DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK BOND FUND

Quarterly Report
September 30, 2005

Rates of Return[1]

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Bond Fund	**6.1%**	**17.9%**	**28.4%**	**25.6%**	**26.1%**	**21.7%**	**13.6%**	**11.4%**
SCM Universe Bond Index	0.1%	5.7%	9.0%	6.9%	7.3%	7.6%	7.9%	8.2%
ML CDN High Yield (hedged)	-0.5%	-0.5%	3.8%	7.0%	16.0%	8.7%	3.5%	
ML USD High Yield (unhedged)	0.9%	2.1%	6.7%	9.5%	15.7%	10.8%	7.2%	6.9%

We have learned it is pointless for bondholders to worry too much about macro things like the economy, hurricanes, or energy prices and the impact they will have on bond rates and prices. While all these influences are important, they are not predictable. Instead for the DK income portfolio, we focus on looking for undervalued income opportunities, and this is the reason DK portfolio returns are much higher than bond index returns, particularly over the past 5 years.

We have tried to think more creatively about generating income since few traditional bonds are attractively priced now that interest rate levels are at 50 year lows. We only invest when we feel confident we are getting an income return that adequately compensates us for the risk. As a result we have portfolio holdings in income trusts like **Harvest Energy** and **Vicwest Corp**. We look for short duration or callable bonds that are out of favour, like **Call-Net $10^5/_8$%** (redeemed in August) and **Sask Wheat Pool 12.0%** bonds callable in January 2006. We hold convertible bonds that pay income and include an equity kicker like **Progress Energy 6.75%** convertible debentures. We are active in short term Bridge loans like **Dollarama Group LP**. The Dollarama Bridge loan was repaid in August and this holding generated an annualized return of over 13% for the portfolio. These holdings as a group provide an attractive alternative to straight bonds and have generated roughly ⅔'s of the DK portfolio return this year. Our goal is to generate an income return in the DK portfolio of 8% and we can only achieve this by finding undervalued income opportunities. Earning 8% is double the income yield available on the SCM Universe bond index currently at 4%.

Portfolio holdings with "equity kickers" benefited the fund this quarter. Progress Energy 6.75% convertible bonds increased by $10 (10%) during the quarter reflecting the increase in the underlying stock and energy prices. In 2003 when **Petrobank Energy** issued additional bonds by adding to the **9%** bonds due July 31, 2006, they also provide bond purchasers with

[1] Returns longer than one year are annualized.

equity warrants as a sweetener. Our bond purchase price in 2003 was $93 providing an income return of 9.7%, and we received 7 warrants per $100 bond to purchase Petrobank stock at $4 until July 31, 2006. Petrobank's stock price increased significantly during the 3rd quarter putting these warrants in the money and adding about $35 in value for each $100 bond we had purchased in 2003. This is a welcome surprise on an investment we made 2 1/2 years ago.

Cash has been building in the portfolio and is currently at 10%. During the second quarter 8% of portfolio holdings were called for redemption and during the third quarter 9% of portfolio holdings were called for redemption. This quarter **Rogers Communications,** which purchased Call-Net early this year, announced they were calling the Call-Net $10^5/_8$% bonds at $107.11 for September 17th; the original portfolio cost was $90. **Dollarama LP** repaid the Bridge loan during the 3rd quarter with proceeds from a longer term bond financing that we also participated in. We intend to be patient with our cash and only deploy cash reserves when we find the right opportunities.

On September 8th, the Minister of Finance released a consultation paper regarding the tax leakage due to the proliferation of the income trust sector. The Government is very concerned about tax leakage, but must balance this with the responsibility to protect the health of the Trust sector that is now $180 billion in size. How the Government will proceed is uncertain and the timeline is unknown. The impact of new policy will be significant and this potential negative will be a cloud over the Trust sector for some time. This uncertainty does not change our strategy. We purchase income trust holdings because we like the business and the industry and we want to participate in the earnings of the company. For example, our two largest income trust holdings substantially increased their unit distributions during the 3rd quarter because the business climate for both companies is much improved. **Harvest Energy** increased the unit distribution in the last quarter by 40% and **Vicwest** increased unit distributions by 20%. We note that any changes to tax policy will have no impact on how well these companies operate and will only affect the amount paid out. Growth in distributable cash in the companies we hold will help offset the potential negative impact from Government policy.

Outlook

We continue to look for interesting income ideas. We do not think 10 year Government of Canada bond yields below 4% today, compensate investors fairly for the potential risks. A lot can happen in 10 years. Our goal is to earn about 8% as an income return and to keep the term of our investments short with a portfolio duration of less than 4 years.

Portfolio Holdings

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

	% of Portfolio	
Vicwest Corp.	12.6%	Building & Construction
Sherritt Intl. Corp.	6.3%	Natural Resources
Harvest Energy Trust	5.2%	Oil & Gas
Rhodia SA	4.7%	Chemicals
Imperial Metals	4.5%	Copper Mining
Paramount Resources	4.3%	Oil & Gas
Dollarama Group LP	3.8%	Retail
Royal Group Tech Mtn.	3.7%	Plastic Building Materials
Progress Energy	3.6%	Oil & Gas
Saskatchewan Wheat	3.5%	Agricultural Operations
Total	52.2%	