Cove Street Capital | Funds

CSC SMALL CAP VALUE FUND — **December 31, 2012 Shareholder Letter**

January 1, 2013

Dear Fellow Shareholder,

The Fund closed out a lion of a calendar year with a quarter whimper, which in some ways is an impressive and positive surprise in and of itself given what we are forced to read in the financial papers every day. We would also note that we had a terrific AFTER-TAX year (no distributions) as we continue to eat into our tax-loss carry forward compliments of 2008.

TOTAL RETURN (%) – as of December 31, 2012 | Symbol: CSCSX

	3 MONTH	1 YEAR	3 YEAR	5 YEAR	10 YEAR	INCEPTION (9/30/1998)
CSC Small Cap Value Fund						
without sales charge	3.19	26.77	16.14	6.05	8.83	10.74
with 3.5% sales charge	-0.42	22.35	14.77	5.30	8.45	10.47
Russell 2000® Index	1.85	16.35	12.25	3.56	9.72	7.54
Russell 2000® Value Index	3.22	18.05	11.57	3.55	9.50	8.75
Russell 2500™ Value Index	4.14	19.21	12.87	4.54	10.20	9.32

Performance shown for the period September 30, 1998 to January 20, 2012 reflects performance for CSC Small Cap Value Fund, a series of CNI Charter Funds, the predecessor to CSC Small Cap Value Fund "The Fund". The Fund has the same portfolio manager and substantially similar investment strategies to the predecessor fund. Performance without the sales charge does not reflect the current maximum sales charge of 3.50%. Had the sales charge been included, the Fund's returns would have been lower. Returns for periods greater than 1 year are annualized.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 1-866-497-0097.

The gross expense ratio is 2.66%. Investment performance reflects contractual fee waivers in effect through 12/31/2014 to keep the expense ratio (excluding acquired fund fees and expenses, brokerage commissions, interest, taxes and extraordinary expenses) at or below 1.69% (Expense Cap). In the absence of such fee waivers, total return would be reduced.

As of January 28, 2013, The Fund will impose a 2.00% redemption fee on shares sold within 60 days of purchase. Performance data does not reflect the redemption fee. If it had, return would be reduced.

Our cause was helped by two takeovers in the quarter: Spartech and Jefferies Corp. Spartech, for longtime investors, has been "in and out" of our portfolio since 2002, as we have tactically "played" some vicious industry cycles that have wreaked havoc on the Spartech plastic and compounding businesses. What needs to be said is that in fact we were miserably wrong on the evolution of Spartech's business model and we should be applauding the management of PolyOne for doubling the stock price of Spartech in the quarter with their takeover. If they can do what three successive CEO's of Spartech could not do—generate a reasonable return on invested capital—then we will be happy to crown them. In the meantime, we have moved on.

Jefferies on the other hand is really merging with Leucadia Corp, creating a much larger and weirder combination of a global investment bank and a pork processor. We jest only somewhat, in that Leucadia is really a private equity firm whose largest investment is in pork, but the rationale for the combination has to do with the Jefferies shareholder being asked to give up some upside for the potential downside protection of a much larger entity. I understand the logic but frankly was perfectly capable of risk-weighting the volatility of Jefferies myself and found myself only modestly enthused by the deal, particularly the lack of the premium bid. However, after meeting with the Jefferies' CEO and nosing around the complex beast of Leucadia, I think this could be a very interesting combination. Jefferies is run by Richard Handler, who has done a terrific and contrarian job of building an investment bank while everyone else seems intent on dismantling the investment banking model. That work continues and I think Leucadia will essentially be rebranded as a private equity firm taking in "other people's money," an aspect which is the real missing leg of the Jefferies entity. We bought Jefferies at 12 and the stock is now selling close to 19, decent work for 15 months. We continue to hold the stock, but that is a shorter term phenomenon, as we will wake up to a $9 billion market capitalization in 2013—not exactly small cap material.

WHAT HAPPENED — Quarter ending December 31, 2012 | Symbol: CSCSX

5 Contributors

Security	Average Weight (%)	Return (%)	Contribution (%)
Spartech Corp	0.79	53.31	1.77
Jefferies Group Inc	2.80	36.89	0.90
Liberty Ventures Srs A	2.41	36.50	0.77
Tessera Technologies Inc	2.60	21.09	0.52
Hallmark Financial Services	3.21	15.36	0.51

5 Detractors

Security	Average Weight (%)	Return (%)	Contribution (%)
Artio Global Investors	2.10	-35.15	-0.96
Approach Resources Inc	4.82	-15.91	-0.80
Central Garden & Pet – Class A	5.00	-13.41	-0.72
Westell Tech Inc – Class A	2.24	-13.55	-0.33
First Financial Bancorp Ohio	2.20	-11.87	-0.30

The 5 Contributors measure the top five contributors to the portfolio's total return and the 5 Detractors measure the five bottom contributors to the portfolio's return. Average Weight shown is a calculation of the average percentage held of each included company over the course of the quarter ending 12/31/12. Return is the total return for each included company over the course of the quarter ending 12/31/12. Contribution is a ranked measure of how each included company contributed to the Fund over the course of the quarter ending 12/31/12.

