AEGIS **Value Fund**

Portfolio Manager's Letter
Quarter Ended June 30, 2014

July 21, 2014

Dear Aegis Investor:

The Aegis Value Fund (Class I) returned 4.39 percent over the second quarter, outpacing the 2.38 percent return of its primary small-cap value benchmark, the Russell 2000 Value Index. Past performance figures for both the Aegis Value Fund and the Russell 2000 Value Index are presented in **Table 1**, below:

Table 1: Performance of the Aegis Value Fund as of June 30, 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	4.39%	2.87%	14.78%	16.00%	26.89%	9.26%	12.07%	NA
Aegis Value Fund Cl. A at NAV	4.34%	NA	NA	NA	NA	NA	NA	2.77%
Aegis Value Fund Cl. A -With Load	0.41%	NA	NA	NA	NA	NA	NA	-1.08%
Russell 2000 Value Index	2.38%	4.20%	22.54%	14.65%	19.88%	8.24%	8.45%	4.40%

** 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.

Fund outperformance was driven by strong gains on investments in metals & mining and energy companies. Energy stocks delivered particularly strong returns as an unusually cold North American winter resulted in increased demand for natural gas, sending inventories to an 11-year low. Furthermore, the deteriorating Middle East geopolitical situation stoked oil supply fears. The price of Brent crude increased 4.27 percent over the quarter, while higher natural gas prices persisted, resulting in strong gains on our **WPX Energy (WPX)** position. Gains in WPX shares, our top performing holding, more than reversed all of the losses posted in the first quarter, boosting second quarter Fund returns by 1.83 percent. Other energy and oil service holdings, such as **Comstock Resources (CRK)**, **Stone Energy (SGY)**, **Patterson Drilling (PTEN)**, and **McDermott (MDR)**, also contributed to overall energy sector gains.

With increased investor optimism and surging valuations in the energy sector, we took the opportunity to reduce our energy positions. Our largest sale was Stone Energy, which generated a long-term gain equal to 144 percent of our average purchase price as we exited the holding shortly after crossing the one-year anniversary of our purchase. We also sold the substantial entirety of our position in Magnum Hunter, and trimmed back holdings of WPX Energy as valuations increased. All-in-all, we liquidated approximately $22 million of energy shares during the second quarter.

Ironically, despite the run-up in energy sector valuations, our biggest Fund purchase, at approximately $5 million, was **Hercules Offshore (HERO)**, a $650 million market-cap offshore driller. Several offshore drillers experienced steep declines earlier in the year amid increased investor concerns about industry overcapacity. Within the context of this general weakness, Hercules is viewed as particularly vulnerable on account of the age of its fleet and the $1 billion of net debt on its books. Hercules recently experienced a two-day, 18 percent share price decline as it was forced to cancel a multi-year contract with Sonangol, the Angolan national oil company, after Hercules was unable to obtain a requisite local representative both acceptable to Sonangol and compliant with Hercules' regulatory anti-corruption compliance procedures. Despite the leverage and recent troubles, we believe that Hercules trades at an attractive 0.8 times book value, a level that may be understated on account of the company's opportunistic acquisition of 22 rigs for $95 million from bankrupt Seahawk Drilling in 2011. Over the last three years, Hercules has realized proceeds of approximately $90 million from the disposition of roughly half of the Seahawk fleet, while retaining the most valuable rigs for its own fleet. Hercules still maintains a backlog of over $1.2 billion, including a recently signed five-year contract with Maersk Oil for a newbuild rig. We believe the company is well-positioned to continue to service its debt, given the lack of near-term maturities and the company's projected 2015 EBITDA of $440 million. With tax loss carry-forward benefits of $490 million, Hercules is likely to pay substantially reduced cash taxes in the near-term. Furthermore, company insiders appear to agree that the stock represents good value, purchasing approximately 400,000 shares so far this year.

We also made a significant purchase of **Peabody Energy Corp (BTU)**, a global $4.4 billion market-cap coal business with extensive, low cost, U.S. thermal coal operations in the Powder River and Illinois basins. Peabody executed the timely spin-out of its high-cost Appalachian coal properties into Patriot Coal several years ago, yet its shares have declined more than 77 percent since peaking in 2011 as a result of the ill-considered $5 billion acquisition of Australian met-coal operation MacArthur Coal. Prices of met-coal, used in steel production, have since been in rapid decline as new supply inundated the market just as Chinese demand began to be moderate. Furthermore, investor sentiment towards coal companies has been negatively impacted in recent years as a result of the U.S. Government's promotion of inefficient, high cost, and unreliable alternative energy sources, coupled with its use of regulatory carbon dioxide mandates to suppress U.S. coal-fired electrical generation.

