September 30, 2008

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Review

September 30, 2008

Rates of Return[1]

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	Since Inception March 31,1993
DK Equity Growth Fund	**-23.3%**	**-26.7%**	**-32.6%**	**-1.8%**	**4.7%**	**14.6%**	**19.8%**	**21.3%**	**18.5%**
S&P/TSX Composite Index	-18.2%	-13.3%	-14.4%	2.5%	4.7%	10.4%	12.0%	9.7%	10.1%
DJIA (in U.S.Dollars)	-3.7%	-16.6%	-19.9%	-1.2%	3.3%	4.3%	5.6%	5.4%	10.0%
S&P 500 (in U.S.Dollars)	-8.4%	-19.3%	-22.0%	-4.7%	0.2%	3.1%	5.2%	3.1%	8.3%

The events that have unfolded in this most recent calendar quarter are unprecedented. A friend aptly remarked recently that this bear market is "stranger than fiction". The bursting of the U.S. housing bubble has essentially brought the global financial system to its knees and has resulted in the biggest restructuring of the U.S. financial system since the 1930's. Let us review what has recently transpired, most of it in the month of September alone. In September, seven of the largest financial organizations in America failed . . . bankrupt, rescued by the government, or taken over by stronger partners. On September 7th, Fannie Mae (The Federal National Mortgage Association) and Freddie Mac (The Federal Home Loan Mortgage Corporation), were put under conservatorship, a.k.a. ~ they were taken over by the U.S. Government. On September 14th, Merrill Lynch, the world's largest investment bank, was acquired by Bank of America. On September 15th, Lehman Brothers, the 4th largest U.S. investment bank, filed for bankruptcy in the largest corporate bankruptcy in history. On September 16th, the Federal Reserve announced that the U.S. Government would provide an $85 billion emergency loan to AIG, the world's largest insurance company, in exchange for a 79.9% equity stake in AIG. On September 25th, Washington Mutual, the largest savings and loan in the U.S., and the largest bank failure in U.S. history, was seized by U.S. bank regulators and then sold to J. P. Morgan. On September 29th, Citicorp made a bid to take over the weakened Wachovia Corporation, the fourth largest U.S. bank, only to be trumped by a higher bid from Wells Fargo on October 3rd. Furthermore, after much wrangling in the Senate and the House of Representatives, U.S. lawmakers, on October 3rd, passed a $700 billion package giving the U.S. Treasury the power to acquire troubled debt securities from financial institutions.

[1] Returns longer than one year are annualized.

Following suit, in late September European governments jumped into the frey with measures to provide support to weakened financial institutions. The stumbling block in Europe is the lack of unison among governments in support of a pan-European program similar to that passed in the U.S. The governments of Ireland and Greece unilaterally announced that they will guarantee all bank deposits. In Great Britain, Lloyds Bank agreed to acquire the weakened Halifax Bank of Scotland (HBOS), and the government nationalized Bradford & Bingley, one of Britain's largest mortgage lenders. The German government proposed a state-led rescue program for the mammoth real estate lender Hypo Real Estate. Belgium's two largest banks, Dexia and Fortis, were rescued by government packages.

Furthermore, in the last week of September, the U.S. Federal Reserve granted a request from the country's last two major investment banks, Goldman Sachs and Morgan Stanley, to change their status to bank holding companies. Both companies had been under enormous pressure since the bankruptcy filing of Lehman Brothers. This now puts both directly under the regulatory supervision of the U.S. Central Bank. Morgan Stanley subsequently raised capital by selling a 21% interest to Mitsubishi Financial Group for $9 billion. Goldman announced that it had done a deal to sell $5 billion of 10% perpetual preferred stock to Warren Buffet's Berkshire Hathaway. In addition, Berkshire received warrants to purchase an additional $5 billion of common stock, exercisable for five years. Buffett followed up his Goldman deal with a similar $3 billion deal with General Electric, the largest non-bank financial company in the U.S. G.E.'s stock had been down 49% from this year's high, amid concerns about the health of its finance arm, G.E. Capital.

