



Investment Guide

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Introduction

The most distinguishing characteristic of the ABC Funds is our firm adherence to true value investing. The funds use a "bottom up", Graham and Dodd style in selecting securities. This style commands thorough, proprietary research on fundamentally undervalued Canadian and American securities and strong investor discipline. All four ABC Funds use this investment approach.

The ABC Funds were started in February 1988 with the inception of its first fund - the ABC Fully Managed Fund (FMF). Less than a year later, in March 1989, came the inception of the ABC Fundamental-Value Fund (FVF). The In May 1996, we launched the ABC American Value Fund (AVF), to provide U.S. diversification. The latest additions were two closed-end funds: the ABC North American Deep-Value Fund on November 1, 2004 and the ABC Dirt-Cheap Stock Fund on April 1, 2006.

This booklet contains all the essential and background information on the ABC Funds as well as investment procedures and information. We recommend that you keep this booklet for future reference.

I.A. Michael Investment Counsel Limited

I.A. Michael Investment Counsel Limited, established in 1985, is dedicated to managing the ABC Funds. The firm's objective is to provide top-quartile performance while preserving clients' capital. By concentrating on securities that we deem to be undervalued, our portfolios are structured for superior long-term returns with limited downside risk.

Ethics

All Canadian personnel are compensated through salary plus a year-end bonus. No individual in the firm has ever been involved in any litigation or legal proceedings related to investment activities.

I.A. Michael Investment Counsel is in compliance with all laws pertaining to the investment industry. The firm is aware of the ethical issues confronting the industry today, and has made every effort to deal with them. This has been accomplished with the guidance of The Association for Investment Managers and Research (AIMR) Code of Ethics, The Investment Funds Institute of Canada (IFIC), and other standard setting bodies of the industry.

We believe entirely in our investment philosophies and in avoiding potential conflicts of interest. Irwin A. Michael is the single largest individual unit holder of the funds, moreover, his family is also invested in the Funds. Irwin Michael does not trade for his own account and has confined his and his family's investments to the ABC Funds. Any investments made by any of the staff outside the funds are first authorized and approved by Irwin A. Michael.

Portfolio Manager

Irwin A. Michael, B. Comm., MBA, CFA earned his Bachelor of Commerce Degree from McGill University in 1971. He was awarded his MBA from the Wharton School of Finance, University of Pennsylvania in 1973 and earned his Chartered Financial Analyst designation in 1979.

Upon graduation from Wharton, Irwin started his career at Hodgson Robertson Laing & Company, in the capacity of fixed-income portfolio manager and bond trader. He then went to Morgan Stanley Canada Limited in the areas of fixed-income research and institutional sales. Prior to forming his own investment counsel firm, Irwin was a partner at Beutel Goodman & Co., where he served as vice-president of fixed income investments and portfolio manager of Dynamic Income Fund. He has also served as a director of the Toronto Society of Financial Analysts and is a former vice president of the Toronto Futures Exchange.

The ABC Family of Funds

The ABC Funds consist of three funds that invest using the same philosophy but differ in portfolio make-up. Read the next section titled "The Value Style of Investing" for information on our style.

ABC Fully-Managed Fund (FMF)

The ABC Fully-Managed Fund is a diversified Canadian balanced fund. While our long-term asset mix target is 50% fixed income and 50% Canadian equities, in practice, our portfolio mix of stocks versus bonds is quite flexible to take advantage of periodic investment opportunities. This fund is RSP eligible.

ABC Fundamental-Value Fund (FVF)

The ABC Fundamental-Value Fund seeks out fundamentally undervalued Canadian equities. We cobble a diversified portfolio of small, medium and large capitalization Canadian value stocks. This fund is RSP eligible.

ABC American-Value Fund (AVF)

ABC American-Value Fund searches out fundamentally undervalued American and foreign U.S. stock exchange listed common shares. While using the same investment techniques as our two Canadian ABC Funds, the American market due to its sheer size provides us with extensive value opportunities. The American Value Fund is unrestrained by the Canadian 20% RSP limits; therefore, it offers maximum portfolio flexibility.

