December 31, 2007

DK EQUITY GROWTH FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Review

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Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	Since Inception March 31,1993
DK Equity Growth Fund	**-8.1%**	**2.1%**	**26.6%**	**29.0%**	**29.3%**	**34.5%**	**19.6%**	**22.0%**
S&P/TSX Composite Index	-1.2%	9.8%	13.5%	16.9%	16.3%	18.3%	9.5%	11.7%
DJIA (in U.S.Dollars)	-3.9%	8.9%	13.9%	9.7%	8.6%	12.2%	7.4%	11.9%
S&P 500 (in U.S.Dollars)	-3.3%	5.5%	10.5%	8.6%	9.2%	12.8%	5.9%	10.4%

Our investment returns in the first and second halves of 2007 were dramatically different. During the first half of the year, our portfolio valuations continued the upward trend that began in earnest in 2001. We sold two key long term holdings at significant profit into the strength in metals prices – **LionOre Mining International** (nickel) and **Paladin Resources** (uranium). In the second half of the year, portfolio valuations declined. The result was a year of near flat returns.

It is important to note that, including 2007, we have experienced flat to negative calendar year returns in 5 out of the 14 years that we have been in business - 36% of the time, yet the annualized return over 14 years has been 22%.

Year	Annual Return	Reaction To
1994	0.0%	• Overvaluation the previous year
1997	-3.2%	• Asian financial crisis; Russian default; Long Term Capital failure
1998	-31.6%	
2000	3.1%	• Tech bubble left us behind

There were two important events that turned the returns downward around mid-year. Firstly, the U.S. housing price bubble finally popped. Mortgage defaults and foreclosures are on the rise and new house sales are falling. As the housing bubble progressed in the U.S. between 2001 and 2007, lending practices became increasingly sloppy. Over these years increasing volumes of much riskier (sub prime) mortgages were written. These sub prime loans were subsequently packaged with other debt instruments such as credit card receivables, auto loans, etc., and sold to banks and other investors as Asset-backed commercial paper (ABCP) and Collateralized Debt Obligations (CDO's). As the value of the underlying mortgage paper has come into question, the value of the

[1] Returns longer than one year are annualized.

ABCP and CDO's has been marked down. For a very humorous, simple, and informative explanation of sub prime loans go to the following link:
http://www.youtube.com/watch?v=SJ_qK4g6ntM

Investors holding these instruments have collectively taken massive write downs. At the time of writing, the global banking community has absorbed write downs of roughly $70 billion dollars. This is likely to go substantially higher. This is a sizeable sum but it is worth bearing in mind that the bursting of the tech bubble in 2000 wiped out $5 trillion in market value of tech companies alone. A painful and disruptive adjustment is underway. As a senior U.S. banker recently said, "Why did the banks have to find new ways to lose money, when the old ways were working well enough?" Investors in these instruments will take losses, and owners of financial institutions (banks) and investments funds that own these instruments will incur losses, some very significant. Very simply . . . the interest rates on these obligations were not nearly high enough to compensate the buyers for the risks taken.

As a footnote, for our client income focused portfolios, in the past three years we did not purchase any of these types of obligations. It is not that we were clever enough to foresee today's problem. It was simply that interest rates were too low and in our opinion did not offer the prospect of sufficient return to compensate for risk.

The collapse of the U.S. housing market and the financial problems that have ensued have raised the risk of a recession in the U.S., and perhaps globally. Two major U.S. banks, Citigroup and Merrill Lynch, have been forced to sell assets and to dilute existing shareholders by taking significant equity capital injections. The U.S. Federal Reserve and other major western world central banks have responded by lowering short-term interest rates and injecting massive amounts of liquidity into the financial markets.

In our September 30th report, we discussed at length, the matter of predicting a recession in the U.S. The conclusion we drew was that it is not worth the angst. Moreover, with the massive liquidity injections by central banks globally, we should be just as concerned about the prospect of rising inflation or even "stagflation". For those not old enough to remember, stagflation was a term that was used in the 1970's to describe the slow economic growth but high inflation rates that characterized the U.S. and other western economies at that time. In that environment the broad stock market indices were "range bound". From 1966 to 1982, across bull and bear markets, the Dow Jones Industrial Average was flat. For positive returns investors have to be more narrowly invested, for example in resource areas such as oil and metals.

The rising threat of economic slowdown in the U.S. and globally has resulted in a significant downturn in the price of base metals and the producing companies.

