

VERTEX BALANCED FUND

First Quarter Report, 2001

Once again we are reminded that stocks are - ah - risky. Hate to pick on Nortel, but have to cause it's too damn easy, and although I like to think after studying a lot of Zen the ego has disappeared, it has not, and your portfolio managers have been soooo right on this one it is painful getting our swollen heads through the door in the morning. So Nortel has fallen from a high of \$124 to \$20. For all intents and purposes, those that bought at its high lost all their money. Then there were those that bought at \$60 because it had become cheap and for all intents and purposes, these investors, too, have lost most everything. Recovery of this lost wealth is going to prove as elusive as finding the lost city of Atlantis. It was hope and wish money and IT IS GONE.

OK, let's stop the narcissistic banter, own up to the facts and not gloss over what really transpired this quarter.

It was a quarter that made the investment business seem like an imprudent career choice - where in hindsight it would have been highly intelligent to walk over to the local Royal Bank branch and deposit the entire portfolio in a 90 day GIC - where a charitable contribution of the loss would be a more appropriate use of capital - where a chimpanzee could have done better - where your team is losing and there's only one quarter left - where....where....where an Amazonian jungle tribesman would laugh his head off that we think money has any meaning at all! Yep, it was that kinda quarter. The first quarter that your fund experienced a material loss since September 30th of 1998. The loss was 6.32% precisely. Not losing money is considered very important to us and although it is comforting to tell you this was better than our benchmark it was below average. Now that the proverbial beans have been spilled, it would be useful to analyze the characters responsible for this pathetic display.

First of all, our entire forward line went on a work to rule campaign. Our three heavyweights, CI Fund Management, Fairfax Financial, and United Technologies all took the quarter off. On top of this, the rest of the team didn't pick up the slack. Banks, consumer products, chemicals and even our utilities performed poorly. Finally, even though the crowd yelled defense, defense, defense from the bleachers, our defense (long term government bonds) failed to provide the downside protection usually reserved for Krakatoa-like shocks. While it is unfortunate stocks have come off a little in price, the trend is upward and these firms are not the types that end up encrusted in volcanic ash.

On to the future....

Predicting the future is tenuous at best but we'll give it a shot. For many years it has been apparent that stocks have become extremely overvalued, with valuation metrics in the jet stream where nothing survives without bottled oxygen. Even after this latest correction many stocks trade at three times the valuation of ten years ago. Nonetheless, an investor can do very well owning stocks. Yes indeed, as long as the price of a stock can be justified by the economic business earnings of the underlying company; and this brings us to a second point. A stock that can pay for itself from its own earnings without prejudice to whether the stock market exists at all has a high probability of making money as an investment. This being said, it's time to hear from the oracle. "The Eeezay money has been made." As far as I can recall, it hasn't been that easy over the last couple of...but...oh, sorry for the interruption, let's let the oracle continue. "It is most probable that markets will bumble along for quite a while, yes quite a while, as earnings catch back up to stock prices...hummm, and everybody hates Japan. Watch Japan." OK, I get the drift. In America, earnings have to go up to defend current stock prices and hopefully foreigners will keep financing the massive trade deficit so that our neighbors can continue to consume like Mr. Creosote, but what do you mean Japan – isn't it really bad in the land of the rising sun, I mean the land of the twelve-year eclipse? "Yes it has been dark across the pacific yet reform is underway and there is a catalyst too. Japanese companies have to mark to market investments that are currently accounted for at cost. Japanese companies will end up booking colossal losses and will sell stocks fully and completely. History shall prove 2001 to show us the bottom of the Japanese stock market." And bonds? "Oh yes bonds...hummm, hard to tell but if you own some, that's good, because I see a tougher road ahead for stocks." Well thanks eh! "No problem, happy to help."

What to do?

With the Oracle's advice in hand it is imperative to maximize income. The greater fool strategy where a stock could be sold to another for higher and higher prices without regard to real business income is temporarily out of service. To maximize income your fund is doing the following: holding bonds. As always, your government guaranteed long-term stripped coupons are yielding in excess of six percent. Your stocks have a higher dividend yield than the market by about a two percent advantage. By writing call options against your stocks and collecting option premiums, income has been enhanced considerably. And yes, Japan is on the radar screen.

Confucius say "never pick grapes before ripe." So now - off to another quarter. Please give us a call if you have any questions.

The Portfolio

The top ten holdings at March 31st were as follows:

Fairfax Financial Holdings	Avista Corp.
C. I. Fund Management	Olin Corp.
Mattel Inc.	Sun Life Financial Services
Royal Bank of Canada	Rockwell Int'l Corp.
United Technologies Corp.	Talisman Energy

Asset Mix

Cash	5%
Fixed Income	43%
Canadian Equities	32%
Foreign Equities	20%

Performance

The Vertex Balanced Fund returned 8.12% for the year ended March 31, 2001.

	Net Asset Value	Rate of Return				
		<u>1 Mo.</u>	<u>3 Mos.</u>	<u>6 Mos.</u>	<u>1 Year</u>	<u>2 Years</u>
Mar. 31, 2001	\$12.33	-2.48%	-6.32%	-1.00%	8.12%	16.66%