NORTHWATER

Northwater Market-Neutral Trust
December 31, 2003
Annual Report

CONTENTS

Message to Unitholders from the Advisor

The Northwater Market-Neutral Trust (the "Trust") is a closed-end fund, comprising a diversified portfolio of market-neutral hedge funds, traded on The Toronto Stock Exchange. As of December 31, 2003, the net asset value of the Trust per unit was $15.81. For the fourth quarter, the net asset value of the Trust per unit rose by 2.09%. For the year, the net asset value per unit increased 10.00% after taking into account distributions per unit of $5.08.

2003 marked the recovery from the bear market in equities, with the S&P 500 rising over 28%. The possibility of a US invasion of Iraq in the first quarter precipitated a weak first two months, but the market rallied as the uncertainty surrounding the situation dissipated. Economic fundamentals improved throughout the year, although the recovery thus far has been largely a jobless one, with the US unemployment rate reaching a nine-year high of 6.4% in June. The Federal Reserve addressed deflationary threats, as well as the jobs situation, by cutting interest rates by a quarter-point to 1.00% in June. Efforts to stimulate the economy also included a softening of the US stance on its 'strong dollar policy' that saw the US dollar fall to multi-year lows against several currencies - all this despite market gains and improved fundamentals.

Northwater continued to alter the Trust's portfolio in order to capitalize on the shifting financial environment. Over the course of the year, twelve new funds were added to the portfolio and eleven funds were removed. The changes were made to assist the Trust in furthering its objective of generating consistent results regardless of overall market conditions.

The tremendous tightening of credit spreads over the year had a positive impact on the Trust's distressed securities managers. Managers were able to take advantage of a return to rational relationships both within the bond market and between the debt and equity markets. Players in these markets also benefited from the rebounding economy and the crystallization of profits stemming from restructuring that began as a result of the credit crisis of 2002. Credit volatility, a large number of potential turnaround situations and a growing number of liquid instruments all prompted an increase in the strategy weight, as the ambiguity in corporate valuations created a wider opportunity set for capital structure arbitrageurs.

Structured finance managers shone in 2003. Managers in these markets benefited from the surging economy and tightening credit spreads. The leverage loan market saw significant refinancing activity as companies strove to take advantage of tighter spreads. Loan originators reported less interest rate sensitivity as a result of the expectation that rates would rise in the future.

The improvement in credit spreads and record issuance in the second quarter also proved quite beneficial for the Trust's convertible bond arbitrage managers. After a strong first six months, however, convertible bond managers struggled as the market dropped to reflect a more balanced level between demand and issuance. In the final quarter, managers experienced mixed results as credit-oriented arbitrageurs fared well while other managers struggled as implied equity volatility continued to decline.

The environment for merger arbitrage in 2003, by contrast, was not nearly as positive. Levels of corporate activity were low as executives were reluctant to participate in merger deals while their stock prices were depressed. In addition, the volume of capital chasing the few remaining deals produced a negatively skewed risk-reward tradeoff. Consequently, the Trust continued to reduce its direct exposure to the strategy over the year.

A sharp sell-off in the bond market sent mortgage investors scrambling to hedge their duration, exacerbating fixed-income volatility in July and August. As a result, several fixed income and mortgage arbitrage managers suffered losses during this period. Primary and secondary effects from the bond market turbulence went largely unnoticed by equity investors, who were busily building stronger economic growth forecasts into their valuations.

Conditions for market-neutral equity managers remained difficult, particularly for those engaged in short-term mean-reverting strategies. Northwater continued to reduce the Trust's portfolio weight in this strategy.

Northwater remains focused on improving the Trust's portfolio by refining its stable of market-neutral managers and delivering strong, risk-adjusted returns. Northwater's strategy is to replace existing managers with others who are perceived to be better able to add value through their unique investment approaches when opportunities to do so arise. As part of Northwater's ongoing process, several new strategies, including structured and trade finance, are being explored for the Trust's portfolio.

Northwater also remains committed to market-neutral investing and believes it is an essential element of any truly diversified portfolio. The Trust's well-constructed portfolio of market-neutral hedge funds offers among the best risk-adjusted returns available in the market today.

