

**DK BOND FUND**  
**Quarterly Report**

**March 31, 2004**

*Rates of Return*

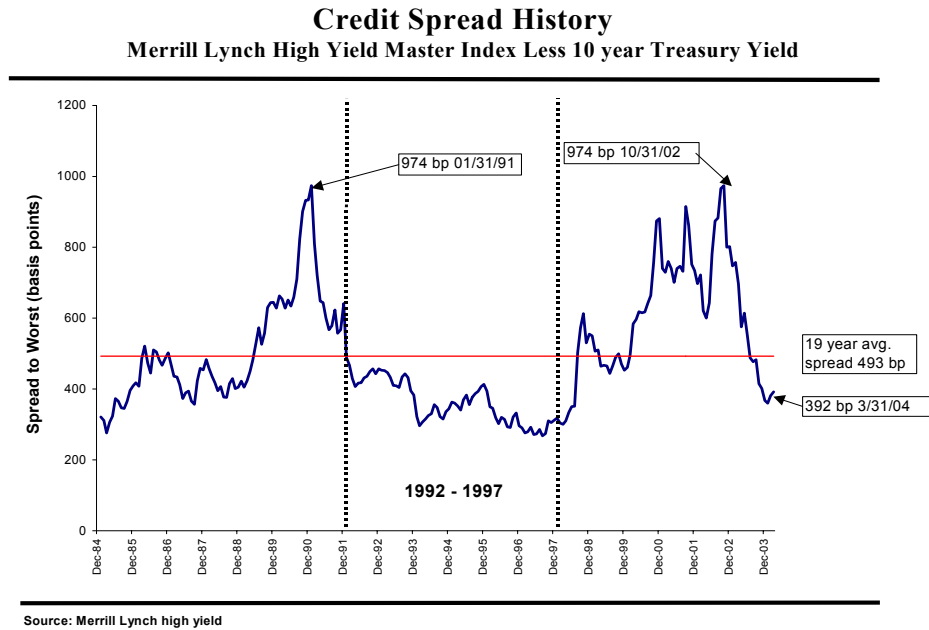
	<u>3 Mths</u>	<u>1 Yr</u>	<u>2 Yrs</u>	<u>3 Yrs</u>	<u>4 Yrs</u>	<u>5 Yrs</u>	<u>10 Yrs</u>
<b>DK Bond Fund</b>	<b>4.5%</b>	<b>26.9%</b>	<b>17.8%</b>	<b>13.7%</b>	<b>8.3%</b>	<b>6.8%</b>	<b>9.8%</b>
SCM Universe Bond Index	3.1%	10.8%	9.9%	8.3%	8.4%	6.9%	8.8%
ML CDN High Yield (hedged)	2.7%	19.6%	10.8%	5.4%	2.9%	2.4%	
ML USD High Yield (unhedged)	2.2%	22.2%	12.4%	8.3%	6.7%	5.1%	7.5%

Portfolio returns in the DKBond fund have been very good in the recent quarter and over the past several years. These superior returns are the result primarily of the narrowing of credit spreads between Government and corporate bonds and declines in interest rates. Interest rates in North America are now at the lowest levels in 40 years. However, we are near the point in the business cycle when pressures for higher interest rates begin to build. For example, in the last business cycle interest rates rose sharply from the low point, by 35% during 1994. This caused negative returns for bonds during 1994; 10-year U.S.Treasuries returned -5.3% and 10-year Canada bonds returned -6.5%.

In the current environment it would be normal for interest rates to increase as the economy strengthens, and as commodity and other prices move higher. In addition, concerns over continuing weakness in the U.S. dollar adds to the pressure for higher interest rates. Our point is simple, we should prepare for higher interest rates.

With this in mind, we are reducing the portfolio's term to maturity. Short term bond prices do not change as much when interest rates change, and more importantly, as these bonds mature over the next several years we will be able to reinvest the proceeds at higher interest rate levels than today. At quarter-end 85% of the bond holdings in the DKBond portfolio were in bonds maturing or expected to be called prior to December 31, 2008 (approximately 4 years).

The following chart shows the movement of credit spreads over the past 20 years. We have discussed in previous reports, the dramatic decline in corporate credit spreads which has been driven by the substantial recovery in corporate bond prices during the past 2 years. Such dramatic reversals are not unprecedented; the previous one occurred in 1991. It is hard to imagine today how high credit spreads were just 18 months ago, and what a great buying opportunity it was for investors.



Today credit spreads are below the 20 year historical average spread. The graph also shows that below average credit spreads can continue for a long period of time as they did in the 6 years 1992 – 1997. Low credit spread levels today, reflect a view that the economy is healthy, with few credit defaults and a new focus by company management on generating free cash flow for balance sheet repair.

## Portfolio Holdings

Narrow credit spreads and low interest rates make certain income trusts look more attractive than bonds. The portfolio holds 9.4% of its book value in income trust assets. For example, in the 18 month period since September 30, 2002, high yield bond prices have increased 31% and the yield has declined by 43%, using the ML USD high yield index. In contrast, we purchased **Timberwest Forest Products** units during the quarter, a very stable business, at \$12.40. This cost price for Timberwest and the level of distribution are exactly the same as 18 months ago.

We also purchased **Menu Foods** income trust, North America's largest private label wet pet food manufacturer; it provides a distribution of 8.6% at portfolio cost.

Some of the shortening of portfolio term we described has occurred naturally. For example; **CP Ships** 10 3/8% due 2012 are callable in 2007. The Company will easily be able to refinance the debt in 2007 at a lower interest cost than 10 3/8% and will do so even if interest rates were to rise. **Sherritt Intl. Corp.** 9 7/8% due 2010 are callable at any time at \$109.875. The capital structure of the Company is complex and we believe Sherritt will put off refinancing these bonds for some time. In the meantime, the portfolio continues to enjoy the benefit of a handsome income return that will not be affected by changes in interest rates.

The DKBond portfolio provided an income distribution of 9% annualized during the first quarter. This is double the yield on the SCMU bond index.

As of March 31<sup>st</sup> the 10 largest holdings were:

	<b>% of Portfolio</b>	
Anchor Lamina Inc.	6.1%	Metal Processor
Alderwoods Group	6.1%	Funeral Services
Saskatchewan Wheat	5.2%	Agricultural Operations
Call-Net Enterprises	4.8%	Telecommunications
Vermilion Energy Trust	4.6%	Energy
CP Ships Limited	4.6%	Transportation
Scott Paper Ltd.	4.5%	Paper Products
Menu Foods	4.3%	Private Label Pet Food
Baytex Energy Ltd.	4.1%	Oil & Gas Production
LionOre Mining Intl.	3.9%	Nickel Mining
<b>Total</b>	<b>48.2%</b>	