September 30, 2012

DK EQUITY GROWTH FUND

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Quarterly Report
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Rates of Return[1]

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs.	15 Yrs	Since Inception March 31, 1993
DK Equity Growth Fund	**10.2%**	**-6.7%**	**-2.5%**	**-1.8%**	**7.5%**	**6.1%**	**-3.1%**	**16.5%**	**10.7%**	**15.8%**
S&P/TSX Composite Index	7.0%	5.4%	9.2%	2.6%	5.5%	4.2%	0.2%	9.8%	6.1%	8.8%
S&P 500 (in U.S. Dollars)	6.4%	16.4%	30.2%	14.8%	13.2%	7.8%	1.1%	8.0%	4.7%	8.2%

In spite of continuing macro concerns, the broad market indices in North America have actually risen in the past calendar quarter and for the year-to-date. However, Deans Knight portfolio returns have lagged the broad indices, in large part because of our heavier emphasis on natural resource producing companies. These areas of the market have not done as well as the broad indices, because of global growth concerns….slow growth and continuing problems in the Euro zone….the anemic recovery since mid-2009 of the U.S. economy from the "great recession"….and worries about China's growth prospects.

Looking back from today, the view resembles very much what we saw looking back from 1980. Back then we saw roughly 10 years of flat returns for the U.S. S&P 500 Index. The decade of the 1970's was a tough one for investors….slow economic growth, persistently high rates of inflation and a loss of faith in government, particularly the U.S. Fast forward….today the U.S. S&P 500 index sits at roughly the same level as it was in the year 2000, 12 years ago. The TSX has done a bit better over this time frame, but more recently, it sits 20% below its level of mid-2008, 4 years ago.

The outcome….investors become frustrated. They are not 'making money'. In fact they perceive that they are losing money. Investors are bombarded by negative media coverage of financial and economic events. We are reminded constantly about the poor investment returns; that Europe is peering into an abyss; the U.S. economy is underperforming and if nothing is done it will topple over the fiscal cliff on January 1, 2013; and China's economic miracle is over and their economy is on the verge of collapse.

[1] Returns longer than one year are annualized gross of management fees.

Regular readers of our quarterly letters know how we feel about this twaddle. Simply put, the media is there to make money by selling advertising. They are not in business to provide the readers and viewers with serious investment advice or serious insight. Moreover, the media mostly promotes conventional wisdom. And we know from experience that conventional wisdom is almost always wrong.

The result of this has been an unprecedented exodus of retail investors from the equity markets as their frustration grows and as the media coverage heightens the tensions and fears. This feels so much like the environment of the late 1970's, when equities were considered dead. We did not know, nor could we see at the time, but just around the corner was the biggest bull market in North America's history. Never forget the wise words of one of our greatest investing legends, Sir John Templeton: "*bull markets are born in pessimism, grown on skepticism, mature on optimism, and die on euphoria*".

Deans Knight will celebrate its 20th anniversary January 2013. We believe we have learned many valuable lessons in these 20 years, and perhaps even many before that time. It is at times like this; when the mood is gloomy, the skies are grey, and it feels right to just give up on equities, that it is wise to focus on a few of those lessons learned.

The most important lesson we have learned over the years is that we cannot predict the future. And for that matter, nor can anybody else. Many learned studies within the field of Behavioral Finance have put this to bed long ago. It cannot be done. Nonetheless the media trots out an endless stream of mavens and pundits that claim they can. We watch, because we seem to have an addiction to predictions. It brings us comfort to listen to someone tell us where we are going. The bottom line….if we really knew what the future holds, would we tell anybody? Of course not.

Investors must deal with what they know….not deal in matters unknowable. Investors today are selling perfectly good companies because they 'do not like the outlook of the future'. They do not like something that is unknowable. If they were honest with themselves, they would recognize that they do not like what they have seen recently or right now….not the future. Most of us project on recent experiences and it becomes our future.

We cannot predict the future. But we can reasonably envision a future and how the companies we own will fare in that future. Big difference. We do not know if the TSX or the S&P 500 will be up or down in 2013. But, is it not reasonable to expect the world to be doing more business in 10 years than today? Is it not reasonable to then assume that the companies we own today, which are mostly global players run by top management teams, will be doing more business and will therefore grow shareholder value?

Today, when we look at the companies we own, most of them are doing more business than 4 years ago, have stronger balance sheets and are meeting or exceeding milestones. But they are trading at lower valuations. Why? Because the majority view of that unknowable future is decidedly negative. We have seen this movie before. Forget the unknowable future, deal with what you know. Deal in the fundamentals of the companies you own.

Another important thing we have learned is to ignore the neuroses of the market. The late great Benjamin Graham called him Mr. Market. Mr. Market has become increasingly bi-polar. Manic sometimes, depressed at other times. Mr. Market has been mostly depressed in recent years, affected negatively by the invective of negative news. Don't fall for his moods. When he is depressed, take advantage of his depression and buy a business from him. When he becomes manic, as he did about dot com stocks in the late 1990's, then sell him a dot com company. Don't buy one from him.

Over many years of investing, (i.e. owning pieces of businesses), we have learned that businesses face challenges. All do. A number of our companies have faced challenges in the past year. In this type of depressing environment, companies with challenges are excessively punished by Mr. Market. This really triggers his depressive gene. But remember challenges are normal. What matters most is how management deals with challenges. Are they recognized, are they dealt with effectively? Does it all lead to a better more valuable business? If yes, buy more.