CHOU ASSOCIATES FUND

(unaudited)

March 20, 1998

Dear Unitholders of the Fund:

After the dividend distribution of $10.22, the net asset value per unit of Chou Associates Fund at December 31, 1997 was $45.76. The Fund was up 40.3% for the year.

The return achieved for 1997 was the best ever by the Fund since it went public in 1986. However, the gain must be put in perspective: it was generated against the backdrop of a roaring bull market, and I readily admit that it is easy to look good when you have such a strong tailwind.

It is no secret that I have been nervous about the stock market for the last few years, yet despite the fact that the portfolio was structured defensively to reflect my sentiments, the Fund has done reasonably well since 1994. For the 3 years ending December 31, 1997, the annual compound return was 31.1%. Having said that, I would add that at today's level, if I had my druthers, I would be totally in cash.

Without question, the investment climate has changed:

If viewed from a perspective of just 13 years ago (1985), or for that matter the midpoint of any decade dating back to 1935, we would have been flabbergasted at the prices paid for an 'average' company. Currently, with the Dow Jones Industrials over 8,900, and its P/E ratio over 25 (versus the historical average of 14), we are looking at an earnings yield on inflated profits that is less than 4%! Now consider that in 1985 anyone paying such prices would have been regarded, and laughably so, as a GAAP (*Growth At Any Price*) investor. And had a value investor – such as yours truly – paid such a price, he would have needed a brain surgeon to search for the large 'GAAP' in his own cranium!

The only way to justify paying current prices is if

a) interest rates stay at current levels, or go down, **AND**
b) companies sustain current levels of profitability and ROE of 20% *plus*, **AND**
c) the fallout from the Asian economic crisis is kept to a minimum, **AND**
d) managements deploy capital wisely, earning 20% plus on investment, **AND**
e) Producer Price Index stays low, signaling that inflation is in check.

In short, an investor can do well only if **<u>all</u>** the pieces, without exception, fall into place.

Even then, I have my doubts. For example, how can the average company maintain an ROE of 20% *plus* when historically its ROE has hovered between 12% and 13% for over 50 years? Mathematically, it just doesn't make sense. And to take it one step further, let us consider the company whose earnings are currently growing at 20%. At that rate, its earnings will double in 4 years and grow six times in 10 years. With GNP growing between 2% and 4% annually, and revenues growing at a rate no greater than 6%, the writing's on the wall: it's inevitable that with time 'earnings will equal revenues', thus creating a business oxymoron.

Far more disconcerting is the optimism shown by ordinary investors and the methodology used to evaluate companies. I can recall a time about 15 years ago when the multiple being paid for a dollar of earnings was the accepted benchmark for identifying undervalued companies. Back then I could find busloads of good companies selling at single digit P/Es. However, as the market took off and stocks started to 'appear expensive' on the basis of P/E ratios, the term EBIT (Earnings Before Interest and Taxes) kicked in and replaced Earnings as the new buzzword.

Currently EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) is in vogue. Granted, under certain conditions and in specific industries, EBITDA can be useful as a first step for valuation, but what I find disturbing is that the term is being bandied about nonchalantly as a 'normal' basis for valuation. It is not uncommon to hear investors say that 'this stock is cheap because it is selling for only 10 times EBITDA'. I can't help but wonder - at the rate we are going, how long is it before EBE (Earnings Before Everything) becomes the norm for evaluating cheapness?

At the moment, your manager has no concrete idea of where to proceed from here. But one thing is certain: I am not willing to overpay. I am willing to forego profit that is rooted in pure market timing and market speculation.

Over the years, the Fund has made its return primarily from three areas. In order of importance, they are:

1) Buying above-average to excellent companies run by skillful managers, at a price far lower than what a knowledgeable and rational acquirer would pay. The acquirer's motivation should be governed by a desire to make a decent return on the cost of acquisition primarily through long-term ownership; it should not be driven by motives such as the need to build a bigger empire at the expense of returns.

2) Buying at deep discount to liquid book value. This type of investment does not require a lot of judgement and it is purely a mathematical exercise. As boring as this strategy may appear, it delivers good return with very low risk, and I will continue with it as long as we can find these kinds of investments. Safety in numbers is the key. I peer through my infrared binoculars and find the cheapest cigar butts, take one last puff from each and spit the spoils out of the portfolio. Sorry folks, no hard feelings, it's only investment!

3) Special situations. An example is PS Group, which is in semi-liquidation. Our cost was $9.75 per share. Over the years the company was paying out $1.50 per share in distributions annually but last year we received $4.00 per share!!

Regardless of the methodology used, the cardinal principle underlying the investments in the Fund is to pay far less than what the company is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want an adequate "**MARGIN OF SAFETY**" and this concept, while unappreciated and ignored by many at the moment, is what distinguishes investment from speculation.

What troubles me, however, is that as the market keeps rising, it is injecting a speculative element that will eventually lead to a permanent loss of capital, a risk that we cannot afford. Instead of getting carried away, perhaps a more appropriate response would be to 'Lie down until the feeling passes'.

Shifting to another topic, the Fund will report Management Expense Ratio (MER) in two ways: one that includes Goods & Services Tax (GST) as part of MER and another that excludes it. GST is a real cost to the Fund, it is not recoverable and, therefore, should be included when calculating MER, as I have done in the past. However, mutual fund accounting allows GST to be excluded when calculating

MER. I believe all the mutual funds follow this convention and, seeing it doesn't make sense to be a lone wolf, I am throwing in the towel. It will now make it easier for investors to compare apples to apples and check how Chou Associates Fund stacks up against other mutual funds on the basis of MER.

For the year 1997, the MER of the Fund was 1.86% without GST and 1.99% with GST.

Yours truly,

Francis Chou

(Manager of the Fund)

CHOU ASSOCIATES FUND
(unaudited)

April 15, 1999

Dear Unitholders of the Fund:

After the dividend distribution of $ 4.31, the net asset value per unit of Chou Associates Fund at December 31, 1998 was $52.07. The Fund was up 23.2% for the year.

The Fund had a good year in an otherwise difficult environment for value investors. While the media heralded the Dow Jones Industrials surpassing 10,000, the rise has made it virtually impossible to buy companies at a price that makes economic sense. We are now paying well in excess of $33 to purchase a dollar of after-tax earnings: that's a return of less than 3% - a percentage which I consider to be totally inadequate.

Most investors are aware that the market is trading at historically high levels and yet I am amused by how some investors have responded. Price to earnings ratio for an average investor are the highest they've ever been while dividend yields are at their lowest – in the past that combination has caused many investors to lose a shirt or two. And yet, instead of being concerned, dissuaded or cautioned by this situation, there remains a sizable contingent who continue to be mesmerized by healthy past returns and fully expect the future to be more of the same.

Think back to a few years ago. Investors wouldn't even think of investing in a company without first, and seriously, considering the answers to these kinds of questions:

1) *How favorable are the economics of the business and where does the company rank in terms of market share?*
2) *How sustainable are its earnings stream?*
3) *How skilful have management been in deploying capital?*
4) *What is the appropriate discount rate to take?*
5) *Is the capital structure too leveraged?*
6) *What would an acquirer pay for in* ***cash****?*
7) *And most important of all, what is the appropriate price to pay for such a company that would give an investor more than adequate margin of safety? Margin of safety is simply paying far less for a company than what it is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. This concept, while unappreciated and ignored by many at the moment, is what distinguishes investment from speculation.*

In today's market, that kind of thought process is considered unnecessary and regarded by some as posing a hindrance to being a successful investor. If anything, I think the process would quickly sober that investor up!

Further, the prices currently being paid for internet stocks represent the extreme form of overvaluation in this ebullient market. It is not 200 times earnings but over 200 times revenues!!! I believe, that at these prices, those betting on internet stocks to deliver high returns are asking for trouble.

I have no interest in buying internet stocks or for that matter any other stocks that I consider to be overvalued for the Fund. Giving in to speculative fever would expose the Fund to major and permanent loss of capital. In addition, it would be a dereliction of duty and a betrayal of the investment principles which have made the Fund achieve respectable rates of return over the long term. When stocks are bought without regard for valuation, I am reminded of a quote: "Those whom the gods wish to destroy, they first blind them with greed."

The 5-year, 3-year and 1-year rate of returns compounded annually for the Fund are 22.0%, 28.5% and 23.2% respectively. In the current environment, it is nearly impossible to achieve returns even approaching these numbers. We must, however, be prepared to accept low returns in the future, possibly in single digits, even if the market goes up substantially.

As for what's new, we are finding pockets of bargains in commodities, commodities-related industries, and companies that have business interests in Eastern Europe and Asia. A proviso, however: because the economics of these types of businesses are not as clear cut, they have to be compellingly cheap before we buy them. We have invested in such companies in the past and have done well with them.

Lastly, on February 8, 1999, Royal Trust took over the record keeping and custodian services of the Fund from CIBC Mellon. The reason we made the switch was that the fees at Royal Trust are 50% cheaper than CIBC Mellon.

For the year 1998, the MER of the Fund was 1.97% without GST and 2.11% with GST.

Yours truly,

Francis Chou

(Manager of the Fund)

CHOU ASSOCIATES FUND
(unaudited)

April 10, 2000

Dear Unitholders of the Fund:

After the dividend distribution of $0.98, the net asset value of Chou Associates Fund at December 31, 1999 was $46.08, down 9.6% for the year. The 3 year and 5 year annual compound return of the Fund was 16.0% and 20.2% respectively.

Factors affecting the 1999 results included 1) Misreading the political dynamics of a takeover of Surrey Metro Savings by Canada Trust and 2) The craze in technology stocks, a phenomenon which has had a negative impact on undervalued stocks, causing them to drop in price as investors pulled out their money and poured it into technology stocks.

Technology stocks

The Fund is not invested in technology stocks. Their current inflated prices make them unattractive and unsuitable to the investment philosophy of the Fund, which is:

1) To buy above-average to excellent companies run by skilful managers, at a price far lower than what a knowledgeable and rational acquirer would pay for cash; and

2) To buy at deep discount to liquid book value for companies with average prospects.

Before we purchase any stock for the Fund, we examine several criteria to determine the intrinsic value of the company we are considering. The stock price serves a useful function and its importance grows, in terms of a buy or a sell decision, as it deviates from the intrinsic value of the company. When the discount is deep enough and provides an adequate margin of safety (a cornerstone of sound investing), we can then make a decision whether to buy the stock.

I'm alarmed by the cavalier way in which people invest in technology stocks; the thought process they are using is a subversion of the investment process. The rise of a stock price for a period of time is by no means an indicator of value, nor is it an assurance that we are looking at a 'can't miss' investment. By all means take advantage of stock prices but do not get seduced by them! Paying 500 times for hot air is not an investment; it's pure speculation.

From an analytical perspective I find it hard to envision a reasonable return materializing when an investor is paying more than 100 times revenues for a business -- regardless of how attractive the future of that business might appear. An example, for instance, is Microsoft which is trading at more than 25 times revenues and 100 times earnings:

As many a sober analyst has pointed out, for Microsoft to deliver low double digit return for investors it has to increase its earnings by more than 40% annually for the next 10 years. This means it will have to earn more than $200 billion in 10 years from the current $8 billion. To put this information in better perspective consider that Coca Cola currently earns $4 billion, General Electric $11 billion and General Motors $6 billion.

Furthermore, keep in mind that already Microsoft does earn a monopoly type after-tax net margin of 38% plus compared to the average industrial company of 5%. Therefore, not surprisingly, I would have to say that buying technology stocks that are trading over 100 times revenues should not be described as an investment, as we know it, but rather, more charitably, as a 'Venture Capital type' investment.

Lastly, let's not play a fool's game by thinking that a stock can be bought at 100 times revenues and then proceed to hope, against hope, that someone who is carried away by emotion, and is unaware of the risk involved, will buy it at 200 times revenues the following week. When the urge hits to make such a leap, take a cold shower until the inclination passes.

Having laid this cautionary foundation, this does not mean that we will never invest in technology stocks. I'm confident that in the future they can be picked up at prices that are sensible and rational to an informed investor who is fully aware of the risks involved.

Now the good news....there are a number of fine companies in sectors such as property and casualty insurance, banks, home builders, unit trusts and retailers, and the like, that are selling at attractive prices. We are taking a look at these as prices are as low as I have seen them for quite some time. Many are down by as much as 70% from highs of 25 times earnings, and are trading at 50% of revenues (versus 100 times revenues!); they have decent balance sheets and above average long term prospects.

In 1999, the Fund's management expense ratio was 1.73% versus 1.97% in 1998. I chose to take a lower management fee than allowed.

Yours truly,

Francis Chou

(Manager of the Fund)

CHOU ASSOCIATES FUND

(unaudited)

April 27, 2001

Dear Unitholders of the Fund:

After the dividend distribution of $3.58, the net asset value of Chou Associates Fund at December 31, 2000 was $46.36, up 8.4% for the year. The 3 year and 5 year annual compound return of the Fund was 6.4% and 15.7% respectively.

Relative to the market index, the results were satisfactory, however they would have been better had it not been for two factors:

1) Our investment in Reliance Group Holdings, a property and casualty insurer in financial difficulty.

2) Selling some of our stocks at below their cost price. The decision to do so was motivated by tax loss selling in order to counterbalance the very substantial realized gains generated for the year. Some consider this a 'bona fide, bone headed' move. To date, the Fund has been fairly successful in identifying and buying good companies at bargain prices. And when prices go down further, logic dictates that we should do more purchasing. Instead, we sold. This short term thinking – minimizing realized gains by taking losses – ran contrary to my better investment judgment. Over the years, I have observed that even the best tenets, if one is not careful, can be shunted aside easily for trivial reasons. It cost us roughly 5% in potential returns for the year 2000.

Impact of Capital Gains on Investment Decisions

Whenever returns are discussed in the industry, it is implied that they are pre-tax. Our Fund efforts to date have been directed towards achieving the best 'after-tax' rate of return as we have been conscious of the high capital gains tax rate of approximately 40%. When presented with a choice of undervalued securities, we prefer to select companies whose intrinsic value grows at a double digit rate as this allows us to defer selling the stock as long as possible. The high unrealized gains in our portfolio, relative to costs, reflect our investment approach.

A case in point is Freddie Mac. Our initial purchase price in 1990 was $3 per share. The current price is $63 – our return to date is 21 times the purchase price, or roughly a 35% pre-tax rate of return compounded annually. If we were to sell at the end of each year, and then repurchase the stock immediately the next day, thus incurring capital gains in the process, the after-tax rate of return would only be 21%. By holding on as we have, if we were to sell Freddie Mac today at the current price, and with the same 40% capital gains tax rate, our after-tax return would be considerably more – 29% compounded annually. While Freddie Mac may be an unusual example due to the extremely high rate of return the Fund achieved on this stock, the same calculations apply to stocks in general.

Here is an example based on a 20% pre-tax rate of return: The after-tax return for a stock that is bought and sold every year is 12%. If it is held and then sold after 10 years, the after-tax return is 15%. A $100,000 investment compounded annually for ten years at 12% grows to $300,000, whereas the same $100,000 compounded annually for ten years at 15% grows to $400,000.

The capital gains tax rate has now dropped to approximately 25% -- considerably lower than the tax rate on dividends or interest income. If faced with a choice of undervalued securities, we lean more towards companies reinvesting their earnings at a reasonable rate rather than those that are paying out dividends.

Technology Stocks

In the 1999 Annual Report I warned, in no uncertain terms, about the dangers of investing in high tech stocks, stating: "I am alarmed by the cavalier way in which people invest in technology stocks; the thought process they are using is a subversion of the investment process…Paying 500 times for hot air is not an investment; it's pure speculation… Let's not play a fool's game by thinking that a stock can be bought at 100 times revenues… and someone… will buy it at 200 times revenues the following week."

In the wake of the collapse of high tech stocks -- where many have dropped as much as 95% from their high -- we are now taking a serious look at several of these that offer good long term prospects, and whose shares are trading below net cash. Let me add that one should exercise caution rummaging through this rubble, as many of the companies are still burning cash.

The severe drop in high tech stocks was exacerbated by speculators borrowing on margin. In my opinion, rather than borrow on margin, such investors might consider 'buying into' the concept of margin of safety, a cornerstone of sound investing.

The markets are still high and a case can be made for us to be out of equities totally. I have reservation about that approach. Years ago I would give undue consideration to market levels, and react at times by keeping anywhere from 25% to 30% in cash, even though there were bargains to be had. Once a certain mindset is formed, we tend to reaffirm our thinking by only looking for information that confirms our bias. We choose statistics on a selective basis, ignore other information that may be relevant, and only listen to people that echo our thinking – and in the process we may be missing opportunities. The key is to make the economic environment a component of our decision making process. The most fundamental task at hand is still to search for above average companies with good economics, run by intelligent management, that are selling at an undervalued price.

At year end, cash comprises 24% of our portfolio, due largely to the fact that true bargains have been few and far between. In the past 5 years the Fund has compounded at 15.7%, more than doubling the money. However, I would caution that in light of high market valuation which has persisted for several years now, I am suggesting that we lower our expectations to single digit returns.

In 2000, the Fund's management expense ratio was 2.00% versus 1.85% in 1999. I chose to take a lower management fee in 1999 than allowed.

Yours truly,

Francis Chou

(Manager of the Fund)

CHOU ASSOCIATES FUND
(unaudited)

April 29, 2002

Dear Unitholders of the Fund:

After the dividend distribution of $4.23, the net asset value of Chou Associates Fund at December 31, 2001 was $52.07. It has been a difficult market, and yet I am happy to report that in the year 2001 the Fund gained 21.4%. The 3 year and 5 year annual compound return was 6.0% and 15.5% respectively.

One of the stocks that had a favourable impact on last year's results was BMTC Group, a furniture retailer in Quebec. The company accounted for approximately 35% of the return for the year.

Over time I have sifted through thousands of bargains which have come in different shapes and flavours such as discount to net-net working capital, discount to book value and low P/E ratio. When all is said and done, those which continue to give me the greatest satisfaction are the ones which display the following characteristics:

1) Above-average to excellent companies as measured by high ROE in excess of 15% sustained over 10 years or more.
2) Companies run by skillful managers as measured by good controls maintained on receivables, inventory and fixed assets.
3) Prudent deployment of capital as measured by a company’s capital expenditures, judicious acquisitions, and timely buybacks of its depressed shares.
4) A stock price which is far lower than what a knowledgeable and rational buyer would pay.

BMTC Group met the above criteria in spades. And when companies such as this one are found, the only rational thing to do is buy as much of the stock as the legal limit allows. In these instances it’s not always necessary to be extra careful about the buy price as long as this price falls within a single digit P/E ratio. Even on the sell side, there isn’t a pressing need to time the sale as the stock price nears its intrinsic value - the reason being that the company's intrinsic value is growing in excess of 15%.

Another characteristic of well-managed companies with good economics is the deferment of capital gains tax in instances where the stock is held for several years. I consider this to be a very important aspect, yet it is one which has yet to be given its due consideration by the investment community. It can add several points to the after-tax return on an annual basis. With all these attributes in mind, an ideal portfolio would be one where we can purchase 10 securities with similar investment characteristics in 3 or 4 different industries. But as it happens in investment we cannot be too choosy - we can only take advantage of whatever types of bargains are present.

The problem that occurs when buying discount to book value, or discount to net-net working capital is that most of these companies earn low (or negative) returns on equity (ROE). In order to do well with this approach it is important to buy when the company's stock price is thoroughly depressed, and then sell when a fortuitous price presents itself during the next few years; otherwise, the long term investment returns would mirror the ROE of the company: historically these figures have averaged out to less than 3 to 4% over 10 years. During those years, and not infrequently, the company may lose money. Its main attraction as an investment, however, is the stock price itself which is selling at a severe discount to liquidation value. As an investment merit, this aspect should not be pooh-poohed. If done in a disciplined way, both on the buy and sell sides, this type of investment provides a fairly attractive return with the added benefit of low volatility. Notwithstanding, one should still recognize these companies for what they are - that is, pieces of CRAP (Cannot Realize A Profit) - and capitalize on them accordingly.

With regard to the current valuation of the market, I maintain the same view that I have held for 5 years - and that is, that the markets are unattractively priced. Even so, the Fund achieved a rate of return of 15.5% compounded annually over 5 years ($1 invested on January 1, 1997 was worth approximately $2.05 on December 31, 2001); however, we should be circumspect about the result and not extrapolate it to the future. I doubt that the overall returns from equities in general over the next 5 to 10 years will be compelling; on the contrary, I believe that the returns may be far more modest than those hoped for by investors. Not only are the P/E ratios and price-to-book values still high (and dividend yields low) relative to historic valuations - the number of companies that are underpriced is at an all time low. In light of this scenario, and with its obvious lack of bargains, we are faced with the question: Should we be 100% in cash? That would make perfect sense, I suppose, if we could accurately predict a business contraction equivalent to the Great Depression. But as we are well aware, and know from experience, it is tough enough to predict the timing of a recession, let alone the degree of severity! My take on this is as follows: What we have done in the past, and what continues to work for us, is to purchase equities only to the extent that bargains are available - and with what was available to us in the last ten years we were able to achieve a rate of return of 16.2% compounded annually ($1 invested on January 1, 1992 was worth approximately $4.49 on December 31, 2001). Now, however, as the bargains are dwindling we should lower our expectations to single digit returns.

In running a portfolio there are always short-term issues to consider as they form part of the bigger picture: these include tax loss selling, interest rate trends, the future economic environment, high valuations and the threat of war, to name a few. The emphasis given to these factors, however, should be put in perspective. Sometimes the <u>weight</u> attributed to them at a subconscious level can be disproportionately high, and if we fail to recognize this influence we run the risk of being derailed from doing what we should be doing, first and foremost, and that is to always diligently hunt for bargains.

By giving undue emphasis to these forces we can easily warp a good concept and turn a sensible long-term investment approach into speculation. For example: I feel fairly optimistic that the Fund - as it continues to be based on the sound investment framework of 'margin of safety' - will give reasonable returns over the next 10 years; in the same breath I would add that I haven't a clue as to how it will perform next week or next year. Predicting short-term performance comes down to the flip of the coin which is as good (or as bad) as gambling. If the outcome of an investment is predicated on time-related factors, unless it is in the area of arbitrage and special situation, the investment will inadvertently turn into speculation. And the shorter the time frame, the more speculative the investment becomes regardless of how sound its underlying investment principles are.

As at April 26, 2002 the Fund's cash level was 23.2% and its MER for the year 2001 was 2.016%.

Yours truly,

Francis Chou
(Fund Manager)

CHOU ASSOCIATES FUND
(unaudited)

August 28, 2002

Dear Unitholders:

I am pleased to report that the net asset value (NAV) of Chou Associates Fund at June 30, 2002 was $60.06 compared to $52.07 at December 31, 2001, an increase of 15.3%. As at August 23, 2002 the NAV was $59.72.

Stock Options: We consider stock options to be both an expense and a dilution.
Before we invest in a company we calculate the potential impact of the following factors on the operating statement: 1) The outcome if stock options were to be properly expensed and 2) The proportion of earnings we anticipate will be diluted in 10 years (the average life span of stock options granted). We consider this analysis essential in understanding the economic reality of our investments -- and conduct it regardless of the 'academic' or 'technical' merits of the arguments advanced by those who oppose expensing stock options, and/or are reluctant to show the dilutive effects of the options when the strike price is 'out of the money'.

If an investor ignores the impact of stock options on operating statements, he or she will develop a misleading picture of a company's financial prospects and potential dilution. Here are some points to consider:

1) We need to be aware of the overall increase in the percentage of stock options granted as a percentage of outstanding shares. In most companies, particularly the private ones, almost all executive compensation is paid in cash. Until a few years ago, public companies also paid most executive compensation in cash. Stock options were not a problem back then as they represented a very small part of a company's outstanding shares. But starting in the 1980s the percentage of options granted, as a percentage of shares outstanding, has been increasing and has more recently mushroomed. It is not uncommon to see stock options represent between 20% and 30% of outstanding shares. That is quite high considering that some 40 years ago, anything greater than 5% would have elicited an outcry of grand larceny;

2) When researching companies we have found it impossible to compare apples to apples between companies in the same industry unless stock options are expensed. Here is a real life example that occurred in the service industry (not high tech): It clearly shows that when options are not expensed we are presented with a misleading picture of how well a company is actually performing. Example: Company A had stock options of 30% outstanding, versus Company B that had a negligible number of options. The wages and benefits costs of Company A were 61% -- almost 10% less than the 67% for Company B. However, upon examination, when options for Company A were properly accounted for, it was determined that the wages and benefits costs would have been 66%. Proper expensing of options has a direct bearing on operating margins, pretax margins, pretax return on capital, and more. These are ratios that are commonly used to measure the economics of the business, as well as determine how well the company is being managed. While at first glance, Company A looked to be an excellent company, once stock options were properly accounted for, its status dropped to mediocre;

3) Stock options cannot be considered 'freebies', as they form part of a total compensation package, which is an expense. Executive compensation is highly competitive, and as such, a company in the

same industry cannot afford to significantly underpay its executives, relative to its competitors, simply because executives are highly marketable and can choose to leave. When cash compensation is not enough, it can be augmented in a variety of ways, in particular, with stock options that form part of the total compensation package. This action, however, has tangible financial repercussions. For example: When a company that does not have stock options, proceeds to acquire a company where stock options were part of the compensation package, that company must make up the difference in cash compensation. When it does that, it raises its operating costs. In light of this example, beware of companies that have a high proportion of stock options -- these companies are understating their operating expenses and, therefore, are overstating their earnings; and

4) With regard to the subject of dilution: One of the arguments posed states that since the strike price is 'way out of the money', there is no dilution. Consider this example, however: Take a stock price at $10 and assume that it is also the intrinsic value of the company. The strike price of the stock option is at $15, which is 50% above the stock price. (In most cases, the strike price gets granted below the intrinsic value due to the dubious practice of option repricing when the stock drops reflecting the drop in its intrinsic value. This is tantamount to enriching and rewarding executives for destroying shareholder wealth). A huge part in valuing companies is the weight we assign to the potential growth of the company. If the company grows at a rate of 15% a year in 10 years, the current $10 intrinsic value will be approximately $40 in 10 years. Surely those stock options will be exercised... We have to conjecture, as we stare at the current financial statements under present GAAP rules, what proportion of the 100% earnings we see currently will be 70% in 10 years. Or will it be 50% or less, as some companies keep issuing 2%-4% of stock options every year? (As if 30% is not generous enough!).

As the examples show, stock options are both an expense and a dilution. For us, this is not an academic exercise but one of real economic significance when we are assessing and valuing companies.

Furthermore, we have rejected many companies as possible investments due to the generous granting of stock options, and the rationales used by CEOs to explain their positions on the subject. In days past, wise men would say that if one is confused by the arguments, follow the money, and if someone is gaining monetarily it would mean that that money is being taken away from someone else in some form or other. If that is the case, why not be upfront about the matter and account for those monies properly?

An even larger issue looms: and that is, the credibility of management. When the CEO downplays the impact of stock options as an expense and dilution, we are led to question other aspects of the financial statements. Can I trust the numbers? Does management use GAAP accounting rules (there is a lot of leeway) to reflect economic reality on its financial statements, or is it otherwise? In light of this scenario, it is not surprising that companies such as Tyco and Elan have seen their stock prices plummet relative to their intrinsic value due to lack of trust in the numbers presented by management.

Yours truly,

Francis Chou

(Fund Manager)

CHOU ASSOCIATES FUND
(unaudited)

May 6, 2003

Dear Unitholders of Chou Associates Fund,

After the dividend distribution of $3.01, the net asset value (NAV) of Chou Associates Fund at December 31, 2002 was $64.67, up 30% for the year. The table below shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rate of return.

	1 Year	3 Year	5 Year	10 Year	15 Year
Chou Associates Fund	30.0%	19.6%	13.8%	17.1%	15.5%
S&P 500 Total Return	-22.1%	-14.5%	-6.0%	9.3%	11.4%
S&P/TSX Total Return	-12.4%	-6.3%	1.3%	9.1%	7.7%

* The indicated returns are the historical annual compounded total returns assuming reinvestment of distributions and do not take into account sales, redemption, distribution or income taxes payable by the investor. Mutual funds are not guaranteed. Their values fluctuate and past performance may <u>not</u> be repeated.

By all accounts we had an excellent year. Our returns were largely attributable to 1) BMTC Group, Akita Drilling and Tri-White, and 2) capitalizing on a few 'distress' opportunities that came our way.

NET-NET WORKING CAPITAL STOCKS

Over the years we have done quite well with stocks that were trading below net-net working capital. Stocks that meet this criterion today are often troubled companies that need to restructure their operations. When assessing these stocks it is necessary to take the following into consideration:

1) The cost of restructuring has mushroomed and if factors such as closing cost, severances, termination of leases and underfunded pension liabilities are not properly factored in, one risks coming to the wrong financial conclusion.

2) Management and investors often differ on their perspective of what action needs to be taken, and when. It is important, therefore, to understand what motivates management and specifically what steers their decision making as well as the timing of those decisions - two factors which can ultimately affect the recovery or fall of a company. As investors we see the steps that need to be taken immediately to salvage whatever value is left. There is a sense of urgency: time is of the essence in preserving liquid assets, capping cash drain, closing unprofitable branches, and selling assets including the sale of the whole company. However, some management may not see it that way: the steps that they must take may be painful to their own self-interest and careers unless they have a meaningful portion of their net worth tied up in the company. When faced with making unpleasant decisions management may choose to dawdle, hoping against hope that their industry will turn around and bail them out. Only when faced with the inevitable does such management experience a true awakening. Unfortunately, by then, most of the cash and/or working capital has been depleted. Cases in point: Cable & Wireless and Touch America; in the end the values we saw at the time of investment proved to be a mirage.