DAVID G. PATTERSON

Chair and Chief
Executive Officer

February 27, 2004

MANAGEMENT DISCUSSION AND ANALYSIS

Northwater Fund Management Inc. (the "Manager") acts as manager of the Trust and, among other things, manages the administration of the Trust and monitors the Trust's investment portfolio. The Manager has retained Northwater Capital Management Inc. (the "Advisor") to provide investment advice and manage the Trust's investment portfolio in accordance with the Trust's investment objectives.

The Manager is responsible for managing the business and administration of the Trust pursuant to the provisions of the trust agreement. In doing so, the Manager must ensure that appropriate information systems, procedures and controls are in place in order to ascertain that information used internally and disclosed to Unitholders is complete and reliable. The Manager takes this responsibility seriously and is satisfied that appropriate systems, procedures and controls are in place for the Trust.

Investment Objectives

The Trust's investment objectives are:

1. Distribute $0.40 per unit per quarter ($1.60 per annum);

2. Steadily grow the net asset value;

3. Ensure that the performance of the Trust is substantially independent of fixed income and equity markets; and

4. Achieve low volatility, which is expected to be less than that of a mid-term bond portfolio and less than one-half that of major North American stock markets.

The Trust is obligated to distribute $0.40 per unit to Unitholders on a quarterly basis. Distributions are determined using the net asset value per unit for the month prior to each quarter end, and are permitted under the trust agreement as long as the net asset value per unit of the Trust at such time is greater than the initial net asset value per unit of the Trust of $18.79.

The Trust is also required to distribute all of its net income and net realized capital gains so that the Trust will not be liable to pay income tax under Part I of the Income Tax Act. Such distributions may cause the net asset value per unit to decline below $18.79.

For the three months ended December 31, 2003, the Trust declared a quarterly cash distribution of $3.67 per unit. This distribution is larger than previous quarterly distributions because the Trust earned significant taxable income from its currency hedging program, which was set up to reduce the foreign currency risk associated with the Trust's underlying investments denominated in US dollars.

The distribution made by the Trust in the fourth quarter resulted in a net asset value per unit of $15.81 at December 31, 2003. By making this distribution, the Trust will not be able to make quarterly distributions until such time as the net asset value per unit of the Trust is in excess of $18.79 unless, at the end of the 4th quarter of 2004, the Trust has net income and net realized capital gains that must be distributed for tax purposes.

Investment Management Process

The Trust's investment objectives are supported by the implementation of an investment management process. The Trust will be dependent on the knowledge and expertise of the Advisor to implement the investment management process. The Advisor's ability to deliver results is managed by a team of investment professionals that research, analyze and monitor the investments of the Trust. The Advisor conducts all of its investment research in-house and has developed all of its trading, risk management and accounting software systems internally.

The Advisor has developed a proprietary selection process that it uses to select and monitor potential hedge fund investments to be made by the Trust. This process is an integral part of the Advisor's strategy for generating value over time and includes:

1. A broad ongoing search for candidate hedge funds that have exceptional return/risk profiles.

2. Rigorous quantitative analysis of the historical performance of the hedge funds identified as candidates for investment that focuses on consistency and sustainability of return and assesses whether the manager of the candidate hedge fund is adding value to the investment process.

3. Statistical analysis to determine the effect on the Trust as a whole of adding and deleting a particular hedge fund or strategy.

4. Qualitative judgments on the strength of the management team and operations of a candidate hedge fund.

5. Mathematical techniques to help determine the weightings of each hedge fund within the Trust's portfolio. These tools compliment the Advisor's qualitative assessment of particular managers and strategies.

In addition, a due diligence process is completed before the Trust makes an investment. All investments within the Trust's portfolio are subject to regular review. Among other factors, the investment team monitors organizational changes made by the hedge fund managers selected as well as changes in policy relative to their investment objectives, hedging strategy, degree of diversification, leverage, and costs.

The Advisor manages and advises client accounts in addition to the Trust. Client accounts with similar investment objectives are generally managed in a similar manner. Investment allocation decisions are subject to client guidelines and restrictions. Limited investment opportunities will be allocated to client accounts in a manner that the Advisor determines is equitable to clients in the circumstances.

