

June 30, 2009

DK INCOME FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK INCOME FUND

**Quarterly Report
June 30, 2009**

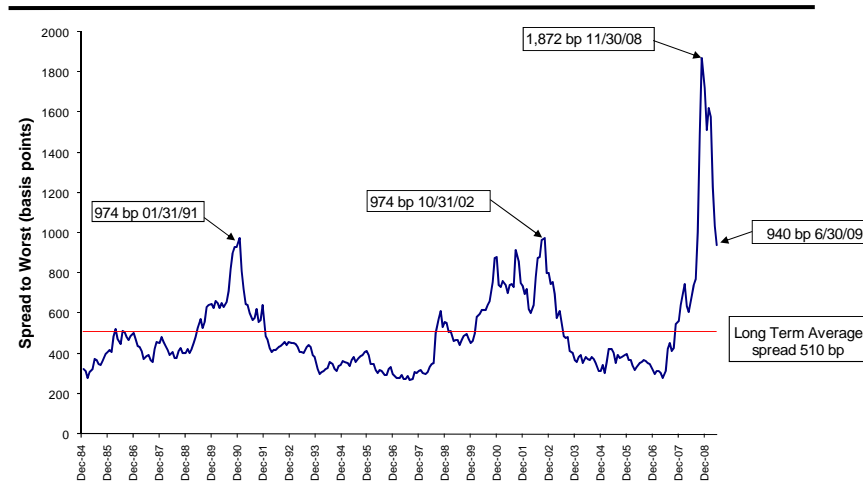
Rates of Return¹

	<u>3 Mths</u>	<u>YTD</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>
DK Income Fund	25.2%	26.8%	-8.8%	-0.7%	5.6%	8.6%	12.8%	9.8%	10.8%
SCM Universe Bond Index	1.2%	2.8%	7.0%	6.9%	6.2%	4.4%	5.9%	6.3%	7.4%
ML CDN High Yield	25.1%	22.4%	-15.7%	-10.1%	-3.3%	-2.9%	-0.7%	0.7%	
ML USD High Yield	23.2%	29.4%	-3.5%	-2.8%	1.8%	2.5%	4.1%	4.4%	6.1%

In the most recent quarter, high yield bond prices rose dramatically. Moreover, credit spreads between high yield bonds and government bonds have narrowed significantly from the record spread levels of late last year.

Credit Spread History

Merrill Lynch High Yield Master Index Less 10 year Treasury Yield



Source: Merrill Lynch high yield

Has the rebound in valuations in this past quarter made our bonds expensive? No. We are investing in the debt instruments of businesses with tangible assets as collateral, strong cash flows and reasonable leverage. These bonds continue to offer very attractive double digit yield to maturity and cash on cash yields of 9.2%. Furthermore, as the above graph shows, spreads are still at historically wide levels.

¹ Returns longer than one year are annualized.

The principal objective of the DK Income Fund is to provide our investors with a stable stream of income; higher than what can be earned on government bonds or investment grade corporate bonds. As the bar chart below illustrates, the Fund has generated stable annual income of 7.5% to 10% for our clients since its inception. This calendar year is on pace to earn an income return of over 11%, the highest since our inception, which points to the tremendous investment opportunity that was available on December 31, 2008.



Market prices can be volatile in the short term. However, we have been able to earn income consistently, and provide additional return from capital gains in the long term. The Globe and Mail, on June 13, 2009, compared the rates of return on 30 high yield mutual funds². The table below shows how the DK Income Fund compares with these same mutual funds as well as the S&P/TSX Composite to June 30, 2009. As you can see, not only have we greatly outperformed our peers, we have also outperformed the S&P/TSX Composite while taking on less risk.

DK Income Fund vs. High Yield Bond Funds
as of June 30, 2009

	YTD	2008	1YR	3YR	5YR	10 YR	15YR
DK Income Fund ⁽¹⁾	26.1%	-21.8%	-10.3%	4.1%	11.3%	8.3%	9.5%
Industry Average ⁽²⁾	15.3%	-17.2%	-4.7%	0.3%	1.3%	3.2%	5.8%
S&P/TSX Composite	17.6%	-33.0%	-25.7%	-0.9%	6.6%	6.2%	8.7%

⁽¹⁾ Returns are net of fees

⁽²⁾ Average return of high yield mutual funds referenced in Globe and Mail article dated June 13

² <http://www.theglobeandmail.com/blogs/number-cruncher/finding-the-gems-of-the-bond-risk-takers/article1180749/>

We would like to highlight two positive developments in our holdings. Firstly, we own secured notes in **GBS Gold International**. These Notes contributed to a large portion of the negative return in 2008 as the Company defaulted in September. The Notes were fully secured by all the assets of the Company and Deans Knight was appointed to lead the secured Noteholders' committee dealing directly with Ferrier Hodgson, the administrator appointed to deal with the disposition of assets and/or restructuring of the Company. In the latter part of 2008, we put the Company's operations on care and maintenance to conserve cash and give us the flexibility to sell assets in a more favourable environment. On December 31, 2008, we reduced our carrying value to \$15 per \$100 of par, which valued the Notes at cash on the balance sheet plus the cash portion of preliminary bids for the assets at the time. The final bid process was concluded in February and a preferred bidder was accepted. Over the course of the next four months, documentation was finalized and the Noteholders signed off on an Asset Sale Agreement. The end result will see Noteholders recover over \$90 per \$100 with the final payment due no later than June 21, 2010.

Secondly, we held a senior subordinated 15% note in **Blackwatch Energy**. Starting in 2007, Blackwatch's cash flows declined significantly as reduced capital spending in the oil & gas industry put downward pressure on utilization and pricing. As a result, the Company was in breach of its covenants. Deans Knight, along with a major shareholder, provided financing to reduce bank debt and ease covenants. Difficulties in the energy services sector continued to persist and in June 2009, the Noteholders agreed to receive shares at \$0.65 in exchange for their debt and accrued interest. This was one part of a series of steps designed to re-position the Company to take advantage of opportunities available in the service industry. The company also raised \$10 million and appointed a new management team, led by John King as CEO, and Hank Swartout as Chairman to the Board of Directors. The recapitalization of the balance sheet and the new management team's track record had a positive effect on the stock, which ended the month at \$0.97. At quarter's end, we priced our shares in Blackwatch at a 25% discount to its trading price to reflect the fact that we have a requirement to hold stock for at least 4 months. On a bond equivalent basis, this values our investment at \$120 per \$100 par value.