

**DK BOND FUND  
Quarterly Report  
March 31, 2003**

*Rates of Return*

	<u>3 Mths</u>	<u>6 Mths</u>	<u>1 Yr</u>	<u>2 Yrs</u>	<u>3 Yrs</u>	<u>4 Yrs</u>	<u>5 Yrs</u>	<u>7 Yrs</u>	<u>9 Yrs</u>
<b>DK Bond Fund</b>	<b>4.7%</b>	<b>11.6%</b>	<b>9.3%</b>	<b>7.6%</b>	<b>2.7%</b>	<b>2.3%</b>	<b>2.6%</b>	<b>6.3%</b>	<b>8.1%</b>
SCM Universe Bond Index	-0.7%	1.6%	9.1%	7.1%	7.6%	6.0%	6.2%	8.0%	8.5%
ML CDN High Yield (hedged)	8.0%	23.0%	2.7%	-1.1%	-2.2%	-1.5%	-0.5%		
ML USD High Yield <sup>1</sup> (unhedged)	7.1%	14.5%	3.3%	1.9%	1.9%	1.2%	1.3%	4.5%	6.0%

While war in Iraq captures the attention of most investors, corporate bonds have become a place of refuge. Despite volatility in most markets, corporate bonds have been very steady and well bid since September 30, 2002. The DKBond fund earned 4.7% during the quarter, the SCMU bond index was negative 0.7%. The SCMU is primarily made up of government bonds. From September 30, 2002, or 6 months, the DKBond portfolio earned 11.6% versus 1.6% for the SCMU index. For one year the DKBond fund earned 9.3% compared to 9.1% for the SCMU.

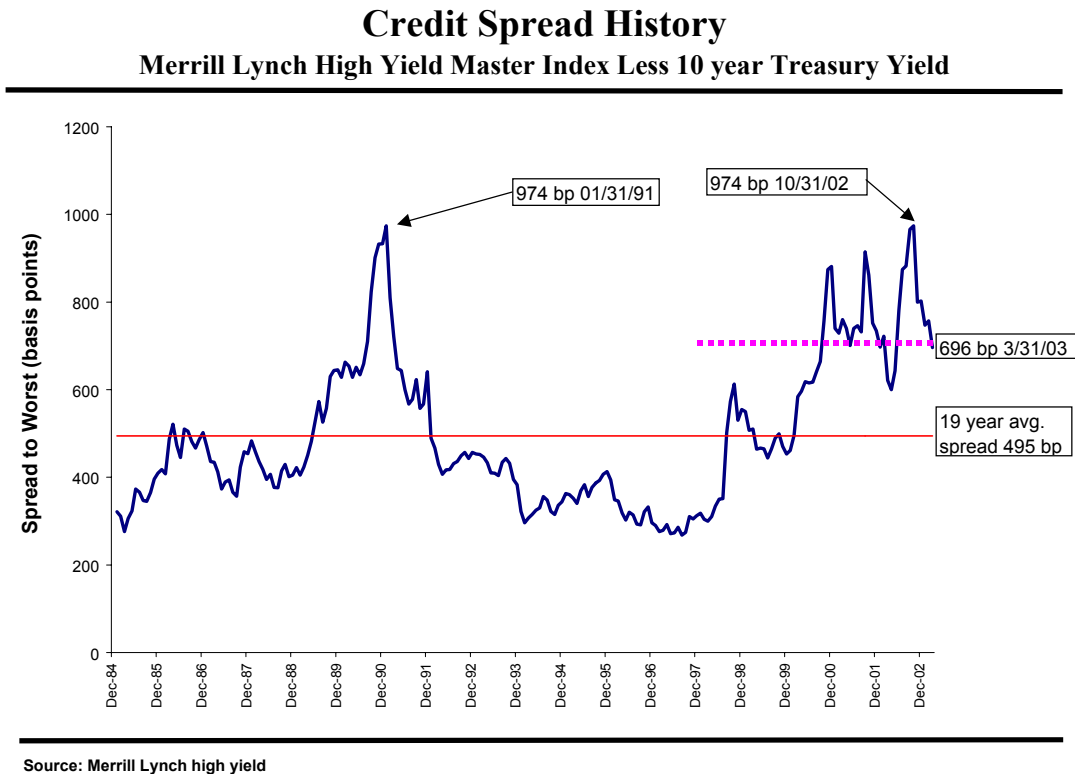
Financial market reaction to war or peace can be sharp, but it is normally brief. Markets tend to revert to the fundamental drivers (economy, valuation etc.) that were in place prior to the event. A recent article in the New York Times (March 30, 2003) outlines a study showing that major non-economic events, like war, do not frequently coincide with stock market turning points. The study, starting with the impact of Pearl Harbour on December 7, 1941, shows that following major non-economic events there is volatility but the broad market trends are just as likely to follow in the same direction they were headed prior to the event. While this may indicate further problems for stock markets, the positive trend in corporate bonds should continue as it has in the past 6 months.

