DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK EQUITY GROWTH FUND
Quarterly Review
December 31, 2003

Rates of Return

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Equity Growth Fund	**20.4%**	**57.4%**	**44.5%**	**39.3%**	**29.2%**	**25.7%**	**16.8%**
Nesbitt Burns Small Cap Index (Unweighted)	16.1%	46.3%	19.4%	14.1%	9.2%	10.6%	5.7%
S&P/TSX Composite Index	11.3%	26.7%	5.3%	-1.0%	1.0%	6.5%	8.6%
DJIA	13.4%	28.3%	4.4%	1.0%	-0.5%	4.5%	13.0%
S&P 500	12.2%	28.7%	0.1%	-4.1%	-5.3%	-0.6%	11.1%

In terms of annual rates of return, Deans Knight equity clients have had the best consecutive 4 calendar year returns in our 11 year history. It was the great bubble in technology and telecommunications stocks of the late 1990's that created the opportunity. While most investors were focused on these two dramatically overvalued areas, many very good businesses in other industries were ignored and were available to be purchased at very low valuations. For example, following the Asian crisis in late 1997, the price of crude oil declined to roughly $11 per barrel by late 1998. At the time, oil companies could be purchased for a song. With base metal prices in the tank that same year, nickel and copper producers were a steal. Retailers, door makers, key makers, and many other easy to understand businesses, were not sexy enough to attract the attention of the new breed of money managers and day traders.

In our investment philosophy, it is the price that you pay for a business that is the most important determinant of future returns. In the late 1990's the technology and telecom stocks were all too expensive for our taste. Instead, we purchased oil companies, mining companies, and other old economy businesses that were priced very attractively for us. Many held their values and some have appreciated remarkably during the bear market, while many of the technology and telecom stocks lost 90% or more of their value. Below are some of the stocks that we owned on December 31, 1999 and what happened to the share prices from then until December 31, 2003 or until we sold the shares:

	Price Dec 31/99	Price Dec 31/03 or (Sale Date)	% Gain
ABER DIAMONDS	$9.00	$28.00 (Apr 4/03)	211%
CINRAM	$11.75	$27.62 (Nov 7/03)	135%
COTT CORP.	$7.70	$26.91 (Dec 6/01)	249%
DENBURY	$6.00 US	$13.91 US	132%
ELECTROHOME	$14.75	$28.00 (Feb 29/00)	90%
ENCAL ENERGY	$6.60	$11.81 (Mar 9/01)	80%
JUBILEE MINES	$0.57 AU	$4.24 AU (Oct 31/03)	644%
LIONORE MINING INTL	$1.65	$7.97	383%
PEAK ENERGY SERV.	$1.95	$3.55	82%
PRUDENTIAL STEEL	$13.00	$21.25 (Jan 12/00)	63%
RITCHIE BROS.	$27.75 US	$53.10 US	91%
VERMILION	$4.45	$16.52[1]	271%
WESTERN STAR TRUCKING	$23.85	$41.50 (Aug 23/00)	74%
WINPAK	$57.00	$100.00	75%

Other holdings acquired after 1999 that have contributed to the growth of the fund are: First Quantum Minerals and Peyto Energy Trust, increasing in price 310% and 738% respectively since we first purchased the securities.

In the late 1990's an enormous amount of new capital was directed to technology and telecom companies. We referred to it in our December 2002 report as the largest misallocation of capital in history. As a result, these industries have suffered from a massive overcapacity problem. Conversely the old economy industries were denied capital and as a result, there are no major new gold mines, no major new nickel or copper mines, and generally fewer overcapacity problems in the old economy.

KEY COMMODITY PRICES

	WTI Oil	NYMEX Gas	Gold	Nickel	Copper
Dec 31, 2002	$31.20	$4.79	$342.75/oz	$3.24/lb	69.85¢/lb
Dec 31, 2003	$32.52	$6.19	$417.25/oz	$7.23/lb	103.12¢/lb
% Change	4.2%	29.2%	21.7%	123.1%	47.6%

