emotion-driven crisis of confidence in the dollar, cash and dollar denominated bonds may lose purchasing power while equity and commodities markets surge higher. We continue to believe that a portfolio of deeply undervalued stocks is likely to prove more effective than cash at insulating investment capital should a future inflationary scenario of this type materialize.  Furthermore, we believe that deeply undervalued special situation securities can better grow capital under a wide variety of economic scenarios for stock specific reasons.  With this in mind, we have been working hard to keep the Fund invested, and have recently been allocating a high proportion of Fund capital into securities we believe to be undervalued within the energy, and metals & mining sectors, as some securities within these sectors appear to us to be both deeply undervalued, and also nicely positioned to perform well should inflation accelerate.

We continue to work diligently to keep the portfolio invested in companies that we believe are among the most undervalued available in the market today.  Employees at Aegis maintain investment in excess of $20 million in Fund shares, and we continue to prudently monitor our portfolio companies for developing risks.  Should you have any questions, please feel free to call the shareholder reps at (800) 528-3780.  You are also welcome to call me personally at (571) 250-0051.

Sincerely,

Scott L. Barbee

Scott L. Barbee
Portfolio Manager
Aegis Value Fund

**Please see the following page for important information.**

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

**Mutual fund investing involves risk. Principal loss is possible. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in smaller and mid-cap companies involve additional risks such as limited liquidity and greater volatility. Value stocks may fall out of favor with investors and underperform growth stocks during given periods. Investments in Real Estate Investment Trusts (REITs) involve additional risks such as declines in the value of real estate and increased susceptibility to adverse economic and regulatory developments.**

*An investment cannot be made directly in an index.*

*The letter refers to eight issues held by the Fund: Tecumseh Products (A&B), Swift Energy, WPX Energy, Patterson Drilling, EPL Oil & Gas, Nevsun Resources Ltd., and Amerigo Resources Ltd. As of March 31, 2014, these stocks represent 3.3%, 1.5%, 0.0%, 5.6%, 2.6%, 2.4%, 2.4%, and 1.4% of total Fund assets respectively. Fund holdings are subject to change and should not be considered a recommendation to buy or sell a security. The letter also refers to Energy XXI, Shanghai Chaori Solar Energy Science & Technology Company, Banco BPI, Intesa Sanpaolo SpA, and Bank of Ireland, which are not and have not been a holding of the Fund. Current and future portfolio holdings are subject to risk.*

**Price to Book:** A ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share. **Book Value:** A company's common stock equity as it appears on a balance sheet. **Price to Sales:** A ratio to compare a stock's market value to its earnings per share. **EBITDA:** Earnings before interest, taxes, depreciation, and amortization expense. **S&P 500 Index:** An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. **Russell 2000 Value Index:** measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. **Tangible Book Value:** The net asset value of a company, calculated by total assets minus intangible assets (patents, goodwill) and liabilities. **The Russell 2000 Index**: measures the performance of the small-cap segment of the U.S. equity universe and is constructed to provide a comprehensive and unbiased small-cap barometer. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. **Initial Public Offering:** The first sale of stock by a private company to the public.

Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value.

Diversification does not assure a profit or protect against loss in a declining market.

Opinions expressed are subject to change at any time, are not guaranteed and should not be considered investment advice.

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