

**March 31, 2008**

**DK INCOME FUND**

**DEANS KNIGHT**  
CAPITAL MANAGEMENT LTD

**DK INCOME FUND**

**Quarterly Report  
March 31, 2008**

**Rates of Return<sup>1</sup>**

	<u>3 Mths</u>	<u>1 Yr</u>	<u>2 Yrs</u>	<u>3 Yrs</u>	<u>4 Yrs</u>	<u>5 Yrs</u>	<u>10 Yrs</u>	<u>Since June '93</u>
<b>DK Income Fund</b>	<b>2.8%</b>	<b>9.5%</b>	<b>9.8%</b>	<b>13.4%</b>	<b>17.2%</b>	<b>19.1%</b>	<b>10.5%</b>	<b>11.9%</b>
SCM Universe Bond Index	3.0%	5.8%	5.6%	5.4%	5.3%	6.4%	6.3%	7.6%
ML CDN High Yield	-5.0%	-7.2%	1.3%	1.5%	2.3%	5.6%	2.5%	
ML USD High Yield	-3.0%	-3.5%	3.8%	4.9%	5.4%	8.6%	4.9%	6.8%

We have stated in numerous quarterly reports since 2003 that bonds, in general, were not attractive investments with credit spreads between government and high yield corporate bonds and interest rates at historical lows. Simplistically, investors were not being properly compensated for the risk. In order to maintain our income stream to our clients, we shifted focus away from high yield bonds investing in bridge/mezzanine financings and Income Trusts. Prior to the "Credit Crunch" on June 30, 2007, only 22% of the portfolio was invested in high yield bonds. This decision shielded us from the full impact of the credit crunch with the return on our portfolio from the peak of the high yield market on May 31<sup>st</sup> being flat versus negative returns in most other markets. The table below shows how we fared since May 31<sup>st</sup>:

**Return May 31, 2007 to March 31, 2008**

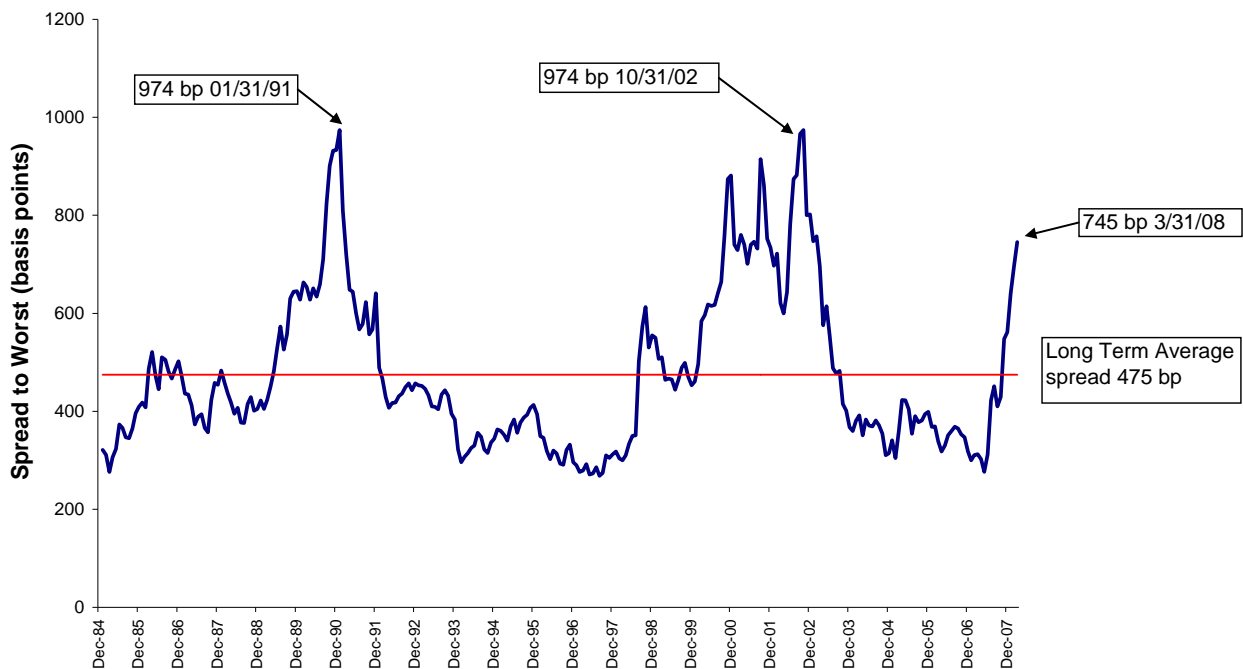
<b>DK Income Fund</b>	<b>0.2%</b>
ML CDN High Yield	-8.0%
ML USD High Yield	-5.5%
S&P/TSX Composite Index	-3.0%

Credit spreads have widened as a result of the credit crunch (see graph below) high yield bonds are again providing double digit yields. We expect spreads to continue to widen across the high yield market regardless of whether or not the individual credits are in any distress. This will provide us with the opportunity to invest in the debt of businesses with tangible assets as collateral, strong cash flows and reasonable leverage at attractive yields where we are being more than compensated for the risk.

<sup>1</sup> Returns longer than one year are annualized.

## Credit Spread History

### Merrill Lynch High Yield Master Index Less 10 year Treasury Yield



Source: Merrill Lynch high yield

In addition, with the banks curtailing lending activities, it provides us with more opportunities to negotiate private debt financings, such as bridge, mezzanine and short-term secured loans offering high coupons and equity incentives to enhance returns. These financings are typically short term, high coupon, in some cases fully secured and, most importantly, provide capital growth through “equity kickers” in the form of warrants or convertible debt. Historically, we have achieved annualized rates of return of 20% in these investments.

We continue to compliment high yield and private debt financings with investments in a select number of income trusts, 30% of the portfolio is currently invested in income trusts. With yields on high yield debt rising, income trusts in general are becoming less attractive investments. It is reasonable to expect our weight in income trusts will decline especially as we approach the 2011 deadline when trusts become taxable at the corporate level.

The largest and most important holding in the portfolio is cash and cash equivalents, currently 20% of the portfolio. Our large cash position will allow us to take advantage of the opportunities we expect to see in debt investments.