# VERTEX BALANCED FUND

## Third Quarter Report, 2006

Oil is down $17 from its high and that's about where it should be trading…..nope, I don't mean today's price which is $59.50, down $17 from $77 or so, I mean $17 - that's right $17, yup, about $17. Actually I'm being generous. After six years of being well above the 138 year median price of $15.17 (inflation adjusted) it's likely to fall well below $17. Hey, who doesn't like to make predictions? Don't worry. This doesn't make me any more of a kook than those who predicted it would go to $40 when it was trading at $12! Humans tend to mentally anchor expectations to the most recent history making it appear, in this case, that $40 to $80 oil is normal rather than an aberration. Long term history is a much more reliable indicator than recent history and the long term history of commodities is they have been getting cheaper for 2000 years. This applies to copper, steel and a whole basket of commodities that are trading many standard deviations from trend……and all the while everyone is talking about a housing bubble! Wow - must be that Wall Street and Bay Street have had a major vested interest in keeping the commodity bubble alive. Hmmm. Couldn't be - stop being so cynical you….Wall St. and Bay St. only have your best interests at heart.

Enough about oil and commodities as your fund doesn't own any. You know where I think this stuff's going. What's hot off the press today is that not a single noteworthy puff of wind made landfall after the dire predictions of the disastrous hurricane season that was to befall us - the mother of all hurricane seasons…..bla, bla bla, bla bla. Oh is there a trend here? Yes, yes, yes - there is. The trend was mental anchoring yet again. Hurricane forecasters predicted a worse season than last because the last was worse than the previous. Yes indeedy, forecasters had to ignore 100 years of history and concentrate on only two in order to come up with this forecast and find some reasons to back it up like global warming or whatever when really the thing was just a coin flip. Same with oil - it's just a coin flip, although many will conjure us reasons like China, India, "Hubbert's Peak" oil theory, violence in the middle east and so on to justify their $100 oil forecasts while ignoring 138 years of oil history and rising inventories for six years straight. Oh sorry, I said no more oil talk. It was relevant to the subject at hand though - mental anchoring and forecasting. Anyway, what it means for us is that the stuff that's been falling (commodities) is not in your portfolio and the stuff that's going up, - everything else (with emphasis on hurricane exposed property and casualty companies), is in your portfolio and at a considerable discount to my estimation of worth. What's not to like about companies trading close to book value - at 6 to 10 times earnings with growing earnings streams? Not all our companies are this inexpensive but compare this to the TSX market's 17 times earnings with (in my estimate) potentially shrinking earnings streams as those commodities prices go back to long term trend from short term aberration. Did I mention we don't own any commodity stocks?

While it is really not my intention to make predictions, just some fun on the side, it is worth noting that with the decline in commodity prices the Canadian dollar's rise against the US dollar is probably over. If correct, this is good news for your balanced fund. We are 55% USD exposed and I'll be honest here, the USD decline didn't exactly help us over the last few years. It didn't hurt us too much either considering it's been declining for five years in a row (please see your five year annualized return below). Who knows? The US dollar may even rise against our dollar but hey – let's recognize it for what it is - a coin flip at best. There's no return on equity on currencies - ultimately they are a zero sum game and it all works out in the wash. Of importance only is how stable and profitable our chosen portfolio of companies turns out to be.

Now for the meat - there have been no additions, deletions, changes or deviations due to fund manager tinkering. There have only been fluctuations.

## PERFORMANCE

| | Rate of Return (Class A) | | | | | |
|---|---|---|---|---|---|---|
| **Net Asset Value** | **3 Mos.** | **1 Yr.** | **2 Yrs.*** | **3 Yrs.*** | **5 Yrs.*** | **7 Yrs.*** |
| **$14.5104** | **9.84%** | **6.97%** | **10.54%** | **10.24%** | **11.70%** | **11.61%** |

*Annualized

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

## THE PORTFOLIO

The holdings in the Vertex Balanced Fund at September 30th, 2006 include:

| | | |
|---|---|---|
| BCE Inc. | CTS Corp. | Bristol-Myers Squibb |
| Partner Re | Bank of America | Vishay Intertech Inc. |
| Fairfax Financial Holdings | Harleysville Group | XL Capital Ltd. |
| Mattel Inc. | Kemet Corp. | Intel Corp. |
| Montpelier Re | Seamark Asset Mgmt. | IPC Holdings Ltd. |
| Odyssey Re | Sceptre Asset Mgmt. | Merck & Co. |
| Angiotech Pharmaceuticals | QLT. Inc. | Level 3 Comm. |

## ASSET MIX

| | | | |
|---|---|---|---|
| Cash | 0% | Canadian Equities | 24.7% |
| Fixed Income | | Foreign Equities | 51.4% |
| Canadian | 19.3% | | |
| Foreign | 4.6% | | |

Vertex One Asset Management