AEGIS Value Fund

Portfolio Manager's Letter
Quarter Ended December 31, 2013

January 21, 2014

Dear Aegis Investor:

The Aegis Value Fund delivered a 3.99 percent return in the fourth quarter of 2013, bringing the Fund's 2013 annual return to 35.24 percent. The Fund's fourth quarter return trailed its primary small-cap value benchmark, the Russell 2000 Value Index, which surged 9.30 percent, bringing its 2013 return to 34.52 percent. The Fund's limited investments within the strongly performing financial services sector, and the particularly poor performance of our investment in shares of insurance holding Tower Group were the primary factors in the Fund's fourth quarter shortfall relative to the benchmark return. 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 December 31, 2013

			Annualized				
	Three Month	**Year-to-Date**	**One Year**	**Three Year**	**Five Year**	**Ten Year**	**Since Inception***
Aegis Value Fund	3.99%	35.24%	35.24%	17.86%	32.13%	9.58%	12.27%
Russell 2000 Value Index	9.30%	34.52%	34.52%	14.49%	17.64%	8.61%	8.45%

** 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 1.43%.

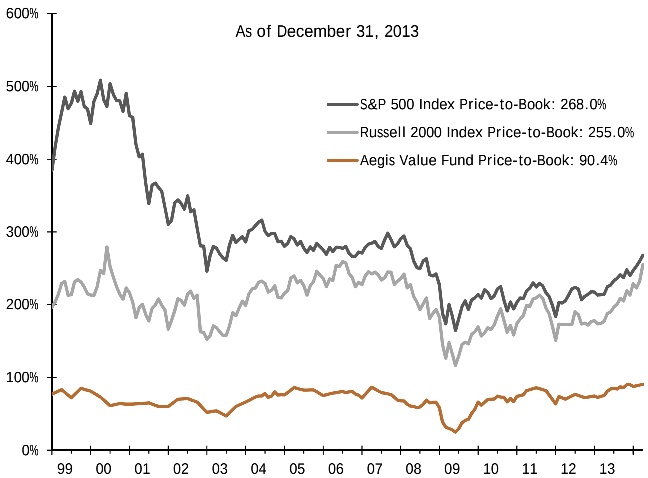
In the fourth quarter, the market's broad-based, large-cap S&P 500 Index was up 10.51 percent to close 2013 with a gain of 32.39 percent. The year marked the S&P 500's best annual return in the last 15 years as investors managed to suppress fears of a negative market reaction as the Federal Reserve began its long-messaged shift towards "tapering" of its heavy-duty monetary injections, which it finally announced in mid-December. Investors also shrugged off the latest ill-fated political attempt late in the year to reduce the mushrooming size and scope of the federal government, which resulted in a cantankerous budget battle and led to a 16-day government shutdown. Ultimately, the advocates of government restraint failed, up to 800,000 federal employees received paid time-off, and hard won federal government spending cuts mandated by the "sequester" were partially reversed in a widely hailed "bipartisan compromise" that avoids difficult spending reduction decisions and all but assures worsening federal budget deficits.

While the Fed's colossal quantitative easing program enables national politicians to continue to engage in imprudent deficit spending while avoiding near-term consequences, it also lulls investors into complacency as asset prices are propelled higher. In just 2013 alone, the aggregate market capitalization of the S&P 500 has climbed by an astounding $3.7 trillion. Boosted by strong equity and real-estate related gains, overall household net worth increased 2.6 percent to $77.3 trillion in the third quarter of 2013, according to the Federal Reserve. In the five years since the Fed initiated its first quantitative easing program in 2008, household net worth has now climbed a significant 34.8 percent.