Years ago we might have anticipated, with bated breath, that 'there must be a pony somewhere in that basket of net-net working capital stocks', but current experience has taught us that unless we factor in the cost of restructuring, and the mindset of management, we may find a pony, yes - but it will be a dead one!

DISTRESSED SECURITIES

Although our past successes in 'distressed securities' could be described as anything from average to awful, it has not deterred us from continuing to look in this area. Our broad based definition of distressed securities encompasses companies that 1) emerged from Chapter 11 (Criimi Mae common and preferred shares) 2) are in Chapter 11 (Worldcom senior notes), and 3) have debt securities trading at prices that indicate that they are candidates for Chapter 11 (Elan debentures, RCN senior notes, Time Warner Telecom senior notes, Level 3 senior notes, and Tyco common shares).

The down side to distressed securities is that even if we perform all the due diligence we want we could still end up financially distressed. The reason being that there are too many imponderables to consider - factors which cannot be measured, evaluated or foreseen - and these unknowns leave us vulnerable. Distressed securities involve companies that have one or more serious deficiencies including weak economics, stretched balance sheets, liquidity problems, incompetent management, accounting frauds, potentially mutant cockroaches - you name it. One or more of these negatives may be serious enough to drive some companies into severe financial crises that could potentially bankrupt them. Therefore, one must proceed with eyes wide open and accept that there is a good chance that at some point, most likely sooner than later, one of the companies will tank.

The up side is that because of the uncertainties and the stigma associated with distressed securities, the stocks and bonds of these companies are often selling at deep discounts to their potential 'recovery' values. Remember, we are always searching for bargains and starting in the latter half of 2001 we found many opportunities in this category - a greater number than in other 'more comfortable' sectors. Some of the major purchases for the Fund were:

1) Criimi Mae (common shares) at about $3.75, year-end price $10.19
2) Criimi Mae (preferred class B shares) at about $14, year-end price $21
3) RCN (10.125% senior notes) at about $28, year-end price $22
4) Time Warner Telecom (9.75% senior notes) at about $34, year-end price $55.75
5) Worldcom (6.5% & 8% senior notes) at about $15, year-end price $23
6) Elan (0% debentures, 2018) at about $27.50, sold at $48
7) Tyco (common shares) at about $8.25, sold at about $12.60
8) Level 3 (9.125% senior notes) at about $43, tendered to the company at $45 (bought/tendered in 2001)

As the listing shows, we did quite well in 2002 in distressed securities. There is a caveat, however: The gains were notable due mainly to our strategy of concentration. At the time of investing, we put 9.4% of the Fund assets in Criimi Mae (common and preferred shares combined), 9.2% in Worldcom senior notes, 8.9% in Elan debentures, 3.4% in Time Warner Telecom senior notes, and 3% in Tyco common shares. If we had not concentrated, the gains would have been positive but far less positive than the gains actually achieved in 2002.

With regard to 'concentrating', we acted based on a maxim that is still not widely appreciated: What good does it benefit an investor if he does not take advantage of his good ideas in a meaningful way? Good ideas are rare and may only pop up every few years.

We believe the windows of opportunity for distress situations will decline significantly in the future.

ACCOUNTING ISSUES

When analyzing companies we are always aware that their adherence to Generally Accepted Accounting Principles (GAAP) does not necessarily ensure an accurate portrayal of a company's financial position. It is no secret that there is enough leeway for management, within the GAAP rules, to showcase the financials in the best possible light. Of particular concern to us are the areas where management can, and do, play with numbers.

As investors we tend to use different metrics for different industries when calculating a company's worth. These metrics are a standard of measurement specific to the industry being considered. Using these metrics we are able to develop 'rule of thumb' or 'back of the envelope' calculations - that is, a rough estimate of the company's net worth if the accounting is transparent (plus or minus a few adjustments).

Problems occur in that management, aware of the metric that is being used to evaluate their own company, may be tempted to use this knowledge to stretch the GAAP rules in order to make their financials look better. As an investor be sure to identify and examine closely the metric used to measure the company's net worth and then check every item that goes into that calculation.

Here are examples of what some companies have done:

'Percentage growth in annual revenues' was an important metric in the 1997-2001 period for builders of telecom network companies. We found that one builder was swapping revenues that in our opinion have no economic value - close to a billion dollars - with other network builders.

'Earnings before interest, taxes, depreciation and amortization' (EBITDA) is an important metric for cable and telecom companies. We found that some normal operating expenses that should have been expensed were being capitalized. In some cases operational expenses, such as employee costs, were being capitalized for the first 2 years from the day the licenses were granted.

'Growth in net income' is an important metric for evaluating companies. In 2002 some multinational companies lost billions of dollars in their pension funds, but boosted their pre-tax returns in the hundreds of millions by using an unrealistic 9% or more as their expected pension fund investment rate of return! If more appropriate rates of return were used by some companies we would discover that many a pension fund is significantly underfunded. Choosing to use unrealistic rates will have serious repercussions down the road for some companies.

'Free cash flow' is an important metric for some service industries. Keep an eye out for items that do not belong in the calculation including non-recurring items such as sale/leaseback, deferred revenue, and sale of receivables.

Today's financial statements are so closely scrutinized by investors that it is downright comical that some management still believe that the adoption of soft accounting will go unnoticed. Knowledgeable investors will simply make the adjustments needed to reflect what is reality. In the end, what management fail to recognize is that any gains achieved by playing with numbers to make financials look good, will ultimately lead to a much greater loss - their reputation. Soft accounting also affects management's relationship with investors and sets a wrong example to their employees. It erodes credibility and forces the question - can management be trusted?

Philosophers long ago suggested that 'All is lost save honour' is the honourable way to conduct human affairs, but nonetheless some management still continue to believe in their metric, or should I say mantra, of 'All is lost save EBITDA' regardless of how soft that EBITDA may be.

MARGIN OF SAFETY - OUR CREDO

As we have stated in our past letters, the cardinal principle underlying the investments in the Fund is to pay far less than what the company is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want an adequate "Margin of Safety" and this concept, while unappreciated and ignored by many, is what distinguishes investment from speculation.

RELATIONSHIP WITH FAIRFAX FINANCIAL HOLDINGS (FAIRFAX)

I run the Chou Funds. I am also a Vice President of Fairfax. In late 2002, Fairfax invested $50 million in Chou Associates Fund and will invest a further $50 million in the Fund in the first half of 2003. In order to avoid conflicts of interest, perceived or real, we have agreed to the following arrangement:

1) If at any time Fairfax and the Chou Funds desire to purchase or sell the same security within the same price range, any such purchase or sale will be made proportionately to the amount of such security which each of them desires to purchase or sell.

2) Fairfax will not exercise any voting rights attaching to units of Chou Associates Fund or otherwise in any manner attempt to influence the affairs of the Chou Funds.

3) The Chou Funds will not invest in Fairfax and will not knowingly sell securities to Fairfax nor purchase securities from it.

Fairfax and I will review the arrangement regularly to ensure that we have successfully avoided any conflicts of interest.

In situations similar to mine, most executives would generally continue to receive compensation consistent with their positions as an executive. However, I have chosen to forego all remuneration and benefits whatsoever - including salary, bonus, incentive compensation, employee benefits and other perks associated with my position as an executive of Fairfax (if for convenience I remain a member of any medical or other group benefit plan with Fairfax, I will pay the full cost of participation).

EXPECTATION OF FUTURE RETURNS

Although we had an excellent year in 2002, we are more pleased with our 10 and 15 year results. The market, in general, is still not cheap and we are less than enthusiastic about its future prospects. With that understanding it would be irresponsible of me to extrapolate the Fund's returns of 2002, or the 3 year return, to the future. To be on the safe side, the returns for 2002 should be considered an aberration. Realistically, we would consider it excellent performance if we achieve single digit annual returns for the next few years. Most investors are painfully aware that the market has lost over 40% of its value from its high of 3 years ago. Any positive return is a great return under these circumstances.

A word of caution: Markets are inherently volatile in the short term and therefore can affect the Fund adversely, short term; while the Fund has never suffered large annual losses, they are certainly possible. Having said that, securities that the Fund holds are cheap relative to what they are worth and performance numbers should therefore work out reasonably well in the long run. That has been our experience. Nonetheless, the amount of money that investors choose to invest in the Fund should only be to the degree that they can afford to lose 40% or more of their investment. This may sound drastic, but sleeping well is also an important consideration.

COMPENSATION

The Fund pays a 1.5% management fee plus other expenses such as custodial, record keeping, legal, audit and filing fees. The MER for 2002 was 1.87%. The drop in MER was due primarily to the increase in assets. In general, I would like to see the MER kept below 2%.

Although the management fee is a fixed fee I have always approached it as if it had to be earned. I believe that management fees, in general, should correlate to positive long-term results.

GROWTH IN ASSETS

Some investors have expressed concern regarding the influx of cash to the Fund and whether this factor will have a negative impact on its performance. These points are worth noting:

1) We are considering closing the Fund to new investors once its assets reach a certain value. The number being discussed is $1 billion, a figure that far exceeds our current net assets. This amount is subject to further review.

2) The billion dollar figure must be put in perspective; in today's global economy a billion dollars in assets is considered a relatively small amount for a fund that is open to invest almost anywhere in the world.

3) The major portion of our returns in the past 15 years has been generated by investing in mid to big capitalization stocks such as Freddie Mac, Citigroup and Progressive, to name a few.

4) Finally, and it is worth repeating, our success to date is due to our adherence to the concept of 'Margin of Safety'. As the Fund's assets grow, we will continue to make decisions based on this concept and the same investment criteria that we have used in the past.

OTHER MATTERS

I am pleased to announce that Jingyun Huang joined Chou Associates Management Inc. in December 2002 as a full time administrator. She is responsible for all non-investment related matters.

We are planning to open two new funds, Chou Europe Fund and Chou Asia Fund, in the summer of 2003, subject to the approval of the various securities commissions in Canada. We expect a prospectus for these funds will be available at that time.

We have a redemption fee of 2% if unitholders redeem their units in less than 2 years. Instead of the fee going to the Fund Manager, it will be put back into the Fund to benefit remaining long-term unitholders. We hope that this fee is enough to dissuade short-term investors from jumping in and out of the Fund to chase short-term performance.

Effective May 14, 2003, the minimum amount required to invest in Chou Associates Fund will be $10,000.

As at May 2, 2003, the NAV of the Fund was $60.44 and the cash equivalents were 51.6% of assets. The Fund is down 6.5% from the beginning of the year. Some of the decline can be attributed to the strong Canadian dollar.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND

(unaudited)

April 22, 2004

Dear Unitholders of Chou Associates Fund,

After the distribution of $1.40, the net asset value ("NAVPU" or "NAV") of Chou Associates Fund at December 31, 2003 was $65.58 compared to $64.67 at December 31, 2002, an increase of 3.6%. The table below shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2003	1 year	3 year	5 year	10 year	15 year
Chou Associates Fund	3.6%	17.8%	9.9%	15.8%	14.8%
S&P/TSX Total Return	26.0%	-1.0%	6.5%	8.5%	8.4%
S&P 500 Total Return	28.2%	-4.1%	-0.6%	11.0%	12.2%
S&P 500 Total Return($Cdn)	5.6%	-8.7%	-3.9%	10.7%	12.7%

- The indicated returns are the historical annual compounded total returns assuming reinvestment of distributions and do not take into account sales, redemption, distribution or income taxes payable by the investor. Mutual funds are not guaranteed. Their values fluctuate and past performance may <u>not</u> be repeated.

Factors influencing the 2003 results

<u>Cash Position:</u> Our average month end cash position of 52% has had a restraining effect on returns. We chose to maintain cash because, as is explained later, we were not able to find investments meeting our Margin of Safety criteria and we were not as flexible as we might have been on the prices we were willing to pay on some bargains.

<u>Foreign exchange:</u> The strength of the Canadian dollar had a negative impact on the 2003 results. If we had calculated the NAVPU in $US, the Fund would be up 25.7%; this valuation method highlights the return for 2003 in the most favourable manner and therefore one should take it with a grain of salt. The fairest method is to use one currency in a consistent manner and live with the consequences of not hedging the currency for that given year. We believe that the fluctuation in foreign exchange rates should not have a material impact on long-term results.

<u>Concentration:</u> We normally like to concentrate our holdings. When we first buy, we tend to put as much as 3%-5% of the Fund's assets into a stock but in 2003 we failed to do that as we were not as flexible as we might have been on the prices we were willing to pay. When we examine our past mistakes, we find that we have lost a lot more by missing or buying an insignificant amount of a stock, because we would not pay a dime more for an obvious bargain, than by buying a stock that has gone down substantially from our purchase price.

<u>Distressed Securities:</u> One distressed security that did not work out was the subordinate debt of Fleming. In retrospect, we clearly overestimated management's ability to restructure its debt obligations. That move cost the Fund roughly 3.5%. Our forays into distressed securities over the last two years have been reasonably successful even if we include the Fleming mistake. We do not see the area of distressed securities as attractively priced now.

Investing in non-financial companies with significant deferred revenue

We have looked at a number of companies in construction related industries, funeral services and trading stamps. Those businesses all involve fixed contracts where cash is paid upfront for services or goods to be delivered later. The obligation to make this delivery is labeled 'Deferred Obligation' or DO. When valuing these kinds of companies, we should consider the following factors seriously in addition to the normal valuation methods we use as investors for valuing companies:

1) Regardless of the value we put on the company, that value should be reduced by the amount of the deferred revenue shown on the balance sheet. For example, when a company receives \$100 million in cash on a fixed contract type of business to render services which will cost it \$95 million (assuming a typical net margin of 5%), the company will eventually have to spend \$95 million to discharge its obligation. Often, for a financially strapped company, management uses the \$100 million in cash to pay down debt – and, in doing so, paints a picture that the company's financial position has improved significantly. Worse still, the company may acquire similar companies which may appear as good deals but are fraught with huge future obligations that the seller could easily choose to understate.
2) In many cases, the deferred revenue amount is not even close to the amount required to discharge its obligation. The actual amount of the DO, which management uses internally to monitor the work still to be done, is frequently much higher than the deferred revenue shown on the balance sheet even when the company states that its revenue recognition policy is based on the percentage of completion method.
3) Based on the above, some companies in the construction and other DO-type industries may look to be doing well as long as the growth in revenue continues. But when revenue slows down, or just flattens out, there is a disproportionate hit to earnings. And to add insult to injury, the company runs out of cash in a very short time. This is when the chickens come home to roost and a dire financial picture emerges.
4) One can make a case that companies receiving cash upfront have better economics but, in reality, when the company's financial position is poor, there is stronger temptation for management to knowingly bid for contracts whether they are profitable, or not, as long as they get the cash upfront.

However, for every 10 DO-type companies that stumble, there will be one that truly exploits the favourable economics and comes out ahead. It requires exceptional management with outstanding capital allocation skills. In addition, and equally important, management in these instances must be willing to look at the cost of DO for what it truly is and therefore not minimize the costs and/or underplay the seriousness of any deficiencies. One company that comes to mind is Blue Chip Stamps ("Blue"), a company I remember fondly because it was one of my first picks as a neophyte investor in the 1979/1980 period.

When Warren Buffett and Charlie Munger took over control of Blue in 1969, the only business it had was trading stamps. The company would sell trading stamps to the supermarkets in return for a fee. The shoppers would get a certain number of stamps for each dollar spent in a store. The concept is somewhat similar to what Canadian Tire does in Canada with its Canadian Tire money. Years ago, shoppers would accumulate these stamps in a book until they had enough stamps to redeem them for small consumer items like toasters, bowls, toys, lawn chairs, etc. However, the redemption of stamps would sometimes take several years and, in some cases, the redemption would not take place at all. Meanwhile, the company would have had the use of the money which in investment parlance is commonly referred to as the 'float'.

To gain perspective on how this money can be used, consider that in 1969, Blue's revenue was $108 million, float was $79 million and book value was just over $28 million. To cut a long story short, this is what Buffett/Munger did with the float:

1) They bought See's Candies (See's) for $25 million in 1972. In 1999, it had operating profit before taxes of $74 million. On page 61 of the 1999 Berkshire Hathaway annual report, it mentions that, in 1997, See's earned about $59 million on $5 million of net operating assets (these assets are approximately equal to shareholders' equity when the company has no debt). This is indicative of how profitable See's has been over the years. It hardly requires any capital to generate that type of earnings. It is a shame that due to the huge size of Berkshire, See's results since the year 2000 have been consolidated with other subsidiaries and, as such, its extraordinary profitability can no longer be analyzed.
2) They bought Buffalo Evening News (Buffalo) for $32.5 million in 1977. The prior year its operating profit before taxes was about $1.7 million. In 1999, it generated $55 million of operating profit before taxes on $30 million of total assets. I suspect that net operating assets deployed amounts to no more than $10 million. Again, it is regrettable that from the year 2000, its results have been consolidated with other subsidiaries.
3) Blue accounted for the purchase of 80% of Wesco Financial for $49 million in 1977. As of today, the market capitalization is $2.9 billion. That 80% would now be worth $2.3 billion.
4) They purchased marketable securities which today are likely worth about $2 billion. In Blue's 1982 annual report, cash and marketable securities were worth $178 million. This $2 billion may sound far fetched but the compound annual rate of return is only 11.6%.
5) They likely reinvested all the cash generated by See's, Buffalo and other subsidiaries since 1982; if so, today this would amount to close to $2 billion.
6) Based on their extraordinary profitability, See's and Buffalo would be worth well over $1 billion.

Most probably, if Blue had not merged with Berkshire Hathaway in 1982 (another regrettable transaction in the sense a great instructive business story was not fully played out), its intrinsic value would now top $7 billion (give or take a billion) compared to its book value of $28 million in 1969. This occurred in spite of the trading stamp annual revenue dropping to a mere $100 thousand.

If there is a secret to the Buffett/Munger success story, it is their willingness to be brutally honest and realistic in their analyses and assessments. They are highly introspective, always checking and rechecking their assumptions and premises against reality. Executives who sugarcoat business realities and embellish results, downplay issues and disguise potential problems to investors may well fool even themselves. They start believing in their own world of make-believe. Buffett/Munger's formidable powers of analysis would be worth nothing if they looked at problems with rose colored glasses.

Our historical returns and what we can learn from them

As we have stated in our past letters, the cardinal principle underlying the investments in the Fund is to pay far less than what the company is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want an adequate 'Margin of Safety' and this concept, while unappreciated and ignored by most, is what distinguishes investment from speculation.

The Fund's annual returns over 15 years (and since inception) have demonstrated that this concept is so profound and powerful that in spite of making a number of investment decisions that I wished later I had made differently, being blindsided by unpredictable events and getting snookered by unscrupulous management, the Fund still managed to achieve a very satisfactory long term return.

Looking ahead then, it continues to be our opinion that as long as we don't breach our cardinal principle, the Fund should do reasonably well long term.

Expectation of future returns
Based on most common valuation methods such as dividend yield, P/E ratio and premium to book value, the market is not cheap. Four years ago there were sectors that were undervalued that we could exploit. In today's climate, almost all sectors are overvalued. This is an ominous sign. One can still make money in the market but one is doing so without having a large margin of safety. We would caution all investors that from these levels the chances of large permanent loss of capital are extremely high. We feel that it would also be irresponsible to extrapolate the Fund's 3, 5 or 10 year return into the future. Those returns will be virtually impossible to duplicate over the next 10 years.

We are diligently looking for undervalued stocks and will buy them only when they meet our price criteria. However, we will not chase stocks to keep up with the market averages. If given a choice, we would prefer to lose half of our unitholders rather than half of our unitholders' money.

China
We received more calls from investors asking whether we are investing in China than we received about any other country. On the plus side, it is a country that is growing rapidly, its economy is opening up to the western world and it was recently admitted to the World Trade Organization. However, when investing, our first duty is to check where and how we can get tripped up. Some of the negatives are:

1) China is an emerging country. Many of the laws, including investor protection laws that we are accustomed to, are non-existent or not enforced.
2) There are no concrete rules established in Chinese GAAP; much is subject to interpretation and therefore open to extensive abuse. We know of two accounting firms (both belong to the Big Four) that were looking at the same company and they came up with substantially different numbers. There are enough examples of subterfuge in the books that makes one uncomfortable. When you examine the numbers, you are left wondering whether you are looking at the books prepared for a) tax authorities b) management or c) shareholders (patsies?). For example, the profit margins often seem too good to be true. Some Chinese companies gross an obscene 40% plus, versus just 5% in North America for a similar type of business.
3) Although we might have worried more earlier, we now feel somewhat comfortable that there is no turning back to Communism in spite of the rhetoric we still hear from the Politburo. When we asked one Government official about the chances of China reverting back to the old ways, he intoned, "When we talk, we talk left, left, left but we are going right, right, right".

We are looking in China and hopefully can buy some companies with honest management and honest numbers at a cheap price.

Derivatives
Derivatives related issues deserve several pages to do them justice. In brief, we are alarmed by the exponential rise in the use of derivatives. We have chosen to reduce our exposure to financial institutions that rely heavily on derivatives to manage and/or earn profits. We sold the last batch of Freddie Mac (initially bought at about $3) for $52 and Citigroup for $47. These stocks are still undervalued and may continue to do well in the future but they were sold because we did not have the

confidence to properly assess the financial liabilities of these companies. Some 25 years ago, there were fewer entries in the financial statements but at least you were clear on what those liabilities meant. In today's world it is precisely the opposite. In annual reports, there are reams of pages of footnotes which are supposed to enlighten you but which, instead, create more serious doubt about the true nature of liabilities. The deeper one delves into the issue, the greater the concerns become. The three major concerns that we have with companies that rely on derivatives are: 1) They are difficult or impossible to value because the assumptions underlying the valuations are suspect; 2) Even in a mild financial crisis, they will be difficult or impossible to get out of. In practice, this means that they have to be marked down significantly from the market price when you want to sell them; and 3) You have to trust and hope that the counter party with which you have entered into a derivative contract will honour its obligations.

Other matters

We launched both the Chou Asia Fund and Chou Europe Fund on August 26, 2003. We have not charged the full management fee of 1.5%. We have charged a fee only to cover the trailer fees paid to dealers and financial planners (0.5%). We are extending this policy for the year 2004.

The Fund pays a 1.5% management fee plus other expenses such as custodial, recordkeeping, legal, audit and filing fees. The MER for 2003 was 1.86%.

We have a redemption fee of 2% if unitholders redeem their units in less than 2 years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders. We hope this fee is enough to dissuade short-term investors from jumping in and out of the Fund to chase short-term performance.

The minimum amount to invest in the Fund is $10,000 and subsequent investment is $1,000.

As of April 16, 2004, the NAV of the Fund was $69.42 and the cash equivalents were 24% of assets. The Fund is up 5.9% from the beginning of the year.

Yours truly,

Francis Chou

Francis Chou

Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

April 14, 2005

Dear Unitholders of Chou Associates Fund,

After the distribution of $1.47, the net asset value ("NAVPU" or "NAV") of Chou Associates Fund at December 31, 2004 was $70.03 compared to $65.58 at December 31, 2003, an increase of 9.0%. The table below shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return:

December 31, 2004	**1 year**	**3 year**	**5 year**	**10 year**	**15 year**
Chou Associates Fund	9.0%	13.6%	14.1%	17.1%	14.1%
S&P/TSX Total Return	14.5%	8.3%	3.6%	10.1%	7.6%
S&P 500 Total Return ($U.S.)	10.8%	3.5%	-2.4%	12.0%	10.9%
S&P 500 Total Return ($Cdn)	2.7%	-5.7%	-5.9%	10.3%	11.2%

- The indicated returns are the historical annual compounded total returns assuming reinvestment of distributions and do not take into account sales, redemption, distribution fees or income taxes payable by the investor. Those returns are not guaranteed. Mutual fund net asset values fluctuate and past performance may not be repeated.

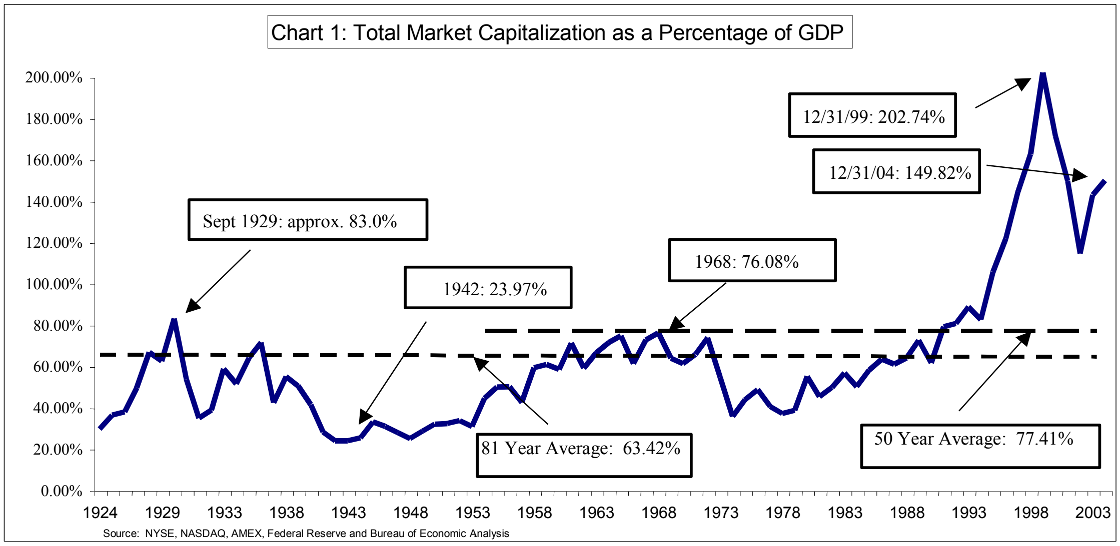
Factors influencing the 2004 results

Cash Position: Our average month-end cash position of 24.8% of net assets has had a restraining effect on returns. We chose to maintain cash because we were not able to find investments meeting our Margin of Safety criteria.

Foreign Exchange: The strength of the Canadian dollar had a negative impact on the 2004 results. If we had calculated the NAVPU in U.S. dollars, the Fund would have been up 17.7%; this valuation method highlights the return for 2004 in the most favourable manner and should, therefore, be taken with a grain of salt. The fairest method of valuation is to calculate all valuations in the same currency. We believe that fluctuation in foreign exchange rates should not have a material impact on long-term results.

General comments on the market

For years we have been saying that the market is overvalued based on P/E ratio, dividend yield and premium to book value. Another important yardstick for determining overvaluation of the market is the ratio of total market capitalization to Gross Domestic Product (GDP). Total market capitalization is determined by adding the market value of each company that trades on the NYSE, AMEX and NASDAQ stock exchanges. GDP is the total value of all goods and services produced in the United States for a specified period. The following chart shows the history of the total market capitalization to GDP ratio for the period from March 1925 to December 2004. Note how the current ratio compares with those of previous years.

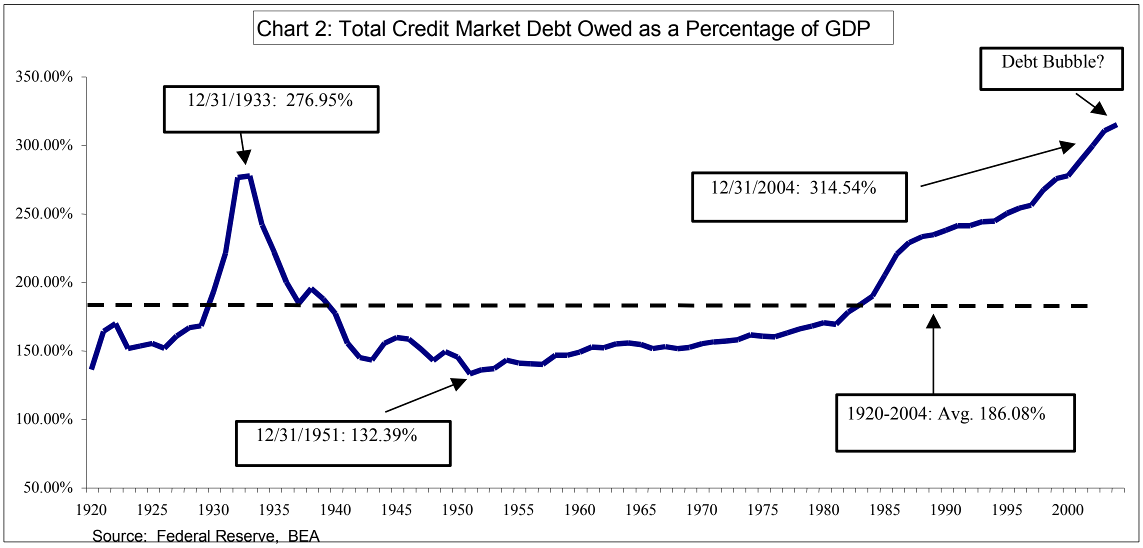


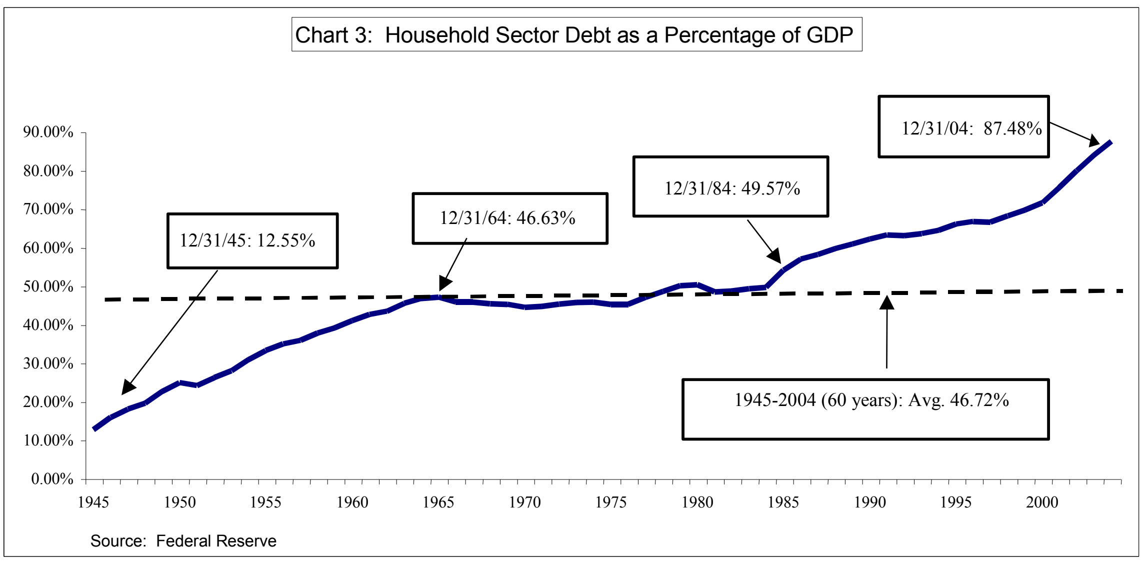
The chart shows that:

1) The last 81 year average is 63.4%.
2) The last 50 year average is 77.4%.
3) During the height of the bull market in 1929 before the great crash, the ratio was approximately 83%.
4) In 1968, another bull market, the ratio was 76.1%.
5) The highest ratio was in March 2000 at 202.7%.
6) The lowest ratio occurred in March 1942 at 24%.
7) At present the ratio is over 149.8%, a dangerous level to say the least, when compared to the historical average.

