March 31, 2010

DK INCOME FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Report

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Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	15 Yrs	Since June '93
DK Income Fund	**3.6%**	**64.2%**	**13.6%**	**12.2%**	**11.7%**	**13.5%**	**12.8%**	**12.1%**	**12.1%**
SCM Universe Bond Index	1.4%	5.2%	5.1%	5.3%	5.4%	5.3%	6.5%	7.5%	7.3%
ML CDN High Yield	5.7%	59.2%	5.0%	0.8%	3.1%	2.9%	3.1%		
ML USD High Yield	4.8%	57.2%	12.0%	6.5%	7.8%	7.7%	7.2%	7.5%	7.4%
S&P/TSX Composite Index	3.1%	42.1%	-2.0%	0.0%	2.7%	7.4%	4.7%	9.3%	9.6%

Looking back to this time last year, high yield bonds were trading on average at 62% of par[2] as we were mired in the most severe bear market since the 1930's. Investors, the media, the analysts, were all paralyzed by fear. The consensus promoted by the media was the world as we knew it had come to an end. Defaults would rise as even good companies would struggle to make interest payments or worse be unable to refinance their debt. However, between that time and the end of this calendar quarter, these same bonds are now trading at 98% of par.

One year ago who could have predicted this outcome?

As we pointed out in our March 2009 quarterly, bonds have a contractual obligation to pay a coupon and, barring a default, investors are "paid to wait". When credit markets improve and spreads return to more normal levels, the high yield bond market has historically provided equity like returns.

One year ago, many of our holdings were valued at market levels suggesting they were going out of business. We continued to invest in the debt of businesses with tangible assets as collateral, strong cash flows and reasonable leverage. These businesses were painted with the same brush as the over-levered companies. Our bonds were priced at levels that, even in the event of a default, we felt would still make money. The media ignored these opportunities choosing to dub the entire high yield sector as too risky. With the benefit of hindsight, their thinking was totally irrational.

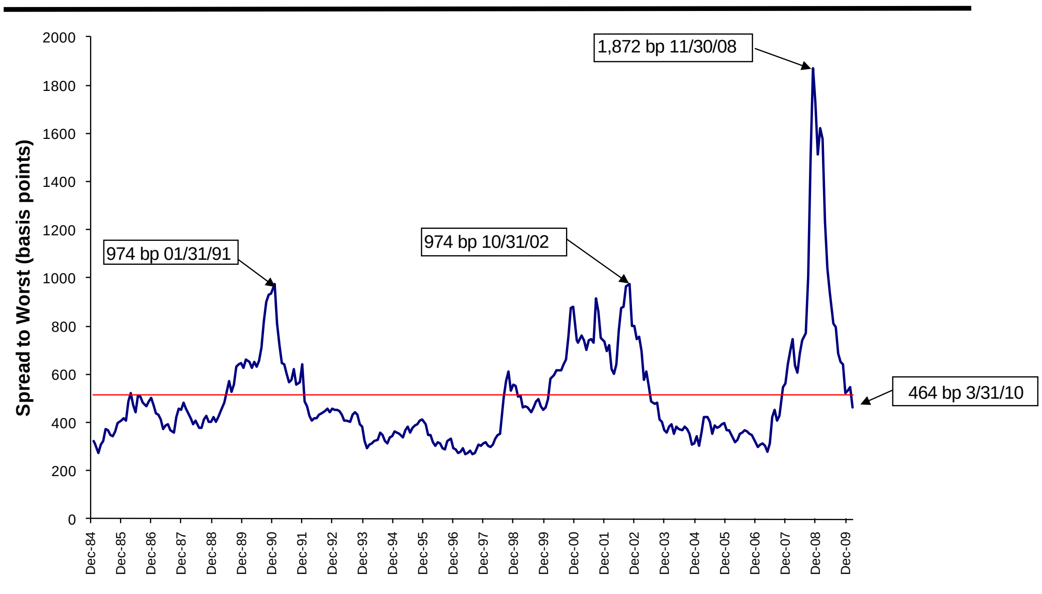
[1] Returns longer than one year are annualized.
[2] Merrill Lynch USD High Yield Index

One of Warren Buffett's simple rules to apply is *"be fearful when others are greedy, and be greedy when others are fearful."* In Warren Buffett's letter to shareholders distributed in March 2009, he discussed the very unusual conditions that existed in the corporate bond and municipal bond markets, and that these securities were ridiculously cheap relative to U.S. Treasuries. In his latest letter, Buffett states "we backed this view with some purchases, but I should have done far more. Big opportunities come infrequently. *When it's raining gold, reach for a bucket, not a thimble."*

Has greed returned and should we be fearful? We don't think so. Credit spreads, as shown in the graph below, are at their historical average. Cash flows of most of our businesses are improving and given the amount of corporate bonds issued in the last year, it is safe to say the credit markets are no longer frozen.

