



DEANS KNIGHT INCOME AND GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

Investment Objective

The Fund's investment objectives are to provide Unitholders with stable monthly distributions and to achieve long-term capital appreciation.

Rates of Return¹

	<u>3 Months</u>	<u>Since Inception March 16th, 2006</u>
DK Income & Growth Fund	8.8%	2.2%

*The returns are calculated on the capital allocated to Deans Knight net of start up fees (\$9.37 per unit)

Market Review

Quarter for the period ending March 31, 2007

There were important developments this quarter in two key holdings in the portfolio. Firstly, one of our largest bond holding is Jean Coutu Group 8.5% due August 1, 2014, 9% of the portfolio at the start of the quarter. We purchased the bonds in March 2006 at an average cost of \$92. In August, Jean Coutu announced the sale of their U.S. pharmacy operations to Rite Aid. As part of the sale, it was intended that Rite Aid assume the obligations of the 8.5% bonds from Jean Coutu. Because Rite Aid is a weaker credit than Jean Coutu we, along with the majority of the bondholders, challenged this intention. On March 30th, Jean Coutu and the bondholders agreed to a settlement whereby Jean Coutu will tender for the bonds at \$109 and pay all legal fees. This holding provided an annualized return for the portfolio of over 26%.

Secondly, on March 26th, LionOre Mining International received a friendly all cash bid of \$18.50 per share from Swiss-based Xstrata. LionOre was purchased as a growth investment and represents 8% of the portfolio. Xstrata is a major diversified mining group involved in the production of alloys, aluminum, coal, copper, nickel, and zinc. The Company is listed on the London and Swiss stock exchanges and has a market capitalization of Cdn \$60 billion. Xstrata acquired Falconbridge Ltd. in a Cdn \$24.8 billion deal in 2006. The LionOre deal is valued at Cdn \$4.6 billion. In our opinion it is a fair deal and we support LionOre's Board of Directors and its management in their recommendation that shareholders accept the bid. In June 2006, we purchased LionOre in the Deans Knight Income and Growth Fund at \$5.46, a 239% return to the \$18.50 bid price.

On behalf of our clients, Deans Knight has been a shareholder since 1996 and we have been opportunistic buyers over the past 10 years. In our opinion, as recently as last year, LionOre was an under followed, underappreciated, and undervalued mining asset. After our purchase in June and the takeover of Falconbridge and Inco, LionOre began to attract a following. Only in the early part of 2007, with record high nickel prices, has it begun to trade at levels that reflect its true value.

It is our view that this is the proper time to accept what we believe is a fair price for the business. The management and board have built a very successful nickel company. In the current environment of record nickel prices (\$20 per pound) we are susceptible to looking at the future through rose coloured glasses. However, we remember very clearly in the days of 1998, following the Asian "meltdown", when nickel was \$1.75 per pound. With the benefit of hindsight, we were wise to have been a buyer in those dark days of low nickel prices and the shareholders may be wise to tender to a bid in this environment of record high prices.

Between the day the bid was announced and April 5, 100 million shares of LionOre have traded at prices 50¢ to \$1 above Xstrata's offer. This represents more than 40% of the outstanding shares. Xstrata needs to attract 662/3% of the outstanding shares to consummate the deal. The shares that have traded have gone to investors that believe either another bidder will appear and pay a higher price, or they can force Xstrata to pay a higher price. We shall see.

Subsequent to quarter end, on April 2nd, KCP Income Fund announced it had received a \$10 cash bid from Caxton-Iseman Capital, a US private equity investment firm. Following the Government's decision to impose income taxes on trusts we more than doubled our position in KCP, the portfolio has a 6% weight in KCP at an average cost of \$8.62. KCP is one of North America's largest and most diverse contract manufacturers of consumer products. KCP has experienced a very difficult operating environment in the last few years; however, we felt KCP was attractively valued, had a strong position in its industry and the potential for growing cash flows. In November, KCP announced they would look at strategic alternatives, including a possible sale. The outcome of this search was a \$10 cash bid for KCP at a 16% premium to our cost.