As fixed income investors began to fret in 2013 over the potentially impending "tapering" of the Fed's massive bond purchasing program, benchmark 10-year Treasury prices dropped, with yields notably increasing from 1.78 percent at the end of 2012 to 3.04 percent by the end of 2013. Bondholders, long accustomed to stable, reliable fixed-income returns bolstered by the tailwind of declining rates, were shocked to contend with the headwind of rising rates for the first time in years. The Barclays U.S. Aggregate Bond Index, a fairly standard intermediate high-grade bond benchmark, dropped 2.02 percent in 2013, registering its first loss since 1999.

Figure 1:

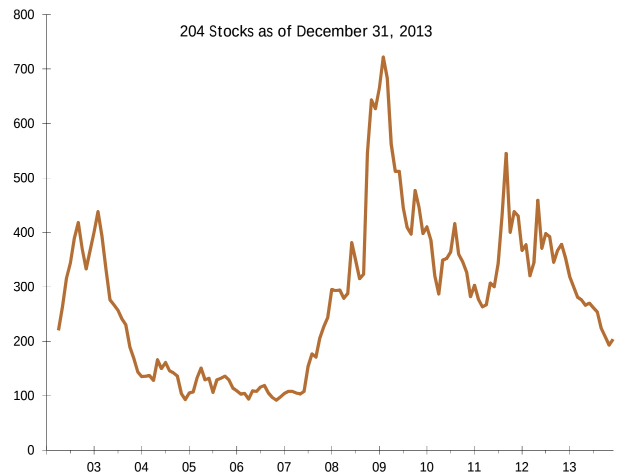
Aegis Value Fund, S&P 500 Index, and Russell 2000 Index Historical Price-to-Book Ratio



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

With the S&P 500 Index outperforming government bonds in 2013 by the widest margin since at least 1978, many investors have been reacting to bond losses by selling bonds and rotating into equities. In the fourth quarter alone, approximately $11.6 billion was pulled from intermediate investment grade bond funds, earning the asset class Lipper's distinction as the fund category with the largest quarterly fund redemptions. Bloomberg's estimated 2013 overall bond redemptions came in at $67 billion. Equities appeared to be the year's destination of choice, with Lipper calculating that equity mutual funds took in approximately $183.7 billion with equity Exchange Traded Funds (ETFs) experiencing estimated inflows of another $138.4 billion in 2013. Investor risk appetite has clearly grown from the previous four years, during which approximately $260 billion was withdrawn from stocks and more than $1 trillion was added to bonds, according to Bloomberg. Vanguard recently determined that investors now have a 57 percent allocation to equities, a level surpassed only twice in recent years: once in the late 1990s telecom/media/technology bubble, and again in the midst of the housing bubble just prior to the 2007-2009 financial crisis.

The rally, which has now lasted five years, has propelled the S&P 500 up more than 170 percent from its bear market low. Given the intensity of the market's recent rise, valuations are beginning to appear stretched, with the S&P 500 now at a ratio of 18.6 times trailing-year earnings, higher than the prevailing ratio during 24 of the 35 market tops since 1900, according to Wall Street Journal Columnist Mark Hulbert. On a book value basis, Hulbert calculates the S&P 500 is at a multiple of 2.7 times book, the highest level since late 2007, and higher than all but five of the 28 bull-market tops since the mid-1920's. Hulbert's data suggest the market is today also expensive on both a price-to-sales basis and a Shiller, price-to-cyclically normalized earnings basis.

With market valuations at lofty levels, it can be particularly challenging to find good investments. Yet, while holding higher levels of cash may have been an effective approach to successfully navigating an elevated market in the past, complicating today's investment landscape is the relatively new concern that cash as an asset class may prove to be ineffective at preserving real net worth in certain potential future scenarios of accelerating inflation. While the likelihood of inflationary tail-risk remains low in the short-term, the danger over the longer-term has increased significantly, particularly given the high and climbing levels of developed country central government indebtedness and the money-printing actions by multiple central banks.