High yield corporate bonds have shrugged off both geopolitics and volatile equity markets in the past 6 months. Investors are attracted to the stability of the high coupon returns available on corporate bonds. Unlike equity mutual funds, corporate bond mutual funds are enjoying very large net inflows. During the first quarter alone net inflows of \$10.5 billion increased the capital of U.S. high yield bond mutual funds by almost 10%. During the last 5 weeks of the quarter, high yield mutual funds experienced the largest 5-week influx on record. Large inflows on top of high cash balances in bond mutual funds increases demand for corporate bonds. As a result, new issue corporate bond volume has picked up this year. Corporations are eager to take advantage of the availability of money and the lower absolute level of interest rates.

<sup>1</sup> The Merrill Lynch USD High Yield bond index (unhedged) is indicative of US high yield bond market returns.

Lower interest rates encourage companies to refinance their debt. For example, we hold **Denbury Resources** 9% debt due in 2008, with a portfolio average cost of \$89. During the quarter Denbury called these bonds at \$104.50 in order to refinance with new 7½% coupon 10-year bonds. The company was able to reduce corporate interest expense and extended the term of their debt. **Sparkling Springs** also called their bonds last quarter and we expect more companies to redeem debt as they repair balance sheets and take advantage of low interest rates.

We continue to look for new opportunities. During the quarter we added new holdings in **Alliance Imaging** (CT Scan), **Overseas Shipping Group** (oil tankers), **Teco Energy** (independent power producer) and **Western Oil Sands**. We also added to holdings in **Extendicare** (nursing homes), **Gerdau Ameristeel** (mini mill) and **Videon** (part of Shaw Cablesystems).



Credit spreads have narrowed significantly since the 4<sup>th</sup> quarter indicating credit conditions continue to improve, as shown above. Another good gauge of credit stress, Moody's 12-month trailing default rate has been declining for over a year confirming that financial stress is lessening. While bond valuations may be less attractive today than at year-end, credit spreads remain well above the historical average. We view bond price changes as random events; in the long run bond returns rarely deviate from portfolio income. The DKBond interest distribution during the first quarter was \$10.68 per unit for an annualized rate of 9.7%. This income return is still very attractive at almost twice the yield available on government bonds.

**The risk of a declining U.S. dollar on U.S. bond holdings**

The U.S. dollar declined by 7% against the Canadian dollar during the first quarter and the DKBond fund has 40% in U.S. bond holdings (of which 16% is foreign content). Because we hedge this foreign exchange exposure the U.S. dollar decline did not have a negative impact on portfolio returns during the first quarter. In addition, through hedging we capture the higher interest rate curve in Canada versus the U.S. and this adds an additional 1% per annum to the return of U.S. dollar portfolio holdings. Finally, we continue to add to U.S. holdings because the best opportunities we see today are in U.S. dollars. We will continue to do our best to eliminate as much FX risk as possible.

**Conclusion**

T.V. reports continue to indicate that there is a lot to worry about. However, equity markets already reflect this concern, having declined by 50% from the peak in 2000. With confidence in credit quality improving, as indicated by sizable inflows to high yield mutual funds, it seems to us like a good time to be invested in corporate bonds in order to earn high current income.