VERTEX BALANCED FUND

Fourth Quarter Report, 2001

Well hello – 11.4% return for the fourth quarter! May I be permitted to reflect upon your portfolio managers in a most favorable light – to wallow around in a swollen ego-induced bliss? No? OK then, but you must agree that it was a fantastic quarter. A quarter in which one must feel more happy than sad, n'est pas? Sure, but what's done is done and let's face it, you guys still lost us money in 2001 – 1.2 perrrr…cent if my math fails me not! Thus, overindulgence in self-love at this juncture is premature, ya know what I mean? Tough customer but admittedly you have a point, and with this in mind let's change the subject and report what transpired during the quarter.

We'll rewind the tape and present it in play-by-play action but remain cognizant that last year is over and unless backing up, looking in the rear view mirror is pointless. I confess, though, that your scribe many years ago attempted to drive forward while viewing the dotted line passing behind while gazing out the rear window, a most ineffectual manner of operating a motor vehicle and equally ineffectual in operating an investment portfolio. Interestingly, if not the grail of investing, most people run their portfolios in this backward looking fashion.

What a freaking deviation! Get on with it would you please? Yes of course, the information you require relates to the question "howa you gonna maka some moola moola dis a-year?" Is that not it? No candy coating, no niceties. Have some patience and we'll answer that question at the end of the letter. Back to the rewind.

After September, the bears got slaughtered. Almost every stock in the entire world was up and up big. If there were a stock market on Mars, it would have been up too. Like the moon affecting the tides, interplanetary markets could not have escaped this universal updraft. The only stock in your fund that went down was Fairfax Financial, which embarrassingly happens to be the largest single holding. Wow, glad to come clean with that one. Repent, repent stock sinner. We'll come back to Fairfax later.

It was a dart throwing quarter where you could have bought anything and made money and for an encore financed your new car for nothing. Yes, it was a great quarter for consumers whether purchasing automobiles, a new house, stocks or stockings. Everything was on sale. TVs, DVDs, and Cheezies. Hotels, motels and No Tell motels, planes, trains and umbrellas for the rain. Yes, everything was on sale. It was one of those times where good news is good news, bad news is good news and no news is even better. What happened is nothing short of extraordinary. No, on second thought it was rather ordinary. Perception changed from resembling the Jimmy Baker fetal position (Tammy got her honorable mention last quarter) to a facsimile of Ben Johnson prior to testing positive for banned anabolic steroids. The world, it seems, was still here. The TV still worked and that for most was a signal everything was OK. What was extraordinary and a little noticed event was that after the Fed abnegated issuing 30-year bonds, the bond market delivered some of the worst losses in history, reducing what would have been a spectacular return to a very good return.

Let's return to Fairfax and then move on to stocks on steroids. Ben got caught and so did Enron.

Fairfax is an insurance holding company that has proudly been where few stocks in Canada have been before. In biblical times it traded over $600 a share. There still remains a six in its handle but the six comes after a one followed by a zero. Fairfax has been caught in a downdraft of poor industry conditions, even poorer corporate performance, September 11 losses and a vote of non-confidence by shareholders. That's the bad news. The good news is that insurance pricing is firming up for the entire industry, customers are lining up to buy insurance and management has confessed that corporate performance has been unacceptable, resulting in a commitment to rectifying the situation. The stock is cheaper than wine in a box. It is priced below the lowest estimate a conservative analyst could calculate as the firm's book value, while most competitors trade at a double multiple of stated book value. Fairfax cost your fund 2% return last year, enough to make an inanimate object like a telephone regurgitate a mixture of wafer boards and transistors had it been counting on the fund for its care free retirement in a Palm Springs attic. The riveting conclusion here is that Fairfax is the kind of stock that makes you nervous to be an owner yet current conditions, including emotional distress, are a prerequisite for triple digit gains. If corporate performance does not improve this year though, it will be a sign that something more ominous is underfoot and the stock will be surgically removed from your fund.

The quarter progressed and gains continued to pile up like Christmas trees after New Years day. Corporate earnings fell, debt levels went up and stocks continued to rise; big stocks, small stocks and stocks on steroids. Stocks on steroids are those that have a market value in the tens of billions with no earnings and largely phony financial statements. Enron, a supposed utility that defied the laws of physical reality turned out to have no physical reality at all, with a market value reduced from $67 billion to…uh…$0. Enron was simply a figment of the imagination when the curtain was drawn. It's alleged geniuses were exposed as…well… alleged criminals awaiting trial. Beware stocks on steroids of which there are many left over from the no questions asked stock buying frenzy of the nineties. As a side-note or embedded-in-paragraph note, Vertex One does random testing for the aforementioned infractions. Infractions include emphasis on "pro-forma" financials – translation, management would rather you concentrate on numbers that they made up, that are not real, that the SEC has not approved, in order that they may continue to sell stock to you and I at inflated prices based on fantasy financial performance. Another tell-tail sign of a firm that is using banned substances is when management refers to the business in which it operates as a "space". It is usually self-evident at this point that they operate in some obscure vacuum commonly know as a black hole in "outer space". Where is this going anyway? The point here is that the stock bubble has re-inflated a bit while atmospheric conditions are beginning to make helium heavier than that element usually supportive of its gaseous form.

Your fund is presently 60% invested in stocks, none of which operate in "spaces". It would be unfair to say money can't be made in "spaces" though. For example, companies like Impark do make money in "spaces" but we're talkin' parkin' spaces. Serious companies make money through industry. Your stocks operate in industries like insurance, banking, factory automation, electronic components, oil services and aerospace. Furthermore, an investigation of the food and drug industries has highlighted a compelling argument to create some "space" for a few good stocks. Specifically, after many years of high altitude flying, firms like Safeway and Merck are showing up on our detuned radar screen with valuations not seen since…since…well, since a long time.

Apart from what has been reported in this far too lengthy prose, little has changed since the end of September. Moreover little has changed much since the spontaneous generation of the Vertex Balanced Fund almost four years ago. The only material change is an increased emphasis on option writing as a component of our strategy. Option writing provides income and subsequent risk reduction. Of course there's a trade-off against greater potential return. With a view that stocks are no longer cheap as explained in paragraphs three and five (although Fairfax is cheaper than wine in a box), this trade-off is a lay-up.

The yield curve is steeper than Everest if Everest were steeper than it is. My banker today offered 1% for a 90-day deposit, how insulting. Compare 1% to 5.7% for a 20-year term. Like tectonic plates something's got to give. My money is on short-term rates rising or long-term rates falling, either way long bonds are the winning ticket so we'll keep clipping those juicy coupons. So howa we gonna maka some moola moola dis a-year? Same as always. Own the same great companies at reasonable prices. Write options when premiums warrant. We'll run not walk away from stocks on steroids and finally, let patience do the heavy lifting.

Matt

The Portfolio

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

		Asset Mix	
Fairfax Financial Holdings	Royal Bank of Canada	Cash	0%
Honeywell	United Technologies Corp.	Fixed Income	40%
C. I. Fund Management	Boeing	Can Equities	30%
Mattel	Tidewater	For Equities	30%
Trizec Hahn	Rockwell International		

Performance

The Vertex Balanced Fund returned -1.21% for the year ended December 31, 2001.

		Rate of Return					
	Net Asset Value	**1 Mo.**	**3 Mos.**	**6 Mos.**	**1 Yr**	**2 Yrs****	**3 Yrs****
Dec. 31/01	**$11.1588***	**1.54%**	**11.39%**	**5.68%**	**-1.21%**	**11.67%**	**12.68%**

* Post Distribution

** Annualized