ABC North American Deep-Value Fund (NADVF)

ABC North American Deep-Value Fund searches out fundamentally undervalued Canadian and American stock exchange listed common shares. This closed-end fund has maximum flexibility to invest in a diversified mix of deep value securities. The country and asset mix, as well as currency exposure, can vary and has no set limits. The portfolio ordinarily will have a mix of 25 to 35 holdings. This fund closed to new money January 31, 2005.

ABC Dirt-Cheap Stock Fund (DCSF)

ABC Dirt-Cheap Stock Fund is a "go-anywhere in the world" equity fund with unlimited investment flexibility. This deep-value fund has no company-size investment restrictions, and, as a result, can opportunistically purchase overlooked, undervalued and less liquid micro-capitalization stocks. We expect this fund to have a mix of 40-60 holdings comprised of Canadian, U.S. as well as Far East, Australian and European equities. The fund will be closed to new money after September 1, 2006.

For the latest quarterly snapshot of the fund portfolios and performance figures, please see pages 6 - 15 of our latest quarterly newsletter - the ABC Perspective.

The Value Style of Investing

The Philosophy

At ABC Funds, the investment philosophy we strictly follow is called "Value Investing". It is a "bottom up", modified Graham and Dodd style of selecting securities for investment in the three funds. Of the up to 500 companies we follow, there are ten investment attributes (see "*The Ten Commandments of Value Investing*") that must be inherent in the stocks we purchase.

The Discipline

Value Investing involves analyzing a company's annual report thoroughly to uncover as many hidden details as possible as well as attempting to uncover hidden values such as tax-loss carry-forwards, undervalued real estate, off-balance sheet assets, etc. In order to stay on top of company developments and direction, it is important to maintain a relationship with the company's management. This enables us to closely monitor and recommend actions that increase shareholder value.

The Ten Commandments of Value Investing

1. *Low Price to Earnings Multiples* - We search out stocks trading at under ten times price to earnings multiples, which reduces the risk of overpaying for a security.
2. *Low Cash Flow Multiples* - We look for companies trading at under five times price to cash flow. This also reduces the risk of over paying and uncovers many "dirt cheap" equities.
3. *Discount to Book/Net Asset Value* - We like to buy stocks trading at a discount to book/net asset value. In many cases, this not only uncovers significantly undervalued stocks but also prime takeover candidates.
4. *Hidden Assets* - Some examples of hidden assets that can be uncovered after a thorough analysis are tax-loss carry forwards, over-funded pension funds, real estate, potential spin-offs, IPOs, and favourable litigation.
5. *Management* - Two types of management could be key in the search for a turnaround candidate: a) Solid, proactive management and b) Poor management, which leaves the company ripe for a proactive acquisition or merger.
6. *Products/Services in tune with 2000 and beyond* - This includes expandable, growing markets with good margins. We tend to avoid companies with outdated, shrinking products.
7. *Value Catalyst* - In order to push up the value of a stock, we look for a significant value creator. Some examples of possible value creators are fresh management with new directions, an important sale or purchase of a meaningful asset, an unsolicited takeover bid, or disgruntled and impatient proactive shareholders who may put pressure on management to make changes or sell.
8. *Discounted Valuations Compared to its Peers* - Comparative valuation measures such as price to earnings and cash flow could indicate a take-over by relatively expensive Canadian or foreign competitors looking to expand market presence.
9. *Contrary Opinion and Under-followed by Investment Analysts* - With little investor exposure, undervalued stocks are 'pregnant with possibilities', providing very little buying competition when attempting to accumulate the security. Generally an undervalued and under followed security will offer terrific capital gains opportunities.

10. *Discipline* - Stay on track and adhere to strict value discipline of low P/Es, strong cash flows and price targets. Do not get sucked into buying the flavour of the day! Combine patience and persistence to attain superior performance. Patience! Patience! Patience!