As can be seen in **Figure 1**, the valuation level of the Aegis Value Fund has not been totally immune to the recent run-up in equity prices. However, as a result of our diligent efforts to recycle capital out of securities where prices have risen to lofty valuations and into cheaper stocks, the Fund's overall increase in valuation has been modest, trailing the increase in the S&P 500 Index. Consequently, our Fund, at approximately 0.90 times book, is now trading at a larger discount to the S&P 500 on a price-to-book multiple basis – a reflection of our assertion that the portfolio is comprised of stocks trading at levels among the cheapest available in today's lofty market.

As can be seen in **Figure 2**, the number of stocks on our watchlist, which we define as domestic companies trading under book value with a market capitalization above $70 million, closed the year at 204, down from 224 at the end of the last quarter. We continue to work diligently to comb through the watchlist, researching and monitoring a variety of potential discount to book investment opportunities in an effort to exploit what is, at least today, a shrinking universe of deep-value opportunities. Should we be unable to identify an adequate number of sufficiently diversified candidates for prudent investment, we will likely hold higher levels of cash, despite our longer-term concerns over the potential for accelerating future inflation. Fortunately, to date we have been able to find enough opportunities offering what we believe to be solid risk/return characteristics to merit investment of the vast majority of our capital, and cash holdings represented approximately 4.1 percent of fund assets at year-end, down from the previous quarter.

Many financial services companies such as banks, securities brokers, and insurance companies are on our watchlist, with banks alone making up about a quarter of our list. Financial services companies have been a meaningful portion of the overall market, and at year-end weighed-in at a heavy 39.1 percent of our benchmark, the Russell 2000 Value. Financials were strong fourth quarter performers, up an average of 9.38 percent as investors became optimistic that bank net interest margins would increase on the back of the Federal Reserve's first move towards what the market expects will be an eventual normalization of interest rates. The KBW Bank Index, consisting of 24 national money-center banks and leading regional institutions, actually closed 2013 up 35.06 percent for the year, its best showing in 16 years.

Over the last several years, the Fund's holdings in the financial services segment have primarily been insurance companies, most of which were purchased at significant discounts to tangible book value. With insurance company valuations on the rise, we have more recently been paring down our insurance holdings. Many of these investments have worked out well for our Fund. For example, the acquisition by Fairfax Financial of portfolio company **American Safety Insurance (ASI)** earlier in the year netted our Fund its third biggest gain of 2013. Given the sales of our insurance holdings over the last year, the Fund's exposure to financial services at quarter-end had declined to approximately 10.9 percent. We believe our lack of investment in the strongly performing financial sector was one of the primary reasons we experienced lower fourth quarter returns.

While we have generally preferred investments in discount-to-book insurance companies over banks, **Tower Group International (TWGP - $2.61)**, a property & casualty insurance company, was unfortunately the Fund's biggest loser in the fourth quarter, detracting 1.30 percent from Fund returns. We initially invested in Tower Group during the third quarter following a significant decline amid horrible investor sentiment and an unrelenting stream of bad news, including the announcement that the company had been under-reserving for insurance losses, 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. When we last wrote, the company had just announced a $365 million charge that reset tangible book value to $7.50. We believed the stock, at roughly $4/share, was trading at well under tangible book value of $7.50. Furthermore, given the books had been scrubbed by third party actuaries, we believed the damage was done, and that a significant recovery was possible over time as the company was either sold or retrenched back to its core roots providing specialty commercial insurance to non-ratings-sensitive small businesses in the northeast. Unfortunately, Tower announced another surprising incremental reserve charge of $75-105 million in December, which dropped tangible book value to the $5.50-$6.00 range. We elected to exit the stock, given that tangible book value net of deferred acquisition costs, a soft asset representing capitalized brokerage commissions, had declined to approximately $2.50 per share. We achieved an average exit price of approximately $2.90. On January 6th, Tower issued a press release announcing that the company had agreed to be acquired for $3.00 per share in cash by a reinsurance entity funded by the Karfunkel family, the founders of Amtrust Financial Services (AFSI).