We had one particular mistake in the quarter which we have unceremoniously removed from the portfolio By the time this letter is in your hands. Artio Global Investors is an investment management firm in New York that is at the tail end of a truly ghastly implosion that has taken its equity assets under management from over $75 billion in 2007 to under $5 billion as I write. I have witnessed my fair share of awful in my career, but this sadly redefines the term. The idea behind buying stock at $3 per share was several fold: $2.20 cents of cash and no debt; a fixed income business with $10 billion in assets with terrific performance that could conceptually be valued at $1.50 per share; and a management team that had taken a big and painful hit in Q3 by firing a lot of people and closing down their attempt at a US equities business. This suggested rational pragmatism, which is always a good thing to have in a people business.

What we have learned and why we have reconsidered on the way to the bank is the following: we were wrong to assume that the fixed income product would be unaffected by the disaster on the equity side. The company has not been able to make any headway in attracting new assets and we have become deeply disturbed by the lack of any material and contractual incentive packages to ensure the loyalty of the fixed income group. "They are good guys and happy here" wasn't quite what we were hoping to hear at a recent meeting with management. We have also been perturbed by some vehement sentiment in the consulting community that suggests the Artio brand is an impediment to raising fixed income money. Secondly, the CEO and CFO are not incented to sell the company quickly in order to rebrand and market the fixed income group. (Although they just got a change in control package that, while not a lot by industry standards, does incentivize them to keep the wheels on.) Thirdly, the largest shareholders are the partners involved in the dying global equity product, and knowing a little something about the mind of an investment manager, I would suggest a high likelihood of reluctance in acting forcefully if that force includes shooting their own foot. Lastly, there is a whole variety of termination payouts due to equity employees if someone were to hive off Global Equity and thus the true level of cash is only 80% of what we originally thought it would be.

All in all, we risk-weighted this investment at half position and thus consider ourselves fortunate to take a 30% haircut in a short period of time. There are some stocks we “want to go down” so we can buy more and this never appeared to be one of them. We took the lump and moved on.

On a going forward basis, we are going to spare you the annual charade of an “outlook,” and simply start with Greek Philosopher Heraclitus:

> No man ever steps in the same river twice;
> For it is not the same river, and he is not the same man

We have a portfolio that represents an eclectic group of risk/reward opportunities without any big concentrations by either industry or sector. That is positive fallout from what we see as “the wrong lean” that was adopted by hundreds of billions of dollars in the largest and most “professionally” managed pools of assets in the world as well as the smallest retail investor. 2012 was the fifth consecutive year of outflows from “long-only” equities in a desire for “low volatility” and the perception of “safety.” This has turned the investment world on its head as what have historically been the “safest” assets are now the most overvalued and “stocks,” which have been viewed as “risky,” are in fact more interesting from a valuation and future return perspective.

Our only comment on this cliff nonsense is to note more of the obvious. It is disconcerting to realize that in the short run we have important people making monumental decisions involving billions of people and trillions of dollars and their actions are not driven or motivated in any way by real dollars or fact-based financial common sense but rather public opinion polls, the next election and the whims of dead economists. It might take a few down 800 Dow days (very buyable) in order to bring this discourse to a close. But to close with this from Emerson:

> In dealing with the State, we ought to remember that its institutions are not aboriginal, though they existed before we were born; that they are not superior to the citizen; that every one of them was once the act of a single man; every law and usage was a man's expedient to meet a particular case: that they all are imitable, all alterable; we may make as good; we may make better.

You rarely see "good value" and "good news" in the same financial period and there is certainly plenty of messiness around the world (and here at home) to unnerve an investor. But what we have seen in equity markets since 2009—in a demonstration of the obvious—is that in an uncertain world sometimes good things happen. Additionally, buying reasonably priced stocks run by management teams who are looking out for the interests of shareholders and trying to make a buck remains, in our view, a very practical all-seasons route to wealth creation.

Best Regards,

Jeffrey Bronchick, CFA
Chief Investment Officer
Shareholder, CSC Small Cap Value Fund

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

The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory prospectus and summary prospectus contain this and other important information about the investment company, and they may be obtained by calling 1-866-497-0097 or visiting www.covestreetfunds.com. Read it carefully before investing.

TOP 10 HOLDINGS – as of December 31, 2012

PerkinElmer Inc	5.2
Alleghany Corp	5.1
Approach Resources Inc	4.8
White Mountains Insurance Group	4.7
Central Garden & Pet – Class A	4.2
Crosstex Energy Inc	3.8
Hallmark Financial Services	3.5
Coinstar Inc	3.4
Avid Technology Group	3.0
Jefferies Group Inc	3.0

Fund holdings and sector allocations are subject to change and should not be considered a recommendation to buy or sell any security. *Current and future portfolio holdings are subject to risk.*

Mutual fund investing involves risk. Principal loss is possible. There is no assurance that the investment process will consistently lead to successful results. Value investing involves risks and uncertainties and does not guarantee better performance or lower costs than other investment methodologies. Investments in smaller companies involve additional risks such as limited liquidity and greater volatility. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe, representing approximately 10% of the total market capitalization of the Russell 3000® Index and the Russell 2000® Value Index includes those Russell 2000® Index companies with lower price to book ratios and lower forecasted growth values. The Russell 2500™ Value Index measures the performance of the small to mid-cap value segment of the U.S. equity universe. One cannot invest directly in an index. Market cap is the market price of an entire company, calculated by multiplying the number of shares outstanding by the price per share. Any tax or legal information provided isn't an exhaustive interpretation of some of the current income tax regulations. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation. Neither the Fund nor any of its representatives may give legal or tax advice.

The Cove Street Small Cap Value Fund is distributed by Quasar Distributors, LLC. Quasar Distributors, LLC is affiliated with U.S. Bancorp Fund Services LLC.