	High Price	**Date**	**2007 Year End Price**	**% Decline**
Copper	$3.78 / lb	May 4. 2007	$3.03 / lb	20%
Nickel	$23.45 / lb	May 4, 2007	$11.95 / lb	49%
Zinc	$1.89 / lb	May 4, 2007	$1.08 / lb	43%

By year end the prices of many of the producers have declined 30% - 50% from their highs as a result of the decline in base metal prices, and also as a result of year end tax loss selling. As an anecdote, your author remembers standing on the edge of LionOre's Tati open pit on December 28, 2000. It was three months before the start of the last U.S. recession and LionOre was trading at $1.20 per share. We sold LionOre to Norlisk for $27.50 this year. The message . . . don't let your thinking get excessively negative because of recession fears. There are always a lot of things to worry about as an investor. There were plenty in 2000/2001 . . . recession / war on terror. There are plenty today . . . recession / war on terror. It has been our experience that it is healthier to be invested when all are worrying, than when nobody is.

Moreover, in times of uncertainty, let us not forget that the main issue looking forward has not changed. Existing mines are depleting and because of many years of underinvestment in new capacity, there is not enough new mine production coming on stream. A lower commodity price environment will serve to exacerbate this situation and result in ultimately higher prices.

The second significant event that reduced valuations on many of our investments since mid-year was the continued appreciation of the Canadian dollar. On November 6, 2007, the Canadian dollar spiked to a record high of $1.09 U.S. It finished the year at $1.00 U.S. From its low of $0.62 U.S. in January 2002, the Canadian dollar has appreciated 61% to the 2007 year end. For Canadian-based export-oriented companies (manufacturers and oil and gas companies), this puts enormous pressure on profit margins. Tremendous adjustments must be made . . . adjustments that take time to implement. The positive side is that well run Canadian companies can be purchased at very attractive valuations as a result.

In the energy sector, oil producers fared much better than natural gas producers. The price of oil rose to a record high of $98.88 per barrel in November. This offset, to some degree, a rising operating cost environment and a rising Canadian dollar. However, the conventional western Canadian basin is predominantly a natural gas oriented basin. Natural gas prices have declined from a high of roughly U.S. $15 per mcf late in 2005 to a year end 2007 price of $7.16 per mcf, a decline of 52%. Land, labour, and operating costs have doubled. In October 2006, the Federal government announced the taxing of income trusts beginning in 2011. Finally, in 2007, the Alberta government announced the planned introduction of higher royalty rates beginning in 2009. A perfect storm. Valuations on Canadian gas-oriented exploration and production companies are trading at their lowest valuations since the bottom of the oil and gas market in early 1999. With everything imaginable working against these companies and the valuations as low as they are, it will not require much positive change to produce an increase in valuations. For example, there are definite signs that land costs and service costs are beginning to ease. Moreover, there are emerging indications that, in response to falling activity in Alberta, the government may ease back on the proposed new royalties scheduled for early 2009.

A few comments on some of our notable non-resource producing companies. **Loblaw's**, Canada's largest grocery retailer, has continued to deliver disappointing earnings and this value play has become more of a value play. The share price has continued to decline as more shareholders give up because the earnings turnaround has not yet materialized. Our view here is to stay the course. With many value investments, patience is severely tested but often rewarded. With Loblaws we

are getting to a valuation level where more bad news might actually produce a catalyst that would be positive for the share price.

On November 29, 2007, Telus announced an all cash $8.25 bid for our investment in **Emergis Inc.** This represented a premium of roughly 19% to previous day closing price. The offer is open until January 16, 2008. Emergis is a leading information technology company that focuses on the Canadian health and financial services sector. We purchased the stock a few years ago at roughly $3.40 per share. Our auto parts manufacturers, **Linamar Corporation** and **Martinrea International** have suffered a reduction of their share values in response to the spike in the Canadian dollar, but both companies continue to grow and generate healthy cash flow. The same story applies to our valve manufacturer, **Velan Inc.** **Menu Foods**, which was hit by its own "black swan" in February with the industry-wide pet food recall, continues to work very hard to recover from this blow. So far Menu's creditors have stood by the Company, as they struggle to right size the business to their current reduced revenue base. Menu is the leading producer of wet style private label pet food in North America. The market value of the Company declined from a 52 week high of $7.50 per unit to a December low of 62¢ . . . a market cap of $12 million. Menu's customers have been working to get the product back on the store shelves. Canadian sales have returned to roughly 80% - 90% of pre recall levels. U.S. levels are only back to roughly 50%. Wal-Mart, the largest U.S. customer has been slower to restock as they have been dealing with 6 separate recalls on private label products. The turnaround at Menu has been painful and there are still obstacles to overcome . . . a strong Canadian dollar among them. However, prior to the recall, Menu was generating annualized EBITDA of roughly $40 million. Getting halfway back to where they were would have a significant positive impact on the value of the business.