AEGIS **Value Fund**

AEGIS FUNDS

Portfolio Manager's Letter
Quarter Ended September 30, 2013

October 25, 2013

Dear Aegis Investor:

The Aegis Value Fund delivered another quarter of positive performance, turning in a 7.30 percent gain in the third quarter of 2013. The Fund's return slightly trailed its primary benchmark, the small-cap focused Russell 2000 Value Index, which surged 7.59 percent. Past performance figures for 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 September 30, 2013

			Annualized				
	Three Month	Year-to-Date	One Year	Three Year	Five Year	Ten Year	Since Inception*
Aegis Value Fund	7.30%	30.06%	39.39%	22.64%	15.09%	10.14%	12.20%
Russell 2000 Value Index	7.59%	23.07%	27.04%	16.57%	9.13%	9.29%	7.96%

** Aegis Value Fund Inception 5/15/98*

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. The fund has an annualized expense ratio of 1.47%.

Large-cap stocks also continued their rise, with the S&P 500 Index climbing another 5.24 percent during the quarter. The third quarter was marked by a surprising Federal Reserve policy U-turn as the Fed's well-telegraphed and widely expected September curtailment, or "tapering," of monetary stimulus was unexpectedly postponed. While news of the continuation of "quantitative easing" lifted market prices, it may well have also damaged the Fed's credibility and reputation for ensuring monetary stability. As the next Fed Chairman will have a significant impact on setting monetary policy, the fact that Larry Summers, considered more hawkish on inflation than nominee Janet Yellen, was forced to withdraw his name from contention after his monetary views were seen as politically unacceptable, does not burnish the Fed's credibility or its reputation for independence.

With no end in sight to the $85 billion of monthly Federal Reserve money printing and bond purchases, the dollar dropped against most other currencies in the quarter, falling 3.89 percent against the euro and dropping 6.00 percent against the pound. The dollar even fell 0.92 percent against the moribund yen, whose government has been explicitly attempting to engineer a currency decline. As inflationary fears began to resurface, the price of gold rebounded, climbing 8.39 percent in the quarter. Oil prices also strengthened, increasing 5.98 percent, although intensifying Middle Eastern tensions, particularly in Egypt and Syria, have also played a supporting role in oil's rise.

Within equities, growth stocks generally outperformed value stocks, with Lipper reporting that growth funds within its U.S. Diversified Equities fund group showed a quarterly increase of 10.64 percent, significantly outperforming value funds, which returned 6.07 percent. Lipper's U.S. diversified small cap growth funds returned 12.74 percent while its small cap value funds returned 8.10 percent. Price increases in the more speculative, higher-multiple tech names have certainly been a factor in the recent outperformance of growth stocks, with Lipper reporting that within its universe of sector funds, those investing in the "Healthcare & Biotech" and "Global Technology" stock sectors performed the best during the quarter, delivering quarterly returns of 13.53 percent and 12.85 percent, respectively.

We suspect the Fed's unprecedented monetary injections are now once again pumping up the valuations of highly speculative securities and starting to form asset bubbles. Today's Fed actions are reminiscent of the 1998-1999 period, when the Fed eased monetary policy significantly following the implosion of highly levered investment firm Long-Term Capital Management, with prices of many speculative technology stocks again surging.

Consider just a few of today's many popular technology stocks from a group recently featured in Fred Hickey's newsletter, *The High Tech Strategist*: Amazon, LinkedIn, Netflix, Yelp, and Tesla. Together, the market capitalization of these five companies aggregates to a non-inconsequential $240 billion. Extraordinarily, these five stocks climbed an average of 53 percent in the third quarter and are now up, on-average, a whopping 219 percent year-to-date through quarter-end. Remarkably, Tesla and Yelp have yet to show profitability on a trailing-year basis. Netflix trades today at approximately 270 times trailing earnings of $1.21/share, while Amazon trades at 1,270 times trailing earnings of $0.29 per share and LinkedIn trades at 708 times trailing earnings of $0.34 per share. The group of five, on average, trade at a highly speculative 90 times current analyst estimates for 2014 earnings (estimates which are themselves also highly speculative) and at an average of 24 times book value. We find it incredible that investors have returned en masse to speculative tech stocks despite memories of the bloodbath that was taken when the tech bubble burst in 2000. Stocks trading at such high valuation levels generally require extraordinarily unusual levels of profitable growth to deliver long-term investment satisfaction. We believe it is far more likely these kinds of investments will, on average, lead to eventual disappointment and permanent capital loss. Suffice it to say that we intend to avoid mega-high multiple technology stocks, despite the possibility we may risk suffering a near-term performance shortfall vis-à-vis the growth stock indices, as we did in the late 1990s, should this highly speculative market behavior intensify.

