



2nd Quarter Report to Vertex Fund Limited Partners, July 10 2002

The pro business stance that the Republicans in the U.S. have traditionally taken seems to be in disarray. Since George Bush has been in power, we have been in a secular bear market that has been the worst since the Nixon era. The markets are down with such ferociousness that the S&P 500 has wiped out all returns over a 4-year period (– 1.3%) and the Toronto Stock Exchange is flat with a return 0.7%. We have achieved our goals of preserving capital over that time, although we are slightly disappointed about having a down quarter we have had those in the past and expectations should be low in light of a quarter where the S&P declined 17.5%. (Notice our cheeky reference to relative performance). This was the worst quarter in the corporate bond and stock market since we launched our funds wiping \$2.5 trillion dollars of wealth away in US stocks alone.

The contradiction of the US government is begging to be challenged as George Bush's view is pro business, yet he has brought duties on softwood lumber, steel and agriculture suggesting left wing tendencies and a parochial mind set. His get tough stance with the SEC for quicker reporting for insider trades expands his character contradiction, as he himself filed eight months late when he was an insider on the board of directors of Harken Energy whose shares declined by 80% after his timely sales.

The Bush administration wants a stable business environment yet they are growing Money Supply at 12% and inflation will be the next battle with the US dollar turning down. This should help our holdings in Gold, which did not perform well over the quarter as Gold moves in the opposite direction of the Yankee buck. The old saying that a local currency only does as well as its local stock market may be starting to take hold, as the US Capital Markets are the worst performing in the world. Just as the Board of the Canada Pension Plan asks to increase its foreign allocation above 30% for all Canadians, the best place to invest may be at home.

The other threat we see in the US market is the US Legal system. No company in the US has a clear course with out lawyers throwing a brick wall in its face. Asbestos is a great example that affects over 100 million Americans and most Dow 30 stocks have some exposure to this legal threat. The lawyers are the only winners in this scenario. All these threats are pushing the US capital markets pendulum from severely overvalued to undervalued. All stocks that we own in the hedge fund are now cheaper. Stocks such as the independent power producers that we bought at eight times earnings are now three times earnings. Over time we believe that we will be rewarded. Through the last two and half years of this bear market we have had exposure to the market, which in hindsight has hurt our performance, but we are bullish on Canada over the long term and thank you for your support in these interesting times.

Please call us anytime if you would like to discuss these issues in greater detail.

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