

VERTEX FUND

Year End Report 2005

“The inherent vice of capitalism is the unequal sharing of blessings; the inherent virtue of socialism is the equal sharing of miseries”

Sir Winston Churchill*

Aren't hedge funds cool? They hedge away risk and shoot for only giving you positive absolute returns. Well that sure does not describe us in 2005, we didn't do much hedging and we ended the year with one of our smallest short positions ever. From here on in maybe we should rename ourselves the Vertex Equity Long Only Fund. As you know from our past letters (www.vertexone.com), we feel it's important to change our behavior to markets as events happen. Last year we saw the biggest increase in merger arbitrage we have seen in years. We averaged a weight of 30% in the portfolio with most deals on a straight long basis with no hedges in place. Convertible arbitrage and the junk bond market took it on the chin with the downgrade of Ford and General Motors to junk status. This affected almost all capital markets in some shape or form.

So that got us thinking about how we could earn a decent rate of return for the fund regardless of what happens in the markets. Hmmm - why not own a seat on the New York Stock Exchange? So we flew down to meet with the exchange which dates itself from 1792 with 24 original seats and has grown to its current member status of 1366 seats. It's interesting when you walk into an organization how you get a feel for what it's all about. We are happy because our walls are sunshine yellow, yet most folks at Revenue Canada are depressed by the oppressive grey that runs everywhere including their wall dividers. I mention Revenue Canada because it has the same feeling you get when you are at the NYSE. It is an organization filled with lifers that suck all the revenue into their pockets (see Richard Grasso \$187 million dollar pay package), leaving it as the world's most inefficient stock exchange of any G8 nation. It just begs for someone like Goldman Sachs to merge it with Archipelago, an electronic exchange (ECN) and reduce expenses to deliver some returns to the seat holders. At the time we looked at buying a seat it became quite obvious that with a six month wait to process our seat application it was much more expeditious for us to buy shares in Archipelago directly. As luck would have it the shares have outperformed the seats on the NYSE.

When one industry marble moves they all tend to move, so following on that move we built a position in NASDAQ that recently acquired Instinet, another ECN. Despite warnings from Warren Buffett who lobbied against their merger and the pricing power they would have, these two stock exchanges now have a duopoly in the US. Earnings should be quite strong from these two names which, of course, we own unhedged.

In the last quarter we invested in Dofasco because of its spin-out of the QCM mine income trust. It turns out as Canadians we said to the world, "Do you want our best steel company because we don't want it anymore?". The Germans said yes; so what's good for the Vertex Fund and bad for Canada added an extra \$6 million gain in the last quarter.

2005 was coincidentally an average year for unitholders as returns for the year (27.12%) were slightly above our long-term average of 25.33% return since inception, but the fund did have a very efficient tax year as returns were 98% (or better) tax free. Remember past returns should never be seen as indicative of future returns but we will try our best not to regress to the mean.

Gold has had lots of headlines recently and like interest rate forecasting, nobody really has any clue about where the true direction is. The more we talk about it the more market participants get active on it which leaves more opportunity for us. Recent unhedged deals in Placer Dome and Virginia Gold Mines make us excited about GOLD in them thar hills!

The Vertex Equity Long Only Fund also reached another milestone this year growing to over \$500 million in size. We thank you for your support over the last eight years from our humble start of \$1.7 million in 1998.

Happy New Year and please call us if you have any praises or complaints.

*Our thanks for this quote from Canaccord Capital Morning Coffee - the only daily street research I bother reading every day.

PERFORMANCE

The **Vertex Fund** returned 27.12% for the year ended December 31, 2005.

Net Asset Value	Rate of Return (Class A)					Since Inception*
	<u>3 Mos.</u>	<u>1 Yr.</u>	<u>2 Yrs.*</u>	<u>3 Yrs.*</u>	<u>5 Yrs.*</u>	
\$50.8274**	4.37%	27.12%	23.61%	31.53%	18.98%	25.33%

The distribution on December 31, 2005 was \$0.1806 per unit held.

*Annualized

**Post Distribution