When looking at stocks more broadly, even outside the technology sector it is clear that prices have been increasing this year at a pace significantly faster than earnings or book value, pushing market valuation multiples higher. For example, the effect of the recent market strength on price-to-book multiples can be seen in **Figure 1**, which shows that the S&P 500 Index of large-cap stocks traded at 2.47 times book value at quarter-end, materially above the 2.11 times book indicated at the start of 2013. At quarter-end, the Russell 2000 Index of small-caps traded at 2.29 times book value, up from 1.72 times book at the beginning of 2013. While the Aegis Value Fund portfolio has also increased this year, to 0.88 times book value at quarter-end after starting the year at 0.75 times book, it is important to note that on account of capital recycling, price-to-book valuations at the Aegis Value Fund have continued to remain at a significant discount to the broader market despite the Fund's strong performance this year.

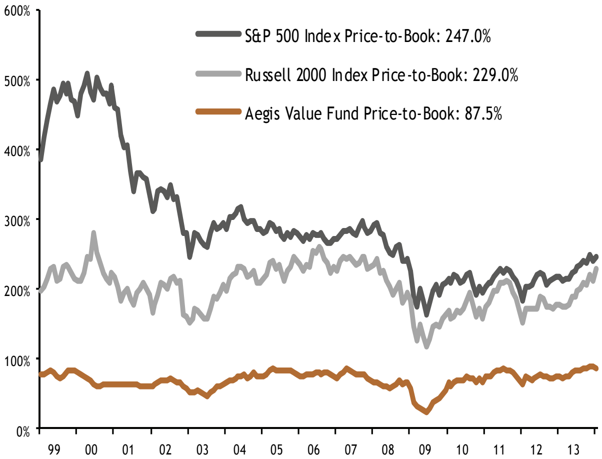
In periods when the investing public may be getting lulled into increased complacency by liquidity fueled market gains, it is very important to maintain objectivity when observing and analyzing the investment environment. On the positive side, car sales have been continuing along at very robust levels. Additionally, U.S. manufacturing overall appears to be showing persistent and even strengthening growth. Housing starts have shown a recovery and non-farm payroll reports continue to show more people are finding work. Production of oil and natural gas in the U.S. has continued to grow nicely. Consequently, chemical companies and other energy intensive manufacturers are now taking advantage of low domestic natural gas prices to drive down production costs and improve competitiveness.

However, despite these economic positives, there are several fault lines in the economy today that are of concern. Chief among our macro-oriented worries is that the Federal Reserve is pursuing its monetary easing policy much too far, easing itself into a deep quantitative hole from which it may prove difficult to exit. The transition period from a Bernanke Chairmanship to a new Fed Chairman in March 2014 will likely delay any change to current monetary policy, as evidenced by the September meeting delay. Fed Chairman nominee Janet Yellen is reportedly a dove on inflation, and is thought to be strongly in favor of continuing the Fed's quantitative easing operations until the Fed meets its "dual mandate," reducing unemployment and keeping inflation low.

Unfortunately, the current implementation of this "dual mandate" approach to monetary intervention is predicated upon the dubious idea that the Federal Reserve can reduce unemployment by merely printing more money. It is clear that a lack of liquidity in the economy can certainly lead to financial stress, elevated debt defaults, corporate reorganizations, and a resulting loss of jobs as companies tighten their belts. However, it is far from certain that supplying additional liquidity today will effectively reduce unemployment. Corporate high yield default rates are already near all-time lows dating back to the birth of the asset class in the mid-1980s so it is unlikely that any additional liquidity would further alleviate systemic financial stress. Despite over $3 trillion of additional monetary injections into the financial system over the last five years, the unemployment rate remains mired at the stubbornly high level of 7.2 percent. The U6 unemployment figure, which includes marginally employed and part-time workers unable to find full-time work, remains stubbornly high at a worrisome level of 13.6 percent. Labor force participation, at just 63.2 percent, is at a 35-year low.

