

DK EQUITY GROWTH FUND

Quarterly Review

March 31, 2003

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>7 Yrs</u>	<u>10 Yrs</u>
DK Equity Growth Fund	2.8%	14.8%	27.3%	23.9%	20.0%	7.5%	8.2%	16.0%
Nesbitt Burns Small Cap Index (Unweighted)	-6.5%	-18.1%	-2.5%	-6.6%	1.5%	-4.8%	-0.4%	3.6%
S&P/TSX Composite Index	-3.5%	-17.6%	-7.0%	-11.1%	0.6%	-1.9%	5.3%	7.8%

On March 31, 2003 the DK Equity Growth Fund celebrated it's 10th anniversary. We thought it would be of interest to revisit the opening paragraph from our December 1993 quarterly report:

“The big return in 1993 for Toronto stocks reinforces our view that predicting short term stock market moves is a futile task. Think back to what the consensus thinking was in the latter part of 1992. The mood was overwhelmingly negative - - the economic recovery had not taken hold; unemployment was high and showing no signs of declining; the Meech Lake Accord was defeated and the country was facing an uncertain future; the TSE 300 performance had been flat for three years; layoffs by major Canadian companies continued; the Canadian economy was in the midst of a painful restructuring in response to free trade; and the Canadian federal and provincial fiscal problems were approaching crisis proportions. In spite of the massive wall of worry the TSE 300 index had its best rate of return in the past 10 years. The results of 1993 are further evidence that the risk is greater of being out of the market when it goes up, than being in the market when it goes down.”

When we started the fund in March 1993, our objective was, and still is, to provide you with a superior long-term rate of return on your capital. We accomplish this by buying businesses that have a sustainable competitive advantage, a proven track record, a strong balance sheet, and a financially committed management team through ownership (not stock options). Most importantly, we attempt to buy these businesses when we feel the public market is mispricing them in our favour (i.e. causing them to be undervalued). This investment approach requires an investor to be disciplined and focused on the long-term viability of a business. Investors with a short-term focus tend to react to news such as the unemployment rate or quarterly earnings and will then put too high, or too low, a value on a company.

During the first quarter of 2003 there was a fair amount of volatility but there was not much net change in the Canadian and U.S. stock market indices. The two charts below depict the course of the Canadian S&P/TSX and the U.S. S&P 500 indices over the past three years. Both declined roughly 50% from the highs in the year 2000, to the low point of last October. Both indices have bumped along just above the lows since then.

S&P/TSX Composite Index Price History
January 1, 2000 to March 31, 2003



S&P 500 Index Price History
January 1, 2000 to March 31, 2003



There is a lot of “grasping at straws” going on these days in an attempt to explain what has happened to the stock market and what will happen in the future. Blame has been liberally apportioned between greed on Wall Street and greed in the executive offices. The end of all bubble markets is characterized by the search for scapegoats. This one has been no exception. In our opinion, as with all such follies, not enough blame has been placed on the greed on Main Street.

The problem as we see it is that most individual investors and institutional investors have been, and continue to, “play the market”. A read of the business press or a viewing of business television is all the evidence one needs to come to that conclusion. Short-term moves in indices are sensationalized. An endless parade of “professional investors” are prepared to give their views on where the market is headed and why. As if any of them know. As a well-known and wise investor once said:

“Short-term market forecasts are like poison and should be locked up in a safe place away from children and also away from grownups who behave in the market like children.”

-Warren Buffet

It has largely been forgotten that the public stock markets are forums where businesses or portions of businesses are auctioned off on a continual basis. In contrast to this, stock markets have taken on a Casino mentality.

In our opinion, all businesses or portions thereof should be purchased as if they are private companies, and the buyers must live off the profits of the company. The profits of the company, relative to how much was paid for the business determines how successful the investment was. However, in today's information society the success or failure of the investment is determined by a quote machine.