The two charts on the following page, Total Credit Market Debt as a percentage of GDP ("Total Debt"), and Household Sector Debt as a percentage of GDP ("Consumer Debt"), plainly show that Total Debt and Consumer Debt have increased significantly in recent years and that U.S. consumers are highly leveraged. As the charts indicate, the average Consumer Debt for the last 60 years was 46.7%; it is now 87.5% and rising. Consumer spending accounts for more than 70% of economic activity (the 60 year average is 60%) and this indicates that the current economic expansion has been fuelled significantly by debt. Also take into account that consumer spending has been financed by the enormous trade deficit with other nations, and that consumer debt has fuelled the housing boom as well as other financial assets, and we are left to speculate on a number of questions and potential repercussions:

1) How much more debt can the economy accommodate? At 314.5%, it is already much higher than the historical average (186%). See Chart 2.
2) What happens if and when interest rates go up, making consumers vulnerable?
3) Are we in a debt bubble?
4) If consumers stop borrowing and the ratios go back to the mean, how severely would the economy suffer?
5) Would the Federal Reserve Board use inflationary policies (historically, an easy way out for indebted countries) to get out of trouble?





We look at these issues in conjunction with other factors such as corporate and federal debts, fiscal and monetary policies, trade deficits and so on. While the issues are important, we do not put much emphasis on them unless they are outliers – that is, they have reached a threshold limit whereby the ratios, if not corrected or contained, should start to have an adverse effect on the economy. And while we can always exercise caution in these instances, we can never assume full control. As one government official[1] aptly stated when reflecting on handling the unexpected – "Condoms are not totally safe. My friend was wearing one and he got hit by a bus."

When investing, the issues mentioned do not mean much if plenty of bargains can be found. What makes us wary about the stock market is that we are not able to find investments meeting our Margin of Safety criteria. I cannot remember a time when bargains in general were so scarce.

[1] Robert Rubin, former Secretary of the Treasury

As usual we believe that it is **not** a good policy to borrow money to invest in stocks or mutual funds. When there are imbalances in the economy and several key ratios show them to be outliers, I strongly urge our unitholders to be debt free. Whether you are short and the market continues to rise or you are long and the market continues to fall, it is important to remember that the market may well stay irrational longer than a debtor can stay solvent[2].

Concept of batting average in investment
In investing there are two kinds of mistakes: Omissions and Commissions. Omissions occur when the stocks you know and understand come down to your bargain price range and yet, for some reason, you defer purchasing them. Commissions are the more common type of mistakes whereby the stocks go down after you purchase them, entailing a permanent loss of capital.

Looking back on our 20 years plus of investing, we feel that our omissions have been far more painful than our commissions. Experience has shown us that it is better to purchase certain stocks that meet our Margin of Safety criteria, and risk making a mistake rather than not buy them. There is an opportunity cost involved when you miss buying a bargain that was in your circle of competence. Similar to baseball, if a batter gets a fat pitch right down the middle of the strike zone, he should take a swing. If he strikes out, so be it. He should not be flailing away, chasing balls out of the strike zone. However, if he strikes out, it should be in spite of his good hitting technique.

In investing there is an opportunity cost involved when you don't swing at a fat pitch. So when opportunity knocks, you should take advantage. From the 1980s to the mid 1990s, if an investor were to pass on a good deal, there were usually another five waiting in the wings. We were really spoiled. Over the last 8 years or so, if you missed out on a good deal, you had to wait for a while before finding the next one.

John Templeton's investment batting average was about .600, that is, 6 out of 10 stock selections did well. When he retired in 1992, he had one of the best mutual fund records spanning over 40 years. In baseball, a batting average of .300 is considered excellent. You don't need to be perfect to be considered a great hitter.

Expectations of future returns

In today's climate, almost all sectors are overvalued. As mentioned earlier, I cannot remember a time when bargains in general were so scarce. You can still make money in the market but you are doing so without having a large margin of safety. We would caution all investors that from these overvalued levels the chances of a large permanent loss of capital are extremely high. We feel that it would also be irresponsible to extrapolate the Fund's 3, 5, 10 or 15 year returns into the future. Those returns will be virtually impossible to duplicate.

In baseball, a high batting average depends crucially on waiting for the right pitches. Similarly, in investing, for us to do well, we have to wait for stocks that meet our Margin of Safety criteria. We said it before, we will not chase stocks to keep up with the market averages. If given a choice, we would prefer to lose half of our unitholders rather than half of our unitholders' money.

[2] John Maynard Keynes

Companies subject to the whims of buyers including retail, restaurants etc

In general, we have done well with retail companies such as BMTC Group. But with retailing and restaurant companies it is difficult to get a handle on how the future will pan out, regardless of how well they may have done in the past. Retailing concepts that work well can be easily duplicated by competitors. Also, if consumer tastes change, the retailing companies are faced with serious financial and operational issues. Liabilities such as operating and capitalized leases suddenly become real short-term debt, much needed cash is used up in severance and closure costs, and a host of other problems crop up. In short, these consequences can quickly put a financially sound retailer into a serious short-term liquidity crisis.

This reminds us of a story of two young business women, named Gloria and Gisella who are owners of their own retailing companies. Gloria was asked what she would do if she were to win a million dollar lottery. Gloria said, "Well, I will pay down the mortgage on my house, take a tour of the world with my sweetheart, buy a villa in the Swiss Alps and live happily ever after." When Gisella was asked the same question, she replied: "Well, (scratching her head), I will keep on retailing until my million dollars are all gone."

In Chou RRSP Fund we took a loss in a retailing company called Denninghouse Inc. When its "A Buck or Two" store concept did not work, we were left with goods worth pennies. Fortunately, for Chou RRSP Fund, it was a small holding.

Our portfolio will have more international (Asia) content in the future

The world is opening up. Over the years we have looked at many companies outside of North America and can say that the best companies in Asia can easily compete with the best in North America. However, last year we warned of some of the problems inherent in China, and we believe that those problems are also applicable to other Asian and less developed countries. The warning is worth repeating:

4) Many of the laws in Asia and less developed countries, including investor protection laws that we are accustomed to, are non-existent or not enforced. Consider what happened to Yukos, a Russian oil and gas company in which Chou Europe Fund has a small holding. The criminal charges laid, and the taxes alleged to be owing (more than the revenues generated), raise serious questions about the motives of the government. Truth can be stranger than fiction.
5) There are no concrete rules established under Chinese GAAP or under other Asian GAAP; much is subject to interpretation and therefore open to extensive abuse. We know of two accounting firms (both belong to the Big Four) that were looking at the same company in China, yet each came up with substantially different numbers. There are enough examples of subterfuge in the books that makes you feel uncomfortable. When you examine the numbers, you are left wondering whether you are looking at the books prepared for a) tax authorities, b) management, or c) shareholders (patsies?). For example, the profit margins often seem too good to be true. Some Chinese companies net an obscene 40% plus, versus just 5% in North America for a similar type of business. This is also true in other Asian countries. Their selling, general and administrative costs (SG&A) are sometimes unbelievably low.
6) Although we might have worried more earlier, we now feel cautiously comfortable that there is no turning back to Communism in spite of the rhetoric we still hear from the Politburo. When we asked one government official about the chances of China reverting back to the old ways, he intoned, "When we talk, we talk left, left, left but we are going right, right, right."

The upside is that these countries have huge labor cost advantages and most of the executives are educated in Western countries. These young executives have gone back to their native countries and have been responsible for changing the political climate for people in business. The changes, if maintained for a few decades, have the potential to make these nations economic powerhouses in the future. Recent changes of one Asian country include the following:

1) Corporate taxes have been reduced to 35%.
2) There is no capital gains tax.
3) There is no tax on dividends.
4) Free enterprise zones are being established where businesses will not be subjected to the huge number of approvals otherwise required and the ruinous delays involved in getting them. At one time it took 32 agencies to get an approval.
5) Other tariffs and roadblocks are being dismantled.

A number of companies in Asia produce free cash flow and some managements are well attuned to the concept of generating cash and deploying it wisely. As one manager[3] said: "Sales are vanity, Earnings are sanity, but Cash is reality."

The key is to buy companies that are soundly financed and well managed. Companies that are mediocre or not soundly financed would be more inclined to hide problems knowing that the investor protection laws we take for granted in North America are virtually non-existent in their own country. We are looking seriously in Asia and less developed countries and hope to buy some companies with honest management and honest numbers, at a cheap price.

Investment awards

Please forgive me for this shameful display of self-promotion but I was honoured to receive the 'The Fund Manager of the Decade' award at the Investment Awards ceremony held December 3, 2004 in Toronto. Morningstar Canada, which hosted the event, introduced this award in 2004 to honour the Canadian mutual fund manager who had produced the best performance over the past 10 years. Essentially, Morningstar sought to answer the question, "If we had to choose only one manager with whom to invest our money - who would it be?" Only a manager with a 10 year record managing a Canadian mutual fund or segregated fund recognized by the Canadian Investment Funds Standards Committee was considered. Based on those criteria, Chou RRSP Fund was ranked first and Chou Associates Fund was ranked third.

Other matters

We launched both the Chou Asia Fund and Chou Europe Fund on August 26, 2003. In 2004, we have not charged the full management fee of 1.5%. We have charged a fee only to cover the trailer fees paid to dealers and financial planners (0.5%).

The Chou Associates Fund pays a 1.5% management fee plus other expenses such as custodial, recordkeeping, legal, audit and filing fees. As the assets of the Fund have grown, the management expense ratio (MER) has trended down from 2.11% in 1998 to 1.77% in 2004.

We have a redemption fee of 2% if unitholders redeem their units in less than 2 years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders. We

[3] A Godrej from Godrej Group

hope this fee is enough to dissuade short-term investors from jumping in and out of the Fund to chase short-term performance.

The minimum initial amount to invest in the Fund is $10,000 and the minimum subsequent investment is $1,000.

We previously indicated that the Chou RRSP Fund was closing to new investors after March 18, 2005. The decision to close was based on the 30% foreign content restriction and the limited value investments available in Canada. Since it is now expected that the federal government will eliminate the RRSP foreign content restrictions, the Chou RRSP Fund will continue to accept new unitholders for the foreseeable future.

As of April 8, 2005, the NAV of the Fund was $72.19 and the cash position was 37% of assets. The Fund is up 3.1% from the beginning of the year.

Except for the audited NAVs and performance numbers of the Fund, the remainder of the above letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou

Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

April 7, 2006

Dear Unitholders of Chou Associates Fund,

In 2005, Chou Associates Fund returned 13.7% while the S&P 500 Total Return Index returned 1.5% in Canadian dollars. In $US, Chou Associates Fund returned 17.1% while the S&P 500 Total Return Index returned 4.9%.

The table below shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2005	**Past Year**	**Past 3 Years**	**Past 5 Years**	**Past 10 Years**	**Past 15 Years**
Chou Associates($Cdn)	13.7%	8.7%	15.2%	15.5%	16.0%
S&P500 ($Cdn)	1.5%	3.3%	-4.5%	7.3%	11.5%
Chou Associates($US)[4]	17.1%	20.1%	21.1%	17.2%	15.9%
S&P500 ($US)	4.9%	14.2%	0.5%	9.0%	11.5%

- The indicated returns are the historical annual compounded total returns assuming reinvestment of distributions and do not take into account sales, redemption, distribution or income taxes payable by the investor. Mutual funds are not guaranteed. Their values fluctuate and past performance may not be repeated.

Factors influencing the 2005 results

Major positive contributors to the Fund's performance were Boskalis Westminster, King Pharmaceuticals, Criimi Mae, Cardinal Health and Utah Medical. Conversely, we suffered declines in OCA Inc., XO Communications, GB Holdings and Allegiance Telecom debt.

Our average month-end cash balance of 32% of net assets has had a restraining effect on returns. We chose to maintain cash because we were not able to find investments meeting our Margin of Safety criteria.

General comments on the market
We continue to have problems finding compelling bargains in the market. Although in the past we voiced deep reservations about the overvaluations in the market, the Fund has done reasonably well over the past 5, 10 and 15 years as we were able to find a few bargains each year. Nonetheless, we remain quite concerned about the overvaluations and the potential negative impact on the Fund.

[4]The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 are based on the $US equivalent conversion of the results of the Chou Associates Fund($Cdn). The investments in the Chou Associates Fund ($Cdn) is the same as the investments in Chou Associates Fund($US) except for the currency applied.

Lately, we have been looking at stocks in the Pulp & Paper Industry. It is a highly cyclical industry and its operations have been negatively impacted by the strong Canadian dollar. Our experience has shown that unless stocks like these are bought dirt cheap, you risk being beaten to a pulp and the stocks will not be worth the paper they are written on.

No single factor is paramount when assessing a company
When hunting for a bargain, there are many factors that merit consideration. Some are macroeconomic, such as the magnitude and trend of trade deficits, interest rates and currencies. Some are company specific, such as fundamental valuations and significant insiders' ownership, to name a few. While each factor is important, placing undue emphasis on any single one can skew one's judgment and lead to significant errors in decision making.

By being aware of our individual biases and how we give different weights to various factors, we can significantly reduce, though not eliminate, the misjudgment that can occur when evaluating a stock.

A case in point pertains to a stock we held in 2005. The company had high cash holdings and its management had significant stock ownership. Accordingly, we felt that management would act rationally and strive to maximize shareholder value. We gave undue weight to this factor and not enough to compelling evidence suggesting that, historically, management had not managed the business for the benefit of shareholders. In fact, they suffered from a syndrome that is popularly known as the bladder problem, 'The more cash one holds, the greater the pressure to piss it away.'

Admit mistakes early, make corrections, then move on
We are fortunate that the Fund has had a satisfactory long-term track record despite some hiccups over the years. In instances, such as the one just mentioned, we are getting better, and faster, at realizing that an error has been made, especially considering that once a decision is made to purchase a stock it can take 3-5 times more evidence to admit that one has not made the best decision. The proper thing to do is to admit the mistake early on and avoid any temptation to justify or rationalize the decision along the way. After that, make the necessary correction and move on. When faced with overwhelming evidence, ignore the tempting retort, "Please, don't confuse me with the facts!"

Over the years I have learned to hold off purchasing a stock until I have assessed the company thoroughly. Only then is it wise to go to the decision making stage. My advice is to stay in the assessment stage as long as possible.

Lastly, it is ironic that decision making pitfalls in the stock market often involve stocks that appear to have the best long term prospects and which give you the feeling that you should buy them for your old age. As it turns out, those feelings can get confirmed fairly quickly. A year later I would feel very, very old.

Small capitalization ("cap") stocks are too small to make an impact on the Fund
The assets in the Fund have now increased to over $400 million. As such, it does not make sense to hold small cap stocks as they, because of their small weighting, do not affect the portfolio materially even if one of them doubles. Therefore, we have started the process of disposing of them although they may be somewhat undervalued. We have found that selling them into the market is not as easy as it sounds. One needs to wait patiently for a buyer and often times the price needs to be discounted by 15%-20% before a buyer will even bite. And this is in a benign environment!

Generally, we do not sell securities between the Chou Funds. But occasionally we sell a small cap stock to either Chou Asia Fund, Chou Europe Fund or Chou Bond Fund if it makes sense to do so for both parties at the prevailing market price.

Management Expense Ratio (MER) is as low as it is going to be

The Chou Associates Fund pays a 1.5% management fee plus other expenses such as custodial, recordkeeping, legal, audit, regulatory fees and filing fees, to name a few. As the assets of the Fund have grown, the MER has trended down from 2.11% in 1998 to 1.75% in 2005.

The average MER for a fund in the U.S. equity category is approximately 2.73%.

We believe the MER for the Fund is as low as it can be. As all funds face greater regulatory scrutiny and increased requirements found in National Instrument (“NI”) 81-106 and possibly NI 81-107 in the future, the cost of running the Fund will increase and result in a higher MER. We hope to keep it below 2% which is still well below the industry average of approximately 2.73%, but if the Sarbanes-Oxley Act in the U.S. is any indication (complying with the Act will cost businesses listed on U.S. stock exchanges an estimated $28 billion in 2007), the costs will escalate as we move forward. At some point, the regulators will have to assess whether the costs borne by the unitholders, as well as the management time and human resources required by fund companies to meet the compliance requirements, are worth the debatable intended benefits.

What may also be affected are the style and manner in which letters to the unitholders are written. We believe that our investors would like to hear from their portfolio manager in a straightforward and forthright manner on how he or she is looking at the investment landscape rather than have the letter drastically rewritten by public relations or legal counsel.

Chou Bond Fund

Chou Bond Fund was opened to investors on September 16, 2005. The minimum initial investment is $10,000, as with the other Chou Funds. The Fund has done quite well from inception to date (2006 year-to-date return of 11.9%) but investors should keep that performance in perspective. Be aware of the risks involved including that of the Manager who does not have a long history of investing heavily in that area. Caveat emptor!! Having said that, we feel optimistic that if we apply the same value principles we have used in the past in investing in equities, we have the potential to do reasonably well in the future.

As with the launch of the Chou Asia Fund and Chou Europe Fund, we will not charge the full management fee of 1.15% to the end of 2006. We will charge a fee only to cover the trailer fees paid to dealers and financial planners (0.15%).

Other matters

Quebec: The Chou Funds are now open to Quebec residents.

Fee Based (“F”) Class shares: Due to consistent requests from financial planners and dealers, we have introduced a new class of shares called F class shares. In this class the dealers will not receive any trailer fees but they can charge any fee with the consent of their client.

Foreign Currency Hedging: Chou Associates Fund has hedged $US 60 million of its U.S. assets.

$US Dollar Valuation: Any investor who requests to purchase the Chou Funds in $US will now be able to do so.

Redemption fee: We have a redemption fee of 2% if unitholders redeem their units in less than 2 years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders. We hope this fee is enough to dissuade short-term investors from jumping in and out of the Fund to chase possible short-term performance.

As of April 7, 2006, the NAV of the Fund was $84.89 and the cash position was 33.4% of assets. The Fund is up 8.5% from the beginning of the year.

Except for the performance numbers of the Chou Associates Fund the remainder of the above letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou

Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 2, 2007

Dear Unitholders of Chou Associates Fund,

After the distribution of $1.26, the net asset value ("NAVPU" or "NAV") of a Series A unit of Chou Associates Fund at December 31, 2006 was $91.65 compared to $78.22 at December 31, 2005, an increase of 18.8%, while the S&P 500 Total Return Index returned 16.0% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund returned 18.8% while the S&P 500 Total Return Index returned 15.8%.

The table below shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2006 (Series A unit)	**Past Year**	**Past 3 Years**	**Past 5 Years**	**Past 10 Years**	**Past 15 Years**
Chou Associates($Cdn)	18.8%	13.8%	14.7%	15.1%	15.7%
S&P500 ($Cdn)	16.0%	6.6%	-0.2%	6.7%	10.7%
Chou Associates($US)[5]	18.8%	17.9%	21.9%	16.9%	15.7%
S&P500 ($US)	15.8%	10.4%	6.1%	8.4%	10.6%

Rates of return are historical total returns including changes in unit prices and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and which could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance.

Factors influencing the 2006 results

Major positive contributors to the Fund's performance were Royal Boskalis Westminster, Berkshire Hathaway, Sears Holdings, The DirecTV Group and Level 3 Communications debts. We suffered declines in Interstate Bakeries, Overstock.com, and Collins & Aikman bank debts.

Our average month-end cash balance of 37% of net assets has had a restraining effect on returns. We chose to maintain cash because we were not able to find investments meeting our Margin of Safety criteria.

General comments on the market

We continue to have problems finding compelling bargains in the marketplace. Not only are the P/E ratios and price-to-book values still high, and dividend yields low, relative to historic valuations, the number of companies that are underpriced is at an all time low. We would caution all investors that their chances of a large permanent loss of capital are high if they invest in today's market leaders at current prices.

Preservation of capital is being given almost zero consideration

[5]The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 are based on the $US equivalent conversion of the results of the Chou Associates Fund($Cdn). The investments in the Chou Associates Fund ($Cdn) are the same as the investments in Chou Associates Fund($US) except for the currency applied.

The cardinal principle of investing is to think first about preserving capital before thinking about making money. In equities, we try to accomplish that by paying far less than what the company is worth, as measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want an adequate "Margin of Safety" and this is what distinguishes investment from speculation.

Although the methodologies may differ, the same cardinal principle applies when one is investing in other financial instruments. For example, the greater the probability of permanent loss of capital, the greater the spread should be between a particular debt instrument and risk-free treasuries. Currently the spreads between the higher risk securities and U.S. treasuries are at near historic lows. Other indicators also are showing that investors are in a euphoric mood and so are chasing yields and/or returns without giving due weight to the risk of potential market disruptions which could result in permanent loss of capital.

The following are some examples:

1) The spread between U.S. corporate high yield debt and 5 year U.S. treasuries is at a near historic low. The average spread between January 1991 and March 2007 was about 481 basis points (4.81%). Currently it is 270 basis points. At its widest, in November 2002, it was 1,094 basis points (source: Citigroup).

2) The spread between U.S. corporate high yield debt and U.S. investment grade bond is approaching the lowest we have ever seen. The average spread is about 436 basis points. Currently it is 187 basis points. At its widest, in November 2002, it was 845 basis points (source: Citigroup).

3) 1.6% of global junk-bond debt (by dollar amount) defaulted in 2006, the lowest default rate experienced by this group since 1981. The historical default rate for junk bonds is 4.9%. Junk bonds are debt offerings of companies rated Ba or lower (by Moody's) and involve investment risks which may include the loss of principal invested as a result of the failure of the company (source: Financial Times).

4) Consumer debt relative to GDP in the U.S. is the highest ever. Over the past 60 years, the ratio was less than 50%. Currently it is over 90% and trending higher.

5) Long term interest rates have been trending down since 1981. In September 1981, the interest rate on 10 year U.S. treasuries was 15.3%. Recently it was at 4.75%. This bull market is 26 years long! Contrarians would instinctively think the trend is due for a reversal.

6) Inflation in the U.S. has trended down from its high of 14.8% in 1980 to less than 2.1% currently. Again, this trend is 27 years long and contrarians would instinctively think it is due for a reversal.

7) Business school graduates are gravitating in large numbers to hedge funds and private equity funds. Historically, they have been attracted to industries that are about to peak or have peaked.

From these examples, it appears obvious that investors are throwing caution to the wind. Risk is not priced into riskier securities at all. Whenever the majority of investors are purchasing securities at prices that implicitly assume that everything is perfect with the world, an economic dislocation or other shock always seems to appear out of the blue. And when that happens, investors learn, once again, that they ignore risk at their peril.

We continue to diligently look for undervalued stocks and will buy them only when they meet our price criteria – in other words - when they are priced for '**IMPERFECTION**'.

Derivatives and financial institutions

We remain a keen and interested observer of derivative instruments. Derivative instruments are financial instruments created by market participants so that they can trade and/or manage more easily the asset upon which these instruments are based. Derivatives are not asset classes unto themselves. Their values are derived solely from an underlying interest, which may be a commodity such as wheat or a financial product such as a bond or stock, a foreign currency, or an economic/stock index.

According to the Bank for International Settlements, contracts outstanding worldwide for derivatives at the end of June 30, 2006 rose to $370 *trillion*. We are alarmed by the exponential rise in the use of derivatives. No one knows how dangerous these instruments can be. They have not been stress tested. However we cannot remain complacent. We believe the risk embedded in derivative instruments is pervasive and most likely not limited or localized to a particular industry. Financial institutions are most vulnerable when (not if) surprises occur – and when they occur they are almost always negative.

As a result, we have not invested heavily in financial institutions although at times their stock prices have come down to buy levels. Some 30 years ago, when an investor looked at a bank, he or she knew what the items on the balance sheet meant. The investor understood what criteria the bankers used to loan out money, how to interpret the loss reserving history, and how to assess the quality and sustainability of revenue streams and expenses of the bank to generate reasonable earnings. In a nutshell, we were able to appraise how much the bank was worth based on how efficiently its bankers were utilizing the **3-6-3** rule.

The **3-6-3** rule works like this: The bank pays 3% on savings accounts, loans out money to businesses with solid financials at 6%, and then the banker leaves the office at 3pm to play golf.

That was 30 years ago and you can see how easy it was to evaluate a bank.

Now, when an investor examines a bank's financials, he or she is subjected to reams of information and numbers but has no way of ascertaining with a high degree of certainty how solid the assets are, or whether the liabilities are all disclosed, or even known, much less properly priced. As the investor digs deeper into the footnotes, instead of becoming enlightened, more doubts may surface about the true riskiness of the bank's liabilities. Those liabilities could be securitized, hidden in derivative instruments or morphed into any number of other instruments that barely resemble the original loans.

We wonder whether bankers are using a rule that is as difficult to understand as their derivative instruments. We call it the **1-12-11** rule, namely, the bank pays 1% on checking accounts, loans out money to businesses with weak financials at 12%, and the banker leaves the office at 11am to play golf with hedge fund and private equity managers where they discuss how to chop and/or bundle the loan portfolios into different tranches and create, out of thin air, new derivative products that are rated triple A (from products that originally were B rated). These products are then sold to institutions (who may be oblivious of the risk involved) that are reaching for yields.

The above example is written tongue-in-cheek and it is not meant to be entirely representative of what bankers do. It is meant to show just how creative participants have been in producing new derivative products, with little regard for a sound understanding of their leverage and true risk characteristics. We may be witnessing a ‘tragedy of the commons’ where the search for quick individual profits is causing a system-wide increase in risk and reckless behavior.

Credit default swaps (CDS)
In our semi-annual report dated August 11, 2005 we informed investors of our interest in CDS. By way of this letter, we are providing our unitholders with the 60 days notice required by securities authorities so that the Chou Funds may choose to invest in CDS commencing no earlier than May 31, 2007.

With that legal announcement out of the way, we can now continue to discuss the investment merits of CDS. Although they are derivatives, we are willing to look into them provided we find that there is sufficient and ample coverage against counterparty risk.

In terms of investment ideas in derivatives, we believe that CDS are selling at prices that are compelling. At recent prices, they offer the cheapest form of insurance against market disruptions. In CDS, one party sells credit protection and the other party buys credit protection. Put another way, one party is selling insurance and the counterparty is buying insurance against the default of the third party’s debt. The Chou Funds would be interested in buying this type of insurance.

To give you some sense of perspective, in October 2002, the 5 year CDS of General Electric Company was quoted at an annual price of 110 basis points. Recently, it was quoted at an annual price of less than 8 basis points.

To make money in CDS, you don’t need a default of the third party’s debt. If there is any hiccup in the economy, the CDS price will rise from these low levels. The negative aspect is that, like insurance, the premium paid for the protection erodes over time and may expire worthless.

Sub-prime mortgage lenders
Some of the greatest excesses of easy credit were committed by sub-prime mortgage lenders. Credit standards were so lax and liberal that homeowners didn’t even need to produce verification of income to be able to borrow up to 100% or more of the appraised value of their houses.

Companies with the most liberal lending practices have started to report serious, even crippling, financial problems. Some optimists believe that the worst is over. However, they may be in for a surprise. Instead of it being the darkest hour before the dawn, it could be the darkest hour before pitch black. It will take a while (and maybe a long while) for the excesses to wring themselves out of the system.

Other matters
Fee Based Series (“F”) units: Due to repeated requests from financial planners and dealers, we introduced a new class of units called Series F units in September 2005. In this class the dealers will not receive any trailer fees but they can charge any fee with the consent of their client.

Foreign Currency Hedging: Several currency hedges existed during the year but none existed as at December 31, 2006.

$US Dollar Valuation: Any investor who wishes to purchase the Chou Funds in $US will now be able to do so.

New Service Providers: Effective November 6, 2006, Citigroup Fund Services Canada, Inc. (CFSC) and its affiliates are the new service providers of fund operation to the Chou Funds.

Concentra Financial is providing the Chou Funds with trustee services for registered products such as administering plans for RRSPs, RRIFs, LRIFs and LIFs.

Investment Awards: Please forgive me for this shameful display of self-promotion but Chou Associates Fund won the 2006 U.S. Equity Fund of the Year at the Investment Awards ceremony held on November 30, 2006 in Toronto.