Investment Strategy

The Trust comprises market-neutral hedge funds that the Advisor believes have excellent expected returns as well as performance histories that have a low correlation with major equity and debt markets. In establishing the hedge fund "mix," the Advisor selects strategies that also have a low correlation with one another, thereby increasing diversification and reducing expected volatility.

The Trust employs leverage as it believes that leverage may enhance investment returns. The Trust is entitled to borrow up to 25% of the net asset value for investment purposes, and an additional 10% of the net asset value for effecting the purchase and buy-back program, maintaining liquidity to effect cash distributions and settling currency hedging transactions. The financial leverage as at December 31, 2003 was 23.22% (2002: 24.80%). The decreased leverage reflects a reduction of temporary borrowings made for investment purposes.

Investment Portfolio and Activity

The Trust invests in hedge funds that emphasize sectors of the capital markets that the Advisor believes are relatively inefficient. The Advisor believes that such sectors offer arbitrage opportunities and should reward insightful investment analysis.

Because the Trust is invested in hedge funds that pursue non-traditional investment strategies, it is subject to the special risks of investing in these strategies. For this reason, the Advisor seeks to diversify the Trust's portfolio across seven broad investment strategies and across 42 hedge funds. The hedge funds in which the Trust is invested are located in offshore jurisdictions and prepare audited financial statements, in accordance with US or International generally accepted accounting principles (GAAP).

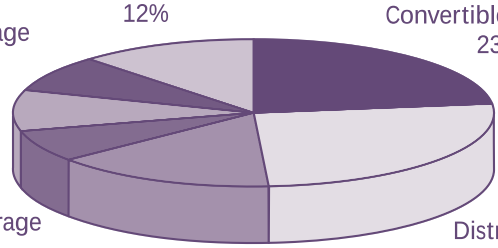
During the year, as part of its regular investing activities and with a view to meeting the investment objectives, the Trust placed investments with 12 new hedge fund managers (2002: seven hedge fund managers) and redeemed investments from 11 other hedge fund managers (2002: seven hedge fund managers).

As at December 31, 2003, the Trust was invested in 42 hedge funds (2002: 41 hedge funds) with 35 managers (2002: 35 managers) engaged in seven unique market-neutral or hedged investment strategies. This wide array of hedge fund investments has created broad diversification through which the Trust seeks to achieve its risk/return objectives and market neutrality.

Asset Allocation by Investment Strategy

Hedge Fund Investments

	As at December 31, 2003			As at December 31, 2002		
Strategy	**No. of Hedge Funds**	**Fair Value**		**No. of Hedge Funds**	**Fair Value**	
Distressed securities	10	$ 22,732,743	26%	6	$ 17,951,387	15%
Convertible arbitrage	9	20,507,803	23%	8	28,295,170	23%
Fixed income arbitrage	5	12,969,326	15%	5	15,837,957	13%
Merger arbitrage	6	10,879,361	12%	7	19,271,280	16%
Market-neutral equity	5	7,872,392	9%	9	23,069,210	19%
Mortgage-backed securities arbitrage	3	6,998,041	8%	3	9,644,827	8%
Structured finance arbitrage	4	6,186,803	7%	3	7,530,959	6%
	42	88,146,469	100%	41	121,600,790	100%
Settlement receivable (due) on currency futures		(118,177)			81,428	
		$ 88,028,292			$ 121,682,218	



Review of Financial Results

Performance

During 2003, the performance of the Trust continued the positive trend established in 2002, posting a return of 10.00% (2002: 8.47%) for the year, taking into account distributions made during the year. Six out of seven of the Trust's strategies contributed significantly to the overall return. In particular, structured finance arbitrage, distressed securities and merger arbitrage strategies were key to the success of the Trust in 2003. The overall results are comparable with the prior year and are consistent with the long-term expectations for the performance of the Trust.

With the continued trading discounts prevalent in the market, the Trust was again able to capitalize on the share buy-back and cancellation program during the year to provide additional returns to the unitholders. Over the year, this program contributed 0.22% (2002: 0.50%) to returns.