Despite the government interference and negative investor sentiment, we like Peabody shares, primarily as an opportunity to own bargain-priced reserves of low cost energy. Peabody maintains low cost coal reserves equivalent to approximately 40 years of production. In fact, the company's 8 billion tons of coal reserves have been calculated to have roughly the same amount of energy in British Thermal Units (or BTUs) as Exxon Mobil's oil reserves, yet Peabody's market cap is just one percent of Exxon Mobil's $446 billion market valuation. While the company is generating only $800 million of EBITDA today, it trades at a modest multiple of 5.5 times our estimate of longer-term potential normalized EBITDA, and at a low 1.1 times book value.

We believe Peabody's focus on thermal coal and its relatively low level of leverage compared to its peers will likely ensure its survival. While U.S. energy policy remains politically tilted towards uneconomic alternatives, consumption of inexpensive thermal coal worldwide is growing rapidly, driven by India and China, and coal exports from the U.S. are on the rise. Consider that China added more coal-fired electricity generation capacity in the last five years than currently operates in the U.S., and many analysts expect another U.S. equivalent will be added in China over the next six years. We believe that U.S. energy policy may eventually improve, as higher power costs and deteriorating US electrical grid reliability are likely to eventually result in a politically driven reversal of the regulatory war on coal.

Balancing the purchase of Hercules and Peabody with our other energy sales, the Fund's holdings in the energy, coal and oil-service sectors closed June at 24.8 percent of Fund assets, down 2.7 percentage points over the second quarter.

Overall, fundamental business conditions at the companies within our portfolio generally tracked to expectations, with few signs of investment thesis deterioration, and several cases of modest upside surprise. Several metals and mining portfolio companies, in particular, have shown reasonable operational improvement by cutting costs and growing production and resources. Gold prices themselves have shown more resiliency in 2014, rising 3.0 percent in the second quarter, driven by inflation fears and geopolitical uncertainty. On the flipside, we did have a few pockets of fundamental deterioration. For example, **Mitcham Industries (MIND)**, a manufacturer and lessor of seismic equipment, declined after the company lost a lucrative contract to supply seismic equipment into Russia following the impositions of U.S. sanctions in response to the Russian invasion of Crimea.

The prices of several of our holdings were negatively impacted by index-driven selling as Russell rebalanced its Indices this year. We understand that **Tecumseh Products (TECU)**, **Luby's (LUB)**, **Bassett Furniture (BSET)**, **California First National Bank (CFNB)**, **Hardinge (HDNG)**, **Cal Dive (DVR)**, and **Zaza Energy (ZAZA)** were all deleted from the Russell 2000 Index at the end of June. We believe these deletions resulted in a material amount of tech-

Table 2: Market Valuations Have Surpassed Historic Bull Market Peaks

Measure	Current level	Most extreme level at prior peaks	Percentage of prior bull-market peaks with lower valuations than the current market
Price/earnings ratio	18.9	46.7	69%
Cyclically adjusted P/E ratio	26.0	43.8	86
Price/book ratio	2.6	4.8	82
Price/sales ratio	1.7	2.1	89
Tobin's Q ratio	1.1	1.5	89
Dividend yield*	2.0%	1.2%	86

** Dividend yield is an inverse indicator; lower readings indicate greater overvaluation.*

Note: Data cover period from 1900 to present, except price/book ratio (since 1925) and price/sales ratio (since 1955).

Source: Ned Davis Research; Standard & Poor's; Robert Shiller; Andrew Smithers; WSJ (Hulbert on Investing By Mark Hulbert) July 12, 2014.

nical selling by index funds and other index-tracking asset managers who were then obligated under their mandates to eliminate positions in these stocks. For example, we estimate that nearly 1.6 million shares of Tecumseh Products, equivalent to nearly 24 trading days of volume, were ejected by index funds. Impacted by index selling, Tecumseh ended-up the Fund's biggest decliner in the second quarter, dampening Fund returns by 1.38 percent. Fund holdings in these companies subject to Russell 2000 elimination represented 9.8 percent of Fund assets at June 30th, and collectively negatively impacted Fund returns by an estimated 2.12 percent. We remain optimistic that the technical selling pressure recently experienced in these Fund holdings is likely to abate as index managers complete their rebalancing transition.