Figure 1:

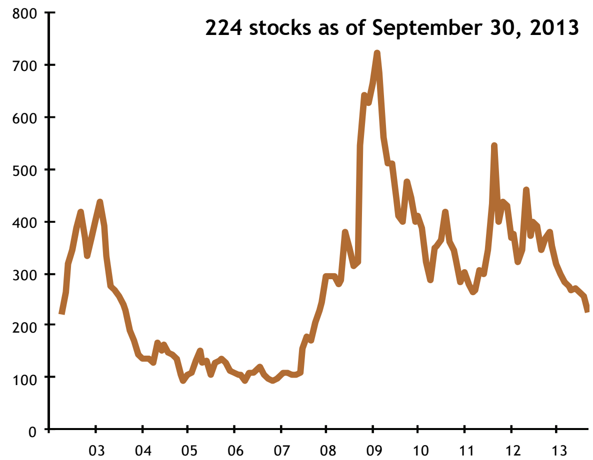
Aegis Value Fund, S&P 500 Index, and Russell 2000 Index Historical Price-to-Book Ratio



Source: Aegis Financial Corp and Bloomberg

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

We believe that Fed leadership, in pursuing a policy of liquidity injections targeting a reduction in unemployment, is either mistakenly or willfully ignoring the fact that significant factors external to monetary policy have been clearly impacting unemployment. In the last 12 years, the number of food stamp recipients has nearly tripled to 47.7 million Americans, with more than 15 million added since 2008. Additionally, 11 million Americans are now on disability, a growth of two million in the last six years. Given that generous unemployment and other benefits typically erode as work is obtained, and that taxes on income from work have been on the rise, the financial disincentives to work have risen considerably. One recent policy institute study estimated that in 12 states today, gross working wages of at least $30,000 per annum are required to be financially better off than receiving welfare. In the District of Columbia, across the river from our offices, welfare benefits are so lucrative that $50,820 in pre-tax wages are required to be better off engaged in work than on the dole. Additionally, regulatory burdens on small businesses have also been on the rise, with many small firms holding back from growing employment as a result. The tax and regulatory environment was recently cited by the National Federation of Small Business survey as the "biggest impediment" to small business.

The Federal Reserve's interest rate suppression and quantitative easing policy may now actually be creating additional economic instabilities. While savers are penalized by money market interest rates subverted to levels beneath the rate of inflation, borrowers are obtaining the benefit of cheap capital loans. Resultantly, asset prices worldwide have been on the rise as buyers have taken advantage of low interest rate loans to bid asset prices higher. This Fed policy has been the likely culprit in the creation of the widest wealth disparity gap between rich and poor since 1928. In contrast to real household income, which has dropped 8.3 percent since 2007, the prices of houses nationwide over the last year has been on a Fed powered upswing, resulting in a rapid drop in home affordability. The National Association of Realtors Home Price Affordability Index indicated that in January, the median household earned 207.9 percent of the amount required to qualify for a conventional mortgage on a median priced home. By August 2013, the Affordability Index had fallen significantly to 156.1 percent. These trends do not bode well for the economy or future social harmony.

Perhaps worse than the distorting asset price impacts, the Fed policy of interest rate suppression and money printing has been incentivizing the accumulation of destabilizing levels of debt. Courtesy of the Federal Reserve, the Federal Government debt level has recently crossed through $17 trillion as deficit spending in recent years has been easily financed with low interest rate borrowings, enabling postponement of politically difficult budget choices. While consumer loans declined for a short period during the 2008 and 2009 recession, these loans have now increased 22 percent in the last three years, driven by a whopping 61 percent expansion in the amount of student loans outstanding. Total household debt, which includes mortgage debt, is now back to near 2007 highs. High yield corporate bond issuance in 2012 was $347 billion, the highest amount on record. Margin debt in September just hit an all-time high of $401 billion, up 4.8 percent in just one month, surpassing the previous highs of 2007.

We believe that the longer the Fed maintains its policy of rapid monetary expansion at zero interest rates, the greater the threat of an eventual strong and economically damaging inflationary response. We also believe the longer the Fed postpones the normalization of its balance sheet and the raising of interest rates, the higher the pain the increasingly leveraged economy will face when the Fed does decide to act. In an April 18th presentation, the International Monetary Fund (IMF) suggested that the Federal Reserve itself could suffer losses of a staggering $500 billion, or three percent of Gross Domestic Product (GDP), as it "normalized" interest rates. Incredibly, this loss level was described as the "most likely scenario" with the IMF indicating that losses could even be somewhat worse should the Fed need to react more aggressively to rein in inflation. In its October 2013 Global Financial Stability Report, the IMF also warned that global bond investors worldwide could lose $2.3 trillion if interest rates rose by merely one percentage point. To put this level of loss into context, *Grants Interest Rate Observer* recently noted that total worldwide banking losses from 2007-2009 were only $2.1 trillion. It is also worth considering that Volcker had to push rates higher by over 10 percentage points to quell inflationary pressures 30 years ago.

