DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK BOND FUND

Quarterly Report
June 30, 2005

Rates of Return[1]

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Bond Fund	**3.3%**	**11.1%**	**31.2%**	**25.3%**	**22.0%**	**18.5%**	**13.1%**	**11.2%**
SCM Universe Bond Index	4.5%	5.6%	12.0%	7.5%	8.8%	8.8%	8.3%	8.5%
ML CDN High Yield (hedged)	1.8%	0.0%	8.8%	8.4%	13.2%	7.1%	4.3%	
ML USD High Yield (unhedged)	2.6%	1.1%	10.6%	10.4%	14.2%	9.3%	7.1%	7.1%

Because interest rates are at 50 year lows, we have been looking to non-traditional income investments to generate cash flow. These investments have provided ⅔ of the portfolio return in the past 12 months and the majority of the year to date return. An example is income trusts; these portfolio holdings generate income for distributions of 11% (based on current market values) that is 40% more income return than from our corporate bond holdings. Also, on average the market values of income trust holdings are well above the portfolio book cost.

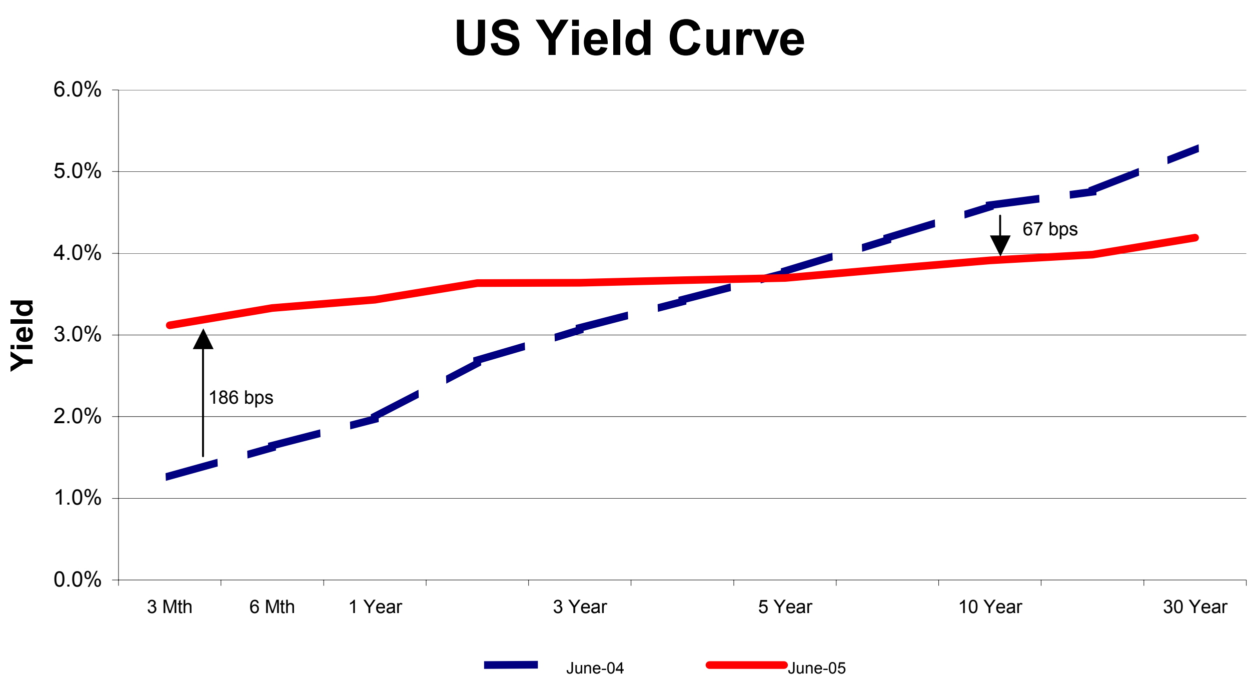
We continue to find interesting opportunities; recently we invested in two private debt placements of **Imperial Metals Corporation**, a publicly traded company listed on the TSX. Deans Knight knows the Company very well and as a result, we were able to participate in these private transactions. In March, we purchased convertible debentures with a coupon of 6% due in 2010 with a conversion price of \$8.65, a premium of 20% on the purchase date. In June, we participated in a second transaction providing a short-term line of credit. This loan carries an 8% coupon and has a one-year maturity. As a sweetener, the DK portfolio also received 133.5 warrants per \$1000 of loan to purchase shares at \$6.00 for a period of two years. Shares of Imperial Metals were trading at \$5.95 on June 30th. These two investments are backed by assets, pay an attractive current income and provide the opportunity for additional returns from capital gains.

We received the news we have been waiting for on **Vicwest**, the largest portfolio holding. On June 20 shareholders approved the conversion into an income trust. As a trust Vicwest intends to distribute \$1.11 annually that will provide a 10.3% income return (based on the June 30 market value). Vicwest shares have appreciated significantly because the company is able to generate strong cash flows, as unit holders in a trust structure we will now participate in this success more consistently by collecting a high annual income.

[1] Returns longer than one year are annualized.

It is challenging to find attractive new income investments in the current low interest rate environment. Moreover, many corporate borrowers are taking advantage of the low interest rate environment by exercising the option to call their outstanding debt. Normally the call price acts as a deterrent because companies must call outstanding bonds at a price well above $100. However, companies are willing to pay this premium now if it allows them to replace their high coupon debt with low cost longer term financing. For example, we had 3 bonds called for redemption this quarter representing about 8% of the portfolio. **MetroPCS** 10.75% bonds were called at $119.25, **Laidlaw Intl.** 10.75% bonds were called at $117.17, (Laidlaw was upgraded to an investment grade credit which further reduces their future interest cost) and **Advertising Direct** 9.25% bonds (bought by Yellow Pages) were called at $105. The good news is DK income earns a significant premium over cost that adds to past returns, the bad news is we are not able to replace the attractive coupon payments we are losing with new bond investments in the current environment.

The US Federal Reserve has raised the overnight bank lending rate nine times over the past year to 3.25% from a low of 1%. Normally, when the US Federal Reserve increases short term rates long term bond interest rates follow the trend. However, over the past year, 10 year US treasury rates have actually declined by 0.65%. Declining US long term rates would indicate that bond investors are confident that economic growth will ultimately slow and inflationary price pressures will continue to moderate. We do not agree. The increase in US short term rates together with the decline in long US rates has led to a flat yield curve, as shown below. When the difference between long term and short term rates is small there is no incentive for us to hold longer term bonds.



We find it hard to understand how investors can view a 3.9% 10-year US treasury bond as an attractive investment. We prefer to look for more interesting income ideas and keep the duration of the DK income portfolio to a relatively short 3.6 years.

Portfolio Holdings

As of June 30th, the 10 largest holdings were:

	% of Portfolio	
Vicwest Corp.	12.3%	Building & Construction
Sherritt Intl. Corp.	5.4%	Power Producer
Harvest Energy Trust	5.0%	Oil & Gas
Imperial Metals	5.0%	Copper Mining
Paramount Resources	4.8%	Oil & Gas
Call-Net Enterprises	4.6%	Telecommunications
Baytex Energy Ltd.	4.0%	Oil & Gas
Saskatchewan Wheat	3.9%	Agricultural Operations
LionOre Mining Intl.	3.6%	Nickel Mining
Gerdau Ameristeel	3.4%	Steel Mini Mills
Total	52.0%	