

## **VERTEX BALANCED FUND**

### **First Quarter Report, 2004**

China, China, China, China, China. It's "all about" China. It's not about Ming Dynasty collectables, Chinese food, chickens or chopsticks. If forest products companies could learn anything from their mining brethren, they would build a gorgeous case for Malthusian Chinese population growth creating such a demand for wood that chopsticks production has become the tipping point to a global shortage of wood. Ha ha – chopstick that boke camel back! Good grief mate, you get so distracted sometimes, could you chop stick to the story line please. Yes of course – as I was saying, it's supposedly about Chinese growth and Chinese demand for zinc, Chinese demand for copper, Chinese demand for nickel, Chinese demand for lead and....well....the Chinese...they just demand it all and then some more. A plethora of mining companies are looking for metals yet seemingly, like a Disney cartoon, are drilling clear through the earth missing any deposits and discovering China. The discovery and promotion of China has done more for mining company shares than any big find ever has. This of course negates the tricky requirement of having to actually find an exploitable mineral deposit before you've cashed in your stock options and sold your seed stock. Ah, the stock market's a beautiful thing.

Now being more cynical than cynicism should allow, especially for one under 40, it is important to state up front that there's a good chance my world view might be a tadpole distorted. Thus it is incumbent upon me to issue the following disclaimer; the views expressed above, below, and besides are pretty twisted and unharmonious with the grand orchestra of consensus. Your penman believes that Marco Polo has been freshly reincarnated. Yes, you heard it right. It's as if the bold traveler just arrived back in Venice spinning his incredible yarn, except Marco's been doing his work through the medium of today's mining industry executives, economists and stock salesmen. Last millennium belonged to America, this millennium belongs to China, they will tell you. I've heard it all now. A 100 year forecast brought to you by none other than your good friends on Wall Street and Bay Street.

China itself can't be disputed (except by the Taiwanese and the Dalai Lama). Nor can one dispute China's economy as a significant economic force but let's all get a grip. China hype is starting to sound like Japanese hype in the late 80ies. I know, I know, it's different THIS time.....and I don't understand and all that stuff, however, allow me to put forth an alternative hypothesis.

Demand has pulled commodity prices higher. We can all agree on this. However, the proliferation of hedge funds in recent years has resulted in speculation on currencies and commodities like we haven't seen since the Hunt brothers' silver fiasco in the late 1970ies. How much of the escalation in commodities prices can be explained by speculators? How much is the result of producers building inventories in excess of their requirement because they too have bought into the China to the moon story? How much? The answer is nobody knows but it is significant. Moreover, one could turn the economic storybook upside down. Current economic consensus is that China is financing America's trade deficit and this is a serious problem for the US. The alarmists ring the tune that if the Chinese stop taking payment in US dollars, America is toast. The dollar will fall faster than the principle of terminal velocity should permit. However, what happens if America stops buying Chinese goods? The consequences are so dire for China the Chinese will stop at nothing to keep the American consumer kicking. Now I'm no economist and don't got no fancy University degree but it seems that cupid himself couldn't have come up with a more appropriate liaison. It's not as if China doesn't have its own problems. There are broke Chinese banks sanctioned by the government giving away free money to build more factories, shopping centers, and more this and more that. Economists are quite concerned about what's going on under the waterline in the US but ignore the same in China.

That's a lotta spurious hearsay, innuendo and speculation on your part so what's the point? Ah hum...the point...yes. The point is that it's imprudent not to play devil's advocate to conventional investment themes. Dogma doesn't end at religion and politics. Dogma thrives in the investment business. There's nothing that's "all about" one thing or "all about" another thing. There's way more going on in business and the world to make blanket statements of the like we hear everyday. That's all. Ah wait, no that's not all. Ah, yes it is - you're such a windbag!

Please, enough sharing of your clandestine views. How about the balanced fund? Right then. It's remarkable. It really is. The Vertex Balanced Fund continues to perform very well despite having had no mining stocks at all and a significant exposure to the declining US dollar – something that shouldn't happen. Curiously, the same phenomenon transpired during the tech bubble with the Balanced Fund performing well with no exposure to tech stocks. How so? Here's the thing. Many thousands of businesses are available for purchase in the marketplace. At any point in time, there are at least 1,000 that are priced extremely attractively. Seldom are these attractively priced businesses available in hot, promoted, bandwagon-y sectors of the economy or the market. What's hot right now? Tech is hot yet again. Energy is hot, metals and mining is hot. Income trusts are hot. Let me digress for a moment. In Joseph Heller's classic novel *Catch 22*, the protagonist Yossarian, a bombardier flying for the allies in WWII, claims that it's not just the Germans trying to kill him. He protests that his own generals sending him over enemy lines are trying to kill him too. In his mind, they're both the enemy and his only objective in the war is to stay alive until peacetime. Winning is meaningless to him – especially if he's dead. Reader, I'm going somewhere with this. I am, I really am. Yossarian would have made a good portfolio manager. Stocks in the sectors mentioned above are the most likely to get killed.

The lion's share of our time at V1 is ensuring that stocks with a possibility of getting killed, stay out of your fund. Our portfolio consists of boring companies doing boring things. Sometimes it's so boring that it feels like a Maytag commercial. Why do you think this letter is so long? Got nothin' else to do but blab! I've even commenced conversations with myself, as the reader with a keen eye may have noticed.

OK now, all kidding aside. The Balanced Fund was up 6% for the first quarter and 37% for the year ended March 31, 2004. A review of last year's first quarter report reveals the line "there is no better place to have your money than the Vertex Balanced Fund right now". What a forecast. It's the best one-year return we've ever had. I wouldn't be so bold as to say the same again but would be so intrepid as to say it's still a great place to be.

Thanks for your support as always.

## PERFORMANCE

The Vertex Balanced Fund returned 37.77% for the year ended March 31, 2004

| <b>Net Asset<br/>Value</b> | <b>Rate of Return</b> |                     |                       |                       |                       |                       |
|----------------------------|-----------------------|---------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                            | <b><u>3 Mos.</u></b>  | <b><u>1 Yr.</u></b> | <b><u>2 Yrs.*</u></b> | <b><u>3 Yrs.*</u></b> | <b><u>4 Yrs.*</u></b> | <b><u>5 Yrs.*</u></b> |
| <b>\$14.1238</b>           | <b>6.17%</b>          | <b>37.77%</b>       | <b>12.03%</b>         | <b>11.55%</b>         | <b>10.69%</b>         | <b>13.57%</b>         |

\*Annualized

## THE PORTFOLIO

**The top 20 holdings in the Vertex Balanced Fund at March 31st were as follows:**

|                            |                  |                           |
|----------------------------|------------------|---------------------------|
| Fairfax Financial Holdings | Bank of Montreal | Emera Inc.                |
| CIBC                       | Enerflex Systems | Sun Life Financial        |
| Mattel Inc.                | Tembec Inc.      | Tidewater Inc.            |
| Northbridge Financial      | TSX Group        | Winn Dixie Stores         |
| CI Fund Management         | ACE Ltd.         | Prudential Financial Inc. |
| Nexfor Inc.                | Kroger Co.       | Odyssey Re Holdings       |
| Bank of Nova Scotia        | Honeywell Int'l. |                           |

All bonds are government guaranteed

## Asset Mix

|              |     |                   |     |
|--------------|-----|-------------------|-----|
| Cash         | 0%  | Canadian Equities | 50% |
| Fixed Income | 25% | Foreign Equities  | 25% |