

# VERTEX FUND

Second Quarter Report, 2008

For Whom the Bell Tolls

The Vertex Fund produced one of the best quarters over the last three years with a return of over 13%. One stock that we didn't own through the quarter was BCE as the credit crunch came to play on whether the banks that originally signed up to fund the deal would have the cash to pay up. BCE is the poster child for the US credit crisis. It got sold at the height to a private equity firm and has had to renegotiate the terms to help assuage the banks' funding concerns. Financial firms are running to the markets for financing as fast as possible before the door slams shut. Write offs have hit over \$300 billion and many forecasters, including Paulson who called this American debt bubble correctly, are saying that write offs will hit over \$1 trillion dollars. At that level many more banks will fail in the US.

The situation has become so serious that Fannie Mae and Freddie Mac (loosely sponsored government enterprises that today represent 80% of all mortgages issued in the US), are insolvent. Together they have \$86 billion in capital supporting nearly \$5 trillion in mortgages. Just as banks world-wide that were trying to hide off-balance sheet assets, they now have to bring them back onto their books. The US government just added \$5 trillion of debt to its books. We have seen a 2% default rate wipe out all the equity from these companies. We should have been short these companies but we missed it and have been kicking ourselves ever since. The difference between this cycle and the last one in the 1980s is that the accounting rules have changed. Back then most banks were bankrupt by today's standards. In the past they did not have to write down Latin American loans (LDCs), CDOs and SIVs etc. to a market price as they do today under fair value accounting rules. In the last month of the quarter our short position in US builders and financials helped the portfolio substantially. When companies are subject to raising more capital and the crowd psychology has changed, it is typical to see a run on the bank. To make a bad situation worse, as we enter a recession we are experiencing a bear market in half of all stock exchanges globally. Most countries are experiencing increased inflation with new price records in the UK and Japan, not to mention unusually high inflation rates in the following countries: Ukraine (30%), Venezuela (29%), Vietnam (25%), Kazakhstan (19%), Latvia (18%), Qatar (17%), Pakistan (17%), Egypt (16%), Bulgaria (15%), Russia (14%), the Emirates (11%), Estonia (11%), Turkey (9.7%), Indonesia (9%), Saudi Arabia (9.6%), Romania (8.6%), China (8.5%) and India (7.6%) and as I write this the United States just announced a PPI number of **9.2%**. *Inflation is now here in a big way.*

Things are much better back here in B.C. and we can thank the premier of Alberta for sending us \$441 million of new money from oil and gas land sales. And if you add Saskatchewan we see over \$1 billion has left Alberta for safer pastures based on the new royalty rates in Wild Rose Country.

Because of higher oil and gas prices we are seeing more takeovers in the oil patch as current commodity prices have made these stocks very cheap on the futures curve. Deals in Grey Wolf, Cadence, CHC Helicopter, Duvernay Oil and Gas mean 50% of our portfolio is invested in oil and gas assets that have some sort of catalyst. Below is a portfolio break down of the merger deals as of mid-June that we are involved in.

|                       | June 16, 2008   |            |
|-----------------------|-----------------|------------|
|                       | <u>Absolute</u> | <u>Net</u> |
| Largest Position Size | 5.17%           | 5.17%      |
| Top Five              | 15.21%          | 13.64%     |
| Top Ten               | 20.45%          | 18.79%     |
| Average Position Size | 1.00%           | 0.88%      |

To help pay for all these deals we have sold our positions in Nexen and, of course, BCE.

As always, feel free to call us with any comments you may have. Enjoy a great summer - especially the long-awaited sunshine.

## PERFORMANCE

The Vertex Fund (Class A) returned 10.07% for the year ended June 30, 2008.

| <u>Net Asset Value</u> | <u>Rate of Return (Class A)</u> |               |                |                |                |                         |
|------------------------|---------------------------------|---------------|----------------|----------------|----------------|-------------------------|
|                        | <u>3 Mos.</u>                   | <u>1 Yr.</u>  | <u>2 Yrs.*</u> | <u>3 Yrs.*</u> | <u>5 Yrs.*</u> | <u>Since Inception*</u> |
| <b>\$60.8275</b>       | <b>13.32%</b>                   | <b>10.07%</b> | <b>16.27%</b>  | <b>16.99%</b>  | <b>22.57%</b>  | <b>22.38%</b>           |

\*Annualized

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

Vertex One Asset Management