Your author was recently asked to be a pundit on Report on Business T.V. (Webster's defines pundit as "any learned man"). What was significant about the interview was the reporter's singular focus on the War in Iraq and what impact this would have on the future direction of the stock market. In fact, the War has become the main focus of almost all market forecasters since it began officially on March 20th. For obvious reasons, we can understand the interest in the war. However, what we cannot understand is the attempt to use the war as a tool to value a business. That makes no sense whatsoever to us.

Back to market predictions for a moment. There was an interesting piece on this subject that was reported recently by Investech, a U.S. market newsletter. The writer looked at the predictions made by 22 well-known U.S. market experts who appeared on the popular television program Wall Street Week in early 2001 and again in early 2002. They were asked for their predictions on where the Dow Jones Industrial Average and the NASDAQ would finish in each year. In both years, for both indices, every one of the forecasters was too high. We have analyzed and summarized the results below:

	2001		2002	
	<u>DJIA</u>	<u>NASDAQ</u>	<u>DJIA</u>	<u>NASDAQ</u>
Actual Close	10,021	1,950	8,342	1,336
Range of 22 Predictions	11,400 to 13,170	2,250 to 4,600	10,235 to 13,750	1,700 to 2,810
Median of 22 Predictions	12,100	3,010	11,150	2,250
% Median Prediction Above Actual	21%	54%	34%	68%

What lessons are to be learned from this?

- 1) Don't get your investment advice from T.V. or newspapers.
- 2) There are no pundits (learned men) when it comes to market forecasts.
- 3) Only optimists are invited to appear and reappear on T.V. shows and in the popular press.
- 4) Conventional wisdom always prevails on popular T.V. shows and in the popular press. No serious investment thinking is presented.

The number was 5,048.62. It was mid March 2000, when one of the great bubbles of all time popped. It was the NASDAQ close, the value of the "new economy". There have been signs recently that we are seeing the final act of that play. Remember the famous Las Vegas COMDEX trade show? It was the largest technology trade show in the world and at the zenith of the bubble, it attracted hundreds of thousands of visitors. Los Angeles based **Key 3 Media**, the operator, filed for bankruptcy protection in March because of declining attendance. Furthermore in March, news-stands were selling last issues of Red Herring, the magazine that was the voice of the "new

economy”. As U.S. Defense Secretary Donald Rumsfeld was quoted recently *“there are many ideas that are bold, exciting, innovative and new – but also foolish”*.

We have been recommending that investors remain wary of technology and telecommunications companies. We have argued that too much cheap capital was allocated to these sectors in the 1990’s. In March we were reminded of this when **WorldCom** announced it would write-down the value of its assets by \$80 billion. Roughly \$45 billion was worthless goodwill i.e. overpaying for acquisitions. However, \$35 billion was the write-down of hard assets, a 75% reduction. This implies that WorldCom paid \$1 for hard assets that are now worth 25¢. So what about the assets of all the others – **Cisco, Lucent, AT&T, and Nortel**. We still have concerns about the sector’s pricing power in light of the resulting overcapacity. We still do not know the depth of the “telechasm”.

There was not much change in the value of your portfolio in the past three months. On balance, base metals and oil & gas stocks were slightly higher and industrial and consumer type companies were mixed. We are comfortable with most of the valuations in our portfolio. We are also continually looking for new opportunities to buy into good franchises at low valuations, and we are finding some.

As far as the broader market is concerned, we have no view on where the benchmarks are going in the short run. However we suspect that with these benchmarks down 50% from year 2000 levels, it is time for investors to go hunting for companies. The majority of valuations may still not be attractive but the point is there will be more interesting situations now than there were in the late 1990’s.

As of March 31st the portfolio breakdown by industry group stood as follows:

Oil & Gas	32.2%
Metals & Minerals	20.3%
Industrial Products	22.2%
Consumer Products	14.8%
Merchandising	4.3%
Transportation	3.0%
Financial Services	1.5%
Cash & Miscellaneous	1.7%
	<hr/>
	100%