Redemption Fee: We have a redemption fee of 2% if unitholders redeem their units in less than 2 years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders. We hope this fee is enough to dissuade short-term investors from jumping in and out of the Fund to chase possible short-term performance.

As of March 2, 2007, the NAV of a Series A unit of the Fund was $93.43 and the cash position was 43% of net assets. The Fund is up 2.0% from the beginning of the year.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 12, 2008

Dear Unitholders of Chou Associates Fund,

After the distribution of $2.31, the net asset value ("NAVPU" or "NAV") of a Series A unit of Chou Associates Fund at December 31, 2007 was $79.97 compared to $91.65 at December 31, 2006, a decrease of 10.2%, while the S&P 500 Total Return Index decreased 10.3% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund returned 5.8% while the S&P 500 Total Return Index returned 5.5%.

The table below shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2007 (Series A unit)	**Past Year**	**Past 3 Years**	**Past 5 Years**	**Past 10 Years**	**Past 15 Years**
Chou Associates($Cdn)	-10.2%	6.6%	6.5%	10.1%	13.5%
S&P500 ($Cdn)	-10.3%	1.8%	2.8%	2.1%	8.6%
Chou Associates($US)[6]	5.8%	13.8%	16.8%	14.1%	15.4%
S&P500 ($US)	5.5%	8.6%	12.8%	5.9%	10.5%

Rates of return are historical total returns including changes in unit prices and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and which could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance.

Factors influencing the 2007 results

Canadian Dollar: The strength of the Canadian dollar against the U.S. dollar, the pound sterling, and the Euro had the biggest negative impact on the results of the Fund. The dramatic difference in performance results between the net asset value per unit (NAVPU) priced in Canadian dollars, versus U.S. dollars, is attributable to the fact that on December 31, 2006, one U.S. dollar was worth approximately $1.17 Canadian, whereas one year later, on December 31, 2007, one U.S. dollar was worth approximately $0.99 Cdn. Even if the price of an American security remained the same in 2007, it would have nonetheless shown a depreciation of roughly 15.1% at year end when priced in Canadian dollars. Similarly, a security denominated in the pound sterling and the Euro would have depreciated by roughly 13.5% and 6.1% respectively.

For the year 2007, the average monthly assets held by the Fund in non-Canadian securities was 86.6%. As such, the strength of the Canadian dollar had a significant impact on the Fund's results.

Round Trips: For the year 2007 we took more than our fair share of "round trips." Some of the undervalued stocks we bought did appreciate to close to fair value, but unfortunately we hung on

[6] The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 is based on the $US equivalent conversion of the results of the Chou Associates Fund($Cdn). The investments in the Chou Associates Fund ($Cdn) are the same as the investments in Chou Associates Fund($US) except for the currency applied.

for too long. In hindsight, it would have been better to sell them rather than wait for the last 5% to 10% of appreciation which would have brought them right up to fair value.

Major positive contributors to the Fund's performance were Royal Boskalis Westminster, Berkshire Hathaway and Flagstone Reinsurance Holdings. We suffered declines in Sears Holdings, King Pharmaceuticals, Biovail Corporation and XO Holdings.

Hedging Currency for the long term

We are long term investors and, in general, our bias has been to concentrate on stock selections and not worry about currency fluctuations. With years like 2007, the question arises as to whether there have been major disparities in annualized returns over the long term between a hedged portfolio and an unhedged portfolio; in other words, does one offer more advantageous performance results during currency fluctuations? Two studies, one covering the period from 1975 through 1988 and the other from 1988 through 2003, confirm that with respect to the long term there have been no material differences in returns.

The study for the period from 1975 to 1988 was conducted by Lee Thomas, and presented in a paper titled "The Performance of Currency – Hedged Foreign Equities". I first read about his findings in an article written by Tweedy Browne, a famous value investment firm in the United States. Excerpts from the Tweedy Browne article appear below.

"A study by Lee Thomas, 'The Performance of Currency – Hedged Foreign Equities', examined the performance of equities in Germany, France, Canada, the United Kingdom, Japan and Switzerland from 1975 through 1988, comparing unhedged results to hedged results for a U.S. dollar investor. These six stock markets accounted for about 88% of the world market capitalization, excluding the United States. The study used FT-Actuaries Indices returns, included dividends and assumed that the beginning of each month the investor hedged by selling forward (for U.S. dollars) for one-month delivery the foreign currency value of his equity shares. Over the 1975 through June 1988 study period, the compounded annual returns on hedged and unhedged foreign equities were **16.4%** and **16.5%** respectively."

The study for the period from 1988 to 2003 was done by Meir Statman, and Glenn Klimek, Professor of Finance at Santa Clara University. They wrote, "We examined hedged and unhedged portfolios during 1988 - 2003 and find that their realized returns and risk were virtually identical. Portfolio managers who care about the risk and expected returns of policy portfolios could have chosen to hedge or not to hedge by the toss of the coin. The mean monthly returns of unhedged global portfolios were higher than those of hedged ones in eight of the 16 years from 1988 through 2003 and lower in the other eight…. The **8.53%** mean annualized return of the unhedged global portfolio was slightly lower than the **8.60%** mean annualized return of the hedged portfolio during the overall 1988-2003 period."

While the effect on long term results may be statistically insignificant, on a year-to-year basis, currency swings can truly distort results. These swings can be heart stopping, particularly for our unitholders, and especially when the currency goes against them. This was evident with the Fund in 2007. But in this situation the reactions were mixed. We received a number of calls regarding the results. Investors from Niagara Falls on the U.S. side of the border were quite pleased with the 2007 performance (+5.8%), whereas investors just half a mile away, in Niagara Falls, Canada, expressed concerns about the Fund's performance (-10.2%).

We don't know what the true value of the Canadian dollar is vis-à-vis the U.S. dollar but we would hazard a guess that it is somewhere between 80 cents and $1.20. Therefore, we believe that the Canadian dollar is trading in the range of fair value. However, on a short term basis, it is subject to many variables such as the current price of energy, monetary and fiscal policies of both countries, carry trades by currency speculators (they can swing it either way by 30%) and so on.

When deciding to hedge vs. not hedge, it is only in hindsight that there can ever be certainty that the right decision was made. It is virtually impossible to sustain any reliable degree of success in predicting which way to go. When measured on a year to year basis we have been wrong in the past and it is likely that we will be wrong again in the future. But there is little need for concern. The ramifications of such hedging decisions should only affect short term performance results for the Fund. We are long term investors and therefore, over the long term, whether we 'got it right' or not should be immaterial.

Our bias at this time is 'not' to hedge because we believe that the Canadian dollar is trading in the range of fair value. In the long run, it will be influenced significantly by energy prices. Based on the latest trade figures, Canada's trade with the world is at a deficit net of energy. With the dollar at parity with the U.S. dollar, all the numbers from exports, tourism, manufacturing and retail sales look appalling when compared to last year. The only time where we may be inclined to hedge the currency is during a period of extreme undervaluation. So for now, be prepared for a bit of a bumpy ride, and some extra volatility, but take into account the results of the aforementioned studies which indicate that (at least in the past) it all evens out in the long run. And remember, hedging currencies comes with a cost…about 1% a year.

One final thing to consider: As the Fund's perspective is long term, the fluctuations in performance should also be put into perspective. An 85 year old woman approached me recently and asked, "How would you define long term to me? Based on your definition, I will be dead anyway." I was flummoxed, obviously, and sheepishly replied, with great optimism, that perhaps she might live to be 115 and set the record for the longest living person on earth.

We do offer an alternative to investors who believe strongly that the Canadian dollar is going to strengthen considerably against the U.S. dollar. We offer units of the Fund in U.S. dollars, and investors can switch the units denominated in Canadian dollars to U.S. dollars without any penalty, charges, or incurring a capital gain or loss in so doing.

General comments on the market

Despite a decline of about 10% from its high, the market is not cheap, however it is not expensive either. For years we have been lamenting the fact that we cannot find any decent bargains, but lately four sectors have been hit hard and we can find plenty of companies in those sectors that are selling significantly below what they are worth. The four sectors are: retail, media, telecommunications and cable, and pharmaceuticals.

Repricing of risk

At the time of writing last year, preservation of capital was given almost zero consideration. However, this year there has been a huge repricing of risk. The following are some examples:

1) The spread between U.S. corporate high yield debt and 5 year U.S. treasuries was 270 basis points a year ago. Currently, it is 778. At its widest, in November 2002, it was 1,094 basis points (source: Citigroup).
2) The spread between U.S. corporate high yield debt and U.S. investment grade bonds was 187 basis points a year ago. Currently, it is 549. At its widest, in November 2002, it was 845 basis points (source: Citigroup).

Last year, we wrote that some of the greatest excesses of easy credit were committed by subprime lenders. Credit standards were so lax and liberal that homeowners didn't even need to produce verification of income to be able to borrow up to 100% or more of the appraised value of their houses.

The chickens are coming home to roost for companies that were in any way associated with housing and housing related issues, and those companies include commercial and investment banks, mortgage lenders, monoline bond insurers, hedge funds, you name it. So far, they have announced $255 billion (source: Deutsche Bank) in losses. While the numbers may look awful, the reality is far worse. The problem started with subprime borrowers and it is spreading to Alternate A borrowers (between subprime and prime) and ultimately, although to a lesser degree, it will affect prime borrowers. The reason for the spreading is that credit standards were equally lax with Alternate A borrowers and prime borrowers. On top of that we have yet to factor in the impact of liquidity squeeze from financial deleveraging, and that of loans in leveraged buyouts, commercial real estate, automobiles, margin loans, structured products, and the like. Institutions were so driven by incentives to securitize assets into asset backed securities and CDOs (Collateralized Debt Obligation) that they were willing to overlook the true riskiness of the securities involved. Those securities were then morphed into derivatives or any number of exotic instruments that barely resemble the original loans. Credit standards did not matter but volume and liquidity did, and 'mortgages' was one product that easily satisfied that criteria.

In general, we find that executives who sugarcoat business realities and embellish results, downplay issues and disguise potential problems to investors may be trying to fool their audience, but eventually they end up fooling themselves. They start believing in their own world of make-believe.

We would be careful about buying any financial stock. It is virtually impossible to find out what toxic brew the financial companies may hold in their balance sheets (either because they may not want you to know the truth or because even they don't know the truth themselves). Financial companies use 'best estimates' for many line items on the balance sheet and when companies are in trouble, they frequently have a chance to downplay the seriousness of the problems. Most of them are honourable but there are a few who use, what I've coined, "the 'DROP' principle" on unsuspecting investors. (D is for dribbling out the bad news slowly, R is for raising money, and OP is for dishing out the most optimistic projections.) Once the money has been raised from investors, these companies will announce a few months later 'the big drop' – that is, to take a big writedown. Yet still, having said that, we are looking for companies that are not involved directly with financials but, instead, have been somewhat tainted by association.

Our historical returns and what we can learn from them

As we have stated in our past letters, the cardinal principle underlying the investments in the Fund is to pay far less than what the company is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want an adequate 'Margin of Safety' and this concept, while unappreciated and ignored by most, is what distinguishes investment from speculation. It is different from volatility, where stocks can go up or down in a given year.

Fortunately, we have over 20 years of performance to show what can be accomplished for investors while employing the "Margin of Safety" concept.

If you look at the following table, in 1999, 1994 and 1990 we had negative years but each time we bounced back. Even if you invested at the high, let's say in 1998, 1993 or 1989, you would still do reasonably well long term. When you are a value investor, you have no control on short term volatility. While the future is never certain, we have no reason to believe the statement "If you buy stocks that are undervalued, good things happen to you eventually", will not be as valid in the future as it has been in the past. The current environment reminds us of 1999 – stocks that were expensive became more expensive and stocks that were cheap became cheaper but eventually 'value will out' – as the expression goes. As the subprime (mortgage) meltdown and the bursting of the credit bubble play themselves out, they directly and indirectly affect the prices of almost all debt and equity securities, and the market will be highly volatile for a while. Therefore, the unit value of our Fund will also be volatile. So, this is not the time to get too anxious. Volatility is playing into our hands. We wouldn't be finding stocks or fixed income debts as cheap as they are now if it wasn't for this fear in the market. Market participants that invested in the toxic brew securities are dumping debt and equity securities indiscriminately as they are forced to raise cash to meet margin calls and redemptions. We would encourage our unitholders to review and understand the table as it may help them to not fret too much. As you can see, we have done reasonably well in the long run.

Notwithstanding, the amount of money that investors choose to invest in the Fund should only be to the extent that they can afford to **lose 40%** or more of their investment. This may sound drastic, but sleeping well and not getting too anxious are also important considerations both for the manager and the unitholder.

	Chou Associates Fund	
Period Ended	Growth in $10,000 Invested	Annual Return
Dec.31, 1986	10,000	
Dec.31, 1987	10,502	5.0%
Dec.31, 1988	12,001	14.3%
Dec.31, 1989	14,244	18.7%
Dec.31, 1990	**12,722**	**-10.7%**
Dec.31, 1991	15,681	23.3%
Dec.31, 1992	18,817	20.0%
Dec.31, 1993	21,863	16.2%
Dec.31, 1994	**21,300**	**-2.6%**
Dec.31, 1995	27,904	31.0%
Dec.31, 1996	34,235	22.7%
Dec.31, 1997	48,035	40.3%
Dec.31, 1998	59,187	23.2%
Dec.31, 1999	**53,489**	**-9.6%**
Dec.31, 2000	57,967	8.4%
Dec.31, 2001	70,397	21.4%
Dec.31, 2002	91,504	30.0%
Dec.31, 2003	94,773	3.6%
Dec.31, 2004	103,319	9.0%
Dec.31, 2005	117,462	13.7%
Dec.31, 2006	139,511	18.8%
Dec.31, 2007	**125,258**	**-10.2%**

Rates of return are historical total returns including changes in unit prices and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and which could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance.

Credit default swaps (CDS)
In last year's letter, we informed investors of our interest in CDS. We wrote, "In terms of investment ideas in derivatives, we believe that CDS are selling at prices that are compelling. At recent prices, they offer the cheapest form of insurance against market disruptions. In CDS, one party sells credit protection and the other party buys credit protection. Put another way, one party is selling insurance and the counterparty is buying insurance against the default of the third party's debt. The Chou Funds would be interested in buying this type of insurance…. To give you some sense of perspective, in October 2002, the 5 year CDS of General Electric Company was quoted at an annual price of 110 basis points. Recently, it was quoted at an annual price of 8 basis points. To make money in CDS, you don't need a default of the third party's debt. If there is any hiccup in the economy, the CDS price will rise from these low levels. The negative aspect is that, like insurance, the premium paid for the protection erodes over time and may expire worthless."

Subsequent to that letter it took until mid September 2007 for all of our compliance and regulatory approvals to be put into place and by then the prices of CDSs had moved appreciably. In accordance with our prospectus we could invest no more than 5% of the net assets of the Fund, at the time of purchase, in CDSs.

We missed the low hanging fruit, but the good thing is we now have these approvals in place and can exploit the situation next time. The current price of General Electric's 5 year CDS is at 168 basis points, and shows the potential for gain.

Other matters
Foreign Currency Hedging: None existed in 2006 and 2007.

U.S. dollar Valuation: Any investor who wishes to purchase the Chou Funds in $US is now able to do so.

Independent Review Committee: Under the provisions of National Instrument 81-107 Independent Review Committee for Investment Funds ("NI 81-107"), which came into force on November 1, 2006, it is now required that all publicly offered investment funds, such as the family of Chou Funds, establish an independent review committee ("IRC") to whom the Manager is to refer all conflict of interest matters for review. This instrument further mandates that the IRC be composed of at least three independent members and requires that they report, at least annually, to the Manager and shareholders in respect of the IRC's duties.

The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Bruce Kerr and Joe Tortolano.

The IRC report is posted on our website www.choufunds.com. Hardcopies are available, upon request, by contacting Chou Associates.

Management Fees Waived: We waived a portion of the management fees for the Chou RRSP Fund. The MER should have been 1.70% but instead it was 1.62%. We also waived the management fees for the months of November and December for the Chou Europe Fund. The MER should have been 1.87%, but instead it was 1.63%.
New Location: Effective Thursday, November 1, 2007, we have moved our corporate office to the following location:

110 Sheppard Avenue East

Suite 301, Box 18
Toronto, Ontario M2N 6Y8

Redemption Fee: We have a redemption fee of 2% if unitholders redeem their units in less than 2 years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders. We hope this fee is enough to dissuade short term investors from jumping in and out of the Fund to chase possible short term performance.

As of March 7, 2008, the NAV of a Series A unit of the Fund was $73.90 and the cash position was 32.3% of net assets. The Fund is down 7.6% from the beginning of the year.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 13, 2009

Dear Unitholders of Chou Associates Fund,

After the distribution of $2.58, the net asset value (“NAVPU” or “NAV”) of a Series A unit of Chou Associates Fund at December 31, 2008 was $53.96 compared to $79.97 at December 31, 2007, a decrease of 29.3%; during the same period, the S&P 500 Total Return Index decreased 22.6% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund decreased 42.6% while the S&P 500 Total Return Index decreased 36.9%.

The table shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2008 (Series A)	**1 Year**	**3 Years**	**5 Years**	**10 Years**	**15 Years**
Chou Associates ($CAN)	-29.3%	-9.0%	-1.3%	4.1%	9.8%
S&P500 ($CAN)	-22.6%	-6.9%	-3.4%	-3.7%	5.8%
Chou Associates ($US)[7]	-42.6%	-10.3%	-0.1%	6.6%	10.3%
S&P500 ($US)	-36.9%	-8.3%	-2.2%	-1.4%	6.5%

Rates of return are historical total returns including changes in unit prices and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and which could reduce these returns. The returns are not guaranteed. The Fund’s past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2008 Results

CANADIAN DOLLAR: The weakness of the Canadian dollar against the U.S. dollar had a positive impact on the results of the Fund. However, we did not receive the full benefit from the weakening of the Canadian dollar. The reason was that we had entered into a currency contract for 23% of the portfolio against the rise of the Canadian dollar versus the U.S. dollar. The currency contract cost the Fund approximately $45.3 million. Had we not contracted against the Canadian dollar, the performance of the Fund, though still negative, would have been better. The returns would have been approximately -22% instead of the -29.3%. The -22% is not an absolutely correct number because it does not incorporate the purchases and redemptions of the Fund over the contract period. Even though the number may not be exact, it does give a more accurate assessment of how the portfolio of the Fund performed for the year 2008.

INVESTING TOO EARLY: One of the hazards of being a value investor is that every now and then you are bound to buy stocks too early. Over the last few years, we have communicated through our letters, our deep concern about the easy credit, irresponsible lending, housing bubble and the potential dangers of derivatives like CDOs (collateralized debt obligations) impacting financial companies. As pessimistic as we were over the years, we did not anticipate how

[7]The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 are based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

severely these factors would paralyze and cripple the financial system when the bubble did burst. There was no place to hide.

And so, based on the information we had in 2007, we purchased some stocks at prices that, in hindsight, were too high. The ensuing economic crisis, credit freeze and deleveraging severely impacted the intrinsic values of some of the stocks we purchased. As you may be aware, the intrinsic value is based on the sustainability of earning power and when it is negatively impacted by any severe economic crisis, the intrinsic value is impacted also. As a consequence, we suffered a permanent loss of capital investing in those companies.

While the stock prices of other companies we bought too early declined with the economic crisis, their fundamentals were not impaired. We expect these companies to do quite well in the future. We classify such losses as a temporary quotational loss of capital and not a permanent loss of capital. A unitholder facetiously said that we suffered from a severe case of premature accumulation.

As you can see, we cannot forecast the market. Speaking from hindsight, perhaps, we could have done a better job of safeguarding capital but most likely, if we were given the same information as we had in 2007, we would have made substantially the same investment decision as we did then.

Major positive contributors to the Fund's performance were King Pharmaceuticals, Sanofi-Aventis and Watson Pharmaceuticals. Conversely, we suffered significant price declines in Royal Boskalis Westminster, McClatchy, Media General, Gannett, Office Depot and debt securities of Abitibi.

Repricing of Risk

At the time of writing two years ago, preservation of capital was given little consideration. However, in 2008 there was a huge repricing of risk. For example, the greater the probability of permanent loss of capital, the greater the spread should be between a particular debt instrument and risk-free treasuries. Currently the spreads between the higher risk securities and U.S. treasuries are at near historic highs. Other indicators are showing that investors are running scared, and banks and financial institutions are hoarding capital instead of lending. The following are some examples:

1) Two years ago, the spread between U.S. corporate high yield debt and U.S. treasuries was 311 basis points; a year ago it was 800 basis points. Currently, it is over 1,600 basis points, down from its peak of over 1,900 basis points in December 2008. (Source: JP Morgan).

2) Two years ago, the spread between U.S. investment grade bonds and U.S. treasuries was approximately 85 basis points; a year ago it was approximately 274 basis points. It is now over 550 basis points, which is slightly down from its peak of 592 basis points in December 2008. (Source: JP Morgan).

3) In December 2008, an auction of 4 week treasury bills ended with a 0% yield (currently they are yielding 8 basis points or 0.08%). The yield on 10 year treasury is 2.94% (up from 2% in December 2008) but down from 4.75% two years ago. In September 1981, it was 15.3%.

4) Today, investment bankers and anyone working for the financial/investment industry are considered the new pariahs of society. They are the butt of jokes. My favorite one is, 'What is the difference between an investment banker and a pigeon'? 'At least a pigeon can still put a deposit on a house'.

The examples show that the pricing of risk has changed 180 degrees from a couple of years ago. One can argue that corporate bonds, both investment grade and non-investment grade, are mispriced more than equities. In addition, if corporate bonds are cheap, the treasuries are in bubble territory. In our opinion, this is the worst time to hold cash and short-term treasuries unless you believe we are headed into a 1930's style depression. If you believe that you should redeem all of your Fund units.

General Comments on the Market

ZOMBIE COMPANIES: The Fed and the U.S. government have a tough job in tackling the financial crisis and, whatever actions they take, they are scrutinized, criticized and/or second guessed. There is no one perfect approach. Every approach has its pros and cons. However, where zombie companies are concerned, we would prefer to give companies that are insolvent and failing the opportunity to reorganize and restructure their capital structure in an organized way. When they do emerge from reorganization, they will come out leaner and stronger. What we are seeing now is that the U.S. government has pledged $9.7 trillion (and still counting) to counter the financial crisis. Billions of dollars have been given to prop up failing financial institutions and still they are asking for more financial assistance. The requests from the very large financial institutions are not based on business and investment merit but more on the line that if they don't receive more bailout money, they would have to file for bankruptcy and that would precipitate a chain reaction that will totally paralyze not only the U.S. financial system but also the entire Western banking system. The sooner we recapitalize the zombie companies in some form or the other (including nationalization for a short-term period) the quicker we can unfreeze the credit market and get the economy moving again.

MARK-TO-MARKET ACCOUNTING: We have been hearing of late that the current financial mess is caused in part by mark-to-market accounting. Nothing could be further from the truth. The financial mess was caused by misguided policies and actions on the part of some companies and would have occurred regardless of whether this accounting rule was in place or not. As investors, we prefer transparency and clarity and unless these rules exist, companies will not disclose what the assets are currently worth in the market. Obviously, when there are extenuating circumstances like the period we are in now, good and toxic assets may be priced at unduly low prices. In such a case, we would favour a provision that gives companies some grace period before they have to take action to shore up their balance sheets either through asset sales or by raising capital. In the end, transparency should prevail over opaqueness and undisclosed market values in the financial statements.

INFLATION: Almost all governments whose economies have been adversely affected by the financial crisis have been providing all kinds of liquidity including printing money to minimize the impact of the credit freeze on their economies. Historically, that is how nations have tackled their debt burden and this episode is no different. In the short term it may work, as the liquidity will counter some of the deleveraging and credit freeze in today's crisis. But longer term such actions can bring huge unintended consequences including the return of high inflation and the likely debasement of the U.S. currency. We don't know the timing of it but all that excess liquidity will have to go somewhere when normal times return.

MORE REGULATION: Yes, we will have a more regulated environment going forward. You can bet your last dollar on it. There is a need for regulatory reforms to ensure that, in the future, the near collapse of the world financial system does not happen again. And more regulation of financial institutions will most certainly lower their future growth and profitability.

We need to also get away from the notion of 'too big to fail'. Failing financial companies have used this excuse to hold us ransom in giving them financial assistance.

PENSION ASSETS: Most corporate pension plans have a majority of their assets invested in equities. With the markets down at least 40% across the world, we can safely assume that pension assets are down significantly. Eventually, companies have to make up the shortfall of their underfunded pension assets and therefore, their cash flow and earnings will take a significant hit in the future.

RECOVERY OF THE STOCK MARKET AND ECONOMY: The economy may get worse before it gets better. However, I have strong faith in the strength and resilience of a free market system. In the 20th century, the standard of living went up seven times in spite of the Great Depression, two World Wars, the oil embargo in the 1970s, interest rates of 15% or more to combat inflation and so on. The current financial crisis is severe, probably not as bad as the Great Depression, but worst of all the recessions in the 20th century. One unitholder said, 'This market feels worse than a divorce. You lose 50% of your assets and you still have your spouse'.

The good news is, if one wants to look at the current situation in a contrarian manner, most of the bad news is already reflected in the stock prices. We don't know whether the stock market has hit bottom yet but we suspect that when we look back at the current environment 10 years from now, we will classify this as one of the best periods for buying stock and debt securities.

BANKING SECTOR: Banks that have not been affected by the financial crisis will do quite well in the future. With the governments driving the treasuries to yield nearly 0%, the spread between what the banks are paying for deposits and borrowings in the market (like FDIC insured), and what they can lend at is enormous. For the first time in many years, banks are being paid handsomely for the risks they are taking. See the section under 'Repricing of Risk'.

CREDIT DEFAULT SWAPS (CDS): In general, the CDSs are way overpriced. What a dramatic difference from two years ago. To give you some sense of perspective, in October 2002, the 5 year CDS of General Electric Company was quoted at an annual price of 110 basis points. Two years ago, it was quoted at an annual price of 8 basis points and lately it is priced at over 900 points.

Some pricing in the CDS market is absurd. Barrons (March 9, 2009) reported that, 'A Merrill Lynch analyst Friday noted it was more costly to protect oneself from the possibility of a default by Berkshire Hathaway (ticker: BRKA) than one by Vietnam. And General Electric (GE) CDS prices outstripped those of Russia -- a country that a dozen years ago actually did default on its foreign debt'.

Other Matters

WAIVER AND REBATE OF MANAGEMENT FEE: Almost all management fees, net of trailer fees paid, were rebated for 2008 and all prior years for Chou Europe Fund since its inception in September, 2003.

The Manager waived approximately 77% of the management fees for 2008, net of trailer fees paid, for Chou Bond Fund.

The decision to waive or rebate the management fees, in whole or in part, is reviewed annually and determined at the discretion of the Manager without notice to unitholders.

FOREIGN CURRENCY CONTRACT: The amount contracted at December 31, 2008 was approximately 34% of the net assets.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in $US is now able to do so.

INVESTMENT AWARDS: Please forgive me for this shameful display of self promotion but Chou Associates Fund won the 2008 Small/Midcap Global Equity Fund of the Year at the Investment Awards held on December 3, 2008 in Toronto (please stop laughing .... I am not making this up).

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Bruce Kerr and Joe Tortolano. The 2008 IRC Annual Report is available on our website www.choufunds.com.

As of March 13, 2009, the NAV of a Series A unit of the Fund was $49.59 and the cash position was 1.8% of net assets. The Fund is down 8.1% from the beginning of the year. In $US, it is down 12%.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND

(unaudited)

March 15, 2010

Dear Unitholders of Chou Associates Fund,

After the distribution of $1.53, the net asset value ("NAVPU" or "NAV") of a Series A unit of Chou Associates Fund at December 31, 2009 was $68.46 compared to $53.96 at December 31, 2008, an increase of 29.7%; during the same period, the S&P 500 Total Return Index increased 8.6% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund increased 51.1% while the S&P 500 Total Return Index increased 26.4%.

The table shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2009 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years
Chou Associates ($CAN)	29.7%	-6.3%	2.1%	7.9%	11.9%
S&P500 ($CAN)	8.6%	-9.0%	-2.3%	-4.1%	5.9%
Chou Associates ($US)[8]	51.1%	-2.9%	5.0%	11.5%	14.1%
S&P500 ($US)	26.4%	-5.6%	0.4%	-1.0%	8.0%

Rates of return are historical total returns including changes in unit prices and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and which could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2009 Results

THE CANADIAN DOLLAR AGAINST THE U.S. DOLLAR: The gains on forward currency contracts helped minimize the negative impact the stronger Canadian dollar had on the results of the Fund. On December 31, 2008, one U.S. dollar was worth approximately $1.22 Canadian, whereas one year later, on December 31, 2009, one U.S. dollar was worth approximately $1.05 Canadian.

RECOVERY OF THE STOCK MARKET: After unprecedented interventions by governments around the world, the Fund benefited from the recovery of the global equity and fixed income markets that began in early March. Capital markets also opened up to give companies access to much needed capital.

[8]The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 are based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

Some of the major positive contributors to the Fund's performance were Media General, Watson Pharmaceutical, RCN, Sears Holdings and Royal Boskalis Westminster.

Securities in the portfolio that declined the most in 2009 were Berkshire Hathaway, K-Swiss and Abitibi-Consolidated debt.

Perspective on the 2009 Results

The Fund had one of the best years in its history both in absolute terms and when compared with the S&P 500 index. The Fund was up 29.7% and was able to recover most of the losses suffered in 2008. However, gloating about the 2009 result without taking the 2008 result into account does not provide the whole picture. Historically, our results have been excellent in bad markets. But the 2008 result was average at best, and while our result for 2009 was excellent, the 2008 result pulled down our 2-year average of 2008 and 2009 to above average. This shows that a negative result has a bigger impact than a positive result and being able to minimize losses in a bad year goes a long way toward achieving decent results on a long-term basis. We feel confident that the 'Margin of Safety' concept we follow will continue to give us satisfactory results in the future. My confidence is based on having achieved solid results over the long term.