Net Asset Value and Price Per Unit

The value of investments held by the Trust is affected by factors beyond the control of the Advisor, the Manager or the Trust. The process of valuing investments for which no published market price exists is based upon the definitive or provisional value of the underlying holdings of the hedge funds supplied by administrators or managers of the underlying hedge funds. These values are net of the management fees and expenses to which the underlying hedge funds are subject.

The Trust's net asset value per unit is calculated and reported monthly. For the year ended December 31, 2003, the net asset value per unit of the Trust fluctuated between a low of $15.81 and a high of $19.54 (2002: low of $18.66 and high of $19.27 per unit), after taking into account distributions. The wide range of net asset values in 2003 reflects the substantial distributions recorded at year end.

Market Price of Units

The market price for units of the Trust is determined by the actions of buyers and sellers in the market. The daily closing price of the units fluctuated between $16.00 and $19.00 (2002: $16.50 and $18.00) during the year.

Distributions

During the year, the Trust made distributions in all of the quarters totalling $5.08 per unit ($26,606,800 was distributed in aggregate) as compared to four distributions in 2002 in the amount of $1.08 per unit ($5,909,697 in aggregate). The distributions of $5.08 per unit (2002: $1.08 per unit) included payments of $1.00 per unit (2002: $0.13 per unit) towards distributions that were in arrears. As at year end, there were no distributions in arrears (2002: $1.00 per unit; $5,344,359 in aggregate).

The character of the quarterly distributions for tax purposes has been determined as of the end of the year in accordance with the trust agreement and the tax laws then in effect. There can be no assurance that income tax laws will not be changed in a manner that adversely affects the Trust or distributions paid by the Trust and the Manager will continue to monitor any changes in the tax laws as they occur.

Distribution History

Record date	Date distribution paid	Character of distribution for tax purposes	Amount per unit
March 31, 1998	April 22, 1998	Return of capital	$0.32
June 30, 1998	July 21, 1998	Return of capital	$0.37
December 31, 1999	January 31, 2000	Return of capital	$0.57
March 31, 2000	April 14, 2000	Return of capital	$0.97
June 30, 2000	July 14, 2000	Return of capital	$0.88
September 29, 2000	October 13, 2000	Return of capital	$0.73
December 29, 2000	January 12, 2001	Return of capital	$0.31
March 30, 2001	April 17, 2001	Return of capital	$0.92
June 29, 2001	July 17, 2001	Return of capital	$0.84
September 28, 2001	October 19, 2001	Return of capital	$0.41
March 28, 2002	April 19, 2002	Return of capital	$0.07
June 28, 2002	July 19, 2002	Return of capital	$0.48
September 30, 2002	October 18, 2002	Return of capital	$0.08
December 31, 2002	January 17, 2003	Return of capital	$0.45
March 31, 2003	April 16, 2003	Return of capital Net income Realized gain	$0.00637 $0.62166 $0.12197 $0.75000
June 30, 2003	July 22, 2003	Return of Capital Net income Realized gain	$0.00527 $0.51391 $0.10082 $0.62000
September 30, 2003	October 24, 2003	Return of Capital Net income Realized gain	$0.00034 $0.03316 $0.00650 $0.04000
December 31, 2003	January 29, 2004	Return of Capital Net income Realized gain	$0.03119 $3.04199 $0.59682 $3.67000

Management Fees

Management fees will only be accrued and paid if such accrual and payment will not prohibit the payment of current distributions. To the extent that Northwater's management fee is deferred, it will not be reflected in the net asset value of the Trust. In the event that there remain arrears in distributions and/or management fees on the Trust's termination date, December 31, 2007, the management fees then owing will only be paid to the Manager to the extent that such payment does not result in the Trust's net asset value per unit falling below $18.79.

As at December 31, 2003, deferred management fees were $9,611,830 (December 31, 2002: $8,356,051) or $1.84 per unit (December 31, 2002: $1.56). To date, neither the Manager nor the Advisor has received management fees.

Net Income from Operations

For the year ended December 31, 2003, the Trust's net income from operations was $9,420,485 (2002: $7,993,620). As consistent with the Trust's objectives, the key contributing factors were the realized gains on hedge fund investments and on currency hedging.

