December 31, 2010

DK EQUITY GROWTH FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Review
December 31, 2010

Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	15 Yrs	Since Inception March 31,1993
DK Equity Growth Fund	**24.1%**	**39.5%**	**49.7%**	**6.1%**	**5.1%**	**13.9%**	**24.6%**	**17.3%**	**19.2%**
S&P/TSX Composite Index	9.4%	17.6%	26.0%	2.1%	4.0%	6.5%	6.6%	9.5%	10.0%
S&P 500 (in U.S. Dollars)	10.8%	15.1%	20.6%	-2.9%	-0.8%	2.3%	1.4%	6.8%	8.0%

It has been an interesting few years to say the least. It seemed stranger than fiction in many respects as we lived it. However, when we look back now at the financial panic of 2008, the resulting recession, and the subsequent recovery, it is simply history repeating itself just one more time.

As our regular readers know well, we strive constantly to cut through the noise, and to keep things as simple as we can. With that in mind, in our September 2008 report we wrote that prior to this past bear market, there had been 20 bear markets in the previous 100 years. Following each of these 20 bear markets there were 20 recoveries. Surprise! History repeated itself following this 21st bear market.

In this 21st bear market the broad market indices in North America declined sharply and then bounced back over the ensuing two years.

	Peak	Low	% Decline	Dec. 31/10	% below Peak
TSX Composite	15,073.13 (18Jun08)	7,566.94 (09Mar09)	49.8%	13,443.41	10.8%
Dow Jones	14,164.53 (10Sep07)	6,547.05 (05Mar09)	53.8%	11,577.51	18.3%
S&P 500	1,565.65 (10Sep07)	676.53 (03Mar09)	56.8%	1,257.64	19.6%

The broad indices have not yet fully regained all the ground that was lost. However, if history is a guide to the future, in each of the 20 previous bear markets, in the ensuing recovery, the indices reached levels significantly above previous peaks.

[1] Returns longer than one year are annualized.

Moreover, as we wrote in our September 2010 report, in our opinion most companies, including our own investee companies, are stronger today than they were prior to the recession. Debt levels are lower, cost structures are lower, and earnings are better.

Is it likely following this, the 21st bear market in the past 100 years, that broad market indices will surpass their previous peaks? We do not make forecasts. However, suffice it to say it would be very unusual if these indices do not surpass their 2007/08 peak levels. As a famous investor accurately said, *"it is not difficult to tell what will happen, but it is very difficult to tell when it will happen"*.

Much has been made of this "great recession" by the media over the past few years. If you had followed the media pundits you would have concluded that the world had come to an end; that global economic growth would never resume; that consumers would never again open their wallets; and that company valuations would never recover.

Well, it didn't turn out that way. Not even close. This past year, as a matter of fact, turned out to be a surprisingly good year for the economy. In spite of all the bogey men . . . excessive government debt . . . the eurozone crises . . . the struggles of the PIGS (Portugal, Ireland, Greece, and Spain) . . . the concerns about double dip recessions . . . threatened trade war . . . guess what happened? Global GDP has risen by close to 5%, well above its long-term trend rate, and well above forecasts of one year ago. Global industrial output is now higher than it was in 2007. Even the left-for-dead U.S. consumer is alive and well. American shoppers are splurging again as though it is 2007. According to preliminary retail data released just after Christmas, U.S. shoppers spent more money this holiday season than before the recession. Moreover, world oil demand, which contracted during the recession, has rebounded to 87.4 million barrels per day[2], an all time high and roughly 100,000 bpd higher than 2007.

Well if the global numbers are good, why is the mood in the world's largest economy, the U.S., so gloomy? Why is there so much commentary regarding America's supposed failings relative to the rest of the world? When you examine matters more closely, the answer is not so much that the U.S. has been failing, but rather it is a matter of other regions of the world catching up. At the end of WWII, the U.S. accounted for roughly 50% of total global output; twice what it is now. This is in spite of the fact that the U.S. GDP grew an average of 3.3% per annum. Why did the U.S. lose ground on a relative basis? Because most of the rest of the world was in ruins at the end of WWII.

