

VERTEX BALANCED FUND

Third Quarter Report, 1999

The Current Scene

Our countrymen have finally given up on the Canadian stock market. Canadian net investment in foreign stocks rose \$13 billion in the first seven months of the year. In July alone, the increase was \$5 billion. This would be alarming if it weren't for American investors' increasing appetite for Canadian stocks. Americans have increased their holdings of Canadian stocks 23% over last year. At the same time the Canadian dollar has been stronger than the greenback leaving investors in Canada a two-fold win, once on Canadian stocks and again on a stronger currency. The overwhelming theme this year has been the strength of resource-based companies and the poor performance of the financial services sector, especially the banks, due to a belief that strong economies in Asia will lead to demand for commodities which in turn will drive prices for goods and services higher.

Bonds, in Canada and globally, have been very poor performers due to renewed fears of inflation. Inflation had previously been buried since 1994. Each day brings an economic report that is viewed as inflationary. Whether it's the CPI or the PPI or a wage settlement, the market is viewing the glass as half-empty. Although we still hold the view that inflation is benign, over the near term there may be some cyclical inflation. Oil came off a low of \$12 U.S. a barrel last year to a trading range in the low twenties this year, but still trades at the same levels as two years ago. The most important point is that the Fed will not tolerate inflation. They have made that clear. This is very different than in the 70's when western governments were formally implementing inflationary policy. There are only a few rouge governments, like ours in British Columbia, that still exist while pursuing this kind of policy. Looking at the big picture, this is very good news for bond investors.

The Portfolio

As a result of the large rise in interest rates, we believe that bonds and financial stocks have discounted an increase in the rate of inflation already. These interest rate sensitive investments have declined to such an extent that they represent excellent value. The banks and bonds are priced where they were well over two years ago. With the entry of the life insurance companies as public companies and the regulatory changes to the financial services sector in the U.S., the stage is being set for a flurry of acquisitions and consolidation. In line with this view we continue our earlier posture and remain cautious in our approach to equities, thus the portfolio has been positioned largely in both financial services and long term government bonds.

With the advent of the fuel cell, fiber-optics and the ever-increasing processing speed of computers, the information age is upon us. The New Millennium promises to be a time of unparalleled growth as the rate of change continues to accelerate. The Internet will provide huge productivity gains as more businesses incorporate its use and the consumer continues to benefit from a cost perspective as well as convenience. Our challenge will be to identify and capitalize on the opportunities presented by this technology-driven revolution.

The top 10 holdings at September 30th were as follows:

| | |
|---------------------------|---------------------------------|
| Celestica International | Nexfor Inc. |
| C. I. Fund Management | MacKenzie Financial Corp. |
| Onex Corp. | Toronto Dominion Bank |
| Intelligent Polymers Ltd. | Cogeco Cable Inc. |
| Pico Holdings Inc. | Fairfax Financial Holdings Ltd. |

Asset Mix

| | |
|-------------------|-----|
| Cash | 6% |
| Fixed Income | 40% |
| Canadian Equities | 40% |
| Foreign Equities | 14% |

Performance

We are pleased to report that for the year ended September 30, 1999 the Vertex Balanced Fund returned 12.77%.

| | Net Asset <u>Value</u> | <u>Rate of Return</u> | | | |
|---------------------------|---------------------------|-----------------------|---------------|---------------|---------------|
| | | <u>1 Mo.</u> | <u>3 Mos.</u> | <u>6 Mos.</u> | <u>1 Year</u> |
| September 30, 1999 | \$10.40 | 0.39% | -0.59% | 3.83% | 12.77% |