VERTEX BALANCED FUND

Year End Report 2006

It's Only Just Begun.

In last year's 4th quarter report it was recommended that you sell your Canadian centric commodity exposed, income trust exposed, currency exposed funds, stocks, indexes and make the move to the Vertex Balanced Fund. Well, if one had done that, it would have been a good thing but not for the reason I would have expected. Indeed the fund returned 18% for the year but surprising to me was how well Canadian stocks performed. It seemed obvious (to your penman anyway) that commodity stocks had had their day but despite all the writing on the wall, speculators, investors and chimpanzees continued to say "I believe". Well, with China and India and western consumption and, and, and the runnin' out of oil problem, commodities got to go higha! I-I-I BELIEVE! Yesi, yesi, yesi. Well commodities did go higha but then ended the year lowa, however the Canadian dollar hung in dare pretty good eh and Canadian bank stocks took up the slack where commodity stocks started giving up a little bit of ground. This led the TSX to a double digit return.

So back to the last paragraph, the main reason it was suggested to move into the Vertex Balanced Fund was for safety. It occurred to me that eventually the commodity market would crack and badly, just like it always has in the history of commodities. It didn't….and hasn't really….YET. That is why I've titled this report "It's Only Just Begun". The Canadian dollar, after hitting a high over 91 cents in May, is trading today at 85 cents. Oil, after hitting a high over $77, is trading today at $58.50. Natural gas started the year at $10.61 and now trades at $6.19. Gold, after hitting a high of $714, trades today at $628.00. Having stated these declines, prices are still astronomically higher than their long term inflation adjusted averages. The thing about commodities is they don't grow like stocks. Commodities don't give you a return. There is no return on equity. At best they are like owning land with no building to rent out with all the associated holding costs. Those who would argue against me hold the view that commodities will become scarce. History tells us otherwise though. Commodities, oil included, have become less scarce with the passing of time – even with the industrialization of the west and now the industrialization of the east. Not only that, we've barely scratched the surface of the earth. Pardon the pun, but really. Only about 30% of sedimentary basins where we think we know that oil should be found have been explored. Why I say we think we know is that there is an alternative to fossil fuel theory that suggests oil may result from a chemical process rather than a biological one. "Fossil Fuel Theory" could turn out to be our generation's flat earth. I'm agnostic as to where oil comes from but would suggest that if oil is of biological origin the price is going a lot lower. If it is of a chemical origin it's going lower than a lot lower. The price will only be determined by extraction costs. History has shown that with technological advances the cost of extracting a barrel has declined in dramatic fashion over the last 100 years. I can't even imagine where these advances are going in the next two decades. Very recent history has shown the increase in these costs is the result of….high commodity prices. It takes a lot of energy and materials, oil included, to get a barrel of oil from the ground to your electrical socket.

One really has to have "faith" to hold on to a dogmatic belief in the world's running out scenario. Evidence and history refute this lap dog, head nodding, throw out your critical thinking skills, way of looking at our world. It is revealing what consensus views are on the subject though. Just do a causal search on Amazon by inserting "oil doom" or "end of oil" or….fill in the blanks and it will spit out hundreds of titles.

Have we been here before? Oh yes, we have. Back in 1919 the US Geological Survey said America would run out of oil in nine years. What happened nine years later? The oil industry was decimated from a glut of oil. In the 70s, Jimmy Carter said that "wells were drying up all over the world" and urged conservation. Less than 10 years later oil prices had fallen by about 66% with a glut of oil. Now we have the latest Hubbert's Peak crowd who every year push out a date for peak oil production cause it never seems to happen. In fact, in Saudi Arabia, where little exploration has happened in years, production has been going up. One can only imagine if exploration began in earnest in the Middle East what would happen to world reserve calculations. The fact is, right now when we are supposed to be in anarchy resulting from the scarcity of oil, OPEC is cutting production to try and prop up oil prices! I might add that this is happening simultaneously with China and India's growth miracles. Wow! As I said, one must really stick their head in those greasy oil sands to not see the fallacy of doomsayers' shrills. OK, no more puns. But wait – I'm not done yet…..what about how recovery rates from current reservoirs have been going up and up and up. What about shale oil? What about tar sands? Yes indeedy my friends, this abundant supply is on top of an almost endless supply of conventional oil reserves. History makes current concerns amusing. I'm willing to bet based on the evidence at hand and human ingenuity, that like whale oil, the world will run out of a need for oil prior to it running out of oil and the price will continue down and down and down and then down again. Politics might make prices volatile but geology and technology will trump politics in sending prices lower and lower and lower.