The following table presents expense ratios for the years ended December 31, 2003 and 2002. The initial line of the table presents the ratio of total expenses to weighted average net assets. The following lines present alternative measures that the Manager feels are of value to investors and that provide additional information with respect to the Trust's expenses.

Ratio of expenses to weighted-average net assets	**2003**	**2002**
Total expenses	0.62%	0.80%
Total expenses excluding loan interest and stand-by fees	0.22%	0.20%
Total expenses including management fees deferred in the year	1.89%	2.05%

Currency Hedging

The Trust uses derivative contracts to hedge the currency exposure of investments denominated in U.S. dollars. A portion of the Trust's liabilities, which are denominated in U.S. dollars, provides a natural hedge to the U.S. dollar denominated assets.

The following table summarizes the impact of currency exchange for the years ended December 31, 2003 and 2002 after taking into account the hedging activities of the Trust.

		2003	**2002**
Currency exchange on hedge fund investments denominated in U.S. dollars:			
Net realized gain (loss)	$	(5,720,310)	1,289,942
Change in unrealized appreciation (depreciation)		(16,305,280)	(2,024,914)
Currency hedging of U.S. dollar denominated investments		21,016,325	1,508,529
Translation gain on natural hedge		3,104,974	303,612
Net impact of currency exchange	$	2,095,709	1,077,169

Purchases for Cancellation

Under its trust agreement, the Trust is required to make purchases of units of up to 2% of the outstanding units per quarter if the price at which the units trade in the market is less than 92.5% of the net asset value per unit as at the close of business on the preceding valuation date. In addition, the Trust may purchase units whenever they are offered for sale at less than their net asset value.

In December 2003, the Trust filed a notice of intention to make normal-course purchases of its units with The Toronto Stock Exchange. In its filing with the Exchange, the Trust indicated an intention to purchase up to 521,216 of the units of the Trust, representing 10% of the public float of the Trust then outstanding. In accordance with exchange rules and by-laws, the Trust may not pay more than the most recent market price for the units purchased. Units purchased under the bid are cancelled.

During the year ended December 31, 2003, the Trust purchased 106,800 units (2002: 345,300 units) for cancellation under these programs for a total amount of $1,859,388 (2002: $6,023,255). Given that the net asset value of the units cancelled amounted to $2,082,600 (2002: $6,545,379), this resulted in a gain of $223,212 (2002: $522,124) for the Trust. This gain reflects a 0.22% (2002: 0.50%) addition to the overall return.

Distribution Reinvestment Plan

The Trust offers investors the opportunity to enroll in a Distribution Reinvestment Plan (the "Plan"). The Plan allows investors to conveniently acquire additional units of the Trust by reinvesting their cash distributions. Purchases are made in the market if units of the Trust are trading at a price that is less than their net asset value. If units of the Trust are trading at a price that is greater than their net asset value, new units will be issued at a price that is the greater of their net asset value and 95% of the weighted average of the trading prices of the units over the five-day period prior to the declaration of the distribution. Purchases made under this plan in 2003 amounted to 3,964 units (2002: 1,477 units).

The Plan is a way to participate in the growth of the Trust. There is no charge to the participant for enrollment in the Plan.

If you are a registered unitholder and are interested in enrolling in the Plan, please complete an enrollment form and send it to the Plan Agent: CIBC Mellon Trust, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario M5C 2W9, or call 1-800-387-0825. Enrollment forms are available from your broker.

If you are the owner of units in an account with a broker or financial institution, you may provide them with a direction to enroll your units in the Plan.

Unitholder Meeting

On March 19, 2004, Unitholders were provided notice of a meeting to be held by the Trust on April 19, 2004. The special resolution to be voted on by the Unitholders at the meeting would permit the Trust to make regular quarterly distributions of 2% of the Trust's net asset value without regard to the original net asset value threshold of $18.79 per unit and would permit the Trust to pay the existing management fee of 1.25% of net asset value to the Manager on a current basis without regard to the Trust's original net asset value threshold of $18.79 per unit and without regard to the level of cumulative distributions. If this resolution is approved, the Manager will waive all deferred management fees for the period from the inception date to March 31, 2004. The proposal would also permit the Manager to extend the term of the Trust by two years to December 31, 2009 and permit the Trust to issue additional units to increase the assets of the Trust. Finally, the proposal would permit the Manager to terminate the Trust prior to December 31, 2009 if doing so were in the best interest of Unitholders.