Since the Great Recession low of March 2009, over $15 trillion has been added to the market value of US equities, with the S&P 500 having climbed 224 percent, including dividends. The S&P 500 has now gone without a 10 percent loss for 33 months, the longest stretch of uninterrupted gains since 2003. Investors are in an optimistic mood, seduced by recent market gains propped-up by low interest rates and Federal Reserve money printing. Hedge funds, caught flat-footed being overly hedged during several years of market gains, have now reportedly been reducing short-side exposures. Short interest in the benchmark S&P 500 Index recently dropped to approximately 2 percent of total shares in the index, close to the lowest level since Markit began tracking the data in 2006. Investors have also increasingly borrowed money to buy shares. May's NYSE Margin debt, at $439 billion, has more than doubled since the February 2009 low of $173 billion, and is well above of the 2007 peak of $381 billion.

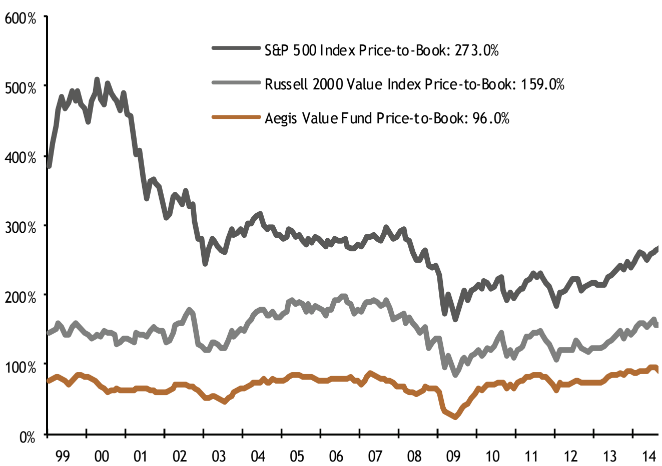
We have concerns that broad market valuations are stretched. A recent Mark Hulbert piece in the Wall Street Journal was instructive. Hulbert reviewed the market's valuation based on several different metrics: earnings, cyclically adjusted earnings, book value, sales, dividend yield, and asset replacement value (known as Tobin's Q). Current valuation multiples were compared against those presiding during the peak of each of the 35 historic bull markets occurring since 1900, as determined by quantitative research firm Ned Davis Research. The results, shown in **Table 2**, indicate today's valuation levels are above those reigning during the majority of past bull market peaks. Our conclusion is that markets have now become complacent, resulting in increased investment risk to stocks trading at such high multiples.

Our primary approach for dealing with this kind of market is inherent in our strategy. We focus on investing in special situation equities judged to be valued among the cheapest in the market. As **Figure 1** shows, stocks in the Aegis Value Fund traded at just 96 percent of book value at the end of the second quarter, well beneath the multiples of the general market. Under our deep-value approach, we buy stocks we believe are already priced for disaster that offer high potential for return. Deep-value investing requires the discipline to buy and hold the very companies that other investors are often selling in a panic. It can be difficult to sail towards a storm and can be highly disconcerting, regardless of how carefully the route has been planned or the weather evaluated.

Unfortunately, there has been limited opportunity to pick-up bargains by way of panic selling recently. As seen

Figure 1:

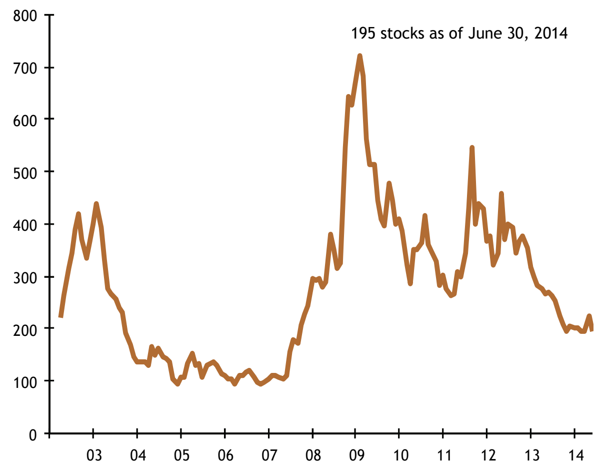
Aegis Value Fund, S&P 500 Index, and Russell 2000 Value Index Historical Price-to-Book Ratio



Source: Aegis Financial Corp and Bloomberg (Data from 9/30/1998 to 6/30/2014)

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 6/30/2014)

in **Figure 2**, over the last nine months there have been fewer investment candidates in the deep value sector, with the number of stocks on our discount-to-tangible book value watchlist hovering at around 200 companies. While a higher number of watchlist candidates exist today than during the 2003-2007 bull market, roughly a quarter of current watchlist companies are highly levered small-cap banks and financial institutions with anemic earnings and challenged business models, courtesy of the government's current regulatory scheme. Many of the other companies on the watchlist are permanently impaired, leaving fewer investment candidates with acceptable risk/reward ratios. We are working diligently to maintain a strong understanding of all the companies on this list in order to exploit the opportunities that do exist, but high valuations make this work more difficult.

