DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK EQUITY GROWTH FUND

Quarterly Review
September 30, 2005

Rates of Return[1]

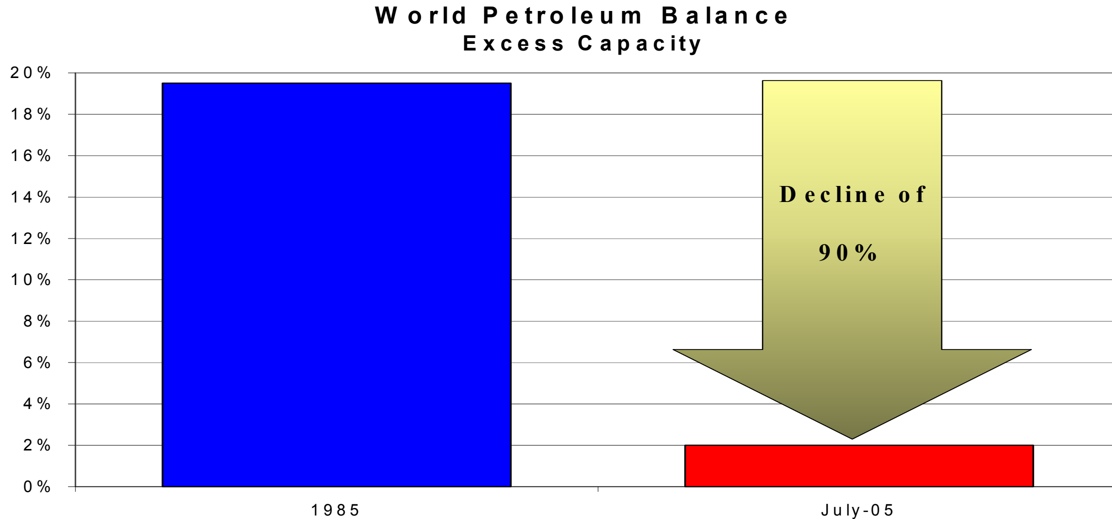
	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Equity Growth Fund	**23.1%**	**37.1%**	**50.2%**	**46.6%**	**47.1%**	**46.3%**	**36.1%**	**20.2%**
Nesbitt Burns Small Cap Index (Unweighted)	8.6%	9.0%	19.4%	19.4%	26.2%	20.6%	9.1%	7.8%
S&P/TSX Composite Index	11.6%	20.7%	29.3%	24.0%	23.5%	14.7%	3.0%	11.2%
DJIA	3.4%	-0.3%	7.2%	9.1%	14.2%	6.8%	1.9%	10.3%
S&P 500	3.6%	2.8%	12.3%	13.1%	16.7%	6.0%	-1.5%	9.5%

Oil again dominated the market's attention in the third quarter of this year. In the wake of Hurricane Katrina, crude oil (WTI) reached a record price of $70.50 per barrel and natural gas in the wake of Hurricane Rita traded to a record high of $14.50 per mcf. In the case of both hurricanes a significant amount of oil and gas production and transportation in the Gulf of Mexico was knocked out. It may in fact be months before the extent of the damage can be completely assessed and production restored. To put these oil and gas prices in perspective, the table below shows the average annual price for crude oil (WTI) and natural gas over the past 7 years.

	1998	1999	2000	2001	2002	2003	2004
Crude Oil (WTI $ per barrel)	$14.40	$19.27	$30.37	$25.96	$26.14	$31.06	$41.47
Natural Gas (Henry Hub $ per mcf)	$2.08	$2.27	$4.30	$3.96	$3.37	$5.49	$5.90

It is important to recognize the distinct and accelerating uptrend in average annual prices. There is such total focus in the press about the hurricanes and their importance regarding high energy prices that most people are ignoring important information. Although the damage to facilities in the Gulf of Mexico and the adjoining states is impacting oil and gas prices, it would not be so if we currently had substantial excess capacity to produce these commodities. In our opinion, which has been oft stated on these pages, the underlying reason for the distinct uptrend in oil and gas prices over the last 6 years has been the gradual erosion of excess capacity in the world over the past twenty years. The bar chart below shows that estimated excess capacity as a percentage of the annual oil consumption has declined from a level of close to 20% in 1985 to a less than 2% today.

[1] Returns longer than one year are annualized.



We believe that the majority of this limited current excess capacity is in Saudi Arabia. This however remains uncertain, as the Saudis do not provide the information we need, nor do they allow independent audit of their production and reservoirs. Matt Simmons, a respected Houston-based expert on the world oil and gas industry, recently published a book on the subject entitled: “Twilight in the Desert – the Coming Saudi Oil Shock and the World Economy”. In the book he postulates that Saudi production may already have reached the natural peak that all oil reservoirs eventually reach, and may soon begin an irreversible period of decline. If you really want to frighten yourself, then read “The Long Emergency – Surviving the Converging Catastrophes of the Twenty-First Century”, by James Howard Kunstler. In his book he argues that the western world way of life has been built on artificially cheap oil. With the peaking of global production, prices will rise and significantly alter the way we live.