If the above-mentioned resolution is not passed by requisite majority, the Unitholders will be asked to approve an alternate extraordinary resolution to amend the trust agreement to give the Manager the power to wind-up the Trust prior to the termination date of the Trust.

Management's Responsibility

The accompanying financial statements have been prepared by Northwater Fund Management Inc., the Manager of the Trust ("Manager"), and approved by the Board of Directors of the Manager. The Manager is responsible for the information and representations contained in these financial statements and other sections of the Annual Report.

The Manager maintains appropriate processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and include certain amounts that are based on estimates and judgements. The significant accounting policies that management believes are appropriate for the Trust are described in note 3 to the financial statements.

PricewaterhouseCoopers LLP are the external auditors of the Trust. They have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the financial statements. Their report is set out on page 15.

Benita M. Warmbold, CA

Treasurer
Northwater Fund
Management Inc.

Daniel C.R. Mills, CFA

Vice President
Northwater Fund
Management Inc.

NORTHWATER MARKET-NEUTRAL TRUST

Financial statements

For the year ended December 31, 2003

Auditors' Report To the Unitholders of Northwater Market-Neutral Trust

We have audited the statement of investment portfolio as at December 31, 2003 and the statements of net assets of Northwater Market-Neutral Trust (the Trust) as at December 31, 2003 and 2002 and the statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We have conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the investment portfolio as at December 31, 2003, the financial position of the Trust as at December 31, 2003 and 2002 and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

February 27, 2004
(except as to note 12 which is as of March 19, 2004)

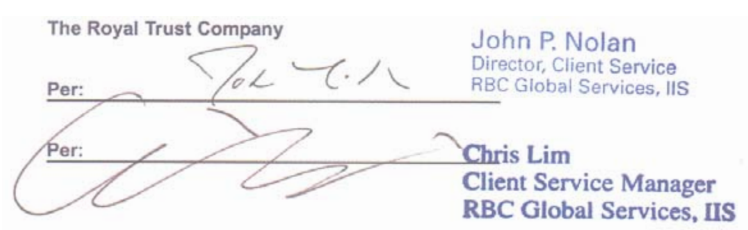
NORTHWATER MARKET-NEUTRAL TRUST

Statements of Net Assets

As at December 31, 2003 and 2002

		2003	2002
Assets			
Cash and short-term investments	$	20,131,416	4,423,068
Hedge fund investments, at fair value (note 4) (cost: 2003 - $82,227,807; 2002 - $90,571,350)		88,028,292	121,682,218
Hedge fund redemptions receivable		13,163,788	3,450,448
		121,323,496	129,555,734
Liabilities			
Professional and custody fees payable		64,879	38,993
Interest and standby fees payable		23,196	22,629
Distribution payable		19,221,842	2,404,962
Bank loan (note 7)		19,225,073	25,254,941
		38,534,990	27,721,525
Net assets and unitholders' equity	$	82,788,506	101,834,209
Number of units outstanding (note 5)		5,237,559	5,344,359
Net asset value per unit	$	15.81	19.05

Signed on behalf of the Trustee,



The accompanying notes are an integral part of these financial statements.

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Operations

For the years ended December 31, 2003 and 2002

		2003	2002
Investment income			
Interest	$	84,559	86,015
Other income		30,928	106,037
		115,487	192,052
Expenses			
Interest and standby fees		395,351	627,653
Management fees (note 6)		-	-
Professional and custody fees		64,510	58,086
Other fees		152,506	153,961
		612,367	839,700
Net investment loss		(496,880)	(647,648)
Realized and unrealized gain (loss) on investments			
Net realized gain (loss) on:			
Hedge fund investments		16,627,154	3,534,178
Currency exchange on hedge fund investments		(5,720,310)	1,289,942
Currency hedging of investments		21,016,325	1,508,529
Change in unrealized appreciation (depreciation) on:			
Hedge fund investments		(8,805,498)	4,029,921
Currency exchange on hedge fund investments		(16,305,280)	(2,024,914)
Net gain on currency, excluding hedge fund investments		3,104,974	303,612
Net realized and unrealized gain on investments for the year		9,917,365	8,641,268
Net income from operations for the year	$	9,420,485	7,993,620
Net income from operations per unit for the year*	$	1.80	1.45

*Based on the average number of units of 5,237,559 outstanding for the year (2002 - 5,516,926).