Despite these kinds of insurance reserve issues that can surface from time-to-time, we have preferred investing in insurance companies rather than banks. Many banks today remain highly levered, despite the financial crisis. This high leverage is a direct result of heavy government involvement in banking, including FDIC account deposit insurance, Fed discount window emergency borrowing availability, political lending mandates, regulation, and government competition for loan business in the form of Fannie Mae, Freddie Mac and other federal agencies. These government interventions work together to suppress loan rates and boost banking costs, requiring banks to keep leverage high in order to sustain profitability. Today, banking institutions, with assets consisting of mortgages and other loans with government suppressed yields, are levered-up at ten-to-fifteen times equity. Even after the significant write-downs and reserve strengthening actions of recent years, we believe the industry remains vulnerable to heavy equity write-downs and losses under a variety of lower probability tail-oriented scenarios. The example of Bear Stearns in 2008 made it clear that high leverage levels can be destabilizing, causing even small write-downs relative to total assets to rapidly erode book value, leaving shares purchased, even at a significant discount to book, heavily exposed to loss. Bank assets also tend to be described in a non-granular way, often leaving investors guessing about the composition of a loan book based on its disclosed aggregate characteristics, which are often weighted-average related. We believe opaque derivative contracts and other counterparty risks are often not adequately described in the regulatory filings or quantifiable with sufficient precision to invest in bank equities with confidence.

Furthermore, with developed country central government debt having expanded profoundly in the wake of the recent financial crisis and today approaching a 200-year high in relation to gross domestic product, we are concerned the government may be slowly transforming banks into highly regulated, low returning utilities, charged primarily with implementing government policies imposed with the objective of opaquely taxing savers and enabling the servicing of government debt. We worry that these policies may eventually grow to include mandated lending to the government, explicit or implicit interest-rate caps, cross-border capital restrictions, and other rules aimed at restricting the returns, choices and opportunities of savers. Professors Reinhart and Rogoff, two of the world's foremost experts on historical financial crises, have delineated many historical examples of such moves, which they have labeled "financial repression." Reinhart and Rogoff recently claimed in an International Monetary Fund (IMF) whitepaper that the advent of these kinds of policies may now be more likely as developed nations struggle with their high debt burdens. We believe earning a solid investment return on bank investments may prove especially challenging in such an environment.

The Fund's recent investment in shares of **McDermott International, Inc. (MDR - $9.12)** provided its biggest gains in the fourth quarter, adding 0.65 percent to the quarter's returns. The offshore energy construction firm, with $2 billion in enterprise value, designs and builds offshore platforms and subsea oil transportation pipelines and other energy-related infrastructure. We initiated a position in McDermott in August at levels just under book value, after the company reported a surprising $150 million second quarter loss – the result of charges on the restructuring of McDermott's US operations, as well as impairments on contract overruns on a few of McDermott's larger projects. One particularly troublesome impairment of a deepwater subsea installation contract in Malaysia left the street highly concerned that McDermott's strategy of deepwater expansion, towards which the company was in the process of making $500-600 million of additional vessel newbuild capital commitments, was lacking proper engineering and management oversight. After conducting our own assessment, we concluded that McDermott's current issues with its growth into the deepwater contracting space are likely to prove temporary, the newly hired CEO has the experience necessary to help situate the company for success in the deepwater construction market, and the company is well positioned for a cyclical upswing. As current low margin contracts are completed and stop impacting results, we believe margins will improve to the extent that the company will be able to generate annual EBITDA of $500 to $750 million within the next couple of years. We would note that McDermott's recently departed CEO may have apparently felt likewise, as he purchased $500,000 of stock in early August at roughly the same time the Fund was purchasing shares. At quarter-end, McDermott was 3.4 percent of Fund assets.