The point of all this is to reinforce to our readers the very important message, that high energy prices are not the result of hurricanes. They are the result of steadily declining excess productive capacity butting against global demand that has been growing at an average annual rate of about 1½% over the past 20 years. The optimum case scenario is that prices of oil and natural gas will rise, or perhaps they already have, to a level that will gradually destroy some demand, and place the market in better demand/supply balance. This could allow time to discover, develop, and bring on additional supplies, and to develop additional sources of energy. The worst case scenario is a further spiking of prices which could trigger substantial damage to the world economy.

What has all this meant to our investment strategy in the past, and where does this lead us in the future? Well, the past is obvious. Since the low point of oil prices in late 1998, we have realized huge profits from the investments in oil and gas companies that we made seven years ago. Remember, we were making these investments during the technology mania when most investors believed that oil was an old economy industry, and not worthy of attention. They forgot that among other things, the massive growth in the use of personal computers was the single most important factor in driving the growth for electricity in the western world in the late 1990s . . . and roughly 30% of electricity in the U.S. is produced by burning natural gas.

Since 1998 oil and gas companies have gone from representing only 8% of the TSX Composite index to roughly 25% today. As a consequence of this, and the huge returns that have been made, investors are now drawn to oil and gas companies like "moths to a fire". In many cases they are overpaying for companies and they will get burned. We are not exiting the oil and gas business entirely just yet, but we are gradually (and we stress gradually) reducing certain positions.

What are we looking for now? The glib answer is . . . for any business that we can understand, and that we believe we can purchase cheaply. If we look back at our 14 years investing for clients, it is clear to us that the majority of our profits have been made this way . . . oil & gas, base metals, lock and key companies, healthcare companies, steel, truck companies, forest products, auto parts, etc. . . . all when they were out of favour with the "voting machine" (i.e. the stock market).

If you look closely at your portfolio you will notice that some out of favour companies have begun to appear (again, we stress gradually). **Menu Foods** is the largest manufacturer of private label wet pet food in North America. It is structured as an income trust and has had to cut its distribution twice in 2005 due to short term business issues. The Company has fallen out of favour with portfolio managers holding Menu for its income stream and created a large sell off in the units. This has created a buying opportunity for those of us who want to own the Company for its strong franchise value and who believe that current problems will eventually be resolved. **CAE Inc.** manufactures flight simulators and provides flight simulator training. The Company was unpopular for some time after the fallout of the 9/11 terrorist attacks and the slump in the airline and business jet industries. However the Company has paid down debt, sold non core businesses, and its key business units are showing signs of improvement. **Emergis Inc.** is a technology company born out of the old parent company, BCE Inc. At present the technology sector is out of favour with most investors. Since the collapse of the technology sector in 2001, investment capital has been slow to return. However, Emergis is a cash flow positive company focused on strong margin business and the bottom line. **Linamar Corporation** designs and manufactures machined components for the automotive and aerial lift industries. The Company's stock has been out of favour recently because it is associated with two unpopular sectors; the North American automotive industry and Canadian manufacturing. However, the difficulties in these sectors have been opportunities for Linamar as they have shown an ability to remain healthy and expand while others struggle.

The pace at which we move is dependent on the availability of investments that qualify and the availability of stock. The key message to our clients is that patience is the most important trait for the successful long term investor. It took a long time to realize the value from the investments we made in the late 1990's, and that made us look good today. Moving as we are now, with some new deep value situations, it again may take some time to surface the value that we believe is there.

As of September 30th, the portfolio breakdown by industry group stood as follows:

Energy	47.5%
Base Metals & Minerals	20.6%
Industrials	20.0%
Consumer Discretionary	5.7%
Information Technology	2.8%
Utilities	1.4%
Other Materials	1.1%
Precious Metals	0.5%
Cash & Miscellaneous	0.4%
	100%

As of September 30th, the 10 largest equity holdings were:

Paladin Resources	6.9%	Uranium Mining
CAE Inc.	5.7%	Aerospace Equipment & Services
Petrobank Energy & Resource	5.7%	Oil & Gas
Mahalo Energy	5.2%	Oil & Gas
Kereco Energy Ltd.	5.2%	Oil & Gas
Paramount Resources Ltd.	4.9%	Oil & Gas
West Energy Ltd.	4.6%	Oil & Gas
LionOre Mining International	4.5%	Nickel Mining
Kagara Zinc Ltd.	4.3%	Zinc Mining
Clear Energy Inc.	4.2%	Oil & Gas
	51.2%	