Credit Spread History

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



Source: Merrill Lynch high yield

However, this is not to say we think all bonds are still attractive.

Bill Gross, manager of the world's biggest bond fund at Pacific Investment Management Co., recently stated in a Bloomberg Radio interview, "Bonds have seen their best days. Duration should be shorter than the index and you should be taking a little more risk in terms of spreads." He later went on to state that "Real interest rates are moving higher. That's the main bear element in the bond market."

Essentially, Mr. Gross is saying yields on high grade government/corporate bonds with long maturities are too low given the threat of rising interest rates. To illustrate this point lets look at Rogers Communication bonds whose 10 and 30 year bonds currently yield 5.1% and 6.3%, respectively. If we assume government yields increase by 2% over the next 4 years and the spread remains unchanged, what effect would this have on the price these bonds? The answer: prices on Rogers' 10 and 30 year bonds would fall by 6.5% and 20%, respectively!

By contrast, a rising interest rate environment will not have a significant impact on our holdings, which currently yield 8.2%, because the average bond in the DK Income portfolio will mature in the next 5 years at par. The fact is rising interest rates are positive because it signals a stronger economy. As our holdings mature and credit quality improves, we will be reinvesting cash from these maturities at higher rates.

During the quarter, **Athabasca Oil Sands** 13% Notes due July 30, 2011 were called at $107. Athabasca is an oil sands company, focused on developing their oil sands leases in the Athabasca region of Northern Alberta. On August 28th, 2009, Athabasca signed a joint venture with PetroChina to develop their Dover and McKay River projects. PetroChina agreed to pay $1.9 billion for 60% of these two assets (approximately 3 billion net barrels of recoverable resource). Upon closing of the Joint Venture, Athabasca was required to call our bonds at $107. Our investment in the Athabasca bonds had an annualized IRR of 18%.

In addition, **CGA Mining Ltd.** 12% Notes due November 22, 2012 were called at par in March. CGA is a gold mining company with a low cost operating mine in the Philippines. In 2007, we helped structure the note to ensure our security and receive an attractive 12% coupon. In addition, each $100 of debt receives 25 warrants to purchase CGA shares at $1.03 for three years. At the exercise price of $1.03, CGA was valued at 0.5x NAV on a conservative basis. We still own the shares which currently trade at over $2. Our investment in CGA has an annualized IRR of 21% to March 31st.

Although 23% of the portfolio has been called in the past 6 months, we are still finding attractive investment opportunities. One example is **North American Energy Partners** (NAEP) who refinanced their existing debt in March with a 9.125% Debenture due in 2017. NAEP provides a wide range of heavy construction and mining, piling and pipeline installation services to customers in the Canadian oil sands, mineral mining, commercial and public construction and conventional oil and gas markets. NAEP's EBITDA in 2009 was $120 million and, post financing, the Company will have Net Debt of $235 million.

Despite the low debt level, NAEP has only a B credit rating due to the perceived cyclical nature of their cash flows. As a result, the Company has to pay a high coupon and adhere to stricter covenants protecting the bondholders. Although a portion of the Company's business is cyclical, NAEP has a strong management team with a core oil sands business generating recurring cash flows sufficient to service its debt. With a yield of 9.125%, we are more than compensated for the risk.

We continue to invest in debt of businesses with good management teams, tangible assets as collateral, strong cash flows, reasonable leverage and with a strong security package. We maintain a short maturity of 5 years and still produce a yield of 8.2%. This is a much more attractive opportunity than lending to the Government of Canada for 10 years at 3.6% or investing in a portfolio of investment grade bonds yielding 4.5% and maturing in 10 years.