On February 18, 2010, Chou Associates Fund won the Lipper Fund award for the best 5-year fund for the Global Small/ Midcap category. (*Please stop laughing ..... I am not making this* up).

General Comments on the Market

SOVEREIGN GOVERNMENTS DO NOT DEFAULT ON THEIR DEBT?: It is hard to believe that governments can and do default on their debts and, as the following table shows, even with their power of taxation and the ability to print money, governments have to obey the laws of economics. Just like an individual or a corporation, if governments cannot service their debt, they either default or have their debt rescheduled. As the table also shows, it is not only poor emerging third world or African countries run by dictators that default, but also long established democracies with duly elected governments that are governed by a rule of law and that are considered modern economies. It is an eye opener to see that since the year 1800, Greece has spent roughly 50% of its time either in default or debt rescheduling; Spain has spent approximately 23% of its time in default; and Mexico and Russia around 40%.

Country	Share (%) of years in default or rescheduling since independence or year 1800	Total number of defaults and/or reschedulings
Greece	50.6	5
Mexico	44.6	8
Russia	39.1	5
Hungary	37.1	7
Brazil	25.4	9
Spain	23.7	13
Austria	17.4	7
Germany	13.0	8
China	13.0	2
India	11.7	3

France	0	8
United Kingdom	0	0
United States	0	0
Canada	0	0

Source: This time is different *Eight centuries of financial folly* by Reinhart & Rogoff

The table is important because it demonstrates that it is not too farfetched to think that well-known democratic countries can and do default on their sovereign debt.

WAS THE GREAT STIMULUS A SILVER BULLET? - THINK AGAIN: It now appears that the great stimulus provided by almost all governments has averted the second Great Depression and the North American economy may well be on its way to recovery. However, looking forward, unless we find a credible way to repay or at least comfortably service the enormous and growing burden of government debt, we are going to face immense challenges. By overloading governments with too much debt, the stimulus may have pushed the problem from the private sector to the government sector and may have made it worse. If we take a snapshot of the growing gross debt as a percentage of GDP before and after the meltdown, we get a pretty good picture of the potential trouble some countries may face in the future.

Country	Debt as a percentage of GDP 2007	Debt as a percentage of GDP 2009	Debt as a percentage of GDP 2010 (projected)
Japan	167.1	189.3	197.2
Iceland	53.6	117.6	142.5
Italy	112.5	123.6	127.0
Greece	103.9	114.9	123.3
Belgium	88.1	101.2	105.2
France	69.9	84.5	92.5
USA	61.8	83.9	92.4
Portugal	71.1	83.8	90.9
Hungary	72.2	85.2	89.9
UK	46.9	71.0	83.1
Germany	65.3	77.4	82.0
Canada	64.2	77.7	82.0
Ireland	28.3	65.8	81.3
Brazil	57.4	66.9	69.6
Spain	42.1	59.3	67.5
India	42.3	45.0	45.7
S Korea	25.7	33.2	36.8
Australia	15.3	15.9	20.3
China	21.9	20.0	20.0
Russia	6.8	7.2	7.4

Source: JP Morgan provided data on Brazil, China, India and Russia. All other data obtained from the OECD.

At some level, debt becomes an intolerable burden and increases the chance of a default. Historically, when gross debt exceeds 70% of a country's GDP, the warning signs start flashing.

While we all wished the great stimulus would prove to be a silver bullet that would resolve all the problems stemming from the world financial crisis, that has hardly been the case. If history is any guide, it takes a long time for countries to successfully emerge from a financial crisis. They must deal with a huge increase in unemployment along with a profound increase in government debt. The problem is exacerbated by lower tax revenues in the future caused by lower output and unemployment. We think the next few years will be rocky, with economies lurching from one crisis to another.

As an investor, we believe there will be enormous opportunities but the key to investment success will depend on how we avoid some of the inevitable potholes we will find in our path.

We would also like to add a caveat to those who are investing in the Chou Funds: markets are inherently volatile in the short term and can adversely affect the Chou Funds. Therefore, investors should be comfortable that their financial position can withstand a significant decline - say, 50% - in the value of their investment.

TOO BIG OR TOO WELL CONNECTED TO FAIL: One would imagine that the great financial crisis would precipitate meaningful banking and financial reform but I doubt that will be the case. As long as the financial institutions are too big or so well inter-connected to the financial system that their failure may precipitate a chain reaction that threatens the world financial system, the government will protect them from failure. The rescue of AIG turned out to be essentially a bailout of the investment banks. When executives, especially CEOs, suffer no serious financial consequences when their actions bankrupt or put their companies in deep financial distress, it encourages risky and unethical behaviour. Such perverse incentives need to be discouraged. The Board of Directors is supposed to protect shareholders but more often than not, directors are just patsies for the CEOs. In a damning 2,200 page report, written by bankruptcy examiner Anton Valukas on Lehman Brothers, he wrote of one episode on March 20, 2007, where the chief administrative officer, Lana Franks Harber of Lehman's Mortgage Capital division, e-mailed a colleague to summarize her discussion with Lehman President Joseph Gregory with regard to her presentation to the Board of Directors: “Board is not sophisticated around subprime market -- Joe doesn't want too much detail. He wants to candidly talk about the risks to Lehman but be *optimistic and constructive - talk about the opportunities that this market creates and how we are uniquely positioned to take advantage of them.*” (italics emphasis added). The report then states, "Consistent with this direction, the Board presentation emphasized that Lehman's management considered the crisis an opportunity to pursue a countercyclical strategy.... Management informed the Board that the down cycle in subprime presented substantial opportunities for Lehman."

More than once, under a bankruptcy restructuring, I have seen the very CEOs who ran the company into the ground getting 5% of the recapitalized company without putting up any of their own money. In most occupations, there are penalties for egregious failure but the CEOs of public financial companies are in a league of their own. Many get paid obscene amounts of money for risky and reckless behaviour. There is a joke on Wall Street: "Today, President Obama announced a salary cap of $500,000 for executives at banks and companies that have received taxpayer bailout money. And the CEOs asked: ‘Well, that's $500,000 a week, right?'”.

DEBASEMENT OF CURRENCY: Almost all governments whose economies have been adversely affected by the financial crisis have been providing all kinds of stimulus funds to minimize the impact of the liquidity and credit crisis on their economies. They are all falling over (competing with) one another to see who can debase their currencies further.

INFLATION OR DEFLATION: The huge surplus of excess capacity in almost every sector in the world presents a strong case for deflation down the road. But with the explosion of government debt in most of the world, it is hard to believe that governments will let future generations deal with the enormous debt with currencies that will have a higher purchasing power than they have now. Historically, the easy way out for governments has been to inflate their way out of their debt problem.

NON-INVESTMENT AND INVESTMENT GRADE BONDS ARE FULLY PRICED NOW: The historically high spread between U.S. corporate debt and U.S. treasuries narrowed in 2009. Three years ago, the spread between U.S. corporate high-yield debt and U.S. treasuries was 311 basis points; at December 31, 2009 it was 657 basis points, down from its December 2008 peak of 1,900 basis points. Three years ago, the spread between U.S. investment grade bonds and U.S. treasuries was about 85 basis points; at December 31, 2009 it was 162 basis points, down from its December 2008 peak of 592 basis points. (Source: JP Morgan)

Given the above, we believe that investment and non-investment grade corporate bonds are now fully priced.

It is similar with equities. Most stocks are now close to being fairly priced and it is harder to find bargains. Although we won't likely see the lows that we saw in February/March of 2009, the risks of investing in equities are greater now.

Other Matters

FOREIGN CURRENCY CONTRACTS: None existed at December 31, 2009.

CREDIT DEFAULT SWAPS: None were purchased in 2009.

CONSTANT MATURITY SWAPS: None were purchased in 2009.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in $US is now able to do so.

CHANGE IN MINIMUM INVESTMENT: The minimum amount to invest in the Fund is now $5,000 and subsequent investment is $500.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Bruce Kerr and Joe Tortolano. The 2009 IRC Annual Report is available on our website www.choufunds.com.

As of March 12, 2010, the NAV of a Series A unit of the Fund was $73.50 and the cash position was 0.3% of net assets. The Fund is up 7.4% from the beginning of the year. In $US, it is up 10.3%.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 15, 2011

Dear Unitholders of Chou Associates Fund,

After the distribution of $0.71, the net asset value ("NAVPU" or "NAV") of a Series A unit of Chou Associates Fund at December 31, 2010 was $80.89 compared to $68.46 at December 31, 2009, an increase of 19.2%; during the same period, the S&P 500 Total Return Index increased 8.3% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund increased 25.5% while the S&P 500 Total Return Index increased 15.0%.

The table shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2010 (Series A)	**1 Year**	**3 Years**	**5 Years**	**10 Years**	**15 Years**
Chou Associates ($CAN)	19.2%	3.0%	3.1%	9.0%	11.2%
S&P500 ($CAN)	8.3%	-2.8%	-0.9%	-2.7%	4.5%
Chou Associates ($US)[9]	25.5%	2.8%	6.5%	13.6%	13.6%
S&P500 ($US)	15.0%	-2.8%	2.3%	1.4%	6.8%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2010 Results

THE CANADIAN DOLLAR AGAINST THE U.S. DOLLAR: The strength of the Canadian dollar against the U.S. dollar had a negative impact on the results of the Fund. The difference in performance results between the net asset value per unit (NAVPU) priced in Canadian dollars, versus U.S. dollars, is attributable to the fact that on December 31, 2009, one U.S. dollar was worth approximately CAN$1.05, whereas one year later, on December 31, 2010, one U.S. dollar was worth approximately CAN$0.99. Even if the price of an American security remained the same in 2010, it would have shown a depreciation of roughly 5.7% at year end when priced in Canadian dollars. As at December 31, 2010, our investments in U.S. dollars were approximately 95.9% of assets.

[9] The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 is based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

After unprecedented interventions by governments around the world, the Fund continued to benefit from the recovery of the global equity and fixed income markets that began in March 2009.

Positive contributors to the Fund's performance were International Coal Group, King Pharmaceuticals, Watson Pharmaceuticals, Valeant Pharmaceuticals, Overstock.com, Primus Telecommunications and debt securities of Abitibi-Consolidated. Securities that declined the most in 2010 were Media General, Sears Holdings, Sanofi-Aventis, and debt securities of Level 3 Communications.

We believe that equities and debt securities, both investment and non-investment grade, are now close to fully priced.

In equities, we believe the financial, retail and pharmaceutical sectors are undervalued. We favour a basket approach versus concentrating on one or two stocks in those sectors.

Debt Securities Can Be As Volatile As Equities

There is a common misconception that debt securities, whether investment grade or non-investment grade, do not fluctuate as much as equities. The following table shows that is not the case.

Ratings	**Price High 2007**	**Price Low 2008-2009**	**Price High 2010**	**Price at 12/31/2010**
Investment Grade				
AAA	176.40	157.00	206.30	199.60
AA	169.50	153.70	202.50	198.10
A	173.20	149.20	215.70	210.10
BBB	169.70	142.40	221.70	215.40
Non-Investment Grade				
BB	298.50	232.02	404.91	401.16
B	277.18	182.63	322.30	321.82
CCC	196.09	87.13	242.31	242.31
NR	169.86	118.05	270.87	270.87

This table is not precise. During 2007-2010, many companies' ratings were changed by rating agencies. As an example, some companies included in the aggregate as BBB in 2007 were rated differently in 2008-2009 because of changes by rating agencies. (Source: JP Morgan)

As you can see, debt securities, whether investment grade or non-investment grade, can be as volatile as equities. Yet this is where opportunity lies for investors who understand the recovery value of bonds. Namely, bonds can provide a higher margin of safety without sacrificing equity-like returns. However, if your valuations are wrong, the punishment can be as severe as it can be with equities.

In cases where we were uncertain about the investment merits of buying a company's common shares, we had no hesitation buying its undervalued debt securities if it met our criteria, especially if the debt security was selling at a price that gave us at least 10% yield to maturity (YTM). This 10% return may not sound like much until you remember that equities, on average, have generated long-term returns of around 8%-9%.

Investing in Debt Securities
In aggregate, over the years, our returns for the family of Chou Funds from investment grade and non-investment grade debt securities have been satisfactory.

While the following focuses on our experience with non-investment grade debt securities, it is largely applicable to investment grade securities as well.

When we look at what happened in 2008, we learn that a number of investment grade securities were quickly downgraded to non-investment grade. We also learn that investors cannot rely on rating agencies for guidance, even for investment grade securities. Rather, that investors must do their own due diligence and rely on their own experience and judgement.

Many investors are afraid to touch non-investment grade debt securities fearing that such companies may soon need financing or refinancing. These investors especially fear that troubled companies may not be able to refinance their debt, or if the companies restructure their debts, they risk losing some or all of their investment.

While we agree that investing in non-investment grade securities can be tricky, we have not shied away from them when we believe their prices provide us with an attractive return and adequate margin of safety. Although we have made our share of mistakes, over the long-term, we have been pleased with our results. I would like to share with you what has worked for us and the pitfalls we try to avoid.

Before we invest in troubled companies we always ask questions and base our decisions on some of the criteria outlined below. It is impossible to list all the criteria but these are the main ones we look for:

1) *Where does the debt security we are considering rank in the company's capital structure? And what would the company be worth if it had to liquidate?*

We start by setting a desired target rate of return, and then try to buy the most senior security in the capital structure that meets the return target. We know that in a restructuring, it's a dog-eat-dog world, and senior holders will show no mercy to investors holding lower ranked securities. Experience proves it is prudent to give up some return by buying senior debt versus taking a chance on more junior securities even though they have the potential to earn a much higher return.

For example, imagine two scenarios with scenario-one offering the prospect of recovering 50 cents on the dollar for a junior security trading at 25 cents on the dollar, and scenario-two offering the possibility of recovering 100 cents on the dollar for a senior security that is trading at 80 cents and that is backed up by 200 cents of collateral. The wise course, in our view, is to invest in the second scenario and not succumb to the temptation of the first as we believe maximizing the margin of safety on the principal invested is just as important for debt securities as it is for equity securities.

2) *How competent is management?* Assessing the competence of management is as critical when buying debt securities as it is when buying equities. In the financial crisis of 2008, when money was tight, a lot of companies were facing liquidity issues. When companies need financing or refinancing, they are in a bind and require strong, competent managers who can run the operation while navigating the restructuring process. As a result, we seek management teams that are passionate about their work and own enough equity in their company to care deeply about its future. We are not interested in companies with managers who are just doing their job, collecting their salaries, stock options and other perks. And we are especially averse to CEOs who view their companies as a job for fear they'll do a job on investors, that is, deliver 'just over breakeven' (job) profits. We are always on the look-out for competent CEOs and management teams who think and act like owners. One of the best times to invest in a debt issue is when a company is facing a short-term liquidity issue rather than an operational issue.

3) *Is the underlying business strong and able to generate consistent free cash flow?* The economics of a business are important. Ultimately, a company has to repay or restructure its debt. In either scenario, having a strong underlying business that can generate strong cash flow can be vital. Strong cash flows make it easier for companies to repay or refinance debt, or sell assets at higher valuations. One must be careful when buying into an industry with excess capacity since overcapacity is normally equated with negative or below average return on capital.

4) *What do the bank and bond covenants look like? Is there a cash flow sweep recapture?* In some instances, debt comes with a cash flow sweep, which means that free cash flow left after all the needs of operations have been met can be used to buy back debt at par from debt holders. This cash flow sweep could be monthly, quarterly or yearly. For example, R.H. Donnelly's bank debt has a quarterly cash flow sweep and is trading at 77 cents. However, every quarter, whatever free cash flow that is left is used to buy back the bank debt at 100 cents.

5) *What does the company's balance sheet look like and what is its liquidity position? Will it need to raise additional capital?* It is important to understand the liquidity position of the company and know if it has adequate resources to pay interest on current debts and any debts that may be maturing. If the company has to raise capital to meet its financing and operational needs, oftentimes this capital is very expensive and dilutive to existing bondholders.

6) *If the company goes through a restructuring, will it cause permanent damage to the business by diminishing the value of the brand or by alienating customers?* If the company decides to restructure, it has implications not only for the company and its employees but also for its customers. It is critical to understand the impact on customers and if they will continue to do business with the company or move to a competitor instead. If it is the latter, there will be diminished revenues and possibly negative cash flows.

One of our best deals involved Brick Ltd., a retailer of largely lower-end household furniture, mattresses, appliances and home electronics, which we purchased for the Chou RRSP Fund. We attended a meeting during which an executive succinctly described the reasons for their operational problem thusly: 'We tried to go to the middle of the road, and the oncoming traffic killed us'.

Brick Ltd. had a financing/liquidity issue in 2009 and in May of that year, succeeded in raising $120 million to recapitalize their balance sheet, pay off senior notes and partially repay their Operating Credit Facility. We were already impressed with the company and were further impressed when the founder of the company said he was willing to invest $10 million on the same terms as the other debenture holders. The Debt Unit consisted of $1,000 principal amount 12% senior secured debentures maturing in five years, and 1,000 Class A Trust Unit purchase warrants. Each warrant entitled the holder to purchase one Class A Trust Unit for a strike price of $1.00, which was very close to the stock's trading price.

Under the able stewardship of Mr. Bill Gregson, Brick continues to make a remarkable turnaround. A $1,000 investment is now worth $2,925, not counting the 12% coupon that we have been clipping all along.

Uneasiness With the Government Policies

We went through a traumatic financial crisis in 2008 and 2009 and you can argue that under exceptional circumstances, the Government can, maybe should, intervene in the economy, as the U.S. Federal Reserve (Fed) did with massive quantitative easing starting in 2008. As we all know, governments everywhere have intervened in securities markets for decades by artificially lowering interest rates during declines and artificially supporting prices. That said, I'm always uneasy when this happens, primarily because such interventions skew the markets and make it difficult for investors to determine the soundness of a business and its prospects for future success.

In addition, government intervention puts investors in the dilemma of having to factor in how much quantitative easing the Fed will apply and for how long. For example, when analyzing some of our fixed income investments in 2008, we assumed the Fed would likely continue providing enough liquidity to keep financial institutions afloat. As a result, we bought Wells Fargo 7.7%, 2049, and Goldman Sachs 5.793%, 2043 for the Chou Bond Fund and paid $36.75 and $43.25, respectively. Interestingly both companies' debts were rated investment grade. At December 31, 2010, they were trading for $103.75 and $85.35, respectively. Our investment was predicated on the Fed providing the liquidity financial companies needed to stay solvent. It was okay in 2008 when we were facing a one-of-a-kind financial crisis, but continuing with that policy is unwise. We believe it is preferable that the Fed has soundly-based economic and monetary policies rather than have it open the tap at every hint of a slowdown. Let the market do its job!

Other Matters
FOREIGN CURRENCY CONTRACTS: None existed at December 31, 2010.

CREDIT DEFAULT SWAPS: None existed at December 31, 2010.

CONSTANT MATURITY SWAPS: None existed at December 31, 2010.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in $US is now able to do so.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Bruce Kerr and Joe Tortolano. The 2010 IRC Annual Report is available on our website www.choufunds.com.

As of March 11, 2011, the NAV of a Series A unit of the Fund was $83.16 and the cash position was 29.5% of net assets. The Fund is up 2.8% from the beginning of the year. In $US, it is up 5.0%.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 16, 2012

Dear Unitholders of Chou Associates Fund,

After the distribution of $1.28, the net asset value ("NAVPU" or "NAV") of a Series A unit of Chou Associates Fund at December 31, 2011 was $65.94 compared to $80.89 at December 31, 2010, a decrease of 16.9%; during the same period, the S&P 500 Total Return Index increased 4.4% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund decreased 18.8% while the S&P 500 Total Return Index increased 2.1%.

The table shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2011 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years
Chou Associates ($CAN)	-16.9%	8.7%	-4.0%	4.9%	8.3%
S&P 500 ($CAN)	4.4%	7.4%	-2.9%	-1.6%	3.4%
Chou Associates ($US)[10]	-18.8%	15.5%	-1.3%	9.7%	10.4%
S&P 500 ($US)	2.1%	14.1%	-0.3%	2.9%	5.5%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2011 Results

The majority of the losses incurred by the Fund were related to our investments in the retail and financial sectors. 2011 was a year in which macro events, such as concerns about the sustainability of the economic recovery in the U.S., uncertainty in Europe, and growing concerns of a slowdown in China, made stocks that we still believe are undervalued go down further.

Positive contributors to the Fund's performance were equity securities of Sanofi, Watson Pharmaceuticals, Valeant Pharmaceuticals, and the debt securities of Level 3 Communications.

Securities that declined the most in 2011 were equity securities of Sears Holdings, Sprint Nextel, Overstock.com, AbitibiBowater, and Class A warrants of Bank of America.

In 2011, we identified a number of equities and non-investment grade debt securities that we view as undervalued.

[10]The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 is based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

In equities, we believe the financial, retail and pharmaceutical sectors are undervalued. Thus, as the prices of financial and retail sector equities fell during 2011, we added to our positions. We favour a basket approach versus concentrating on one or two stocks in any sector.

Investing in U.S. Financial Institutions

We continue to believe that most financial institutions are undervalued and present excellent, long-term investment opportunities.

Since 2010, we have invested in the common stocks of banks and in their TARP warrants. The latter are stock warrants that were issued to the U.S. Treasury by the banks when they received funds under TARP. These stock warrants give the holder the right to buy the bank's stock at a specific price. When the banks repaid TARP funds to the U.S. Treasury, the U.S. Treasury either sold the stock warrants back to the banks or auctioned them to the public.

In 2011, stock prices and their associated TARP warrants declined further, giving us the opportunity to buy more of them. In a letter I wrote two years ago, I explained our rationale for buying them. Those reasons are still valid and I'd like to revisit them.

It has been five years since the financial crisis began in 2007. As each year has gone by, the quality of bank earnings has improved, the books have become cleaner, the risks have become lower, and bank management has become far more risk averse. It is too bad that we had to go through so much turmoil to get there.

It's heartening to know that Stress Test Results announced by the Federal Reserve on March 13, 2012, show that today the majority of the largest U.S. banks have sufficient capital reserves to withstand the large losses that would result from the extreme economic conditions of the stress test – a peak unemployment rate of 13 percent, a 50 percent drop in equity prices, and a 21 percent decline in housing prices.

Under these hypothetical conditions, losses at the 19 bank holding companies were estimated to total $534 billion during the nine quarters covered, and the aggregate Tier-1 common capital ratio, which compares high-quality capital to risk-weighted assets, fell from 10.1 percent in the third quarter of 2011 to 6.3 percent in the fourth quarter of 2013. In summary, the results show a significant increase in capital over the past three years, with 15 of the 19 bank holding companies maintaining capital ratios above all four of the regulatory minimum levels, even taking into account their plans for capital actions, such as paying dividends and buying back or issuing shares.

With the exception of Citigroup, all the banks whose common shares and/or TARP warrants we bought, exceeded the stress test requirements. For example, JPMorgan Chase, whose market cap is currently $170 billion, boosted its 2012 annual dividends to $4.58 billion and is authorized to buy back $15 billion of its stock, with $12 billion in buybacks authorized for the year 2012. In defense of Citigroup, it would have passed the test if it were not for its plans to return capital to shareholders through dividends and stock repurchases.

Depending on the price, we like the banks' TARP warrants because they have several characteristics that make them appealing long-term investments. Specifically, they are long dated, with most expiring around 2018-2019. This time frame of six-plus years allows banks to grow their intrinsic value to a high enough level to have an appreciable impact on the strike price of the stock warrant. In addition, we believe the strike price will be adjusted downward for any quarterly dividend that exceeds a set price. This is rarely seen in a stock warrant. An example: for Bank of America class 'A' warrants, the strike price is adjusted downward for any quarterly dividend paid exceeding one cent a share.

Bank TARP warrants are complex, with terms and conditions that are unique to each bank. Thus we encourage you to research them for yourself and draw your own conclusions. The legalese is quite intimidating but there is some help on the way. Some banks have started to pay dividends that exceed a set price, and we are starting to see how anti-dilution clauses that were added to protect TARP warrant holders apply with regard to:

a) the adjustment of the strike price.
b) the number of shares you can purchase for each warrant you hold.

Europe

Even though Greece has reached a restructuring deal on its sovereign debt, we do not believe the Eurozone is out of the woods yet. Rather, it has only averted a short term disaster. This is not the first time that Greece has had to restructure its debt. Since 1800, Greece has spent roughly 50% of its time in default or debt rescheduling and Spain has spent approximately 23% of its time in default or debt rescheduling. At one time, we were led to believe that only emerging third world countries default on their sovereign debt, not long established democracies with duly elected governments and modern economies. In the end, the laws of economics prevail. If you have profligate spending, irresponsible government, high debt levels relative to the GDP, there comes a tipping point when economic reality sets in.

Looking ahead 10 years, we expect Euro countries' GDPs to be higher than they are now, but getting there won't be a smooth ride. The best protection for investors, in my opinion, is to buy solid companies, whose intrinsic value will grow with time. It is difficult to predict what will happen to the Euro, except to say the EU needs to undergo deep structural reform to solve its problems. Getting the sovereign debt of Greece restructured buys them time but more needs to be done.

The Eurozone issues are serious and, if not resolved, they have the potential to negatively impact the global economy. Here is a funny story of a French tourist visiting Canada.

Pierre, an expensively attired middle-aged French tourist on his first trip to Toronto strolls into the bar of his 5-star hotel. The elegant hostess smiles, leads him to a table and beckons her prettiest server to take care of him.

They talk, flirt a little and she giggles a bit. When he draws her closer and whispers in her ear, she gasps and runs away. The hostess frowns then sends a more experienced waitress to the gentleman's table.

They talk, flirt a little and giggle a bit. He whispers in her ear and she too screams, “No!” and walks away quickly.

The hostess is surprised that this ordinary looking man has asked for something so outrageous that two experienced waitresses would have nothing to do with him. Rather than alienate a high-powered customer, she asks Lucille, her seen-it-all, heard-it-all bartender, to take his order. They talk, flirt a little and Lucille even giggles a bit. When he whispers in her ear, she screams, “NO WAY, BUDDY!” then smacks him as hard as she can and leaves.

The hostess is now intrigued, having seen nothing like this in all her years working in bars. It’s been a while since she waited on tables, but she’s confident she still knows how to say no to a man without offending him. Besides, she has to find out what this man wants that makes her girls so angry. She also sees a chance to teach her girls a lesson in managing men with tact and diplomacy.

So she goes to Pierre’s table, wishes him a pleasant evening and tells him she’ll personally take care of his needs. Although it’s against the rules for bar staff to sit with customers, as the hostess, she exempts herself. They flirt a little, giggle a bit and talk.

Pierre leans forward and whispers in her ear, “Can I pay in Euros?”

Investing in China a Conundrum
Companies based in China are regarded with grave suspicion that makes investors skeptical about the cash on their balance sheets. All things being equal and their revenues coming from the U.S. or Canada, these companies would be considered undervalued even at stock prices 50% to 100% higher. For example, take a look at Qiao Xing Mobile Communication (QXM), a company in which we have holdings. If we look only at its June 30, 2011 balance sheet, without putting any value to their operations, we see the following positives:

1) Net cash per share of approximately \$6.20 compared to the stock price of 98-cents on December 30, 2011. Another way to look at it is that you can buy this company for approximately \$55 million and get approximately \$328 million in net cash.
2) Net-net working capital per share of approximately \$7.40.
3) Book value per share of approximately \$6.98.
4) On September 8, 2010, Qiao Xing Universal Resource (XING), the parent company, offered to buy out the minority shareholders of QXM for 1.9 shares of XING plus 80 cents in cash. The stock price of XING, which is listed on the NYSE, traded between \$1.45 and \$3.55 per share from the offer date to the end of 2010. This means the value of the offer was fluctuating roughly between \$3.55 (\$1.45 x 1.9 + \$0.80) and \$7.55 per share. Unfortunately, on April 7, 2011, the offer was rejected by the minority shareholders of QXM. Since then, the stock price of QXM has plummeted from \$4.32 to below a dollar.
5) It is listed on the New York Stock Exchange.
6) It is currently audited by Crowe Horwath, a recognized international auditing firm. Crowe Horwath LLP is one of the largest public accounting and consulting firms in the United States.

The negatives are not as obvious, but deserving of caution. Key among them:

1) The founder and CEO has taken some questionable actions. Since China's business environment is a bit like the Wild West, it is difficult to find companies and/or management with a totally pristine reputation. Moreover, a lot of businesses, including Qiao Xing's, are intertwined.
2) Most of the cash is held in China. Cash may not be accurately stated or it cannot be repatriated to North America in an economically efficient manner.
3) Most revenue numbers cannot be verified.
4) Accounting for receipts is not a common practice in China.
5) You cannot verify the company's numbers even though it retains a well known accounting firm, is listed on NYSE, and thus must adhere to strict compliance and accounting standards.

There are a number of firms doing business in China that have similar characteristics. They are also extremely cheap, and as I've said, if their stock prices were 50% to 100% higher, and if their businesses operated in U.S. or Canada, they would be considered undervalued. Yet, while they raise red flags, we think we can invest prudently in China if we use a basket approach, keep our positions appropriately sized and closely monitor developments at the companies.

Other Matters

NAME CHANGE OF THE AUDITORS: As a result of a merger effective March 1, 2012, our auditors Burns Hubley LLP are now known as KPMG LLP. The auditors' report has been signed accordingly.