The accompanying notes are an integral part of these financial statements.

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Changes in Net Assets

For the years ended December 31, 2003 and 2002

	2003	2002
Net assets - beginning of the year	$ 101,834,209	105,773,541
Net income from operations for the year	9,420,485	7,993,620
Unit transactions (note 5)		
Net asset value of units cancelled	(2,082,600)	(6,545,379)
Gain on units acquired and cancelled	223,212	522,124
	(1,859,388)	(6,023,255)
Distributions to unitholders (note 8)		
Return of capital	(226,142)	(5,909,697)
From net realized gains	(4,326,795)	-
From net income	(22,053,863)	-
	(26,606,800)	(5,909,697)
Net assets - end of the year	$ 82,788,506	101,834,209
Distributions per unit for the year*	$ 5.08	1.08

*Based on the actual number of units outstanding on record date.

The accompanying notes are an integral part of these financial statements.

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Cash Flows

For the years ended December 31, 2003 and 2002

	2003	2002
Cash flows from operating activities		
Net income from operations	$ 9,420,485	7,993,620
Items not affecting cash:		
Net realized gain on hedge fund investments	(10,906,844)	(4,824,120)
Net realized loss (gain) on currency futures	199,605	(163,367)
Change in unrealized appreciation in value of hedge fund investments	25,110,778	(2,005,007)
Changes in non-cash working capital:		
Increase (decrease) in payables	26,453	(17,032)
	23,850,477	984,094
Cash flows from investing activities		
Purchase of hedge fund investments	(46,944,412)	(22,699,542)
Proceeds on sale of hedge fund investments	56,481,459	34,042,508
	9,537,047	11,342,966
Cash flows from financing activities		
Repayment of bank loan	(6,029,868)	(1,800,246)
Distributions paid	(9,789,920)	(3,504,735)
Acquisition of units	(1,859,388)	(6,023,255)
	(17,679,176)	(11,328,236)
Net increase in cash and short-term investments	15,708,348	998,824
Cash and short-term investments at the beginning of the year	4,423,068	3,424,244
Cash and short-term investments at the end of the year	$ 20,131,416	4,423,068
Supplementary information:		
Interest paid	$ 394,784	637,907

The accompanying notes are an integral part of these financial statements.

NORTHWATER MARKET-NEUTRAL TRUST

Statement of Investment Portfolio

As at December 31, 2003

	Maturity Date	Face Value	Cost	Fair/ Market Value	Percentage of Investment Portfolio
Hedge fund investments					
Distressed securities			$ 20,934,866	$ 22,732,743	21.02 %
Convertible arbitrage			20,398,614	20,507,803	18.96
Fixed income arbitrage			12,546,384	12,969,326	11.99
Merger arbitrage			9,272,998	10,879,361	10.06
Market-neutral equity			7,555,051	7,872,392	7.28
Mortgage-backed securities arbitrage			7,096,306	6,998,041	6.47
Structured finance arbitrage			4,423,588	6,186,803	5.72
			82,227,807	88,146,469	81.50
Settlement due on currency futures contracts (note 9)			-	(118,177)	(0.11)
Hedge fund investments, at fair value			82,227,807	88,028,292	81.39
Cash			1,657,899	1,657,899	1.53
Treasury bill					
Canada	March 8, 2004	$1,680,120	1,680,120	1,680,120	1.55
Commercial paper					
Darwin Trust	January 16, 2004	3,877,200	3,875,572	3,875,378	3.58
Macro Trust	January 16, 2004	5,945,040	5,942,305	5,942,246	5.49
Merit Trust Senior Notes	January 16, 2004	3,877,200	3,875,572	3,875,378	3.58
Storm King Funding Trust	January 15, 2004	3,101,760	3,100,240	3,100,395	2.88
Cash and short-term investments		18,481,320	20,131,708	20,131,416	18.61
Total investment portfolio		$18,481,320	$102,359,515	108,159,708	100.00 %
Liabilities over other assets				(25,371,202)	
Net assets and unitholders' equity				$ 82,788,506	

The accompanying notes are an integral part of these financial statements.

