Vertex Balanced Fund Second Quarter Report 1998

This is the first quarterly report for the Vertex Balanced Fund. Our job this quarter was putting the cash in your fund to work. In order to get this job done, it is imperative that we begin with a view of the capital markets.

The Current Scene

There are two fundamental factors that drive stock prices, earnings growth and interest rates. Presently, investors seem to be discounting the rosiest scenario for corporate earnings growth. The market price to earnings ratio is now at about 25 times, leaving little margin for disappointment. A review of corporate reports provides less than encouraging results. So far this year we have seen lackluster earnings growth and from a number of industry sectors, a substantial drop from last year. Earnings then, cannot explain current P/E multiples, leaving interest rates holding the key to current stock valuations. Government of Canada 30-year bond yields have declined from 6.5% to 5.5% over the past year allowing a corresponding rise in stock prices. Most of the recent growth in stock prices is likely attributable to lower bond yields and on a positive note, our research indicates, bond yields will continue to decline.

It is also plausible that fundamental factors alone are not responsible for the level of stock prices. Euphoria may have set in. Constantly heard on the street from professional and amateurs alike is that investors are more sophisticated and comfortable with risk and baby boomers have to buy stocks. This thesis has become so pervasive that one leading Canadian mutual fund company is bringing out a “boomernomics fund”. While it may be true that baby boomers have been saving for retirement by purchasing mutual funds, we do not hold the view that human psychology has made a permanent shift. In fact, it is more likely that investors believe they are comfortable with risk because they have not experienced losses. The risk over the past six years in Canada and longer in the U.S. , has been that stocks were going up and you didn’t own enough! Interestingly, with the exception of a select group of stocks, well over 50% of stocks listed on North American stock exchanges were down last year.

The portfolio

Consistent with our belief that deflation is a more likely economic scenario than inflation and that long-term interest rates will continue to trend downwards, the fund was equally balanced between long-term bonds and stocks during the quarter. To be more precise the average term to maturity in our bond portfolio at quarter-end was 15 years. On the equity side, the ratio of risk verses reward in the equity markets makes stocks less attractive than in prior years. Bearing this in mind, the portfolio consists of 14 stocks diversified by industry with average price to earnings of about two thirds that of the relative indices. This value strategy should reduce the impact if markets turn down.

Performance

We are pleased to report that your fund produced a return of **2.2%** for the quarter against the median balanced fund of **-.2%** placing the fund in the top 25% of Balanced Funds.

Fund Unit Value

The fund opened on April 3rd of this year with a value of $10.00 per unit. Monthly unit values can be found in most papers under the mutual fund heading "Other Funds" and also on our web page at www.vertexone.com

1998	Net Asset Value	Monthly Return
April 3	$10.00	
April 22	$ 9.92	-0.79%
April 30	$ 9.78	-1.43%
May 31	$ 9.94	1.64%
June 30	$10.22	2.79%

We would like to take this opportunity to thank you for entrusting us with the care and management of your investments. Vertex One Asset Management is now close to $40 million under management. Should you know of anyone that could benefit from our services, we would really appreciate referrals.

Vertex One Asset Management