FOREIGN CURRENCY CONTRACTS: None existed at December 31, 2011.

CREDIT DEFAULT SWAPS: None existed at December 31, 2011.

CONSTANT MATURITY SWAPS: None existed at December 31, 2011.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in $US is now able to do so.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Bruce Kerr and Joe Tortolano. The 2011 IRC Annual Report is available on our website www.choufunds.com.

As of March 16, 2012, the NAV of a Series A unit of the Fund was $79.47 and the cash position was 12.2% of net assets. The Fund is up 20.5% from the beginning of the year. In $US, it is up 23.6%. While 2012 is off to a good start, please do not extrapolate these returns into the future.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND

(unaudited)

March 15, 2013

Dear Unitholders of Chou Associates Fund,

After the distribution of $2.52, the net asset value per unit ("NAVPU") of a Series A unit of Chou Associates Fund at December 31, 2012 was $81.20 compared to $65.94 at December 31, 2011, an increase of 27.0%; during the same period, the S&P 500 Total Return Index increased 13.5% in Canadian dollars. In $US, a Series A unit of Chou Associates Fund was up 29.8% while the S&P 500 Total Return Index returned 15.9%.

The table shows our 1 year, 3 year, 5 year, 10 year and 15 year annual compound rates of return.

December 31, 2012 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years
Chou Associates ($CAN)	27.0%	7.9%	2.9%	4.7%	7.6%
S&P 500 ($CAN)	13.5%	8.7%	1.7%	2.3%	2.0%
Chou Associates ($US)[11]	29.8%	9.8%	2.8%	9.6%	10.2%
S&P 500 ($US)	15.9%	10.8%	1.7%	7.1%	4.5%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2012 Results

Positive contributors to the Fund's performance during the financial year ended December 31, 2012 included equity securities of Watson Pharmaceuticals Inc., Sears Holdings Corporation, Sprint Nextel Corporation, Citigroup Inc., Overstock.com Inc. and The Goldman Sachs Group Inc.

During the year ended December 31, 2012, the Fund's largest equity security decliners were RadioShack Corporation and Resolute Forest Products Inc., while the Fund's largest debt security decliner was Level 3 Communications Inc.

The Fund added Dell Inc., MBIA Inc. and American Depository Receipts ("ADRs") of Nokia Corporation to its portfolio. The Fund sold all of its equity holdings of Valeant Pharmaceuticals International Inc., Office Depot Inc., The Gap Inc., USG Corporation and its warrants of Bank of

[11]The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 is based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

America. The Fund also sold its 10.00% senior secured notes of Primus Telecommunications Group Inc., due 2017.

Appearances are Deceiving

As with everything in life, there are always rules to follow and it's no different in the mutual fund industry. When managing mutual funds in Canada, National Instrument 81-102 stipulates that no one security can make up more than 10% of the fund's assets at the time of purchase with that purchase price becoming our historic cost. The problem arises when the stock price drops substantially. At first blush, this would seem to be an opportune time to take advantage of the lower price and buy more of the stock. The problem is that we've already bought close to the 10% maximum limit. The mantra of value investing is that if we are willing to buy a stock at 60% of its intrinsic value, we should buy more of it if it is trading below that. One way of dealing with this compliance conundrum is to sell the security and take the tax loss, wait 30 days and then buy back more of it at a lower price.

This strategy obviously has some limitations. It takes more than a day or two to sell a security when we have a large position. We try to get the best price possible and therefore must proceed in an orderly way without artificially suppressing the price. This process can take some time, maybe a month or two – or even longer. When we finish selling the security, we hope the price of the underlying security doesn't rise. In fact, you take the optimistic road and hope the price will drop even further. In the worst case, if the price rises, we forgo the potential gains but, unfortunately, also the chance to concentrate more in the stock we love.

Such was the case with the TARP warrants of Bank of America. Our analysis showed that the warrants were undervalued and we wanted to buy more. But we were limited as to how much more we could buy because our cost base was approaching 10% of the assets of the Fund. So, we decided to sell the entire holding, wait 30 days and then buy back more since our cost base would be so much lower. Alas, mea culpa, my best-laid plans went awry. Instead of staying flat for a month after selling the warrants, the price rose appreciably and we were not able to buy back the TARP warrants at a cheaper price. The higher price was still relatively inexpensive, but I couldn't bring myself to buy at a price considerably higher than what I sold them for.

We would still like to buy the TARP warrants because the thesis for holding them still holds true. As we said in our previous letter: "We continue to believe U.S. financial institutions are very cheap and TARP warrants associated with these companies are an attractive way to invest in them.

Depending on the price, TARP warrants have several characteristics that make them appealing long-term investments. Specifically, they are long dated, with most expiring around 2018-2019. This time frame of six-plus years allows banks to grow their intrinsic value to a high enough level to have an appreciable impact on the strike price of the stock warrant. In addition, we believe the strike price will be adjusted downward for any quarterly dividend that exceeds a set price. This is rarely seen in a stock warrant. An example: for Bank of America, class 'A' warrants, the strike price is adjusted downward for any quarterly dividend paid exceeding one cent a share.

Bank TARP warrants are complex, with terms and conditions that are unique to each bank. Thus we encourage you to research them for yourself and draw your own conclusions. The legalese is quite intimidating but there is some help on the way. Some banks have started to pay dividends that exceed a set price, and we are starting to see how anti-dilution clauses that were added to protect TARP warrant holders apply with regard to:

a) the adjustment of the strike price.
b) the adjustment to the number of shares you can purchase for each warrant you hold."

What Will Happen if Greece Reverts to the Drachma?
In our last letter, we wrote with regard to investment in the Euro countries and Greece in particular.

"When investors are optimistic of the future, it is hard to find bargains in the market. But introduce some fear and uncertainty and you will find a plethora of bargains. The Eurozone is the perfect environment for finding bargains. For example, there are plenty of Greek companies with fine economics, strong balance sheets and a shareholder friendly management that are selling for less than 4-times after tax earnings. Let's say that Greece, for one reason or another, leaves the Euro and reverts to the drachma. If this currency were then devalued by 50%, that stock would then be valued at 8-times earnings (in Canadian dollars because of the devaluation), which is still very cheap. The same scenario is starting to play out in Spain and Italy."

Our enthusiasm over this is tempered by the fact that the devaluation of the drachma versus the Euro or the Canadian dollar or any of the major currencies may be greater than 80%. We have seen many examples of this happening to international currencies in the past. One example is the Indonesian rupiah during July 1997 to June 1998, when the currency was devalued by about 90% against the U.S. dollar. We saw a similar situation in Russia, from August 1998 to March 1999, when the ruble was devalued by about 78% against the U.S. dollar as well as in Argentina, from January 2002 to June 2002, when the peso was devalued by around 74% against the U.S. dollar. We believe it would be safer and more prudent to buy stocks after any devaluation of the local currency – at least, that is what our research is showing. The key point is that returns of the Chou Funds will be measured in Canadian dollars and not in drachmas. Therefore, substantial currency devaluation is an important factor to consider when investing in troubled countries. The other alternative is to look for companies that are undervalued and also have a substantial operation outside of Greece.

We did buy Trastor Real Estate Investment Co., a Greek real estate firm, for Chou Europe Fund. When we purchased the stock (average cost Euro 0.46), the dividend yield was approximately 20%, the price-to-book value was less than 30% and the company had substantial net cash on the balance sheet. I am happy to say that this purchase has worked out quite well. It is currently trading at Euro 0.71. In Chou Associates Fund, we bought Nokia, the phone manufacturer, at an average cost of $2.28 per share and it is currently trading at $3.43. It is surprising how manic depressive the stock market can be on certain stocks. In the case of Nokia, it was selling way below the value of its patents. The same story can be said of Research in Motion (now called

Blackberry). We purchased it at an average cost of $7.12 in Canadian dollars for the Chou RRSP Fund and currently it is trading at $15.40.

Non-Investment (or High Yield) Grade Debt Securities
Non-investment grade debt securities are fully priced and in general, I would stay clear of them. According to JPMorgan Chase, high-yield spreads over comparable Treasuries have continued to narrow, closing at the end of 2012 to approximately 561 basis points, compared to 754 basis points at the end of 2011. Spreads peaked during the 2008 financial crisis to 1,925 basis points. In fact, there is a good chance that these debt securities may now be overvalued, and that the possibility of a large, permanent loss of capital is extremely high. In addition, their prices don't reflect the risks inherent in these debt securities.

The Stock Market
In general, we are not that bullish on the stock market. Aside from a couple of industries like the financial institutions in the U.S. and companies in the retail sector, we are not that comfortable with the prices of many stocks. When an index like the DJIA or the S&P500 is undervalued, you don't put that much emphasis on the macroeconomic factors. We know from history that a free market economy that has an established rule of law will do well in the long run. Think of the last 100 years: we have gone through the Great Depression, two devastating World Wars, numerous recessions (some of them more severe than the others), but still the U.S. and the Canadian economies have done well. But when the market is closer to being fairly valued as it is now, I tend to fret about issues that I would ignore if the stock market was very cheap. Some of the issues that are bothering me are listed below.

Low Interest Rates
One of the dangers of low interest rates is how investors evaluate companies based on the discounted cash flow method. When rates are so low, it does not make sense to use long Treasuries as the discount rate. If you do, you end up with an inflated valuation for any company whose growth rate is higher than the discount rate. In this case, anything above 3.11% (the current 30-year Treasury bond rate) is infinity. As a precaution, and to have some sense of reality, I would plug in an arbitrary 10% for the discount rate.

Total Debt versus GDP
Total debt (government and private) as a percentage of GDP in the Western world is at an all-time high and eventually we will have to deal with this all-encompassing problem. It is hard to fathom how debt will be paid off or dealt with but in the past, governments have resorted to monetizing the debt.

Commodities
When certain asset classes, such as commodities, have had an exponential rise in price, they create imbalances that are not readily visible. Commodities that were in short supply before the price rise are now more abundantly available and mines that were uneconomic before are viable now. But nothing grows straight to the sky. As any good Economics 101 course teaches you, when prices rise exponentially, demand should fall. However, recent increases have actually brought in a new class of speculators who believe that buying and hoarding the commodity is the way to make money. In addition, a number of countries have pumped in untold amounts of

money on infrastructure that's not needed. As an example, I have been saying for years that China's economy is not as healthy as the government wants us to believe. Huge sums of money have been put into building cities and highways, but all remain eerily empty. You have to see it to believe it: empty skyscrapers, empty shopping malls, empty highways and not a living soul in those cities. I would be wary of investing in any company where the price of a commodity plays a significant role in the company making money.

Money Supply
The U.S. money supply has expanded substantially since 2007 regardless of how you measure it (M1, M2 or M3). But the full impact of the expanded money supply has not yet been felt because confidence remains subdued. In fact, the velocity of money has plummeted below its previous mid-1969 level. Losses in confidence are short-term in nature and when confidence does return and the velocity of money returns to more normalized levels, watch out for inflation. I would not buy into any long dated fixed-income instruments that are dependent on interest rates particularly those issued by countries that are aggressively expanding their money supply.

Looking Forward
We remain true to our value-investing roots and until the markets are more undervalued, it is likely that the Fund will have more cash/cash equivalents in its portfolio in the coming year than in equities. But if a true bargain arises, I will not hesitate to buy it.

Other Matters

NAME CHANGE OF THE AUDITORS: As a result of a merger effective March 1, 2012, our auditors Burns Hubley LLP are now known as KPMG LLP. The auditors' report has been signed accordingly.

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REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Bruce Kerr and Joe Tortolano. The 2012 IRC Annual Report is available on our website www.choufunds.com.

As of March 15, 2013, the NAV of a Series A unit of the Fund was $91.61 and the cash position was 25.7% of net assets. The Fund is up 12.8% from the beginning of the year. In $US, it is up 10.1%. While 2013 is off to a good start, please do not extrapolate these returns into the future.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 15, 2014

Dear Unitholders of Chou Associates Fund,

After the distribution of $3.29, the net asset value per unit ("NAVPU") of a Series A unit of Chou Associates Fund at December 31, 2013 was $111.46 compared to $81.20 at December 31, 2012, an increase of 41.3%; during the same period, the S&P 500 Total Return Index increased 41.4% in Canadian dollars. In $U.S., a Series A unit of Chou Associates Fund was up 32.2% while the S&P 500 Total Return Index returned 32.4%.

The table shows our one-year, three-year, five-year, 10-year and 15-year annual compound rates of return.

December 31, 2013 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years
Chou Associates ($CAN)	41.3%	14.2%	18.2%	8.0%	8.6%
S&P 500 ($CAN)	41.4%	18.8%	14.8%	5.3%	2.1%
Chou Associates ($U.S.)[12]	32.2%	11.7%	21.4%	10.1%	11.3%
S&P 500 ($U.S.)	32.4%	16.2%	17.9%	7.4%	4.7%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2013 Results

The weakness of the Canadian dollar against the U.S. dollar had a large positive impact on the results of the Fund. The difference in performance results between the net asset value per unit (NAVPU) priced in Canadian dollars, versus U.S. dollars, is attributable to the fact that on December 31, 2012, one U.S. dollar was worth approximately $0.99 Canadian, whereas one year later, on December 31, 2013, one U.S. dollar was worth approximately $1.06 Canadian.

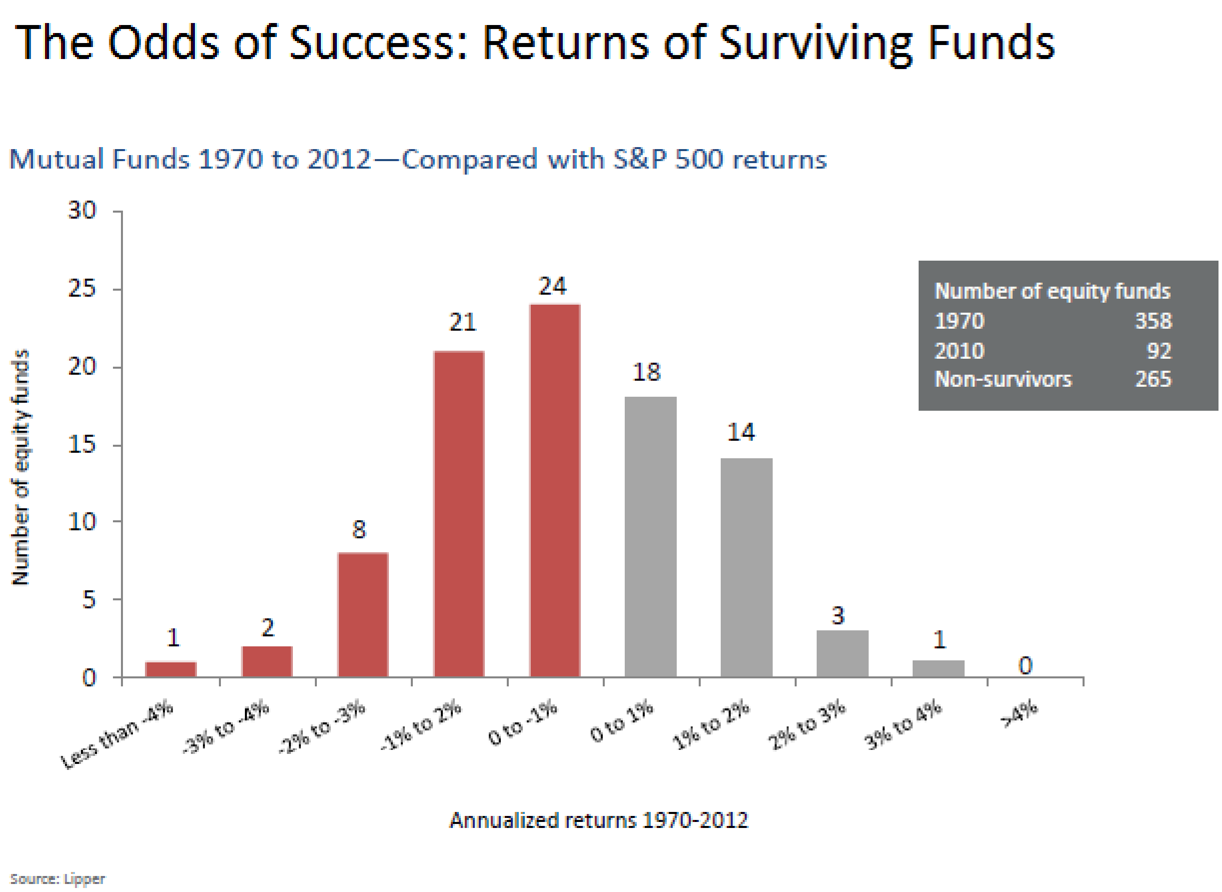
Positive contributors to the Fund's performance during the financial year ended December 31, 2013 included equity securities of International Automotive Components Group North America, Overstock.com Inc., Sanofi ADR and Actavis (formerly Watson Pharmaceuticals Inc.). As a group, our investments in the bank equities of JPMorgan Chase, Citigroup Inc. and warrants of Wells Fargo & Company worked out well during 2013.

[12]The alternative method of purchasing Chou Associates Fund in $U.S. has been offered since September 2005. Performance for years prior to September 2005 is based on the $U.S. equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($U.S.) except for the currency applied.

During the year ended December 31, 2013, the Fund's largest equity security decliner was Olympus Re Holdings Limited, while the Fund's largest debt security decliner was RH Donnelley Inc. term loan.
PTGi Holding Inc. (formerly Primus Telecommunications Group Inc.) declared a special distribution of $8.50 per share of Common Stock during 2013. As a result, the price of the common stock came down accordingly.

The 20-Year Lesson Learned
We believe that the market is currently fairly valued and we sincerely doubt the overall returns from equities in general over the next five to 10 years will be compelling. On the contrary, we believe the returns may be far more modest than those hoped for by investors. Not only are the P/E ratios and price-to-book values still high and dividend yields low relative to historic valuations, but the number of companies that are underpriced is at an all-time low. In light of this scenario, and with its obvious lack of bargains, we would not hesitate to sell our investments and be 100% or 50% cash -- or whatever the number may be.

We were looking to see how many funds have been able to beat the markets on a long-term basis, and found a piece written by Burton G. Malkiel named "*Some Timeless and Timely Investment Lessons*" which highlights the difficulties of competing with, much less beating the S&P 500 Index. Based on his findings on the returns of 358 equity funds, only three equity funds were able to outperform the market by 2%-3%, and one sole equity fund beat the market by 3%-4%. No equity funds were able to outperform any higher than that.



Looking at our 20-year returns, we have outperformed the markets by a comfortable margin. The Chou Associates Fund returned 11.8% in Canadian dollars, while the S&P 500 Index returned 7.9% in Canadian dollars with dividends reinvested. When we reflect back on the reasons why we have outperformed the market, the one that readily comes to mind is that we purchased securities, whether they were fixed income or equities, only when bargains were available at a compelling discount.

We do not put a lot of emphasis on macroeconomic events as long as we are able to buy stocks at a substantial discount to our calculation of their estimated intrinsic value. We have no use for top-down analysis. We do not pick stocks on the basis of how rosy or miserable the economy will be in the near future and which company will do well in that scenario. We are well aware that, with so many variables and imponderables to consider, it is hard to be accurate on macroeconomic events. We know from experience that it is tough enough to predict the timing of a recession, let alone the degree of severity! However, we do keep abreast of what's happening in the world and would take into consideration any serious misallocation of resources either in an industry or sovereign nation because they may have a measurable impact on the company's intrinsic value.

Sober Second Thought Needed

Once we buy a stock that we believe is a bargain, our excitement in finding a good deal at a low price is tempered by caution. We check and recheck our premises and constantly go over the basis for our valuations to ensure they are correct. Did we miss something important? Is the earning power there? Are the assets worth anything? And are we unduly emphasizing something at a subconscious level that is persuading us to buy because we are holding too much cash and cannot find bargains?

Once we buy a bargain, we give no thought to when the stock will rise. We have no idea whether the return will triple, double or go up 50%. Maybe it will in a year, maybe five years -- who knows? Or there may be no rise at all. All of that is beyond our control and the only control we have is the judgment we make on a rough approximation of what the company is worth and how inexpensively we are able to buy it. If our valuation of what the company is worth is anywhere close to being accurate, the stock will do well. Whenever we have lost money, it is because our valuation was wrong and not because someone took advantage of us or because of the “evil” stock market.

So when we look at the stock markets today, most of the equities and fixed income securities are in the range of being fairly valued and the number of bargains is getting scarcer all the time. The world has a lot of problems but if the prices were as cheap as in 2008, we would not hesitate to load up on them. In the depths of the Great Recession in 2008 when stock markets were hitting all-time lows, we wrote, "We don't know whether the stock market has hit bottom yet but we suspect that when we look back at the current environment 10 years from now, we will classify this as one of the best periods for buying stock and debt securities."

The Market is No Patsy

We have comfortably beaten the market over the last 32.5 years. It is not because the market is a patsy. The S&P 500 Index is a formidable competitor. What makes it so strong is that when a company (or companies) falters, it gets replaced by companies with better financials and economics. It would have been way easier to beat the index if the companies that falter or go bankrupt don't get replaced. So, at any given time, we are basically competing with a basket of the best 500 companies that have strong sustainable earnings power. And we have to beat it after fees and all other friction costs associated with running a mutual fund. We are leery about giving performance numbers on a pro-forma basis. There is some subjectivity and discretion on the part of the portfolio manager of what numbers can be used as an input. If we wanted to, we could show that we have outperformed the market by roughly 8%. For example, we could add back fees of roughly 2% and then there are withholding taxes of 15% to 30% on dividends received, depending on the country. Since it is a Canadian Fund, we only receive 85% of the dividends from U.S. companies. There were times when the dividend yield on some of the U.S. holdings was 5% or more, so we could really feel the bite of that withholding tax. Historically, we also, on average, had large cash holdings of 30% or more for an extended period of time. And on top of that, we are reconciling cash inflows and outflows on a daily basis because of purchases and redemptions. We have learned that the best route is to just take the returns that an investor gets after all fees and friction costs associated with running a fund.

Hedge Funds Have a Problem Too

So we can see that the S&P 500 Index is a terrific competitor. Therefore, it does not come as a surprise that index funds have proliferated and so many funds are closet indexers. Even hedge funds have a problem. In his book, *The Hedge Fund Mirage, The Illusion of Big Money and Why It's too good to be True,* author Simon Lack writes: “If all the money that's ever been invested in hedge funds had been in treasury bills, the results would have been twice as good.”

Simon Lack was a true insider. He sat on JPMorgan’s investment committee, allocating more than $1 billion to hedge fund managers and founded the JPMorgan Incubator Funds, two private-equity vehicles that took economic stakes in emerging hedge fund managers.

As we have stated in our past letters, the cardinal principle underlying the investments in the Fund is to pay far less than what the company is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want an adequate margin of safety and this concept, while unappreciated and ignored by most, is what distinguishes investment from speculation. It is different from volatility, where stocks can go up or down in a given year.

The reason for raising the 20-year performance and how we achieved it is that if we cannot find genuine bargains, and they cannot be lukewarm or moderately undervalued, we will not hesitate to be 100% in cash. There are some who may disagree with that move and so be it. Like we have said before, we prefer to lose 50% of our investors rather than 50% of your capital. One good thing is that we have managed the Fund for a long time and thus we are less pressured to follow the crowd or chase the index.

Russia

1) To paraphrase Jim Rogers, a noted investor: You put money in Russia and they will tax it away from you, take it away from you some other way, shoot you in the head, or put you in jail.
2) It is the most hated market in the world.
3) Under some pretext, they are going to annex Crimea. According to one Russian leader, it is not the people who vote that counts, but the people that count the votes that matter.

Perfect three strikes! Bingo!! Maybe a perfect place to find bargains? However, the problems in Russia are real and even though some stocks are really cheap, the chances of expropriation, embezzlement and frauds are real. As an example of cheapness, the price of the proven reserves of some of the big Russian oil companies like Gazprom are one-tenth that of ExxonMobil, which by itself is not selling at an inflated price. As of this writing, we have not bought any Russian oil stocks, however, we do have an investment in a Russian pharmaceutical company. When you invest in any country with no adequate protection for investors, you are always wondering how you can lose money in some nefarious way, and you wonder even more if you can make money even after taking account of some frauds. We should have an index like "Fraud Adjusted Return".

An interesting anecdote to the said Russian pharmaceutical company: When companies trade on different exchanges and they spin-off a subsidiary, one would expect them to do it on the same record and/or ex date. This Russian company traded both on the Russian stock market ("Russia") and the London Stock Exchange ("London"). However, when it spun-off its subsidiary, which was roughly 25% of the value of the parent company, it did so on separate dates. So, if you bought the shares in Russia, in order to get the shares of the spun-off company in January 2014, you needed to have been a registered owner by the record date in late December. But if you bought them in London, the record date to get the shares of the spun-off company is in late March 2014.

You would expect that shares listed in Russia would trade ex-spinoff at a price 25% lower than the ones listed in London, until such time of the London spin-off occurs. However, the shares in London took their cue from the prices in Russia and traded at roughly the same prices as those in Russia. The shares in London are still entitled to the spin-off company, which is worth 25% of the parent company. The shares were already cheap, trading at less than three times free cash flow, and we bought our shares in London. We have not revealed the name as it was bought in 2014, but for the curious and the enterprising investor, enjoy your early Easter egg hunt.

Issues that Continue to Bother Us

<u>Low interest rates can distort valuation</u>

One of the consequences of quantitative easing(s) (QEs) is low interest rates. Indirectly, interest rates have a huge bearing in the calculation of intrinsic value. When we use the discounted cash flow method for calculating intrinsic value, we plug the growth rate for that company in the numerator and plug the discount rate in the denominator. Typically we take the 30-year Treasury bond as the proxy for the discount rate. Some investors may take the 10-year Treasury bond.

However, when interest rates are as low as they are now and you are using that as a proxy, it can create a misguided sense that the stocks are cheap. Mathematically, in the discounted cash flow formula, when growth rate is higher than the discount rate, you can pay any price for the stock and still justify that it is cheap. That is how the math works. If people are convinced that these low interest rates are here to stay for a long time, then stocks are cheap especially for companies whose earnings are growing.

But we would be very careful in using low interest rates as a justification for paying higher prices. It is fool's gold and could lead to serious misjudgment when evaluating companies.

One way of getting around this conundrum is to use a high discount rate. We would ask ourselves: "What intrinsic value will we get if we plug in 15% as the discount rate? What about 12% or 20%?" In this way, we avoid the danger of overestimating the intrinsic value of the companies we are researching.

Non-Investment (or High Yield) Grade Debt Securities

Non-investment grade debt securities are fully priced and in general, I would stay clear of them. Some prices for non-investment grade bonds do not reflect the risks inherent in these securities. A company can float 10-year non-investment grade bonds with a coupon of 5.5% and investors will buy them at 100 cents on the dollar. Just a few years ago, a similar bond would be trading for 60 cents or less.

As a contrast, in 2009, the Chou Bond Fund was able to buy Wells Fargo 7.7%, 2049, a bond rated 'A' by S&P for 37 cents on the dollar. This was not an isolated case. We also bought other 'A' rated papers such as Goldman Sachs 5.793%, 2043, for 43 cents on the dollar in 2008 and Bank of America Capital Trust XV, 2056 floating rate bonds for less than 48 cents on the dollar in 2011. How the prices have changed for fixed-income securities!

At current prices, we believe that there is a good chance that these non-investment debt securities may now be overvalued, and that the possibility of a large, permanent loss of capital is extremely high.

Other Matters

FOREIGN CURRENCY CONTRACTS: None existed at December 31, 2013.

CREDIT DEFAULT SWAPS: None existed at December 31, 2013.

CONSTANT MATURITY SWAPS: None existed at December 31, 2013.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in $U.S. is now able to do so.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Peter Gregoire and Joe Tortolano. The 2013 IRC Annual Report is available on our website www.choufunds.com.

As of March 14, 2014, the NAV of a Series A unit of the Fund was $116.05 and the cash position was approximately 32.9% of net assets. The Fund is up 4.1% from the beginning of the year. In $U.S., it is down 0.2%. While 2014 is off to a good start, please do not extrapolate these returns into the future.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND

(unaudited)

March 16, 2015

Dear Unitholders of Chou Associates Fund,

After the distribution of $0.71, the net asset value per unit ("NAVPU") of a Series A unit of Chou Associates Fund at December 31, 2014 was $124.19 compared to $111.46 at December 31, 2013, an increase of 12.1%; during the same period, the S&P 500 Total Return Index increased 24.2% in Canadian dollars. In $U.S., a Series A unit of Chou Associates Fund was up 2.7% while the S&P 500 Total Return Index returned 13.7%.

The table shows our one-year, three-year, five-year, 10-year and 15-year annual compound rates of return.

December 31, 2014 (Series A)	**1 Year**	**3 Years**	**5 Years**	**10 Years**	**15 Years**
Chou Associates ($CAN)	12.1%	26.2%	14.8%	8.3%	10.2%
S&P 500 ($CAN)	24.2%	25.8%	17.6%	7.3%	2.7%
Chou Associates ($U.S.)[13]	2.7%	20.8%	12.4%	8.6%	11.8%
S&P 500 ($U.S.)	13.7%	20.4%	15.4%	7.7%	4.2%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2014 Results

The weakness of the Canadian dollar against the U.S. dollar had a positive impact on the results of the Fund. The difference in performance results between the NAVPU priced in Canadian dollars, versus U.S. dollars, is attributable to the fact that on December 31, 2013, one U.S. dollar was worth approximately $1.06 Canadian, whereas one year later, on December 31, 2014; one U.S. dollar was worth approximately $1.16 Canadian.

Positive contributors to the Fund's performance during the period ended December 31, 2014 included equity securities of Berkshire Hathaway Inc., Resolute Forest Products Inc., The

[13]The alternative method of purchasing Chou Associates Fund in $U.S. has been offered since September 2005. Performance for years prior to September 2005 is based on the $U.S. equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($U.S.) except for the currency applied.

