

VERTEX BALANCED FUND

Third Quarter Report, 2004

Back in the late nineties Merlin, arguably the greatest wizard in history, couldn't have conjured up companies faster than the successful collaboration between Silicon Valley and Wall Street. When it comes to believing in magic, the stock market is one of the few jurisdictions where adults are all too willing to suspend their disbelief. Unfortunately, what's created from magic dust turns to just plain dust - from dust to dust as they say at funerals. Now some believe in resurrection, others believe in reincarnation and still others believe in ghosts. I believe the dead should just stay dead but what I believe is as irrelevant as stardust in an alternate universe. The stock market is a fantasyland where your wildest dreams can come true....well, that is....if you are a corporate insider, your fantasy comes true by turning everyone else's fantasy into a nightmare. The technical term for this phenomenon is "Transfer of Wealth".

At the funeral of tech, many companies and a ton of capital were buried (only the capital lost was mourned). It's fair to say that we're all happy to see the last of this and that ripyouoff.com. So here we are four years after the tech fantasy turned into a tech nightmare, (transfer of wealth), and I ask myself - "self? Yes? What would life be without tech?" To answer fairly, I'd have to say my standard of living would fall dramatically without it. For example, all the research reports urging your portfolio managers to purchase useless gold stocks come via email. The same goes for those promoting oil stocks and other commodities. (It's important to note these emails didn't require a fossil fuel burning truck delivery to end up in my email box). I receive these emailed reports on my desktop PC, my wireless blackberry or I can retrieve them on my home PC if it pleases me. There is no need to go into great detail on this matter. Everyone can think of how gas is purchased at the pump without an attendant, banking is online, purchasing airline tickets is online, the choice of our seats is online and it's even possible to check in at the airport avoiding a line, online! All of this is "compliments of technology", and rapid technological achievement and its pace isn't slowing.

Let's not rush to the point! No one would ever accuse your penman of rushing to the point. Some would make the accusation that there is no point, or I never get to the point but rushing to the point? The charge has never been laid. There will be a point, however, in time - in time. First it's necessary to set the wheels of thought in motion and for me to write long enough to think of a point. This might not be quite fair to the reader but it's the only way to produce this letter and who ever said life was fair?

At the height of technology mania, just about anyone could start any kind of company; the only criteria was to have a tech sounding name, engage in an Initial Public Offering, sell enough stock and be rich. Profits were unnecessary but accidents did happen and a few companies actually had a sprinkling thereof. But for these few profitable situations, Silicon Valley became the biggest counterfeiting operation in American history by printing either worthless or stratospherically overvalued stock certificates. Things have changed, I admit. Behavior hasn't. Today, just about anyone can start any kind of company; the only criteria is it has to have a resource sounding name, engage in an Initial

Public Offering or a reverse takeover, sell enough stock and be rich. Profits are unnecessary but accidents do happen.

The keen eyed reader might have just noticed that the point has finally been delivered. One can make a case for the usefulness of resources just as the case I made above for technology. But usefulness does not equate to monetary value otherwise water would be much more expensive than gold. It might not be a stretch to hypothesize that technology is more useful to a resource company than is the resource itself. It's kind of counterintuitive don't you know - the Internet is the best thing that ever happened to stock promotion of resources....the antithesis of technology! Wow....I love that.

Yes, yes, I know. I don't get it of course. Resources are no longer cyclical and \$50 oil should be considered cheap cause we're going to run out and....and....and....there's China and India and they're going to want all the west has - bla bla bla, and look how America grew with highways and automobiles and this will require massive amounts of resources especially oil which we're told we're running out of. What's wrong with this scenario? Almost all of it I say. Let's not get the wrong impression of the views being expressed here. These things could very well come to fruition. I'm just saying that it is a big mistake to bet on events conveniently rolling out in a linear fashion. Let's time travel back to around 1900. Learned economists in London can be overheard having a conversation. It centers on the conventional wisdom of the day. "This American economy is going to take off." "Too true, Monty, too true. When the Americans start making money they are going to want lots of horses and carriages. Every American is going to want one." "Yes Henry - quite, quite!! And paper and quills for writing. Yes, they'll indeed need lots of horses and wood and leather. What about horse shoes?" "Yes of course, they'll need lots of iron as well....and whale oil too, for every American will want a lamp in his home. This American demand is going to send the prices for these commodities very high, yes, very high indeed"

We all know America grew very differently than did Europe in the century before. This highlights the folly of the current commodities related prognostications. No one knows 1. What will happen in China and India? And 2. If big growth does happen, will it follow that Chinese citizens will want what we had in the last century? It's a simple cozy scenario but problematic in the context of human experience. Even if it were this simple, what discoveries or shocks will occur to render any of today's predictions to the recycle bin?

In the meantime though, there is another major "transfer of wealth" taking place - similar to the tech transfer but different. It's from resource company shareholders to company insiders. Both constituents might make money but let me be so bold as to predict that if commodity prices fall, and it's more a matter of when not if, insiders won't have to sell their homes and I can't say the same for the hopeful shareholder. History has a way of repeating itself but with just enough of a twist to make everybody wrong and a lot of people broke.

These letters might seem a little anarchistic but you don't need me to regurgitate today's headlines. Remember the headlines of the late nineties? They were ALL WRONG. That's all I'm saying.

You may have guessed by now your Balanced Fund portfolio holds few resource stocks and the reason is simple. Resources are cyclical. Resource stocks rarely earn their cost of capital and thus most go up and then back down to where they started, less what the insiders took out of the company. The creative destruction of wealth is remarkable in this sector of our economy. Energy and Materials now make up 36% of the TSX index. Add in Energy Trusts and the number is even higher. Smithers, the tables have surely turned. Has it reached a speculative frenzy? Possibly. Tech stocks are looking cheap in comparison.

PERFORMANCE

The **Vertex Balanced Fund** returned 9.65% for the year ended September 30, 2004

Net Asset Value	Rate of Return					
	<u>3 Mos.</u>	<u>1 Yr.</u>	<u>2 Yrs.*</u>	<u>3 Yrs.*</u>	<u>4 Yrs.*</u>	<u>5 Yrs.*</u>
\$13.7062	-2.80%	9.65%	14.96%	12.48%	7.47%	12.04%

*Annualized

THE PORTFOLIO

The top 20 holdings in the Vertex Balanced Fund at September 30th were as follows:

Fairfax Financial Holdings	Bank of Montreal	Emera Inc.
CIBC	Enerflex Systems	Sun Life Financial
Mattel Inc.	SKF Pulp Fund	CTS Corp.
Northbridge Financial	TSX Group	Tidewater Inc.
CI Fund Management	ACE Ltd.	Laurentian Bank of Cda.
Norbord Inc. (formerly Nexfor)	Kroger Co.	Canadian Western Bank
Bank of Nova Scotia	Honeywell Int'l.	

All bonds are government guaranteed

ASSET MIX

Cash	0%	Canadian Equities	52%
Fixed Income	25%	Foreign Equities	23%