As a consequence of these unsettling events, combined with an increased likelihood of a U.S. recession and global economic slowdown, global stock markets have slid deeper into bear market territory since our last report. The accepted definition of a bear market is a greater than 20% correction in the broadly based S & P 500 index.

	High	Close September 30, 2008	% Change
S & P 500	1,565.15 (Sept. 10/07)	1,164.71	-25.6%
Dow Jones Industrial	14,164.53 (Sept. 10/07)	10,850.66	-23.4%
S&P/TSX (Toronto)	15,073.13 (Jun. 18/08)	11,752.90	-22.0%

Amid all of the unprecedented developments, it is critically important for our clients to remember that financial booms and busts are not as abnormal as the media lead you to believe.

Over the past 100 years we have had 20 bear markets . . . on average, a bear market every five years. The last bear market was from March 2000 until November 2002, when the S & P 500 declined by roughly 45% - one of the biggest bear markets in U.S. history, caused by the bursting of the technology bubble, and exacerbated by the terrorist attacks of September 11, 2001. As a result, the U.S. economy shrank in Q3 2000, Q1 2001, and Q3 2001. To help us all to keep what is happening in a historical perspective, we have included the following table which shows the S & P bull and bear markets from 1914 until 2007.

S&P Composite Price Index Bull and Bear Markets 1914-2007*

	Market Top	Index High	% Increase	Market Bottom	Index Bottom	% Decrease
**	10/09/2007	1565.15	101%	??	??	??
**	03/24/2000	1527.46	59.6%	10/09/2002	776.76	-49.1%
	07/17/1998	1190.58	304.3%	10/08/1998	957.28	-19.6%
	07/16/1990	369.78	67.1%	10/17/1990	294.51	-20.4%
	08/25/1987	337.89	233.1%	12/04/1987	221.24	-34.5%
	11/28/1980	140.52	61.7%	08/12/1982	101.44	-27.8%
	09/21/1976	107.83	73.1%	03/06/1978	86.90	-19.4%
	01/05/1973	119.87	73.0%	10/03/1974	62.28	-48.0%
	11/29/1968	108.37	48.0%	05/26/1970	69.29	-36.1%
	02/09/1966	94.06	79.8%	10/07/1966	73.20	-22.2%
	12/12/1961	72.64	86.4%	06/26/1962	52.32	-28.0%
	08/02/1956	49.75	267.2%	10/22/1957	38.98	-21.6%
	05/29/1946	19.25	157.7%	06/13/1949	13.55	-29.6%
	11/09/1938	13.79	62.2%	04/28/1942	7.47	-45.8%
	03/10/1937	18.68	131.8%	03/31/1938	8.50	-54.5%
	07/18/1933	12.20	120.6%	03/14/1935	8.06	-33.9%
	09/07/1932	9.31	111.1%	02/27/1933	5.53	-40.6%
	09/07/1929	31.86	408.9%	07/08/1932	4.41	-86.2%
	07/16/1919	9.64	60.7%	08/24/1921	6.26	-35.1%
	11/20/1916	10.55	59.1%	12/19/1917	6.00	-43.1%
				October 1914	6.63	-37.5%

*Source: **Bull and Bear Markets, Past and Present**: Dr. Brian Taylor, President, Global Financial Data, Inc.
**Updated by Deans Knight Capital Management Ltd.

Length of the bear markets:	2 months - 3 years
Decline of the bear markets:	down 20% - down 86.2%
Length of bull markets:	2 months – 8 years
Increase of bull markets:	up 48% - up 408%

What do we learn from the data? Bear markets are normal recurring events. They are a characteristic of the boom / bust nature of a free market system. Most importantly, bull markets typically last longer than bear markets and the rise in value in the bull market, in almost all cases, dwarfs the decline of the preceding bear market.