Portfolio Management

Sector Allocation

I.A. Michael Investment Counsel is opportunistic. Although we address the issues of diversification and concentration within the portfolios, we look for value within individual stocks and the sectors in which they are categorized. If an entire sector is considered cheap, we may overweigh the portfolio within that sector since cheap stocks tend to appear in cheap sectors. As our emphasis is in seeking value, our tendency has been to sell those securities that may even appear to have entered a growth phase and replace them with other undervalued positions. At times this discipline makes us early in purchasing and selling. The ABC Funds have complete investment flexibility and discretion, and are not constrained by any investment mandates by outside parties. We concentrate our efforts on pure value stock picking.

Fixed Income Analysis

Our fixed income investment philosophy is straightforward and simplistic. Through economic analysis, we produce a "top down" interest rate outlook and structure a modified "barbell" portfolio (a combination of short term Canada treasury bills and longer term bonds). We also will take advantage of wide credit spreads e.g. between corporate and government bonds, etc.

Investments in bonds for our ABC Fully-Managed Fund tends to be a combination of moderately liquid, current and deep discount Government of Canada and corporate bonds. In consequence we are less likely to mirror the Scotia McLeod fixed income indices. We may also look at convertible debentures and certain equities with high yields as a surrogate for fixed income or money market securities. We remain flexible and opportunistic in style.

Research

Our investment research is concentrated primarily on Canada and the United States. All securities are researched in-depth before a position is accumulated. At our disposal are electronic and physical files containing such data as annual and quarterly reports, notes from meetings with management, industry research reports, financial models etc. Analysis conducted by reputable North American analysts is also kept on file for breadth and reference. We combine this accumulated research with our own experience, trading acumen and networking to produce disciplined buy and sell targets.

Investing Instructions and Guidelines

Purchasing

Before you can invest in the funds, you must have completed a 'New Account Application Form' and a "SCHEDULE A Subscription Agreement" (contained in the Confidential Offering Memorandum). The minimum initial investment is \$150,000.00 per per fund with a minimum of \$1,000.00 for subsequent investments. This initial investment can be an aggregate of registered and non-registered funds for the investor and/or their spouse and/or trust funds for the investor's children. Cheques are to be made out to *Royal Trust Co. c/o ABC Funds*, post-dated for valuation day. Send the above to I.A. Michael Investment Counsel Ltd. by 5 p.m. two business days prior to the last business day of the month.

ABC Funds are sold directly to investors through officers of I.A. Michael Investment Counsel Limited. Also check with your broker or financial planner as most of them can help in the purchase of the funds.

Additional Contributions

Additional contributions of a minimum of \$1000 can be made at any month end using the same payment options as the original subscription.

Registered Investment Information

RRSP, RRIF or LIF accounts are serviced by Royal Trust, our fund custodian.

To open such accounts and transfer funds, please complete the following in addition to the standard 'Purchasing' instructions:

- ◆ complete Area I of the Revenue Canada form Direct Transfer Under Paragraph 146(16)(a) or 146.3(2)(e), T2033;
- ◆ complete an Application for Membership in the Retirement Savings Plan;

Please note that RRSP transfers can take a few weeks. If your funds are locked-in, contact our office and we will provide you with the necessary forms to have your funds transferred. If making an RRSP contribution to an existing account, simply forward a cheque to our office.

Fees

The ABC Funds' management fee (for our first 3 funds) is an annual rate of 2.00% + GST of the total market value of assets under management. The management fee on the ABC North American Deep-Value Fund and ABC Dirt-Cheap Stock Fund is an annual rate of 1.00% + GST of the total market value of assets under management. On these two funds there is also a performance fee payable of 20% of any returns higher than 10% in a given year. Please see our offering memorandum for complete details. Our management expense ratio is the same as our fees, since all fund expenses are paid out of the management fee, including RRSP and RRIF fees. Furthermore, there are no set-up, transfer, close out, systematic withdrawal/subscription, or switching fees.