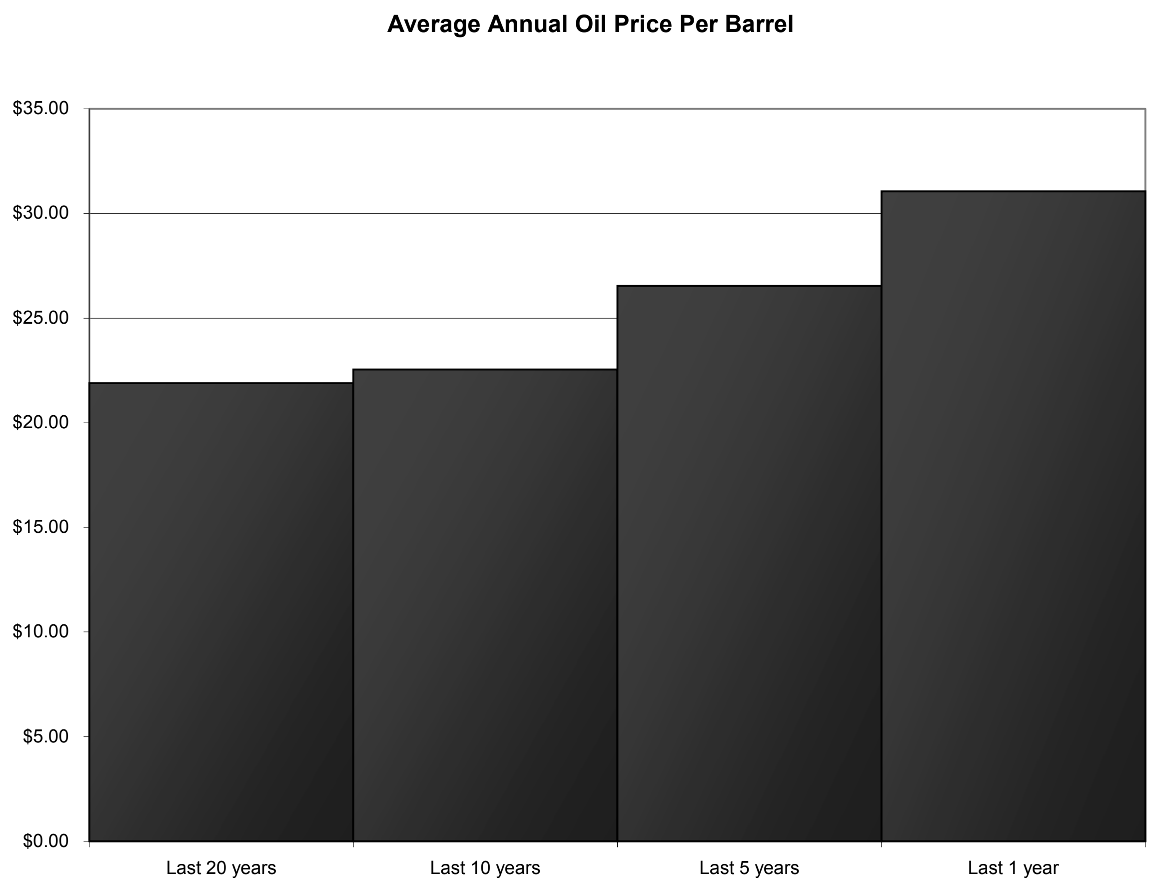
We have put forward the proposition in these pages on many occasions over the past few years that the price of metals and oil and gas were likely to be higher on average over the next 5 years than most analysts expected.

For years, most analysts have argued that oil and natural gas prices are headed lower. It hasn't happened. Oil for example was pegged at $24 per barrel by most forecasters for 2003. The focus of most analysts and investors is too short. We printed the following bar graph one year ago in the

[1] In January 2003 Vermilion restructured the company into Vermilion Energy Trust and spun out an exploreco, Clear Energy. The December 31, 2003 price includes the value of Clear Energy.

report, and it is worth printing again. The point is that the cheap oil and natural gas has been found and produced. Oil and gas are non-renewable resources that are becoming more expensive to bring to market. As long as demand continues to grow the price will trend higher to encourage necessary exploration.

Our view is simply that the average price of a barrel of oil will be higher over the next 5 years than the last 5 years.



Much has been made in the press about the rise in the price of gold. As we wrote in our last report, it has resulted in a mania of sorts in the market for junior gold stocks that is worth being wary of. However the real star in the metals market has been nickel. The 313% rise since the low point of roughly $1.75 /lb in the summer on 1998 brings us to an important point that we have been trying to drive home in the reports for a few years . . . . . that economic growth in China is the single most important determinant today of raw materials prices. Developing nations like China consume more raw materials and energy per unit of economic growth than developed nations, as developing nations are building infrastructure and demanding luxury consumer goods. They are moving from bicycles, to scooters, to cars. For example, China has 3 cars per 1,000 people, where the U.S. has 1 car per person. To move to just 25 cars per 1,000 people (2.5% of the U.S. level) would result in demand for an additional 44 million vehicles. By 2010 China will become the world's second largest car market. China is the world's second largest producer and consumer of televisions. China makes 50% of the world's cameras and photocopiers, and 25% of the washing machines. As a result, China's soaring demand for metals and energy has been the main impetus for rising prices. The bottom line – it is the economies of developing nations . . . China, India, South America, ... , that we must devote our attention toward. Although important, analysts place too much emphasis on changes in growth in the U.S. economy.

Looking back over the last 4 years it would be easy to become complacent. However we are feeling slightly uneasy at the present time. Annualized returns of 29.2% for 4 years means that the prices of the companies we own on average have almost tripled.

Bargains are now hard to find, whereas they were abundant 4 years ago. Remember . . . the price you pay for a business is the determinant of your return. The higher the price, the lower the return. Valuations on our types of companies are higher today than they were 4 years ago. We urge our clients to lower their return expectations over the next 4 years.

In the broader market there are some disturbing signs of a return to the "irrational exuberance" of the late 1990's. The NASDAQ Composite Index has soared by 80% from the low in October 2002 to December 31, 2003. The trailing 12-month price/earnings ratio is now 141.4 times. It would be scary at half that level.

