DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK BOND FUND
Quarterly Report

September 30, 2004

Rates of Return

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Bond Fund	**8.5%**	**15.3%**	**22.8%**	**25.0%**	**19.6%**	**10.1%**	**8.9%**	**10.4%**
SCM Universe Bond Index	2.8%	3.9%	4.8%	6.5%	7.2%	7.6%	7.3%	8.7%
ML CDN High Yield (hedged)	4.3%	5.0%	10.2%	22.7%	10.3%	3.5%	2.7%	
ML USD High Yield (unhedged)	4.6%	6.1%	12.4%	20.5%	12.2%	7.3%	6.0%	7.8%

We believe that Government bond yields are too low and hence investors are being far too optimistic about inflation. We doubt that inflation will remain at or below the 2% level in Canada. In our opinion current Government bond yields do not compensate investors for the inflation risks the economy is experiencing. Our strategy is to keep the portfolio term to maturity short to avoid the danger of higher rates and to purchase income producing assets that can benefit from price increases, particularly in commodities. This strategy has been beneficial, for the quarter the DK Bond portfolio provided a return of 8.5% and 15.3% for the year to date period.

What can investors looking for income expect going forward? Over the past 10 years the SCM Universe bond index (primarily Government bonds) provided investors with an annualized return of 8.7%. Ten years ago the starting portfolio yield on the SCM Universe bond index was 8.4%, or about the same level as the 10-year return. Today the SCMU bond yield is 4.4% or half the starting yield 10 years ago. In this environment, the best income opportunities are not going to be in Government bond investments. Income investors should expect to earn only about a 4.5% return going forward, if they hold mainstream bond investments. Our income strategy has always focused on opportunities outside mainstream bonds but we need to look even further.

For example, we feel there are certain income trusts that provide attractive income alternatives. The DK Bond portfolio has about 10% by book value in trust units. We hold a number of oil and gas royalty trust units that we believe offer a better reward versus risk than from bond investments in the same companies. Also, while royalty trusts provide substantial distributions, the unit prices benefit from rising oil and gas prices and this was an important contributor to portfolio return this quarter. The portfolio has investments in three oil and gas trusts; **Harvest Energy**, **Paramount Energy**, and **Vermilion Energy**.

Another way the DK Bond portfolio benefits from income trusts occurs when companies with bonds outstanding convert to a trust. For example, this quarter **Paramount Resources**, a large portfolio holding, announced that the Company is exploring opportunities to trust certain assets. To do this Paramount will likely have to obtain bondholder approval. To get this approval bondholders will likely be offered a substantial consent fee. This news has increased the price of Paramount Resources bonds by 7 to 8% since the announcement September 27th. You may remember last year when Baytex converted to a trust, the DK Bond portfolio received approximately $20 per bond in extra value as a payment for bondholder approval.

Finally, the income trust market is helping in another way. We have been patient with a portfolio holding in **Vicwest Corporation**, a former Onex company that filed for creditor protection in November 2002. Vicwest provides steel for roofing, agriculture and commercial applications. We led the fight for bondholders and creditors ended up with 100% of the equity in the new company. The new Vicwest shares were listed on the TSX in June 2004. Financial results have improved and with no debt the Company generates significant free cash flow. The result is that Vicwest has become an excellent candidate to be an income trust and this has the potential to further increase the value of the shares we hold in the portfolio. The current share value is more than the original cost of the portfolio investment in Vicwest bonds.

Corporate bonds, of course, form the major portion of the portfolio and we continue to maintain a short portfolio term to maturity in order to protect the capital value when interest rates rise. 85% of the bonds in the DK Bond portfolio mature or we expect will be redeemed within 4 years. As these bonds are repaid we should be able to reinvest at higher interest rate levels than today.

Approximately 40% of the assets in the portfolio are denominated in US dollars. During the quarter, the US dollar declined significantly. As in 2003, it is a good time to remind you that we protect the value of US dollar holdings from currency movements with a defensive FX hedging strategy. We do not predict how the currency markets might move; we only use a hedging strategy to take the currency movements out of the equation. As a result, the 5% decline in the US dollar during the quarter did not have a negative impact on the portfolio return.

The most important element from an income portfolio is income itself. The DK Bond portfolio has provided an income return of 7.2% year-to-date; this is an annualized income level of 9.6%. The DK Bond portfolio continues to generate double the yield available on 10-year Government bonds.

As of September 30th the 10 largest holdings were:

	% of Portfolio	
Anchor Lamina Inc.	5.6%	Metal Processor
Sherritt Intl. Corp.	5.5%	Power Producer
Saskatchewan Wheat	5.4%	Agricultural Operations
Scott Paper Ltd.	5.4%	Paper Products
Vicwest Corp.	5.1%	Building & Construction
Call-Net Enterprises	4.4%	Telecommunications
Baytex Energy Ltd.	4.4%	Oil & Gas Production
Gerdau Ameristeel	4.3%	Steel Mini Mills
LionOre Mining Intl.	4.2%	Nickel Mining
Laidlaw Intl. Inc.	4.1%	Transport
Total	**48.4%**	