DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK BOND FUND
Quarterly Report

June 30, 2004

Rates of Return

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Bond Fund	**1.7%**	**6.3%**	**19.7%**	**17.7%**	**14.6%**	**9.0%**	**7.0%**	**10.1%**
SCM Universe Bond Index	-2.0%	1.1%	3.3%	7.2%	7.8%	7.4%	6.7%	9.0%
ML CDN High Yield (hedged)	-2.0%	0.7%	8.0%	15.4%	6.5%	3.2%	2.1%	
ML USD High Yield (unhedged)	-0.8%	1.4%	10.2%	16.0%	8.8%	6.3%	4.8%	7.5%

One of this year's most anticipated events finally arrived during the last week of the quarter. The U.S. Federal Reserve increased short term interest rates. The fact is, this rate increase by the US Federal Reserve can only be viewed as the first of many in a cycle that will inevitably lead to higher interest rates. When interest rates rise bond prices decline and expectations of rising interest rates caused negative returns during the quarter for the SCMU and high yield bond indices. By contrast we have been preparing the DKBond portfolio for a period of rising interest rates and the portfolio had a positive return for the quarter of 1.7%. For the year-to-date period the DKBond return is 6.3% and for one year 19.7%.

How have we been preparing the DKBond fund for higher interest rates? Firstly, we have reduced the term to maturity of portfolio holdings. Prices of short maturity bonds are less affected by changes in interest rates, and when these short term bonds mature we will be able to reinvest at higher interest rates. For example 92% of the bonds in the DKBond portfolio mature or are expected to be called for redemption within 4 years. Secondly, we focus on income. The income distribution from the DKBond portfolio for the year ended June 30th is 9.25% based on today's unit value. This income return is double that of the SCM Universe bond index yield and this extra income return helps to offset small price declines. Finally, we have been looking for income outside of corporate bonds. In our March 2004 report, we made the point that certain income trusts look more attractive than bonds today because they offer much higher income for the risk being taken.

Our goal in the DKBond fund is to provide income. Credit conditions have improved so much that in many cases corporate bonds no longer provide sufficient return to compensate for the risks. For example, we like **Rogers Cablesystems** because they have attractive credit fundamentals, but we think lending the Company money at 5.5% for 10 years does not make any sense. Rogers Cablesystems issued 5.5% bonds due in 10 years during March. By contrast we believe that certain income trusts have high income payouts (debt like properties) that adequately compensate investors for capital risk. As a result we have added more income trusts to our portfolio holdings during the quarter through the purchase of **Acclaim Energy Trust** and **Paramount Energy Trust.**

Acclaim Energy's recent new issue transaction helps explain how we are finding better value in income trusts than in corporate bonds. Acclaim raised money last quarter through a new issue of convertible bonds and a secondary offering of trust units to fund the purchase of oil and gas properties from Chevron. The trust unit provides a distribution of 15.8% and the convertible bond provides an 8% interest coupon for 10 years with a strike price at a 10% premium to the unit price.

We purchased the Acclaim trust units because we believe they provide a higher income return with no more risk than owning the convertible bonds. We feel the risk associated with trust units is no greater than the bonds for two reasons. First, the high distribution available from the trust unit repays the entire principal invested within 6.5 years while convertible bond holders still have significant investment capital remaining at risk for years 7 through 10. Ultimately the convertible bond return is highly dependent on the ability of Acclaim to repay principal 10 years from now. Second, Acclaim is allowed to make both future interest payments and the maturity payment by issuing additional trust units (this is true of many converts). While Acclaim would not choose this option during normal times, in the event of a problem, this feature would essentially leave convertible bond investors in exactly the same position as trust unit holders all the while earning only half the annual expected payout of the Acclaim trust unit. Investing in Acclaim trust units allows us to collect a higher income payout, participate in more upside growth while accepting, in our opinion, no more risk than owning convertible bonds.

It is obvious that the investment landscape has changed dramatically in the past 2 years. In a low interest rate environment, we are finding few attractive opportunities in corporate bonds. We have to look for income in new areas and we believe certain income trusts provide better potential returns than corporate bonds, as the Acclaim case demonstrates. The result is we have increased the fund holdings of income trusts to approximately 13% in order to take advantage of this change in the marketplace and fulfill our goal of providing income. In 2000, we introduced fund guidelines limiting income trust holdings to 10% of the portfolio. Clearly, this limit is too restrictive and we are in the process of reassessing our investment guidelines for the fund. We will be sending you a proposal for a revised set of investment guidelines in the near future that better reflects the intent of the fund, and allows us to continue to earn value-added income for investors.

As of June 30th the 10 largest holdings were:

	% of Portfolio	
Anchor Lamina Inc.	6.7%	Metal Processor
Sherritt Intl. Corp.	5.5%	Power Producer
Saskatchewan Wheat	5.4%	Agricultural Operations
Scott Paper Ltd.	5.4%	Paper Products
Call-Net Enterprises	5.3%	Telecommunications
Alderwoods Group	5.2%	Funeral Services
Baytex Energy Ltd.	5.1%	Oil & Gas Production
Menu Foods	4.9%	Private Label Pet Food
Laidlaw Intl. Inc.	4.2%	Transport
Gerdau Ameristeel	4.1%	Steel Mini Mills
Total	**51.8%**	