A recent example of bizarre behaviour is the stock price action in a company called **Research in Motion (RIM)**. RIM is famous for its hand-held Blackberry communication devices. We are familiar with and fond of their product. We use them, as do many people in the financial business. However the valuation that the public market places on the business is a bit silly.

At $93 per share the company has a total market value of $7.3 billion. Trailing 12 month sales are roughly $660 million. The price to sales ratio is 11 times. Trailing 12 month earnings per share is 42¢ and forecasted earnings are $1.16, for a trailing price/earnings ratio of 221 times and forecasted price/earnings ratio of 80 times. Just before Christmas RIM released their Q3 results and they were better than expected. Sales for the quarter were $154mm versus a consensus estimate of $146mm. Earnings per share were 20¢ versus estimates of 17¢. On this release, between December 23 and December 31, the market value of the Company increased by 50% or $2.4 billion. It's just like the good old days of 1999 again. Our message is – be careful!

Why do public markets pay way too much for some companies and too little for others? One major reason is benchmarking. What is benchmarking? Benchmarking is a term familiar to those who operate in the pension fund investment management industry. It refers to the measurement standard that investment managers are held accountable to by pension plan sponsors and their consultants. It has important implications as to how public markets function.

Benchmarking was created by pension consultants because of the need to measure the performance of various managers against a benchmark and ultimately against each other. Typically, an investment manager who runs a general Canadian Equity mandate will be benchmarked against the S&P/TSX index. A manager who runs a U.S. mandate is benchmarked to the S&P 500, a global manager to the EAFE index, and so on. In theory this all sounds like a very logical approach to things. However like almost everything in the world of investments, things that appear so logical, are usually wrong-headed. Benchmarking is no exception.

Benchmarking has created an investment management industry that is populated by a bunch of "closet" index fund managers. How so? Well if you are a major pension investment manager and you are benchmarked against the S&P/TSX, you are compelled to design a portfolio that looks a lot like the composition of the index. If you do not, then you run the risk of underperforming the index and the consultant will replace you with another manager. Consultants even go so far as to devise investment guidelines for investment managers that ensure that they are closet indexers. For example, many guidelines that we have seen, mandate that managers have investments in all, or at least a minimum number, of the industry sub-groups that are in the index. Furthermore, many tell the manager that they can only overweight or underweight these industries within narrow limits. This is to reduce what has become the silly notion of "benchmark risk" i.e. having returns that are different than the index. How dumb is that? Having returns that are different than the index is what professional investors are paid to do.

There are two very big problems with benchmarking and the resulting closet index investment style. Firstly, benchmarking is contributing to a decline in investment due diligence. The World Coms, Enrons, Tycos, Nortels and the other big company flame-outs of the past few years occurred because investment managers could not take the risk of not owning these stocks. The stocks were too important in the index they were benchmarked with. So investment managers bought them, without regard to due diligence, but because they were reducing "benchmark risk" . . . music to a consultant's ears, but one of the dumbest investment concepts we have ever heard of. In Canada, when Nortel was soaring, the benchmarking concept became ridiculous at the extreme. Managers complained that when Nortel became 35% of the index, that a revised benchmark had to be created that limited Nortel to 10%. Even though managers did not like Nortel or could not justify the valuation placed on the stock, they could all comfortably own a prudent benchmark-like weight and reduce benchmark risk. Whatever happened to researching companies and investing clients' money in companies that you know and understand and are priced in your favour. This is a frightening concept to most consultants.

Secondly, benchmarking introduces a buy high / sell low bias to investing . . . i.e. buy those industries and companies that have increased in value and sell those that have gone down in value. All benchmark indices are capitalization and volume related in their composition. As Nortel issued more shares and as the share price appreciated and more shares traded, it became a larger weight in the index. As it became a larger weight, benchmarkers are compelled to own more shares or the benchmark risk would go up. Buying more shares pushed the share price up and increased the volume, which increased the weight, and on it went until the bubble finally burst. The process is then repeated in reverse as the stock declines. The result is buy high / sell low.

It works this way for industry groups as well. At the end of the last oil price boom in the late 1970's, oil stocks represented over 20% of the TSE index and the S&P 500. As a result, investment managers with consultant benchmark guidelines had to own lots of oil stocks. Wrong time to buy. When the price of oil reached a low of $11 a barrel in 1998 oil and gas represented a tiny portion of the index, benchmarking dictated that investment managers should have minimal investments in the area. Great time to buy. With oil and gas prices rising again and the industry rising in weight in the indices, guess what? Managers can't buy enough oil stocks.

In our opinion, benchmarking is a well-intentioned idea that has brought on unintentional wrong-headed investment behaviour. We believe pension plans would be better advised to hold investment managers accountable to return objectives that are aligned with the needs of the pension plan. If the plan requires an annualized return of 10% to meet its obligations, what is wrong with that as an accountability guideline?

Our contention is that benchmarking has been one of the main causes of the under-funded positions that many North American pension plans currently find themselves in. It is leading to behaviour on the part of investment managers that creates more volatility and less due diligence. This is not what pension plans should be looking for.