Fund cash levels have been climbing slightly higher in recent weeks, reaching approximately 10 percent in just the last few days as a result of both a lack of quality investment candidates and our disciplined efforts to sell positions having reached full valuation. Although we will not hesitate to invest our cash should we uncover investments offering good risk/reward trade-offs, we are not overly concerned about holding a little more cash in the near-term, given the overwhelming number of stocks we believe to be currently priced for perfection.

Despite all the talk of taper, the Fed is still currently printing money at the impressive pace of approximately $35 billion per month. The Fed has pegged short-term rates at nearly zero for more than five and a half years. With the Fed "put" in place supporting market prices, speculators have re-entered the markets, driving more than five years of stock price gains. With equity valuations rising, many investors, lulled into complacency by today's low volatility environment, are happy to hold overvalued equities, despite the increasing risk. We expect this, too, shall pass.

The Fed today looks to be making early efforts to remove the training wheels from the markets. Conventional wisdom holds that the economy is now strengthening sufficiently to enable the Fed to exit its program of money printing and eventually raise interest rates. However, this conclusion may be premature. Reported inflation, while still low, may be gathering steam, and may yet compel the Fed to increase the pace of tightening.

It is an open question as to how well the economy would deal with any tightening from the Fed's current unprecedented stance of easy money. Given the high financial system leverage, increasing taxes, and regulatory onslaught impacting the country, it would not be surprising to see the economy perform quite sluggishly. We must remember that first quarter Gross Domestic Product (GDP) was revised downward to now imply a 2.9 percent decline from a year ago, albeit weather certainly had an impact. Despite some headline improvement, unemployment still remains stubbornly high, with significantly larger numbers of people underemployed. Labor force participation rates have also plunged, distorting the reported unemployment statistic. On top of it all, the geopolitical situation appears to be more strained than we've seen in quite some time. Should the pace of business slow, financial markets could be quite vulnerable to a downturn, given today's high market multiples.

It is also an open question as to whether the Fed, if confronted with accelerating inflation in the future, will appropriately tighten monetary policy, particularly if the Fed still faces a sluggish economy with higher unemployment. Given the Feds questionable "dual mandate" focus, we have our doubts. However, with all the near-term potential for disorder, we are trying to position ourselves for the possibility of higher levels of future market turmoil. Should Fed tightening drive market volatility, we stand ready to put cash to work in bargains that are unearthed by the turmoil. And should the Fed reverse course and accelerate its money printing, we would anticipate strong performance of our metals & mining securities, which at quarter-end comprised approximately 14 percent of Fund assets.

Overall, we intend to remain methodical, selective and disciplined about the investments we make. We continue to own a portfolio of securities that we believe are as deeply undervalued as any in the market today. As of June 30th, Aegis employees own in excess of $20 million of Fund shares. We remain strongly focused on risk management. Should you have any questions, please feel free to call the shareholder representatives 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 seventeen issues held by the Fund: WPX Energy, Comstock Resources, Stone Energy, Patterson Drilling, McDermott International Inc., Magnum Hunter, Hercules Offshore, Peabody Energy Corp., Mitcham Industries, Tecumseh Products, Luby's, Bassett Furniture, California First National Bank, Hardinge, Cal Dive, Zaza Energy, and Patriot Coal. As of June 30, 2014, these stocks represent 7.3%, 2.4%, 0.0%, 2.9%, 3.3%, 0.0%, 2.2%, 3.0%, 0.7%, 4.2%, 0.5%, 0.9%, 0.9%, 1.2%, 1.6%, 0.4% and 0.0% 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 Seahawk Drilling, Maersk Oil, MacArthur Coal Ltd., and Exxon Mobil, 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. **Price-to-Earnings:** A valuation ratio of a company's current share price compared to its per-share earnings. **Tobin's Q ratio:** A ratio devised by James Tobin of Yale University, Nobel laureate in economics, who hypothesized that the combined market value of all the companies on the stock market should be about equal to their replacement costs. The Q ratio is calculated as the market value of a company divided by the replacement value of the firm's assets. **Cyclically adjusted P/E:** A stock's price divided by the average of the issuing company's most recent ten years earnings adjusted for inflation.

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.

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