June 30, 2011

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report
June 30, 2011

Rates of Return[1]

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	15 Yrs	Since Inception March 31,1993
DK Equity Growth Fund	**-4.4%**	**0.4%**	**32.3%**	**38.2%**	**7.8%**	**1.4%**	**11.3%**	**21.7%**	**15.3%**	**18.6%**
S&P/TSX Composite Index	-5.1%	0.2%	20.9%	16.3%	0.2%	1.8%	5.7%	8.0%	8.9%	9.7%
S&P 500 (in U.S. Dollars)	0.1%	6.0%	30.7%	22.3%	3.3%	-1.0%	2.9%	2.7%	6.5%	8.1%

In the past three months we have experienced a correction in stock prices. The North American broad market indices peaked in April and have drifted lower since then. The TSX Composite was down as much as 10% and the U.S. S&P 500 was down 7% from the peak in April.

This should not come as a big surprise. Trees don't grow in the sky, and neither do stock prices. We forget that these same indices have gained roughly 75% from the financial panic / great recession lows in the Spring of 2009. Interruptions in this trend are to be expected, and they should not be cause for concern.

As we have pointed out repeatedly in recent reports, there are plenty of things to worry about. This most recent decline in values is the result of growing concern that the U.S. economic recovery is slowing down (it is); that China's growth is slowing (it must); and that Greece's debt woes will wreak havoc on the European banks (more liquidity will be thrown at the problem to push the inevitable default further away).

It is fortunate that two of our major holdings received all cash takeover bids this year (**Mantra Resources** and **Peak Energy Services**). Both transactions have settled recently. The timing is good. It provides the portfolio with liquidity, which can now be used to purchase additional shares of some of our investee companies, at these more attractive valuations.

Remember that wise advice *"look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it"*, and *"be fearful when others are greedy and be greedy when others are fearful"*.

[1] Returns longer than one year are annualized gross of management fees.

Are others fearful? You bet they are. Looking at the most recent U.S. investor sentiment indices, we see that bullish sentiment at mid June stood at 29%. This is the 9th consecutive week that it has been below its historical average of 39%. Bearish sentiment stood at 43%, the 16th time in 17 weeks it has been above the historical average of 30%. Our advice . . . don't join the crowd. It is always better to go against the crowd.

As we mentioned earlier, a matter of great concern to markets is economic growth . . . U.S. . . . China . . . global. The market worries that U.S. and global economic growth will fall below 3%. It worries that China will slow from 10% to 6%. Few ever ask . . . is it possible, or is it conceivable, that global growth can be sustained at 3% annually . . . or China at 10%? In his April newsletter, noted market commentator Jeremy Grantham helps keep compound growth in a more reasonable perspective. In the letter, he refers to a talk he gave four years ago to a group of PhD's in mathematics. He referred to the growth rate of the global economy in the previous two years, which had been 4.5%, and pointed to the *"ludicrous unsustainability"* of this compound growth.

Grantham went on to the example of the Ancient Egyptians, whose culture endured for roughly 3,000 years. To simplify the issue, he assumed that each Egyptian started with 1 cubic meter of physical possessions, He then asked his audience how much physical wealth they would have 3,000 years later at a 4.5% compounded growth rate. Not one of the quants came within one billionth of 1% of the actual number, which is 10^{57}, a number so big it could not be squeezed into a billion of our solar systems. Even if you drop the growth rate to 1%, there would be nowhere to put the people and the wealth.

In our opinion, investors are far too concerned about the rate of economic growth. It is not within our control and, more importantly, changes in growth do not have any impact on long term creation of value. Value can be created for shareholders in a contracting economic environment, in a no growth environment, a slow growth environment, or a rapid growth environment. What determines value creation is the competitiveness of the business we own. In a no growth or a contracting economic environment, a company can grow shareholder value by taking business from competitors or creating new avenues of revenue. Conversely, companies can destroy value in a rapidly expanding economy by losing business to competitors.

Keeping matters in a reasonable and simple perspective is essential to making sound investment decisions. Another example . . . June 23rd, the International Energy Agency (IEA) surprised the market by hastily calling a press conference. They announced that their 28 member countries would release 60 million barrels of oil into the market from their collective strategic reserves over the next month in an effort to make oil more affordable. Immediately, the price of crude fell by $5. Yes, 60 million barrels sounds like a heck of a lot of oil, but when you consider that the world consumes 85 million barrels per day, it represents 17 hours of oil consumption. Put in this perspective, it seems hardly enough to dampen the long term price of oil. If the IEA would like to see lower oil prices, then produce more oil. Perhaps the member countries do not have the capacity to do so.

Moreover, this is not the first time the IEA has taken such action. The IEA members released 60 mm barrels in September 2005. The price of crude at the time was $58 per barrel. Today it is $95. So much for the IEA's impact.

Also, on June 23rd, came a report that Saudi Arabia's (the largest oil producer in the world) growing domestic demand for energy is steadily reducing the amount of oil available for export, and driving the kingdom's interest in nuclear power. By some estimates, if the Saudi's growth in energy consumption continues at current rates, there will be very little oil left for export in 20 years.

There has been considerable concern about commodities in general in the past three months. Was the rise in commodity prices a bubble in the past 2 years? Is there a major correction underway? Doubtful. Tom Albanese, the CEO of Rio Tinto summed up the outlook for metals in his address at the Company's annual general meeting in London on April 14th. He stated, *"for too long, our industry underinvested in its future. It did not do enough exploration, it did not train enough people, and it did not build enough capacity to satisfy the surge in demand!"* He went on to point out that over the next 30 years it is projected that the world will consume as much copper as it has over the last 10,000 years. The rise in the price of copper, like other base metals, is the result of capacity constraints. It is not a speculative bubble.