VERTEX BALANCED FUND

Fourth Quarter Report, 1999

The Current Scene

On the one hand there are fashionable stocks, those that you'd be comfortable showing up with at your next cocktail party - sort of like showing up with Marilyn Monroe or James Dean. These are names like Cisco Systems, Research in Motion, JDS Uniphase, Nortel Networks and Qualcom. Everybody wants some of your action. You are hot! Then there are the unfashionable stocks, those that you'd rather not mention. These stocks make you so unpopular that if your hosts find out you own this stuff; you'll never get invited back. These names we need not divulge, suffice it to say they are not wearing the latest tech or biotech clothing. If you mention bonds they will throw you out on the spot. The causes of these phenomena, apart from ignorance and greed, are indexing and momentum investing against a backdrop of a very robust economy.

Many fund managers have become so scared of missing the boat they have dropped stated investment disciplines and indexed portfolios. Few fund managers in Canada do not own Bell and Nortel Networks as they represent approximately 25% of the index and to not own them has been hazardous to one's health.

The proliferation of momentum and index investing has led to a massive polarization in the stock market. Momentum investing involves purchase of shares that have gone up without specific regard to valuation of the company. Indexing involves simply buying shares equal to the weighting of an index such as the TSE 300 or the S&P 500. In Canada, it is possible to replicate the index with very few stocks. As more and more investors use these techniques, stocks included in the indexes that are perceived to have positive futures become more and more overpriced. Next comes the justification and rationalization as to why the fashionable stocks should go higher and why those out of favour are no longer relevant at all. Analysts used to value companies based on earnings or how much one might pay for a dollar of earnings. This has given way to price to sales ratios. It seems that P/Es are so hard to justify, especially when many of the hot stocks have little or no earnings, that it sounds a lot better to say a company has a price to sales ratio of 20 times than a price to earnings ratio of 300 times. Unfortunately, price to sales ratios have also skyrocketed leading analysts to use comparative valuations instead. It goes something like this: ABC Corp sells for $200 a share. XYZ is in the same business and only trades at $50. Target price for XYZ, - $200!

Bonds are as out of style as top hats and tails, becoming so passe that only insurance companies and pension funds seem to be interested. This lack of interest coupled with inflation worries has led to negative returns from the bond component of portfolios.

The Portfolio

With tech euphoria driving stocks and interest rate fears seemingly only affecting bonds; with friends calling daily to find out whether I too had just made a killing in Needlenose Wireless or Flux Capacitor.com, (an enquiry of which would yield little information); we still believe in reason. Vertex, being a believer in technology, is anxious to take advantage of the technology wave. Our approach has always been cautious. At this point, it is appropriate to interject lest the reader begin to think we are wimps. John Thiessen, our own technology Don Juan was the largest institutional holder of America Online ($55) back at M.K. Wong with a cost base of 49 cents. Clearly, we do not lack understanding in the area and are not fearful. We do however have a commitment to invest wisely and not speculate. Accordingly, we will be adding more banking stocks to our portfolios. This begs the question what has banking got to do with technology? Our answer is this; the banking industry has more to gain from the use of technology to reduce costs and increase sales and marketing efforts than just about any other industry. There are ATM machines, Internet banking, online trading, online payment, debit and credit cards, and unlike Amazon and a plethora of other companies, there is no need to deliver a hard product anywhere. Technology companies are leapfrogged by competitors regularly, sending the losers' stock prices straight to hell. By purchasing the ultimate beneficiaries of the technology, we get all the benefit without taking on the technology risk and as a bonus pick up dividend yields averaging 4% and growing. The banks are now trading at less than 10 times earnings. Yes, I am glad you noticed. Vertex still considers earnings important.

We also believe bonds to be of tremendous value. It was brought to my attention today that even though interest rates have risen from a low of 4.7% to 6.5% today, (this is a 40% rise), they are still very low considering a 4% unemployment rate, a rise in oil prices from $12 to $28 a barrel and economic growth in the 5% range. If 6.5% is right for today's conditions, even a mild recession could place the long bond at 4% or lower. With the yield curve starting to invert (the long rate is less than the short rate), bond investors may be very well compensated for the misery of the last few years. The fact remains most of the inflation experienced in the last year can be explained by oil prices. Productivity gains ran over 4% last year and inflation came in somewhere around 3.5%. One could make a sound argument that as long as productivity gains are ahead of inflation while oil prices are at a nine-year high and likely to come down, inflation is unlikely to accelerate.

Getting to the point. The bond market has already priced in inflation expectations. Thus we like bonds and will be buying more, especially long dated government guaranteed bonds. Both financial stocks and bonds will perform well in an environment of stable or declining interest rates. Financial services are a great way to play technology. Pure technology and biotech stocks are soooo overvalued, compared to the companies that benefit from their product and service offerings, it is just a matter of time before the sector gets a serious reality check and you will be happy to know, we won't be there when it happens.

The top 10 holdings at December 31st were as follows:

C. I. Fund Management	Intelligent Polymers Ltd.
Onex Corp.	St. Paul's Company
Celestica	Olin Corp.
MacKenzie Financial Corp.	Toronto Dominion Bank
CIBC	Cogeco Cable Inc.

Asset Mix

Cash	4%
Fixed Income	27%
Canadian Equities	51%
Foreign Equities	18%

Performance

We are pleased to report that the Vertex Balanced Fund returned 14.7% for the year. This compares very favourably to the average balanced fund at 8.8%.

		Rate of Return			
	Net Asset Value	1 Mo.	3 Mos.	6 Mos.	1 Year
December 31, 1999	**$11.01**	**6.49%**	**10.85%**	**10.20%**	**14.73%**