Pricing of the ABC Funds

Funds are valued based on stock prices at close of business on the last business day of the month - 'Valuation Day'. The official price is established with Royal Trust by the close of business day on the 2nd business day later. All redemption and dividend cheques are mailed to clients on or before the 5th business day following the 'Valuation Day'. Unitholders will receive details of the transactions during the second week of the new month. We report the new prices to the media and post them on our web site as soon as we receive them. You should look for a change of price in the newspapers on the 3rd business day.

Redemptions

Redemptions, like all other fund transactions, take place on the last business day of the month (valuation day). Redemption requests, whether partial or complete, must be received, in writing, a minimum of 10 business days before the last business day of the month. Requests received after this point will be processed at the end of the following month.

Distributions

There are three kinds of distributions that concern our funds - interest, dividend, and realized capital gains. Interest and dividend income earned are paid out (when funds are available) quarterly in the Fully-Managed Fund and paid annually in the Fundamental-Value and American Value Funds. Realized capital gains are distributed annually in all three funds. Unitholders will receive a statement for those months that they receive distributions showing the details and new

holdings if dividends are reinvested. Further information on distributions, including past distributions, is available on our web site or by phone.

Keeping Our Investors Informed

One of our most fundamental beliefs and top priorities is client care. We believe that there is no better way to care for a client than to maintain steady communication with them. That is why we have instituted multiple means of communication between portfolio management and the clients of the ABC Funds. Value investing is a style that commands patience, discipline and perseverance from investors. To make it easier for investors, we insist on having a close relationship with each one of our clients.

ABC Perspective (Quarterly Newsletter)

Every quarter, we mail out a 12-page newsletter that contains our quarterly results, a snapshot of the three portfolios at the end of that quarter and substantial commentary on various topics that are of interest to our investors.

1-877-ABC-VALU

We have set up a toll-free line for our clients to call and listen to a 2 or 3 minute market commentary that is updated once a month. Irwin Michael records his thoughts on the current market conditions and his expectations for the month ahead. Our clients are invited to use this service to stay on top of portfolio and market changes. (In Toronto, dial 416-365-9442). We also publish this message online on our abcfunds.com web site.

Meetings

We hold a lunchtime meeting every month at our office where we invite clients and prospects to dialogue with Irwin Michael, portfolio manager of the ABC Funds. We also hold quarterly meetings that are exclusive to our clients. The monthly meetings are much smaller and therefore provide a more one-on-one experience where specific questions can be answered easily.

Web Sites

On the Internet, we have created and maintain two comprehensive web sites that provide 24 hour a day information on or about the funds and our value investment style. We continuously strive to make these sites informative and useful to our clients and prospects that frequent these sites from all over the world.

ABCFUNDS.COM

Our main site, abcfunds.com, has all the pertinent information about the funds such as prices, performance figures and portfolio information. It also contains our quarterly newsletters and commentaries made by Irwin Michael, portfolio manager of the ABC Funds. Any announcements, meeting information and other information is available on this site as well. As a service to abcfunds.com visitors, we have an Update Notification service that sends an email to those that subscribe every time certain information is updated on our web site. Visit our site for the details.

VALUEINVESTIGATOR.COM

Our second site, valueinvestigator.com was launched to highlight the principles of value investing, point out fundamental value opportunities which we have uncovered, and inform interested parties of our value investing style.

To keep the content current, we endeavor to update our Value Investigator site on a regular basis. This site also has its own Update Notification service that sends an email on average of once a week to update its subscribers of the changes and updates to the site.

Contact Information

ABC Funds
c/o I.A. Michael Investment Counsel Ltd.
8 King Street East, Suite 700
Toronto, Ontario
M5C 1B5 Canada

Phone : (416) 365-9696
Toll-Free : (888) OPEN-ABC
(888) 673-6222
Fax : (416) 365-9705
Value Line : (416) 365-9442
(877) ABC-VALU
(877) 222-8258
Web Sites : www.abcfunds.com
www.valueinvestigator.com