In the quarter, one area in which we have been hard at work building investment positions has been the precious metals and mining industry. It is challenging to find a segment of the market more despised by investors. While the S&P 500 was up 32.4 percent, gold was down 28.3 percent, underperforming stocks by over 60 percentage points. Given gold's underperformance, it is no wonder that 2013 has witnessed a massive $40 billion of estimated outflows from gold exchange traded products. The bellwether SPDR Gold Shares ETF alone suffered $25 billion in investor redemptions in 2013, equal to nearly 40.6 percent of its gold holdings at the start of the year. Gold has now fallen approximately 35 percent from its $1900 peak achieved in the second half of 2011. The highly followed Philadelphia Gold and Silver Index (XAU), made up of the largest miners, lost 59 percent, its worst annual return since the beginning of the index in 1984. Junior minors did even worse, with the Market Vectors Junior Gold Miners Total Return Index losing 60.9 percent in 2013, the worst annual showing in its 10-year lifespan. Mining sector funds have also been experiencing significant investor redemptions, resulting in forced selling of mining shares by sector fund managers. We also believe the space was particularly impacted by year-end, tax-loss selling.

The extraordinarily negative sentiment has given long-term, contrarian minded investors a fairly unusual opportunity to buy mining shares inexpensively. At year-end, the mining industry's multiple of price-to-book value was at a more than 20-year low, despite more than $60 billion of mining industry write-offs in the last several years. Today our positions in **Coeur Mining (CDE)**, **Nevsun (NSU)**, **Aurico Gold (AUQ)**, **Amerigo (ARG-TO**), **Dalradian (DNA.TO)**, **Lake Shore Gold (LSG**), **Sulliden (SUE.TO)**, and **Guyana Goldfields (GUY.TO)** represent 9.4 percent of Fund assets. We believe these holdings, on the whole, position us with reasonable cash flow to survive today's

AEGIS FUNDS

commodity pricing environment, and provide us with strong return upside should commodity prices strengthen. Despite the taper talk, we must remember that $75 billion of additional base money is still being created monthly under the Fed's quantitative easing programs. Furthermore, with so much base money now already in the system from previous quantitative easing programs, we believe scenarios where precious metals and other commodities trend higher amid a deflating dollar are now more probable. Given the very high government debt levels as a percentage of Gross Domestic Product (GDP) in today's economy, and the tremendous federal budget impact incurred if interest rates did rise, we find it difficult to imagine the Fed having the appetite to raise interest rates too high, even in an environment where the economy begins to experience building inflationary pressures. As long as short-term rates stay low, government and private incentives to borrow become more pronounced, furthering the potential for a currency event at some point in the future. Should that happen, we believe equity stakes in commodities and miners could perform quite nicely.

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 own in excess of $20 million in Fund shares, and we continue to 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 eleven issues held by the Fund: American Safety Insurance Ltd., Tower Group International, McDermott International, Inc., Coeur Mining, Nevsun, Aurico Gold, Amerigo Resources, Dalradian, Lake Shore Gold, Sulliden, and Guyana Goldfields. As of December 31, 2013, these stocks represent 0.0%, 0.0%, 3.4%, 3.0%, 2.2%, 1.3%, 1.1%, 0.7%, 0.5%, 0.5% and 0.1% 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 Amtrust Financial Services, Fannie Mae, Freddie Mac, 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. **Price to Sales:** A ratio to compare a stock's market value to its earnings per share. **Price to Cyclically Normalized Earnings:** A ratio to compare a stock's market value to its 10 year trailing earnings per share. **Enterprise Value:** A measure of a company's value, calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents. **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. **KBW Bank Index:** consisting of the stocks of 24 banking companies. This index serves as a benchmark of the banking sector. **Philadelphia Gold and Silver Index** : an index of sixteen precious metal mining companies that is traded on the Philadelphia Stock Exchange. **Barclays Capital U.S. Aggregate Bond Index**: An unmanaged index considered representative of the U.S. investment-grade, fixed rate bond market. **Market Vectors Junior Gold Miners Total Return Index:** Market Capitalization weighted total return index that cover the largest and most liquid small-cap companies that derive 50%+ of revenue from Gold or Silver mining.

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

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

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