The timing of the onset of any future crisis is never easy to predict. Markets can provide year-after-year of solid looking returns in a relatively calm, dormant environment, before the fault line experiences a sudden and often violent shift. Currently, both monetary velocity and the money multiplier remain at subdued levels. Reported inflation is also low. However, with the recent addition of more than $3 trillion of high-powered monetary reserves into the financial system, and with $85 billion of additional reserves added monthly under quantitative easing, any expansion of the money multiplier could lead to emotionally driven increases in monetary velocity and significantly higher levels of inflation as investors move to limit holdings of depreciating currency. It is worth noting that broader definitions of money, such as M2 and MZM, are now showing increasing annualized growth rates.

Given increasing market valuations, it should come as no surprise that the number of investment candidates on our watchlist has been in decline. As can be seen in **Figure 2**, the third quarter saw a significant decline in watchlist candidates, from 270 at the end of June to 224 at the end of September. There is now significantly more competition for the investment opportunities that do exist and our job is clearly becoming more challenging. Fund cash holdings, which are typically the residual of our bottom-up focused investment process, have crept a bit higher over the last several months, and at quarter-end, cash and equivalents represented 13 percent of Fund assets.

Cash holdings may position Fund investors well in a scenario where the Fed begins to take the difficult steps necessary to rein in liquidity and raise interest rates to avoid the onset of inflation, a scenario which may well result in serious market tremors. However, we remain concerned that cash may not be as effective at preserving purchasing power in the future, particularly in some admittedly low-probability inflationary scenarios where the continuation of quantitative easing gives rise to a rapid acceleration of inflation, a melt-up of nominal stock prices, and a dollar devaluation.

At the end of the day, we certainly prefer to be invested in well-researched, deeply undervalued equities rather than cash. Equity ownership in general has historically helped insulate investors from loss in the long-term as the dollar's purchasing power has declined. Undervalued equities have held the added bonus of being capable of appreciation under many different market scenarios for company-specific reasons. To date, our experienced team has been able to find a sufficient number of investment candidates offering what we believe are attractive risk/reward characteristics. However, should the market become overpriced in the future, rendering it difficult to replace stocks that have appreciated with a sufficient number of new undervalued special situation equities, Fund cash levels are likely to climb, and Fund returns could lag the market as a result.

Given our concerns about inflation and our asset-oriented research focus, the Fund currently maintains a fairly strong concentration on hard asset enterprises, with energy exploration & production, oil service, and metals & mining equities comprising 12.5 percent, 6.5 percent, and 9.6 percent of Fund assets, respectively, at quarter-end. The Fund's holdings of **Magnum Hunter Resources (MHR - $7.75)** and **Stone Energy (SGY - $35.78)** drove particularly strong Fund gains in the third quarter.

Magnum Hunter, a $1.3 billion market cap company active in energy exploration and production, is best known as an early mover in leading shale and resource plays, having secured mineral-right footholds in the Eagle Ford, Williston Basin and Marcellus. Over the last few months, Magnum Hunter's share price has increased significantly from the $4 range earlier this summer as the market began to realize that the company had acquired mineral leases on prime acreage in the Utica at the attractive cost of $2,000 per acre. Investors have grown excited about the Utica after PDC Energy and Antero recently reported mammoth new well production results on acreage contiguous to Magnum. These results have indicated to the market the possibility that wells on Magnum's Utica acreage might produce as much as 20+ million cubic feet per day of gas and 2-3,000 barrels per day of liquids. With the recent Gulfport Energy/Windsor Ohio deal for Utica acreage now valuing Utica acreage as high as $10,000 per acre, we believe that Magnum's Utica acreage alone could now be worth as much as $5 per share. Adding in our estimated value of proved reserves (at $3.35/share), other non-developed acreage mainly in the Williston, and Marcellus (at $4.25/share), and Magnum's midstream operations scheduled for an IPO in 2014 ($2.60/share also including a small Magnum drilling business) sums to a value of $11.25 per common share after backing out about $3.95 a share of net debt and preferreds (net of cash and warrant exercise proceeds). Magnum Hunter's strong run over the last few months made it the biggest quarterly gainer for the Fund, delivering a benefit of approximately 1.3 percent to the Fund's bottom line.