Goldman Sachs Group and International Automotive Components, as well as Wells Fargo & Company warrants.

Securities of MBIA Inc., and Sanofi ADR were negative contributors to the Fund's performance during the same period.

Our covered call options of Overstock.com Inc. expired in March of 2014.

PTGi Holdings Inc. changed its name to HC2 Holdings Incorporated, which were sold in their entirety. The Fund also sold all of its equity holdings of Actavis PLC.

A Tale of two Scenarios

I have been managing money since 1981 and one of the benefits of managing money for so long is that you get exposed to many financial and economic scenarios.

When I was thinking about the current market, I couldn't help but recall what happened over the fifteen year period 1966 to 1981. The Dow Jones Industrial Average, hit a high of approximately 1000 in 1966 and for the next fifteen years it would approach that level only to recede back again. Inflation, which was subdued in the 1960s, started to go up in the 1970s, the result of printing money in the 1960s to finance the war in Vietnam.

By 1980, the combination of high inflation and low GDP growth was the story of the day. Economists coined the term 'Stagflation'. When Paul Volcker was named Chairman of the Federal Reserve Board (Fed) in 1978, his first mandate was to tame inflation. By June 1981, the federal funds rate rose to 20%. Eventually in June 1982, a highly important economic measure - the prime interest rate, reached 21.5%. The 30-year bond hit a high of 15.2% yield when he put the brakes on money printing. The Dow tumbled, selling at a severe discount to the book value of the Dow.

At that time, I was wondering how much lower the market could go. This was how I looked at the scenario; the interest rate was so high that I felt it could not remain at that level for any extended period of time without just killing the economy. Volcker's mandate was to break the back of inflation, and when he did that, interest rates were bound to go lower. Even if they didn't, the market was incredibly cheap: approximately 6 times earnings and roughly 6% dividend yield. The Dow had been earning for a long time, on average, 13% on its equity and there was nothing to suggest that it was not going to earn the same in the future.

If interest rates went down, the end result would be that the companies would be worth a lot more. The discount rate that you use to discount future earning power is somewhat linked to the prevailing long term interest rate. When companies borrow money, the rate they pay, depending on their credit rating, is benchmarked to the prevailing interest rate plus or minus a few points.

The climate for investing in 1980 was one of extreme fear. For example, pension funds, as a group, invested only 9% of net investable assets in equities. In contrast, in 1971, 122% of net funds available were purchased into equities; in other words, they sold bonds, to buy more of the equities. Those who wanted to get into the investment field in the late 1970s and early 1980s were considered pariahs at the time, and were to be avoided at all social gatherings as one who would avoid the plague.

At that time I was getting totally immersed in the works of Benjamin Graham. I was hunting for every scrap piece of information I could find in the library on Benjamin Graham and Warren Buffett. Although I was new to the investment scene then, the scenario had the smell of sure success for any value investor. Not just a success but something that would enable you to cook up a grand career.

This is what I wrote in 1982, my first annual letter to my Unitholders.

"Is this the time to invest? Yes, definitely. Stocks, in this doom and gloom environment, are cheap by every historical standard...What I would propose in the future, if the market is more demoralized than what it is now, is that we should open this Fund to the public. There is no better time to invest aggressively. Stocks are selling at a substantial discount from book value and even during the Great Depression, the Dow Jones Industrial Average did not trade below book value for more than a few months... Companies in the United States are selling at giveaway prices."

The current scenario is totally the opposite. Some of the questions that bother me now are opposite to what was bothering me in 1981.

1) How low can interest rates go? In Europe, some sovereign bonds are trading at negative yields.

2) The Great Recession occurred in 2008, and now it is 2015 - that is seven long years. Although the recovery has been anemic, at least it's recovering.

3) The velocity of money for M2 is at an all-time low. This can be further highlighted if we hypothesize about what would happen if M2 moved back up to the historical average. If a regression to the mean were to occur – the price levels could be 25% higher than what it is today. Carrying this logic one step further, with the current levels of money-printing growing at approximately 7.2% annualized, this could see a potential price level increase of 50%, if the velocity of money were to move back up to the historical average.

No one can predict the future with any high degree of certainty, but you wonder, if the current policies continue for any extended period of time, when will the chickens come home to roost?

4) Deflationary forces are strong now; eventually, the supply and demand will bring everything into equilibrium as they work through their economic cycles, but you cannot 'un-print' money.

5) Stock prices are close to an all time high if measured by price to earnings ratio, premium to book value or current dividend yield.

6) Junk bonds, the biggest beneficiary of easy money, should be trading at 70, not at 100 cents on a dollar with a 5.5% coupon rate.

7) What happens to the bond and stock markets if interest rates start to rise? In Europe some sovereign bonds are selling at negative yields.

In 1981, I felt the economic conditions were such that you were set up for a huge success. You just needed the courage to load up the truck and buy everything in sight. By contrast current conditions make me feel that investors are being set up for a heartbreaking disappointment, especially for the unwary.

Sears Holdings
As we have indicated before, we believe that Sears Holdings is a misunderstood story. There are many moving parts but we believe Sears Holdings' intrinsic value lies in its real estate assets. It also has other valuable assets such as Kenmore, Craftsman and Diehard. Being a traditional department store has become a tough business during the last decade but, according to management, Sears is transitioning its historic focus on running a brick and mortar department store into a business that provides and delivers value by serving its members in the manner most convenient for them: whether in store, at home or through digital devices.

The value of its real estate allows Eddie Lampert, the controlling shareholder and CEO, the time and money to effect the changes. What Lampert is doing is the right thing to do, considering the possible outcomes – if it works, it'll be a multi-bagger; if the transformation does not work out as expected, we believe the real estate values are high enough that we would not lose money in our investment at current prices after netting out all liabilities. If real estate was the only play from Lampert's viewpoint, it seems that he would have liquidated the company a long time ago.

Caveat Emptor: With Sears announcing the REIT plans for part of their real estate holdings, which could be effected by the end of this year, those who bought Sears on the basis of that if the retail operations do not pan out, the value is covered by its real estate - that kind of reasoning will be less valid than before.

So, after the REIT transaction, you will be betting more on Sears' retail transformation, ostensibly called as 'SHOPYOURWAY'. If it doesn't work out, Lampert will be called 'LOSTYOURWAY', and so will be the investors who are still holding the stock.

The various bonds and debentures in Sears will also have less coverage than before. Lampert was smart enough to structure the debt in such a manner that if parts of Sears were spun off directly or through rights offerings, fraudulent conveyance laws wouldn't come into play.

Some of the debt like the one at Sears, Roebuck and Acceptance Corp. (SRAC) are guaranteed by Sears Holdings, but the assets of Lands' End, Sears Hometown and Sears Canada have flown the coop. On some of these transactions, Sears did receive the cash, and that may mitigate the argument of fraudulent conveyance laws. Unfortunately, the level at which cash is being consumed is unacceptable and if the transformation does not happen soon enough or is not sufficiently successful, it may make staying invested in Sears a highly risky investment, despite its vast real estate holdings.

There is one unusual quirk in the latest bond issuance with a coupon of 8%, maturing in 2019. It looks junior to the SRAC bonds but it gives the warrant holder the right to use this 8% bonds at 100 cents on a dollar to buy Sears Holdings stock at $28.41 per share. No wonder it is trading at 96 cents on a dollar versus 60 cents on a dollar for the SRAC bonds.

Debts at Negative Yields
I never thought that in my lifetime that we would ever see a situation in a developed economy when there is a negative yield on interest rates. A few weeks ago, Finland floated a five-year

note at a negative yield. It sold 1 billion Euros worth of notes at an interest rate of negative 0.017%. In other words, noteholders or bondholders are willing to pay the government the privilege of holding its notes. And this is not an aberration. Countries like Germany, France, Sweden, Netherland, Belgium and Austria have seen their two-year sovereign debt trading at negative yields.

Not to be outdone, a corporate bond of Nestle 3/4% maturing in October of 2016 is also trading at a negative yield. So, you have come to this ridiculous situation where you can borrow money for free.

The question now is, how can one capitalize on the situation? There are several possible ways of doing that, but one way of seeking to take advantage of this type of situation is through an interest rate swap. An interest rate swap is a derivative contract between two counterparties whereby they agree to exchange one stream of interest payments for another, over a set period of time.

We are still considering the use of interest rate swaps and other similar derivatives. If we do use these contracts, we will do our best to quantify the risk of loss from these contracts and minimize losses if interest rates do not move in the manner that we anticipate. Of course, there is no guarantee that our use of these interest rate derivatives will work as intended or that we will accurately predict or analyze the direction of future interest rates.

We are starting to look at credit default swaps (CDS)

One way of assessing investors' appetite for risk is to check the prices of credit default swaps (CDS). In CDS, one party sells credit protection and the other party buys credit protection. Put another way, one party is selling insurance and the counterparty is buying insurance against the default of a specific third party's debt. If the protection buyer does not own debt issued by the third party, then CDS are more appropriately viewed as an investment transaction, rather than a hedging transaction, for the protection buyer notwithstanding the insurance-like features of a CDS. In most CDS, the protection buyer makes the premium payments over the life of the CDS, frequently on a quarterly basis.

We believe that CDS are starting to sell at prices that are becoming interesting. At recent prices, they appear to offer one of the potentially cheapest forms of insurance against market disruptions. We are continuing to monitor CDS prices and may potentially invest in CDS in the future. We are looking at who deals in such investments and we want to examine carefully what counterparty risk we may be exposed to. The mechanics of investing in CDS have changed somewhat from six years ago.

To make money in CDS, you don't need a default of the third party's debt. A dislocation in the economy or deterioration in the credit profile of the issuer may cause the CDS price to rise from these low levels. The negative aspect is that, like insurance, the premium paid for the protection erodes over time and may expire worthless. There is no guarantee that the Manager will make money for the Fund on any particular CDS or correctly predict an increase of value in any particular CDS.

Caution to the Investors
Investors should be advised that we run a highly focused portfolio. In addition, we may have securities that are non-U.S. and could be subjected to geopolitical risks, which may trump or at least negatively influence the financial performance of the company. Also, we may enter into some derivative contracts with regard to CDS and interest rate swaps. Because of these factors, the net asset value of the Fund can be volatile. However, we are not bothered by this volatility because our focus has always been, and continues to be, on how inexpensive we believe the investments are relative to their intrinsic value.

Other Matters

FOREIGN CURRENCY CONTRACTS: None existed at December 31, 2014.

CREDIT DEFAULT SWAPS: None existed at December 31, 2014.

CONSTANT MATURITY SWAPS: None existed at December 31, 2014.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in $U.S. is now able to do so.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than two years. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Peter Gregoire and Joe Tortolano. The 2014 IRC Annual Report is available on our website www.choufunds.com.

As of March 16, 2015, the NAVPU of a Series A unit of the Fund was $132.93 and the cash position was approximately 26.1% of net assets. The Fund is up 7.0% from the beginning of the year. In $U.S., it is down 2.7%. While 2015 is off to a good start, please do not extrapolate these returns into the future.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND
(unaudited)

March 18, 2016

Dear Unitholders of Chou Associates Fund,

After the distribution of $0.07, the net asset value per unit ("NAVPU") of a Series A unit of Chou Associates Fund at December 31, 2015 was $115.50 compared to $124.19 at December 31, 2014, a decrease of 7.0%; during the same period, the S&P 500 Total Return Index increased 20.7% in Canadian dollars. In $U.S., a Series A unit of Chou Associates Fund decreased 22.0% while the S&P 500 Total Return Index returned 1.4%.

The table shows our one-year, three-year, five-year, 10-year, 15-year and 20-year annual compound rates of return.

December 31, 2015 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Chou Associates ($CAN)	-7.0%	13.8%	9.2%	6.1%	9.1%	10.7%
S&P 500 ($CAN)	20.7%	28.5%	20.2%	9.2%	4.4%	8.2%
Chou Associates ($U.S.)[14]	-22.0%	1.9%	2.2%	4.3%	9.7%	10.6%
S&P 500 ($U.S.)	1.4%	15.1%	12.6%	7.3%	5.0%	8.2%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2015 Results

The weakness of the Canadian dollar against the U.S. dollar had a positive impact on the results of the Fund. The difference in performance results between the net asset value per unit (NAVPU) priced in Canadian dollars, versus U.S. dollars, is attributable to the fact that on December 31, 2014, one U.S. dollar was worth approximately $1.16 Canadian, whereas one year later, on December 31, 2015, one U.S. dollar was worth approximately $1.38 Canadian.

Positive contributors to the Fund's performance during the period ended December 31, 2015 were the warrants of JPMorgan Chase & Company.

The Fund initiated equity security positions in Ascent Capital Group Inc. as well as in the second-lien term loan of Exco Resources 12.50%, due October 2020.

[14]The alternative method of purchasing Chou Associates Fund in $U.S. has been offered since September 2005. Performance for years prior to September 2005 is based on the $U.S. equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($U.S.) except for the currency applied.

Securities of Resolute Forest Products Inc., Sears Holdings Corporation, Berkshire Hathaway Inc., Goldman Sachs Group Inc. and Nokia Corporation ADR were the largest negative contributors to the Fund's performance during the same period.

The Fund decreased its holdings of Nokia Corporation ADR by 25%.
Olympus Re Holdings Limited was dissolved in February of 2015, and the Fund received a final liquidating distribution in the amount of $643,930.

Portfolio Commentary
Throughout 2015 and the early part of 2016 stock and bond markets were not cheap in general but some sectors were hit so badly that it makes sense for us to dig deeper when looking at them. For example, let's take a look at the oil and gas sector whose stocks and bonds have fallen dramatically over the past few years:

(US$ In millions, excluding stock, bond and commodity prices)	Comstock Resources ("CRK")		Exco Resources ("XCO")	
	2013	2015	2013	2015
Stock Price[1]	$18.29		$5.31	
Enterprise Value[1]	$1,668		$2,999	
PV-10*[2]	$1,100	$372	$1,300	$402
PV-10 Oil Price[2]	$96.94	$46.88	$96.78	$50.28
PV-10 Nat Gas Price[2]	$3.67	$2.34	$3.67	$2.59
Total Senior Bank Debt[3]		$0		$95
Total Outstanding Secured Bonds[3] (1st or 2nd Lien)		700M		700M
Current Price of Bonds		$0.40		$0.40
"Market Value" of Secured Bonds[3]		$280		$280
Total Sr Bank Debt + "MV" of Secured Bonds		$280		$375
Total Sr Bank Debt + "MV" of Secured Bonds as % of 2013 Enterprise Value		16.8%		12.5%
Current YTM of Secured Bonds[4] (1st or 2nd Lien)		42.6%		49.8%
Most Recent Company Information:	December 2015		February 2016	

*PV-10 is the present value of estimated future oil and gas revenues, net of estimated direct expenses, discounted at an annual discount rate of 10%

1) Per Bloomberg as of 12/31/2013
2) Per 2013 10K SEC Filing, price used to calculate present value
3) Per most recent SEC Filings and Company Presentations
4) Per Bloomberg assuming current bond prices listed above

The first part of the table above shows the Enterprise Value at December 31, 2013 for two companies - Comstock Resources and Exco Resources. Enterprise Value is calculated as the market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents. Enterprise Value is a measure of what stock and bond investors think the entire company is worth.

Lower down on the table is a comparison of these companies' Enterprise Values at December 31, 2013 to the current price of their senior bank debt and their first or second lien bonds. The first or second-lien paper for these companies is currently yielding 42.6% - 49.8%, an attractive rate of return. When you purchase such a senior paper during normal times, the yield to maturity is frequently far below 10%. If the company goes bankrupt, and has little or no bank debt (which is senior to the first or second-lien bonds), most often the second-lien or even first-lien holders will end up owning 90% of the restructured company. Investors today can buy into these papers (first or second-lien) at a fraction of what Enterprise Values were at December 31, 2013 and also below that of the PV-10 value for the year ended 2015. For example, an investor can pay $0.40 for a unit of CRK's secured bonds, which is equivalent to paying $280 million in total for all its secured bonds. This is only 17% of CRK's Enterprise Value back in 2013. Although this is a simplified manner of looking at companies, it contains important and valuable information. These numbers are showing that regardless of what happens to the company going forward, you are more than likely to make a decent return on your investments.

We are looking to purchase more debt securities of oil and gas companies but our focus is on:

1) First or second-lien loans or notes;
2) Situations where the ability to add senior or issue pari-passu debt is significantly limited; and
3) If the company restructures or goes into bankruptcy, the recovery value of the bond is greater than the current price of the bond.

In the same vein, many stocks that we consider as undervalued went down even further. Let's discuss two of our biggest holdings, Resolute Forest Products and Sears Holdings.

Resolute Forest Products
Resolute Forest Products (RFP) is primarily involved in newsprints, specialty papers, wood products and market pulp. As the downturn in global commodities intensified, RFP was not spared, hitting all four of the company's business segments. Management has concentrated on lowering the cost of every segment but this wasn't enough to compensate for the deterioration of prices in their respective markets.

It is hard for us to believe that RFP is trading as low as $4 per share. At $4 per share it means the market capitalization of the company is selling for less than US$400 million dollars. The company has consolidated sales of close to $4 billion and in each of its major business segments, it is a global leader. It is the biggest volume producer of wood products east of the Rockies, the third largest in North America for market pulp, the number one producer of newsprint in the world and the largest producer in North America of uncoated mechanical paper and an emerging tissue producer. With the exception of the wood products segment, which has revenues of approximately $600 million, the other three segments each have revenues of approximately $1 billion. Each of the four business segments could easily fetch at least $400 million in a normal market.

In our opinion, the company's "normalized EBITDA (Earnings before interest, taxes, depreciation and amortization)" is approximately $400 million. In other words, with RFP trading at $4 per share, the market value of the company is being priced for about 1 times normalized EBITDA. The company does have net debt of approximately $365 million, but even if you include net debt, the market is valuing the entire company for less than 2 times normalized EBITDA. It had cash of approximately $300 million a year ago but used approximately $156 million to acquire Atlas Paper and is spending $270 million to convert some of its pulp mills in Calhoun, Tennessee to produce tissue papers.

A couple of years ago, it bought Fibrek Inc. for approximately $126 million. So, if you add the bolt-in acquisitions of Fibrek ($126 million), Atlas Paper ($156 million) and its conversion to tissue paper ($270 million), you end up with $552 million. In addition, the company has tax loss carryforwards of approximately $2 billion which it can use to offset future gains and income. All these factors lead us to believe that at current prices, RFP is very undervalued.

Sears Holdings
In July 2015, Sears Holdings Corporation (SHLD) announced that it had closed its rights offering and sale-leaseback transactions with Seritage Growth Properties ("Seritage"), a recently formed, independent, publicly traded real estate investment trust ("REIT").

In the transaction, Sears sold 235 Sears- and Kmart-branded stores to Seritage along with Sears' 50 percent interests in joint ventures with each of Simon Property Group, Inc., General Growth Properties, Inc. and The Macerich Company, which together, hold an additional 31 Sears Holdings properties. Based on our rough estimate, this represented less than 25% of the company's real estate assets.

Sears Holdings received aggregate gross proceeds from the transaction of $2.7 billion, which provides the Company with enhanced financial flexibility to accelerate investments in its transformation to an asset-light, member-centric, integrated retailer.

However, from our perspective, the most important thing that happened was that Seritage is now a public company and when its stock trades daily, we have a more reliable way of assessing the real estate value in SHLD indirectly. We also know that pre-Seritage and post-Seritage, the profile and the quality of the properties held in Seritage and SHLD is roughly the same.

At the current price of $15 for Sears, the company is being priced in the market for about $1.5 billion. Even if you include the debt of roughly $3 billion, we believe that the price of Sears is severely underpriced.

However, the comparison is not apples to apples. Seritage is a clean real estate company whereas SHLD has some serious problems with its retail operations. As every day goes by, the losses from operations are eroding the value of SHLD that comes from its real estate and brand names. Those brand names such as Kenmore, Craftsman and Diehard, we believe collectively could be worth as much as $3 billion. The transformation from the bricks-and-mortar business to their member-centric Shop Your Way (www.shopyourway.com) is happening; whether it is going to be successful or not is another story. These types of ventures should be classified as "venture capitals" and in spite of all the positive spins written about the transformation, it is still a hit or miss affair. Still, netting out all the negatives and all the losses from operations, we believe that the intrinsic value of Sears is far above the current price of $15.

Deflation vs Inflation

In the history of mankind, we have never really been in a kind of environment where one could make an equally strong case for deflation or for inflation. The arguments for both sides are quite compelling.

If you believe in deflation, these are the points one could make:

1) China, the recent locomotive of global growth, is lurching ahead at an ever slowing speed. Its economy and financial markets in 2015 went through tremendous turmoil, affecting all markets worldwide. China has been a huge success story for the last 30 years as it was responsible for taking away large amounts of manufacturing jobs from developed economies. Its economy grew annually at a double digit rate and we thought this growth would not show any signs of slowing down appreciably in the near future. Even after the Great Recession of 2008, China's economy grew at a pretty good clip. However, most of the growth occurred not because of demand but due to enormous spending by all sectors of its government on unneeded housing and infrastructure. As a result, if one were to go to China now, he would notice a tremendous number of ghost cities with empty houses, empty highways and no people;

2) As shown by the weakness in commodity prices, it will take a while for demand to absorb all the excess capacity built up over the last 20 years;

3) Some sovereign bonds carry negative interest rates;

4) The recovery of the global economy from the Great Recession of 2008 has been sluggish at best.

On the flip side, one could make an equally compelling case for inflation to roar back some time in the future:

1) How low could interest rates go? At negative yields they can’t go much below zero;

2) Although the recovery has been anemic, at least in nominal terms there has been some recovery;

3) The velocity of money for M2 is at an all-time low. This can be further highlighted if we hypothesize about what would happen if M2 moved back up to the historical average. If a regression to the mean was to occur, the price levels could be 25% higher than what it is today. Carrying this logic one step further, with the current levels of money-printing growing at approximately 7.2% annualized, this could see a potential price level increase of 50%, if the velocity of money were to move back up to the historical average;

4) Normal market forces, the incessant balancing of supply and demand, will bring everything into equilibrium as the boom-bust cycle produced by artificial credit creation works itself out, but you cannot ‘un-print’ money.

The current situation reminds me of a story about an exchange between Winston Churchill and MP Bessie Braddock:

At one time when Churchill was drunk, Bessie Braddock yelled at him, "Winston, you are drunk, and what's more, you are disgustingly drunk."

Churchill retorted, "My dear, you are ugly, and what's more, you are disgustingly ugly. But tomorrow I shall be sober and you will still be disgustingly ugly."

That's how I feel about deflation and inflation (eventual consequences of printing too much money).

Volatility & Returns

As you are well aware, the cardinal principle underlying the investments in the Fund is to pay far less than what the company is worth, measured by sustainable earning power and/or hard assets that are not depreciating in value. In other words, we want to have an adequate "Margin of Safety" and this concept is what distinguishes investment from speculation.

This table is an abridged version of the table produced on the inner cover of the annual report:

Period ended	Total value of shares
Dec.31, 1986	$10,000
⋮	⋮
Dec.31, 1998	59,187
Dec.31, 1999	53,489
Dec.31, 2000	57,967
Dec.31, 2001	70,397
Dec.31, 2002	91,504
⋮	⋮
Dec.31, 2006	139,511
Dec.31, 2007	125,258
Dec.31, 2008	88,553
Dec.31, 2009	114,854
Dec.31, 2010	136,916
⋮	⋮
Dec.31, 2015	**$212,854**

In the years 1999 and 2008, we had negative returns, but we were able to bounce back in the following years. An investor who put in $10,000 on December 31, 1986 would have an account worth $212,854 as of December 31, 2015. Even if one invested at a high, let's say in 1998 or 2006, you would have still done reasonably well long term. When you are a value investor, you have no control on short-term volatility. While the future is never certain, we believe the margin of safety principle has served us well and will continue to serve us well in the future. However, the stock markets are highly volatile and there will be periods or years where we may have negative returns. The current environment reminds us of 1999 – stocks that were expensive became more expensive and stocks that were cheap became cheaper. Eventually, however, the cheap stocks will move closer to their intrinsic value. We would like to encourage our unitholders to review and understand the table as it may help them see where they stand. As you can see, we have done reasonably well in the long run.

Nevertheless, we would also stress that the amount of money that investors choose to invest in the Fund should only be to the extent that they can afford to experience a temporary decline of **40%** or more of their investment. This may sound drastic but sleeping well and not getting too anxious are also important considerations both for the manager and the investor.

Other Matters

FOREIGN CURRENCY CONTRACTS: The Fund hedged Canadian dollars against U.S. dollars at 1.3036. The notional amount was US$100,000,000. We closed out the contract and realized a loss of approximately US$4,356,000. The Fund also hedged a second amount for US$50,000,000 at 1.3083, and it is currently outstanding. Please note that as of December 2015,

CHANGE OF SERVICE PROVIDER: We are pleased to advise you that we have moved from Citigroup Fund Services as our asset servicing provider, and we have transitioned custody, fund valuation and recordkeeping for the Chou Funds, managed by Chou Associates Management Inc. to CIBC Mellon effective December 14, 2015. CIBC Mellon is a Canadian leader in asset servicing, with more than C$1.5 trillion of assets under administration on behalf of many of Canada's largest investment funds, pension plans and other institutional investors. Founded in 1996, CIBC Mellon is 50-50 jointly owned by Canadian Imperial Bank of Commerce (CIBC) and by BNY Mellon, a global leader in asset servicing with US$28.5 trillion under custody and/or administration as at September 30, 2015.

Please note this is only notification for our investors, and you are not required to change or update your information. All business practices will remain consistent and you should not notice any change to your day-to-day transactions.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than 12 months. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Peter Gregoire and Joe Tortolano. The 2015 IRC Annual Report is available on our website www.choufunds.com.

As of March 18, 2016, the NAVPU of a Series A unit of the Fund was $93.22 and the cash position was approximately 17.6% of net assets. The Fund is down 19.3% from the beginning of the year. In $U.S., it is down 14.3%.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND

(unaudited)

March 17, 2017

Dear Unitholders of Chou Associates Fund,

After the distribution of $1.67, the net asset value per unit ("NAVPU") of a Series A unit of Chou Associates Fund at December 31, 2016 was $110.60 compared to $115.50 at December 31, 2015, a decrease of 2.8%; during the same period, the S&P 500 Total Return Index increased 8.9% in Canadian dollars. In U.S. dollars, a Series A unit of Chou Associates Fund was up 0.2% while the S&P 500 Total Return Index returned 12.0%.

The table shows our one-year, three-year, five-year, 10-year, 15-year and 20-year annual compound rates of return.

December 31, 2016 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Chou Associates ($CAN)	-2.8%	0.4%	12.7%	4.0%	7.5%	9.4%
S&P 500 ($CAN)	8.9%	17.8%	21.2%	8.5%	5.5%	7.6%
Chou Associates ($US)[1]	0.2%	-7.1%	6.6%	2.6%	8.6%	9.5%
S&P 500 ($US)	12.0%	8.9%	14.6%	6.9%	6.7%	7.7%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the 2016 Results

The strength of the Canadian dollar against the U.S. dollar had a negative impact on the results of the Fund. The difference in performance results between the NAVPU priced in Canadian dollars, versus U.S. dollars, is attributable to the fact that on December 31, 2015, one U.S. dollar was worth approximately $1.38 Canadian, whereas one year later, on December 31, 2016, one U.S. dollar was worth approximately $1.34 Canadian.

The biggest positive contributors to the Fund's performance in 2016 included JPMorgan Chase warrants expiring on October 2018, the equity securities of MBIA Inc., Overstock.com, Goldman Sachs Group, and the second-lien term loan of Exco Resources Inc.

Equities of Valeant Pharmaceuticals, Sears Holdings Corporation, Resolute Forest Products, and Nokia Corporation were the main negative contributors to the Fund's performance during the same period.

[1] The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 is based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

The Fund decreased its holdings of Berkshire Hathaway by 50%, and exited all shares of International Automotive Components Group.

New additions during the year include an equity stake in Valeant Pharmaceuticals, debt securities of Exco Resources unsecured 8.5% due April 2022, Westmoreland Coal Company 8.75% due January 2022, and preferred shares of Overstock.com. The Fund also increased its position in Sears Holdings Corporation and the second-lien term loan of Exco Resources.

U.S. Bank TARP Warrants

Overall, investments in the TARP warrants and equities of the U.S. banks performed well in 2016, as reflected by the increases in prices of each position shown in the following table:

Security	Average Cost Base (ACB)*	Price as of Dec. 31, 2015	Price as of Dec. 31, 2016	% Increase From ACB
JPMorgan Chase Warrants (Oct. 28, 2018)	$12.64	$23.69	$44.27	250%
Wells Fargo Warrants (Oct. 28, 2018)	$7.73	$20.49	$21.33	176%
The Goldman Sachs Group	$127.85	$180.23	$239.45	87%
Citigroup Inc.	$24.60	$51.75	$59.43	142%

** As of December 31, 2016*

Note: Prices are in local currency $US.

In our 2010 semi-annual report we outlined our thesis on why we believed that these warrants were attractive long-term investments. We wrote:

> "So, what is so unique about these stock warrants?
>
> • They are long dated, with most expiring in 2018 or 2019. This time-frame of eight-plus years allows banks to grow their intrinsic value to a high enough level to have an appreciable impact on the strike price of the stock warrant.
>
> • The strike price is adjusted downward for any quarterly dividend that exceeds a set price. Normally, this is not seen in a stock warrant. This is a truly stringent condition. In this case, we should give the government credit for extracting a pound of flesh. An example: for Bank of America, class 'A' warrants, the strike price is adjusted downward for any quarterly dividend paid exceeding one cent a share.
>
> • Many of the banks have excess capital on their balance sheet. When the economy settles down, we expect the banks to use this excess capital either for buybacks or a one-time special dividend that may reduce the strike price on the stock warrants if this provision applies."

