

# VERTEX FUND

Second Quarter Report, 2006

## Dogs Don't Bark in Europe

We recently returned from an eight country, 12 day, "Good Vibrations" tour of Europe. Besides being a great adult backpacking trip (getting to see a World Cup match in Köln; tie game, Sweden and England, 2-2 and watching 50,000 Brits drink over 1,000,000 beers in a 24 hour period), the main reason for our sobriety was to launch the Vertex Offshore Fund. This fund will be based in the Cayman Islands (and I know what you're thinking but we haven't been there yet) which will allow offshore investors to purchase our Vertex Fund.

The amazing thing is that all offshore investors are actually onshore in Europe or in the U.S.A. Most of the investors that we saw are very sophisticated so we felt honored that they couldn't poke any holes in our investment process. It was also nice to see that most of these high net worth families or funds invest mainly in hedge funds. After 30 meetings they all tend to blend into one another and we began to rank offices based on the quality of their coffee. Without a doubt Switzerland came out the clear winner (no meetings in France or Italy).

What struck me most was the reflective mood of investors there. A quarterly piece from one of the fund of funds we visited stated that Europeans were falling further behind Americans on gain in average salaries over the last decade. They should be happy to lose the race, as increased salary without quality of life comes at too high a price. Quality of life should always win over standard of living. Even the dogs felt the tranquil sense of a Euro lifestyle by being well behaved in the restaurants we frequented.

Canadians have become extremely opportunistic, and willing to make a quick buck even if it comes from the hand that feeds us. This past year we have sold the following key assets:

Dofasco to Luxembourg  
Hudson's Bay (founded in Canada) to a US individual  
Molson's (once issued in Canadian Currency) to US brewer, Coors  
Deer Creek Oil Sands to the French oil firm TOTAL  
Fairmont Hotels to a Saudi Investor  
CP Ships to a German shipping company  
Blackrock to Dutch Oil Company, Shell  
Falconbridge to (Place foreign name here)

If you lose head office, you lose the power, which these days makes Calgary home of the new power base and the new head of state (fellow U of C grad), Stephen Harper P.M.

Many of the deals that we see are private equity firms buying these assets. There is so much liquidity in the system that people don't know what to buy so why not buy everything. Pension funds are now allocating money to private equity funds in the same manner as they allocated capital to Venture Capital funds in 2000 and 1999.

It is always easier for an industry to do deals when the wind is at its back. In 1999 and 2000 we did a lot of risk arb in the tech space because it had the capital to get deals done. These days we see a lot of deals in base metals, gold and oil and gas. As a matter of fact, we did our first gold deal less than a year ago. Prior to that, we had never seen one before and currently we are in the double digits for gold deals. Most deals that we see in this cyclical space are actually quite good value so we have owned these names unhedged. This means that the volatility in the Vertex Fund increased in the last quarter as stock markets around the world sold off dramatically. Although the performance is still up this year, the Fund had its third largest sell-off since we launched in 1998. And as in previous sell-offs, we did what we do best! We did nothing!

The Fund still owns all the same names it held at the beginning of the quarter as we expect the catalysts to occur to create value. Although some names went down more than anticipated, such as NYSE, NASDAQ and ATS Automation (not to mention gold and base metals), we are still confident that the unprecedented, globally coordinated building boom that is currently going on will give the markets still another kick at the dog.

We currently own three companies that we expect will spin out their oil sands deposits to shareholders and create a fairly high stub value for us, the shareholders. Although oil shares sold off this last quarter, the price of oil never declined by one drop. If we do head into a recession we believe that global oil consumption will not decline, much like the 2001 recession which had no effect whatsoever on oil consumption. OPEC and Russia can offer no additional exports after a 20% increase in OPEC production since 2002 and a 50% increase in Russian production since 2000 (note their economic power at their head office/state). In this environment we are quite happy to own our oil sands assets which now comprise 10% of the fund.

May all your dogs be this kind and well mannered.

## PERFORMANCE

The Vertex Fund (Class A) returned 18.44% for the year ended June 30, 2006.

<b>Net Asset Value</b>	<b>Rate of Return (Class A)</b>					
	<b><u>3 Mos.</u></b>	<b><u>1 Yr.</u></b>	<b><u>2 Yrs.*</u></b>	<b><u>3 Yrs.*</u></b>	<b><u>5 Yrs.*</u></b>	<b><u>7 Yrs.*</u></b>
<b>\$51.5957</b>	<b>-7.61%</b>	<b>18.44%</b>	<b>23.45%</b>	<b>26.95%</b>	<b>18.63%</b>	<b>23.32%</b>

\*Annualized

Past performance is not indicative of future results  
All data based on the Class A unit values

Vertex One Asset Management