Back to the topic at hand - I will reiterate last year's 4th quarter report and suggest risk is much higher today in the Canadian market than it was last year at this time. Energy and materials make up a whopping 43% of the TSX index. High commodity prices have persisted and high prices ALWAYS bring on more supply. It is the immutable law of economics. Please refer back to the last paragraph. If you're long commodities, you better hope that China's growth rate is going higher than its already miraculously high growth rate and scientists, engineers and inventors take up gardening and no more Hollywood types decide to buy a small car.

To our portfolio: The reason less time is dedicated to what's in the portfolio than what's excluded is it's what's kept out of a portfolio that leads to higher returns in the long run. Avoiding large losses is a key to successful investing. Let me do some quick math. A 50% loss today will require a 100% future gain to get even. At a 10% rate of return (which is high in today's 4.75% long bond world) it will take seven years to break even. Meanwhile, an investor who avoided the loss will have doubled his portfolio in the next seven years. This is why our portfolio is concentrated in stocks of companies where risks are estimated to be high and thus valuations are low. One can make a lot of mistakes and still do very well if an investment is bought at a low valuation. The opposite is true if the investment is bought at a high valuation - one mistake can….

We didn't make any brokers rich this year. 16 of our 21 equity holdings are the same as a year ago. If you haven't guessed already there is a complete and irresponsible absence of commodity related stocks. I say irresponsible for many would argue that it is unsafe not to have exposure to this sector. The portfolio has a number of Property & Casualty insurance firms. Already hurricane predictors have come out with their catastrophic forecast for this year's season. This should help keep pricing firm for those insurance books exposed to weather and has also served to keep P&C stock prices in check. They trade on average at 1.3 times book value and 6 to 10 times earnings. This is about half the valuation of the broad market. Bristol Myers, Merck, Angiotech and Pfizer now make up 8% of your fund. All of these companies have had troubles allowing us an opportunity to pick them up at discount prices. Merck was picked up for $29 and trades now at $45.25. More recently Pfizer was gifted to us at $24 after a promising drug went bad. Our large P&C holdings were purchased after 2005's horrendous hurricane season. Our philosophy is one of panic buying – we buy from panic sellers when the news is bleak. Then…..we wait. What else? 6% is in industrial tech. High tech is so passé. Industrial tech is an admission that technology has largely been commoditized. What's likeable about these companies is their business models all have built in declining prices for their products….not by the year or by the decade…but by the quarter. They are realists. Compare resource commodity companies. They survive on "hope" that copper, zinc, gas and oil won't decline or won't decline too much. To be fair, the great resource commodity firms have always known that better, faster, cheaper is what it takes to prosper over a full cycle.

Bonds represent just under 25% presently, largely due to equities increasing in value over the last two quarters. A few spectacularly high yielders snuck in during 2006. They only represent 2% of the total but serve to increase our overall portfolio yield by .4 of 1% and offer potential for a sweet capital gain if paid off in full on maturity. Finally, some tremendous opportunities have shown up in a basket we'll label securities lending combined with option writing strategies to the tune of about 19% of total. The yields on these trades are staggering.

One final note on my commodity thesis from a purely investment perspective - if wrong, your fund can still do very well like it did in 2006. If right, it's a downright disaster for those attached to a thesis of rising commodity prices. I like our odds better.

P.S. Don't even get me started on global warming, but just so you know what the world was worried about in the 70's, other than running out of oil and food, we have included a wonderful article from the science section of Newsweek titled "The Cooling World". Change is inevitable - climate change included. Humans are comical. What worry will we invent next? Enjoy.

PERFORMANCE

Net Asset Value	Rate of Return (Class A)					
	3 Mos.	**1 Yr.**	**2 Yrs.***	**3 Yrs.***	**5 Yrs.***	**7 Yrs.***
$15.0378**	**9.58%**	**18.00%**	**11.41%**	**11.32%**	**11.34%**	**11.43%**

*Annualized
**Post Distribution

Past performance is not indicative of future results
All data are based on the Class A unit values

THE PORTFOLIO

The holdings in the Vertex Balanced Fund at December 30th, 2006 include:

BCE Inc.	CTS Corp.	Bristol-Myers Squibb
Partner Re	Pfizer	Vishay Intertech Inc.
Fairfax Financial Holdings	Harleysville Group	XL Capital Ltd.
Mattel Inc.	Kemet Corp.	Intel Corp.
Montpelier Re	Seamark Asset Mgmt.	IPC Holdings Ltd.
Odyssey Re	Sceptre Asset Mgmt.	Merck & Co.
Angiotech Pharmaceuticals	QLT. Inc.	Level 3 Comm.

ASSET MIX

Cash	0%	Canadian Equities	27%
Fixed Income		Foreign Equities	49%
Canadian	19%		
Foreign	5%		

Vertex One Asset Management