Since the price of the TARP warrants is contingent on the stock price of the bank, it was important that we held the view that the banks in general were undervalued. This is what we said about the banks in 2010 and 2011:

- "It has been five years since the financial crisis began in 2007. As each year has gone by, the quality of earnings of the banks has gotten higher, the books have become cleaner, the risks have become lower, and bank management has become far more risk averse. It is too bad that we had to go through so much turmoil to get there.
- The financial institutions that survive will be the ultimate beneficiaries of any recovery in the economy.
- Bank valuations that were below 10 times earnings six months ago have decreased even further, with many bank stocks selling below book and some selling at big discounts to tangible book value."

In conclusion, we stated that:

- "For an economy to flourish, we need sound financial institutions that can generate reasonable profits.
- Our investing horizon is long-term – eight years or more remain for these bank warrants. Over that period, we believe that the odds are it will work out to be a decent investment, perhaps even more so for the better capitalized banks. We view it as the glass being more than half full rather than half empty. The bank TARP warrants are complex, with terms and conditions that are unique to each bank, and we encourage you to research them for yourself and draw your own conclusions."

We are now in the year 2017 and the maturity date for the TARP warrants is less than three years away. As the time element grows shorter, we believe the warrant is likely to become more speculative, and therefore we expect to reduce or eliminate the positions in the various TARP warrants. If we believe that the banks in question may still be undervalued, then we will be more likely to invest in the banks' common stock.

However, it is important to note that any future decision to sell the warrants or buy the common stock will be based on our view of the markets at the time, as well as the issues which exist when we make any such investment decision.

Exco Resources

Exco Resources is an independent oil and natural gas company that engages in the acquisition, exploration, development, and production of onshore oil and natural gas properties with a focus on shale resource plays in the United States.

We liked this security because it met our criteria for investing in the oil and gas sector. The criteria that we considered in analyzing this type of investment is that the security should be:

1. A first or second-lien loan or note;
2. Issued by a company with a significantly limited ability to add senior or pari-passu debt to its capital structure; and
3. Of a type that should the company restructure or go into bankruptcy, the recovery value of the bond is likely to be greater than the current price of the bond.

In 2015, we initiated a position in Exco Resources second-lien term loan 12.5%, maturing in 2020. This term loan did quite well in 2016, rising from 56.5 cents on the dollar at December 31, 2015 to 72.9 cents on the dollar at December 31, 2016, an increase of 29.0% excluding interest received.

As of December 31, 2016, the Fund owned about US$37.6 million worth of Exco's second-lien term loan (US$51.5 million in par value). This is one of the largest positions in the portfolio, comprising about 11% of the assets of the Fund (at market value). In addition to the security being very senior in the capital structure, we also hold the view that management seems to be making good decisions with respect to the allocation of capital in a tough environment.

Next we will discuss the three main culprits responsible for the Fund's lackluster recent performance.

Valeant Pharmaceuticals

Valeant has received a lot of bad press (some deservedly so) for the last couple of years. But in mid-March of this year, it announced that the company raised US$3.25 billion in debt maturing in 2022 and 2024, with covenants that are less stringent than the other term loans that the new debt will replace. The changes in covenants include the removal of the maintenance covenants from the Term B loans (consisting of a secured leverage ratio and an interest coverage ratio).

The company will use its net proceeds to repay shorter-term maturities. This is an important step for Valeant because it removes the threat of technical default in the short term, and it gives management time to fix the company and return it to sustainable profitability without looking behind their backs all the time.

In conclusion:

- Valeant could return to trading at normal multiples if its debt of approximately US$30 billion is significantly reduced and once the impact and costs of litigations are determined. Management has indicated that they hope to reduce its debt by as much as US$8 billion through a combination of organic earnings and the sale of non-core assets.
- The company appears to have good cash flow characteristics, generated from solid portfolio pipelines. We particularly like the Bausch and Lomb group and we believe that most of its revenues are less subjected to pricing pressures that are bedeviling the pharmaceutical industry.
- Because the company has almost US$30 billion of debt, it can be misleading just to take one valuation method like Price to Earnings (P/E) ratio to gauge whether Valeant is cheap or not. For example, the current P/E ratio is less than three times, and while this may indicate that Valeant is very cheap, the undervaluation is not as cheap as it appears. One must look at return on a fully capitalized basis (taking debt into account) to get the full picture. Nonetheless, the equity-based multiples are still good indicators, but they should not be used in isolation like any financial ratios.
- Another indicator to look at is how much free cash flow it is generating. It appears that Valeant can generate close to US$1.5-$2.0 billion of free cash flow per year. If that is the case, then with the market capitalization of less than US$4 billion, the company is selling at a

very cheap valuation of around two times free cash flow. Alternatively, one can also view it as a deleveraging play and as the free cash flow of US$1.5-$2.0 billion is used to repay debt, it proportionately raises the value for the common equity by that same amount.

Based on the information we now have, the average price we paid of less than seven times free cash flow is on the high side, but at less than two times free cash flow it is a totally different story. If these numbers hold, we believe that the intrinsic value is much higher than the current price of Valeant.

The Pharmaceutical Industry

As if Valeant has not given enough pain and anguish to our unitholders, we believe pharmaceutical stocks as a group are selling at attractive valuations, even when you take the debt into consideration. They generate their earnings in cash and some of them are down more than 50% from their highs, which is what caught our attention initially. It may look like we are adding more emotional fuel to the fire from our experience with Valeant but we look at mispriced stocks on a case-by-case basis. To avoid getting caught with Food and Drug Administration (FDA) approval and patent expiration issues, we will be using a basket approach.

Sears Holdings

In July 2015, Sears Holdings Corporation (SHLD) announced it had closed its rights offering and sale leaseback transactions with Seritage Growth Properties ("Seritage"), a newly formed, independent and publicly traded real estate investment trust ("REIT").

In the transaction, SHLD sold 235 Sears- and Kmart-branded stores to Seritage, along with SHLD’s 50% interests in joint ventures with each of Simon Property Group Inc., General Growth Properties Inc. and The Macerich Company. The three entities combined hold an additional 31 SHLD properties. Based on our rough estimate, this represents less than 25% of the company’s real estate assets and SHLD received aggregate gross proceeds from the transaction of $2.7 billion.

However, from our perspective, the most important thing that has happened is that Seritage is now a public company. A stock that trades daily provides a more reliable way of assessing the real estate value in SHLD indirectly. We also know that pre-Seritage and post-Seritage, the profile and the quality of the properties that are held in Seritage and SHLD are roughly the same.

Considering SHLD’s brand collections and what we believe to be the value of the SHLD real estate portfolio (based in part upon our analysis of the Seritage valuation over the reporting period), it may appear that at the year-end price of $9.29 for SHLD (about US$994 million in market capitalization), the company is severely underpriced. However, given the company’s net debt of approximately US$4 billion, a pension deficit of about US$2 billion, and the enormous losses it has taken to date to transform its business from a brick-and-mortar business to an asset-light business, we believe that the intrinsic value of SHLD may have been severely eroded (notwithstanding its real estate and brand portfolio).

It is hard to evaluate what kind of value you can assign to the company’s “ShopYourWay” online program even though management has poured billions of dollars into it. From management's perspective, they can argue that "ShopYourWay" could be worth more than the capital invested. However, unless it generates significant amounts of cash or free cash flow relative to the capital invested, it is doubtful if it could be worth anything. It is hard to foresee why investors would give a similar valuation of Amazon.com to "ShopYourWay" even though SHLD's membership program has some characteristics similar to Amazon Prime. In conclusion, even if you take the best case scenario and "ShopYourWay" turns out to be profitable, it could be a Pyrrhic victory.

In hindsight, our initial assessment of SHLD being worth more than $50 per share a few years ago was most likely too optimistic. This is taking into consideration that we received roughly $13-$17 per share in distribution from various spin-offs and later received proceeds from selling them into the stock markets. Nevertheless, we believe that the stock may still be cheap at the current valuation, albeit not at the level that we initially anticipated.

Resolute Forest Products

Resolute Forest Products (RFP) is primarily involved in newsprints, specialty papers, wood products and market pulp. As the downturn in global commodities intensified, RFP was not spared as all four of the company's business segments got hit. Management concentrated on lowering the cost of every segment but these actions were not enough to compensate for the deterioration of prices in their respective markets.

At year-end 2016, the market price of RFP was $5.35 per share with a market capitalization of roughly US$480 million. As we have explained in the past, the company continues to have consolidated sales of close to US$3.6 billion and in each of its major business segments, it is a global leader. It continues to be the biggest volume producer of wood products east of the Rockies, the third largest in North America for market pulp, the number one producer of newsprint in the world and the largest producer in North America of uncoated mechanical paper and an emerging tissue producer. The wood products segment of the company has ongoing revenues of approximately US$500 million, while the other three segments each continue to have revenues of approximately US$1 billion. We believe that each of the four business segments could fetch at least US$400 million in a normal market, and as a result, RFP may be undervalued.

Short Term Performance Impacts Long Term Returns

A lot of investors are not aware that short-term results can have a huge bearing on the five and ten-year annualized compounded returns. For example, let's take Fund A and Fund B. Fund A consistently returns 7% per year for 10 years and therefore its compound rate of return over the 10 year period is 7%. Fund B, on the other hand, returns 8% for the first nine years but suffers a loss of 20% in the tenth year. Its compound rate of return for the 10-year period drops significantly to 4.8%. The impact is more pronounced for the five year returns, a similar decline of 20% in the fifth year would have decreased the 5-year compound return from 8% to merely 1.7% for Fund B versus 7% for Fund A.

We've had to answer the same kind of question in 1999. The S&P 500 index was up close to 13.9%, whereas the Fund was down 9.6%. Again, our ten and five-year annualized returns looked horrible in comparison to the index, but that is how the math works.

The Current Market

The current market keeps reminding me of the period when I started managing money in 1981. The market was incredibly cheap: approximately six times earnings and roughly 6% dividend yield. The Dow had been earning on average 13% on its equity for quite a while and there was nothing to suggest the future would be any different.

However, there was one important caveat. Stocks were incredibly cheap based on what you would pay for a business historically when interest rates were at normal rates.

But by June 1981, the federal fund's rate rose to 20%. Eventually in June 1982, a highly important economic measure – the prime interest rate – reached 21.5%. The 30-year bond yield hit a high of 15.2%. If interest rates stayed at these levels for 10 years or more, then stocks would not be considered cheap, but instead trading closer to fair value.

The reverse is true today. Based on historical ratios, the current prices for stocks are not cheap but if interest rates stay at these levels for an extended period of time, the stocks are not expensive at all.

Suffice to say that we are not comfortable with the current market levels and we are not convinced that interest rates will stay this low for an extended period of time.

Other Matters

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than 12 months. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Peter Gregoire and Joe Tortolano. The 2016 IRC Annual Report is available on our website www.choufunds.com.

As of March 17, 2017, the NAVPU of a Series A unit of the Fund was $111.61 and the cash position was approximately 8.9% of net assets. The Fund is up 0.9% from the beginning of the year. In U.S. dollars, it is up 1.6%.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager

CHOU ASSOCIATES FUND

(unaudited)

August 14, 2017

Dear Unitholders of Chou Associates Fund,

The net asset value per unit ("NAVPU") of a Series A unit of Chou Associates Fund at June 30, 2017 was $113.78 compared to $110.60 at December 31, 2016, an increase of 2.9%; during the same period, the S&P 500 Total Return Index increased 5.6% in Canadian dollars. In U.S. dollars, a Series A unit of Chou Associates Fund was up 6.5% while the S&P 500 Total Return Index returned 9.3%.

The table shows our one-year, three-year, five-year, 10-year, 15-year and 20-year annual compound rates of return.

June 30, 2017 (Series A)	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Chou Associates ($CAN)	24.6%	0.9%	10.5%	4.3%	6.6%	8.5%
S&P 500 ($CAN)	18.0%	17.0%	20.3%	9.4%	7.2%	6.8%
Chou Associates ($US)[1]	24.2%	-5.5%	5.3%	2.3%	7.8%	8.8%
S&P 500 ($US)	17.9%	9.6%	14.6%	7.2%	8.3%	7.2%

Rates of return are historical total returns that include changes in unit prices, and assume the reinvestment of all distributions. These annual compounded returns do not take into account any sales charges, redemption fees, other optional expenses or income taxes that you have to pay and that could reduce these returns. The returns are not guaranteed. The Fund's past performance does not necessarily indicate future performance. The table is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual funds or returns on the mutual funds. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

Factors Influencing the First Six-Month Results

The biggest positive contributors to the Fund's performance in the first half of 2017 included JPMorgan Chase warrants expiring on October 2018, and the equity securities of Nokia, Valeant Pharmaceuticals, Sanofi, and Citigroup Inc.

Equities of Sears Hometown and Outlet Stores, Resolute Forest Products, and MBIA Inc. were the main negative contributors to the Fund's performance during the same period.

During the period, the Fund decreased its holdings of Nokia, JPMorgan Chase warrants, and Citigroup Inc.

New additions during the period include equity stakes in Teva Pharmaceutical and Endo International. The Fund also increased its position in Valeant Pharmaceuticals.

[1] The alternative method of purchasing Chou Associates Fund in $US has been offered since September 2005. Performance for years prior to September 2005 is based on the $US equivalent conversion of the results of the Chou Associates Fund ($CAN). The investments in the Chou Associates Fund ($CAN) are the same as the investments in Chou Associates Fund ($US) except for the currency applied.

U.S. Bank TARP Warrants

Overall, investments in the TARP warrants and equities of the U.S. banks performed well in the first half of 2017, as reflected by the increases in prices of each position shown in the following table:

Security	Average Cost Base (ACB)*	Price as of Dec. 31, 2016	Price as of Jun. 30, 2017	% Increase From ACB
JPMorgan Chase Warrants (Oct. 28, 2018)	$12.64	$44.27	$50.29	298%
Wells Fargo Warrants (Oct. 28, 2018)	$7.73	$21.33	$22.20	187%
The Goldman Sachs Group	$127.85	$239.45	$221.90	74%
Citigroup Inc.	$24.60	$59.43	$66.88	172%

** As of June 30, 2017*

Note: Prices are in $USD.

The maturity date for the TARP warrants is now less than two years away. As the time element grows shorter, we believe the warrant is likely to become more speculative and therefore we expect to reduce or eliminate the positions in the various TARP warrants. If we believe that the banks in question may still be undervalued, then we will be more likely to invest in the banks' common stock.

However, it is important to note that any future decision to sell the warrants or buy the common stock will be based on our view of the markets at the time, as well as the issues that exist when we make any such investment decision.

EXCO Resources

As of June 30, 2017, the Fund owned about US$36.8 million worth of EXCO Resources (EXCO)'s 1.75 lien term loan (converted from the second-lien term loan held previously in Feb. 2017), with US$51.5 million in par value. This is the largest position in the portfolio, comprising more than 10% of the assets of the Fund (at market value).

We liked this security because it met our criteria for investing in the oil and gas sector. The criteria that we considered in analyzing this type of investment is that the security should be:

1. A very senior term loan or note;
2. Issued by a company with a significantly limited ability to add senior or pari-passu debt to its capital structure; and
3. Of a type that should the company restructure or go into bankruptcy, the recovery value of the bond is likely to be greater than the current price of the bond.

In addition to the security being very senior in the capital structure, we also hold the view that management seems to be making good decisions with respect to the allocation of capital in a tough environment.

Valeant and the Pharmaceutical Industry

As if Valeant has not given enough pain and anguish to our unitholders, we believe pharmaceutical stocks as a group are selling at attractive valuations. They generate their earnings in cash and most of them are selling at less than 10 times earnings. Some of them are down more than 50% from their highs, which is what caught our attention initially. It may look like we are adding more emotional fuel to the fire from our experience with Valeant but we look at mispriced stocks on a case-by-case basis. Given our current favorable view of the pharmaceutical industry generally, as next discussed in greater detail, we expect to invest in stocks of more than two or more pharmaceutical companies (that is, to utilize a so-called "basket approach"), in order to reduce the potential adverse effect on fund returns that could result from Food and Drug Administration (FDA) approval and patent expiration issues faced by a single company.

A Historical Perspective

What the pharmaceutical industry has been going through lately reminds me of what happened in the U.S. in 1994. A year earlier, then-president Bill Clinton appointed his wife, Hillary, to head a committee to prepare legislation for overhauling the U.S. health-care system, sending ripples of fear among investors of pharmaceutical stocks. It appeared as if drug prices would be set by the government on the basis of what it would cost to manufacture the product rather than being set by the market. Almost all pharmaceuticals stocks dived for the next of couple of years to unreasonable bargain levels.

It started with the 1992 U.S. presidential election. Clinton, the Democratic president-elect at the time vowed to make drug-price containment and universal health-care a cornerstone of his administration's plan to cut the nation's health-care bill, and promised to unveil a sweeping reform plan within his first 100 days in office. Several other politicians also joined the assault on the pharmaceutical industry by criticizing manufacturers for "drug price gouging" on critical medicines that patients needed by raising prices as high as three times the inflation rate in the 1980s. The political message was to protect American consumers from unfair and unaffordable drug prices by taking away the industry's carrots and replacing them with sticks.

As nervous investors feared that the incoming administration would enforce a tough pricing policy for prescription drugs, drug stocks were hammered starting in the pre-inaugural weeks, and continued to deteriorate with Clinton's victory in November 1992 and throughout debates over Clinton's health-care reform proposal from 1993 to 1994 (*see Figure 1*). The market psychology toward pharmaceutical stocks hit a decade low, as concerns heightened over the drug firms' ability to maintain their profit margins in a constrained pricing environment, despite new products in the pipeline.

Some of the key drug-related legislation proposed then as part of the health-care reform included:

- A new National Health Board would determine the "reasonableness" of new drug prices based on prices charged in other countries and producer costs. They would investigate "unreasonable" drug prices, and require companies to bring prices in parity with other nations if a drug price was higher in the U.S. than abroad.

- Drug companies would have to return to Medicare a rebate of 15% of their average nationwide price of each drug paid for by Medicare.
- The Secretary of Health and Human Services could bargain down the prices of new drugs before Medicare agreed to pay for them. Failures to negotiate an acceptable price could lead to total exclusion from Medicare coverage.
- Doctors would need permission from a government official to prescribe what were deemed as unreasonably priced drugs for Medicare patients.

The health-care reform package was eventually defeated in August 1994, sending an air of relief to the pharmaceutical stocks. They returned to their more fairly valued levels set from 1994 to 1998 (*see Figure 2*). The Republican revolution led by Newt Gingrich gave Republicans control of the Senate and House of Representatives, putting the final nail in the coffin for a health-care overhaul under the Clinton administration.

Similar political rhetoric returned in the latest U.S. election, when both Donald Trump and Hillary Clinton called out drug companies for outrageous and unjustified pricing practices. However, the historical and economic challenges faced in the 1990s still exist today, providing realistic limits to what politicians can do to manage drug prices.

Below are the graphs that compare the prices of three pharmaceutical stock prices both before and after August 1994.

FIGURE 1.

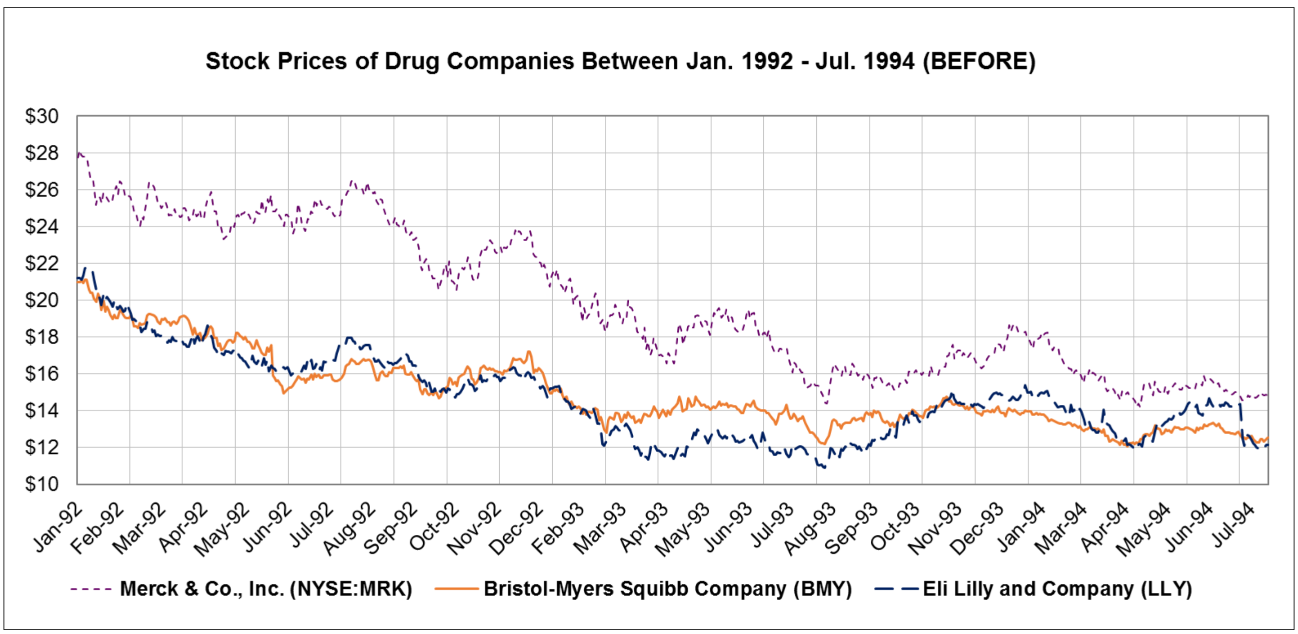
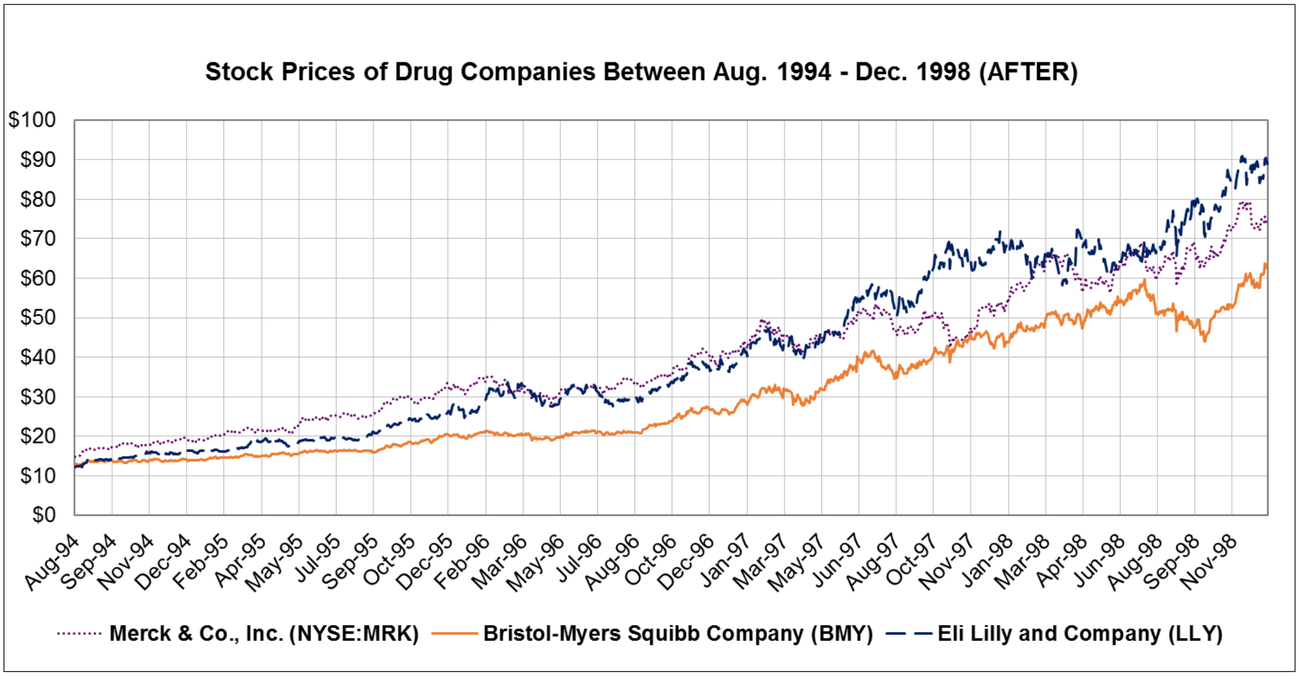


FIGURE 2.



In conclusion, we believe pharmaceutical stocks as a group are selling at attractive valuations, in comparison to the free cash flow and earnings they generate. The recent price drops may present one or more attractive long-term investment opportunities for us.

Sears Holdings

In hindsight, our initial assessment of Sears Holdings being worth more than $50 per share a few years ago was most likely too optimistic. This is taking into consideration that we received in excess of $23 per share in distributions from various spin-offs and right offerings, which we later sold in the stock markets. Nevertheless, we believe that the stock may still be cheap at the current valuation, albeit not at the level that we initially anticipated.

Resolute Forest Products

As of June 30, 2017, the market price of Resolute Forest Products (RFP) was at $4.40 per share, giving a market capitalization of roughly US$395 million dollars. As we have explained in the past, the company continues to have consolidated sales of close to US$3.6 billion and in each of its major business segments, it is a global leader. It continues to be the biggest volume producer of wood products east of the Rockies, the third largest in North America for market pulp, the number one producer of newsprint in the world and the largest producer in North America of uncoated mechanical paper and an emerging tissue producer. The wood products segment continues to have revenues of approximately US$500 million, while the other three segments each continue to have revenues of approximately US$1 billion. We believe that each of the four business segments could fetch at least US$400 million in a normal market and, as a result, RFP may be undervalued. However, we have been disappointed not just in terms of the stock price but management's ability to make sound capital allocation decisions.

Short Term Performance Impacts Long Term Returns

We have been out of sync with the market for about three years – the longest stretch so far. Generally, it has not bothered us because we expected to underperform the market 30%-40% of the time, based on our history of managing money for over 35 years.

A lot of investors are not aware that short-term results can have a huge bearing on the five and ten-year annualized compounded returns. For example, let's take Fund A and Fund B. Fund A consistently returns 7% per year for 10 years and therefore its compound rate of return over the 10-year period is 7%. Fund B, on the other hand, returns 8% for the first nine years but suffers a loss of 20% in the tenth year. Its compound rate of return for the 10-year period drops significantly to 4.8%. The impact is more pronounced for the 5-year returns, a similar decline of 20% in the fifth year would have decreased the 5-year compound return from 8% to merely 1.7% for Fund B versus 7% for Fund A.

We've had to answer the same kind of question in 1999. The S&P 500 index was up close to 13.9%, whereas the Fund was down 9.6%. Again, our ten and five-year annualized returns looked horrible in comparison to the index, but that is how the math works.

The important thing is that we continue to be confident with the value investing principles we believe in, and the process we use to buy and sell stocks. We are trying to buy securities at 60 cents on a dollar. Another way to look at it is that when you buy stock at 10 times earnings versus the market at 25 times earnings, ceteris paribus, you are getting a 10% annualized yield versus the market giving you a 4% annualized yield. This reasoning is logical, and should outperform the market in the long-run. Although there will be periods, like we are going through now, where it does not appear to be working.

Most of the time when value investing has not worked, it is during those periods when the market is trading at an elevated level. Based on historical ratios, the current prices for stocks are not cheap. However, if interest rates stay at these levels for an extended period of time, the stocks are not expensive at all.

Suffice to say that we are not comfortable with the current market levels and we are not convinced that interest rates will stay this low for an extended period of time. We would consider fortunate if the market returns exceed 5% to 6% a year for the next 10 years from these lofty levels.

In conclusion, we do not believe that we have entered a new paradigm; there is definite room for improvement in stock selections but the principle of value investing is sound and, in time the logic will prevail in the end.

Other Matters

FOREIGN CURRENCY CONTRACTS: None existed at June 30, 2017.

CREDIT DEFAULT SWAPS: None existed at June 30, 2017.

U.S. DOLLAR VALUATION: Any investor who wishes to purchase the Chou Funds in U.S. dollars may do so.

REDEMPTION FEE: We have a redemption fee of 2% if unitholders redeem their units in less than 12 months. None of this fee goes to the Fund Manager. It is put back into the Fund for the benefit of the remaining unitholders.

INDEPENDENT REVIEW COMMITTEE: The Manager has established an IRC as required by NI 81-107. The members of the IRC are Sandford Borins, Peter Gregoire and Joe Tortolano. The 2016 IRC Annual Report is available on our website www.choufunds.com.

RISK RATING: As of August 25, 2017, the risk rating of the Fund will be changed from "Medium to High" to "Medium". The Manager used the investment risk classification methodology under NI 81-102 Investment Funds, which will come into force effective Sept. 1, 2017, to determine the risk rating of each Fund. These risk re-classifications are not as a result of changes to the investment objectives, strategies or portfolio management of the Fund.

As of August 14, 2017, the NAVPU of a Series A unit of the Fund was $105.34 and the cash position was approximately 3.4% of net assets. The Fund is down 4.7% from the beginning of the year. In U.S. dollars, it is up 0.5%.

Except for the performance numbers of the Chou Associates Fund, this letter contains estimates and opinions of the Fund Manager and is not intended to be a forecast of future events, a guarantee of future returns or investment advice. Any recommendations contained or implied herein may not be suitable for all investors.

Yours truly,

Francis Chou

Francis Chou
Fund Manager