The strongest detractor from Fund performance in the quarter was **Tecumseh Products (TECUA/TECUB - $8.40/ $8.02)**, which gave back a portion of its gains after a strong performance in the first half of 2013. Shares declined as the company was impacted by several events that we consider minor and transitory, including a one-time warranty charge of $3.3 million for a motor windings crimping failure on a line in India which obscured what was otherwise a very good quarter for the company. Ongoing softness in Europe and a weak US summer air conditioning market driven by an unseasonably cool summer also resulted in a lowering of sales growth guidance. Additionally, the company was unable to close on the sale of its Brazilian foundry at desired pricing despite the plant operating at full capacity. We believe Tecumseh shares remain undervalued and have added to our position during the third quarter.

The Fund's biggest sale in the quarter was the complete elimination of our remaining position in **American Pacific (APFC - $51.13)**. We exited the long-term holding on valuation concerns after the stock appreciated significantly in price in recent quarters.

In addition to the sale of American Pacific, we meaningfully reduced our investment in **American Safety Insurance (ASI)** as the stock rose following Fairfax Financial's (FFH) revised $30.25 per share acquisition bid. We tendered the balance of our position on October 2nd when the deal officially closed. The Fund has been in the process of redeploying proceeds from the sale into **EGI Financial Holdings (EFH CN – Can $14.30**) and **Tower Group International (TWGP - $3.82)**. EGI is a Canadian-based property and casualty insurance company with an expertise in the non-standard Canadian auto insurance market. In recent years, EGI expanded its business beyond its traditional Canadian markets, offering specialty programs including commercial property, professional liability, and warranty insurance. Financial returns from this expansion have been very poor. The company has also joined a few international syndicates offering specialized insurance with somewhat better results. As a consequence of EGI's floundering expansionary efforts, the stock had languished, allowing our Fund to pick up shares at close to 70 percent of tangible book value. At the urging of several of its shareholders, the company in August announced the sale of its nascent, loss generating U.S. property business at a minor discount to book value and the scaling back of its nearly decade-long expansion into Canadian specialty lines. We believe the sale and wind-down of the company's troubled units is likely to spotlight the strongly performing core Canadian specialty auto business and lead to a better valuation.

The Fund's largest purchase during the quarter was property and casualty insurer Tower Group International. At quarter-end, the stock was undergoing unusually heavy selling pressure amid investor panic as the company announced that it had been under-reserving for expected insurance losses. With an unrelenting stream of bad news, including the departure of the head of underwriting, insurance ratings downgrades, massive reserve strengthening and the forced sale of much of the CEO's equity holdings in a margin call, sentiment on the company has turned extraordinarily negative. Our Fund holdings of Tower are today in a loss position, although the downward pressure on the shares appears to have subsided. Nevertheless, with the company now downgraded by A.M. Best and its reserves now thoroughly scrubbed by third-party actuaries, we believe the metaphorical shoe has dropped, leaving a stock trading today at only 50 percent of a third-party scrubbed book value. We are hopeful for a recovery over time as the company is sold or retrenches back to its core roots providing specialty commercial insurance to small businesses in the northeast that are not ratings sensitive.

Given the modest size of the Fund and the experience of the investment team, we continue to believe that we will be able to successfully find a sufficient number of worthy, undervalued special situation stocks to provide shareholders with a competitive return, despite an overall market that does not appear undervalued. In doing so, we intend to remain methodical, selective and disciplined about our investments. Should the number of investment candidates with desirable risk/reward characteristics become insufficient, we will consider holding cash and equivalents. Although we may then face an increased drag on returns on account of holding elevated levels of cash, particularly if the equity markets continue to surge, we believe this option is likely to prove far superior to holding overvalued equities over the long-run. As of September 30, 2013, Aegis employees own in excess of $20 million of Fund shares. We remain keenly 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
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: Magnum Hunter Resources, Stone Energy Corp., Tecumseh Products Co. (A&B), American Pacific Corporation, American Safety Insurance Ltd., EGI Financial Holdings Inc., and Tower Group International. As of September 30, 2013, these stocks represent 2.8%, 2.1%, 2.7%, 1.2%, 0.0%, 2.1%, 2.3%, 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 Amazon, LinkedIn, Netflix, Yelp, Tesla, PDC Energy, Antero, and Fairfax Financial Holdings 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. **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. **M2**: is a broader classification of money than M1. Economists use M2 when looking to quantify the amount of money in circulation and trying to explain different economic monetary conditions. **MZM (Money Zero Maturity):** it represents money readily available within the economy for spending and consumption. This measurement derives its name from its mixture of all the liquid and zero maturity money found within the three "M's." **Lipper US Diversified Equity Average:** An unmanaged index considered representative of funds tracked by Lipper.

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

Fund Distributor: Quasar Distributors, LLC.