Why don't we sell our stocks before each bear market and buy back before the start of the next bull market? The simple answer is we cannot predict the onset of either bear or bull markets. Moreover, we have never found anybody else that can either. Why is it so difficult? Making matters difficult is the fact that all bear markets have their origins during periods of widespread optimism. Conversely, all bull markets have their origins in periods of excessive pessimism. We have referred many times to Nassim Taleb's 2007 book, The Black Swan. In the book he writes about the "scandal of prediction" "where mankind is demonstrably arrogant about what we know". In most cases we simply don't know.

What we do know is that we are in a bear market. What we don't know is how low prices will go and when it will end. Do we sell stocks now? As the late Paul Newman, famous actor and skilled race car driver once said, "It's useless to put the brakes on when you're upside down". We are upside down.

For additional perspective on where we are, we recommend watching the one hour conversation on October 1st between Warren Buffet and Charlie Rose (Google CharlieRose.com). Buffett admits that he cannot predict the short term movements of the stock market. However he does suggest that the U.S. economy will be larger 10 years from now, and stock prices higher, than it is today, and that it will be larger 20 years from now, and stock prices higher, than 10 years from now. He also points out that during the 20th century, the U.S. economy grew 7-fold . . . in spite of two world wars, a great depression, a flu epidemic, and countless recessions.

It would be nice to be completely out of stocks in a bear market. However by the time a bear market is actually declared (i.e. down 20%), a typical bear market is more than half over. We often hear stories of the guy who sold right at the top. What we don't hear are the stories of the masses who sold months or years before the top and missed a big part of the upside. Nor do we hear the stories of how many stayed in cash during the ensuing bull market and bought near the top.

If bull markets have their origins during periods of excessive pessimism, then what is the catalyst that changes the mood of investors, and when does it change? We do not have those answers. What we do know is that investible cash is needed. In that regard, a mountain of cash (buying power) is piling upon the sidelines. In Canada alone, between August 2007 and August 2008 money market fund assets grew by $24.5 billion or 50.8%. In the U.S. over the same period, money market assets increased $744 billion, or 27%. Moreover, according to a recent report by J.P. Morgan, emerging economy central bank reserves rose $1.4 trillion over the past year; global savings accounts rose 65% over the past 4 years; more than 50% of equity managers have overweight cash positions; net credit balances in NYSE cash and margin accounts stand at roughly $150 billion; S & P 500 technology, healthcare, consumer and industrial companies cash balances are at 10 year highs; and short interest on the NYSE is at its highest level since 1976.

As we write this report it is abundantly clear that the process of global deleveraging is well underway. This process is resulting in the forced liquidation and panic liquidation of securities. When holders of securities are compelled to sell, they sell regardless of valuation.

None of us know when this forced liquidation will end. However, we do know that it will. If we enter a global recession, we do know that too will end. When forced liquidation and panic selling take hold, it is critical to remain objective and not be tempted to join in the herd behavior. This is much like passing a kidney stone. We know it will pass, but it sure is painful on the way through.

We are not trying to make light of a serious and difficult situation, but what we are witnessing, is the necessary adjustment process following a period of excessive speculation in housing prices in the U.S. and Europe. As a learned client of ours wrote recently, that although the financial collapse in the U.S. has been "breathtaking and frightening", it is part of the remarkably rapid adjustment process going on within the U.S. economic and financial system. Furthermore, the U.S. Fed and

the U.S. Treasury have reacted proactively, and although their plan may not be perfect, they are moving in the right direction.

In light of the events of the most recent quarter and the stress that is evident in the global financial system, we have reviewed each of our investments to assess how the business and its valuation will be impacted by a slower economy and whether any of our portfolio companies will require new capital to execute their business plan. We believe the companies in our portfolio are well positioned to deliver on their business plans, regardless of market sentiment.