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Following the Halloween decision to tax trusts, unit prices for all trusts declined presenting buying opportunities. For example, we added to Progress Energy Trust, a Canadian natural gas producer. The warmer than normal year in the U.S. in 2006, coupled with worries about a U.S. recession, contributed to the decline in natural gas prices from a high of \$15.39/mcf in late 2005 to a low of \$3.63/mcf in September 2006. Valuations on gas weighted companies have similarly declined. We were able to purchase Progress at net asset value.

In our view we are setting up for a recovery in natural gas prices late in 2007. Although gas drilling in the U.S. is continuing at record levels, production is flat as decline rates on existing wells is offsetting new production. Furthermore, because of lower prices, drilling for new gas has slowed in Canada and production is declining. A normal weather pattern combined with rising demand for natural gas for cogeneration facilities will lead to declining inventory levels and rising natural gas prices.



The reduction in capital spending by major producers caused the energy services sector to experience severe downward pressure on utilization and pricing. As a result, cash flows in 2007 will be significantly lower than the record levels of 2006. We hold Blackwatch Energy Services Trust and Peak Energy Services Trust and both experienced a significant decline from our cost. We believe cash flows in the services sector along with energy prices will improve in time. We intend to increase our position in energy services trusts. Blackwatch is trading at below liquidation value and Peak is trading at a significant discount to book value.

We are focusing attention on originating and structuring private bridge financings. These financings are short term, high coupon, in some cases fully secured and, most importantly, provide capital growth through "equity kickers" in the form of warrants or convertible debt. The companies are typically looking for a bridge to an equity financing or to finance capital expenditures which will provide immediate cash flows to the business. We provide a debt plus warrant structure that is less dilutive than issuing equity. In addition, our ability to react quickly and work with the company provides more flexibility than a bank can offer. Private financings do not need to represent a large portion of the portfolio to have a meaningful impact on returns. The portfolio currently has 15% invested in private financings with the ability to increase this percentage to 25%.

During the 1st quarter, Deans Knight clients were the lead investor extending \$20 million of a fully secured \$46 million bridge financing to GBS Gold International Inc., of which DK Income and Growth lent \$3.75 million. GBS is a publicly traded Canadian company with a \$350 million market cap. The Company has gold assets in Australia producing 150,000 ounces annually. The purpose of this loan is to finance two acquisitions and growth capital expenditures. GBS will be acquiring Australian gold assets near their current operations and over 10% of a Canadian company whose main asset is a 30% Joint Venture interest in a Tanzanian gold asset (the 70% shareholder is Barrick Gold, who operates the mine). We are familiar with the Company and its management. On behalf of our clients, Deans Knight is a large shareholder and we also provided a loan to GBS in 2005 which enabled the Company to close two acquisitions forming the foundation of the Company.

The bridge financing is fully secured and pays a 12% coupon for a term of 2 years. In addition, each \$100 of debt receives 13.5 warrants to purchase GBS shares at \$3.75 for 18 months (\$3.11 at quarter end). The Company's plan is to grow production from 150,000 oz to 500,000 oz by 2009 with 150,000 oz of growth coming from the two acquisitions. GBS expects to generate \$175 million in operating cash flow in 2009. Although this estimate is at today's gold price, even at \$500/oz GBS will generate cash flow in excess of \$60 million. We expect our loan to be paid down out of cash flow or an equity issue within 18 months. The DK fund receives a cash yield of 12% on the note. If GBS shares rise to \$5 and the loan is repaid in 18 months, the potential total annualized return is 25%, which is very attractive in addition to being well secured.

As of March 31st the 10 largest holdings were:

	% of Portfolio	
Jinshan Gold Mines (Private Debt& Warrants)	8.1%	Gold Mining
Vicwest Income Fund (Income Trust)	8.8%	Building & Construction
Lionore Mining Int'l (Equity)	7.8%	Nickel Mining
Paramount Resources (Bond)	7.3%	Oil & Gas
GBS Gold Intl. Inc.	6.7%	Gold Mining
Masonite Intl. (Bond)	6.6%	Door Manufacturer
KCP Income Fund (Income Trust)	5.9%	Contract Manufacturing
Jean Coutu(Bond)	5.6%	Drugstores
Harvest Energy(Bond & Income Trust)	5.4%	Oil & Gas
Data Group Income Fund(Income Trust)	4.9%	Document Management
Total	68.5%	



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