If you believed the media reports, and most do, you would think the U.S. economy performed disastrously over the past few years. Well, as it turns out, the U.S. economic growth was at worst flat, and at best, sluggish. Can you imagine the media reaction if it had actually contracted over these years?

	U.S. GDP	
2006	$13.4 trillion	
2007	$14.1 trillion	
2008	$14.4 trillion	
2009	$14.1 trillion	(the recession)
2010	$14.6 trillion	

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2 IEA Oil Market Report ~ December 10, 2010

It feels bad because the U.S. is showing statistical growth, but much slower growth than the 3.3% average since 1945. Growth in the 0-3% range feels lousy, much the same as it did in the 1970's.

Moreover, it also feels lousy because this economic recovery in the U.S. has been so far, a jobless one, with the national unemployment rate stuck at 9.4%, not far below the recession peak of 10.2%. Why has unemployment remained high, even though the recession officially ended in mid 2009? In our opinion the answer is twofold. Firstly, businesses in this recession, to a greater extent than in previous recessions, slashed costs and repaired their balance sheets. This has meant operating their businesses with fewer people. That said, as revenues increase going forward, businesses will be compelled to increase employment. Secondly, every economic study known to mankind clearly shows the majority of those employed in North America are employed by small businesses. Furthermore, almost all new jobs are created by small businesses, not big companies, and not government. U.S. small businesses were especially hit hard by this recession, and new job formation by small business has been sluggish to recover. This too will change. The extension of the Bush tax cuts will be a powerful incentive in that regard. The "rich" that the Democrats rail against, that benefit from the tax cut, are the small business owners. The cuts put more money in the hands of these entrepreneurs, and boost confidence. This, plus the payroll tax cut will begin to kick start job formation and consumer spending.

There were two new significant developments in the portfolio over the past few months. Firstly, we received an all cash friendly takeover bid of $8 per share for our holdings in **Mantra Resources** (8.1% of the portfolio). The bidder is the Russian Government controlled uranium company, ARMZ. Mantra, as you will recall, is developing a very large, low cost uranium deposit in Tanzania. On behalf of our clients we control 11.7% of the outstanding shares. We believe $8 represents a fair price and are prepared to accept this offer. That said, this transaction will not close for a few months and there exists the possibility that other parties may become interested and submit a competing bid. We intend to hold onto our shares until closing.

The other development was an investment that we made in **Northland Resources** (3.7% of the portfolio). Northland Resources is an iron ore exploration and development company focused on developing its Kaunisvaara Mine in Sweden. This mine will begin production in 2013 and ramp up to its full capacity of 5 million tonnes per year by 2015. It will produce an iron concentrate among the world's highest grade and lowest impurity levels. Thus Northland will benefit from a 25% price premium over its lower grade competitors. While we can't predict the price of iron ore in 2013, we believe the growing demand for steel by the Chinese will help support pricing. At today's prices this company would produce about $500 million in annual cash flow. If prices happen to drop to 2008 lows this company could still produce nearly $300 million in cash flow. We began purchasing Northland at a market capitalization of $510 million.

We have been satisfied with the annualized return that we have provided our clients over the past 18 years. That said, not all of our investments have been successful. In December, we wrote down the value of our investment in **Altus Energy Services** to zero. Altus is a private company that provides a broad range of services, primarily to the oil and gas industry in Northern Alberta (construction and maintenance of storage tanks, tank and pipeline coating services, field construction, and equipment rental). We made a relatively small investment in Altus in 2006. We felt that we had a good understanding of the business because we have owned a variety of service companies over the years.

Altus, however, got caught in the slowdown in activity and spending in the oil patch following the decline in oil prices from the peak of roughly $140 per barrel in mid 2008 to a low of just over $30 per barrel in late 2008. Revenues contracted, cash flow went negative, and their bankers pressured them to repay their loans. On December 21st, Altus applied for protection under the Companies' Creditor Arrangement Act to provide for an orderly restructuring of the Company. In our opinion, it is unlikely that we will receive any value for our shares.