NORTHWATER MARKET-NEUTRAL TRUST

Notes to Financial Statements

For the years ended December 31, 2003 and 2002

1. Establishment of the Trust

The Northwater Market-Neutral Trust (the "Trust") is a closed-end investment trust established under the laws of the Province of Ontario pursuant to a trust agreement made as of July 18, 1997, and restated on August 17, 1999. The Royal Trust Company ("Royal Trust"), acts as Trustee. The Trust began operations on July 30, 1997 when it completed its initial public offering. The Trust's units are listed on The Toronto Stock Exchange under the symbol NMN.UN. The Trust will terminate on or about December 31, 2007, and the net assets will be distributed pro rata to the unitholders unless an alternative later termination date is approved by a two-thirds majority vote of the unitholders at a meeting called for this purpose. The Trust retained Northwater Fund Management Inc. (the "Manager"), under a management agreement dated July 18, 1997. Northwater Capital Management Inc. (the "Advisor") acts as the advisor for the Trust. The Advisor is registered in Canada as an adviser in the categories investment counsel and portfolio manager and as a dealer in the category limited market dealer under the *Securities Act* (Ontario), as amended, and as an adviser in the category commodity trading manager under the *Commodity Futures Act* (Ontario), as amended. The Advisor is registered as a securities adviser under the *Securities Act* (Quebec), as amended. The Advisor also has equivalent registrations in the Canadian provinces of New Brunswick, Prince Edward Island, Nova Scotia, Saskatchewan, Alberta and British Columbia under the securities legislation in these provinces. The Advisor is also registered in the United States as an investment adviser under the U.S. *Investment Advisers Act* of 1940, as amended, and as a commodity trading advisor and commodity pool operator under the U.S. *Commodity Exchange Act*, as amended. The Advisor is a member of the U.S. National Futures Association (the "NFA").

2. Investment Objectives of the Trust

The Trust's investment objectives are to: (i) distribute $0.40 per unit at each quarter end ($1.60 per annum); (ii) steadily grow the net asset value per unit; (iii) ensure that the performance of the Trust is substantially independent of fixed income and equity markets; and (iv) achieve low volatility, which is expected to be less than that of a mid-term bond portfolio and less than one-half that of major North American stock markets.

3. Summary of Significant Accounting Policies

These financial statements are prepared in accordance with Canadian generally accepted accounting principles.

(a) Investments

The assets of the Trust are invested in cash and short-term investments, market-neutral hedge funds and currency futures contracts.

Investment transactions are accounted for on a trade date basis. Investments are valued on the last day of each month ("Valuation Date").

Cash and short-term investments consist of cash in interest bearing accounts at Royal Trust, cash held with the futures broker and short-term investments with maturity of less than 90 days when purchased. Short-term investments are valued at the bid price for such instruments on each Valuation Date. Interest income is accrued on a monthly basis.

Investments in market-neutral hedge funds are valued on the basis of the definitive net asset values reported by the administrators or the portfolio managers of such funds on the Valuation Date or, if not available, the most recent provisional net asset values based on preliminary returns reported by the administrators or the portfolio managers of such funds. The difference between fair value and cost is shown as unrealized gain or loss on investments. Average cost is used to compute realized and unrealized gains and losses.

(b) Foreign Currency Translation

Assets and liabilities in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the year end. Transactions during the year in currencies other than Canadian dollars are translated at the rates of exchange prevailing on the respective dates of such transactions. Foreign exchange gains and losses are recognized in the Statement of Operations on each Valuation Date.

(c) Currency Hedging

The Trust enters into exchange-traded currency futures contracts to hedge the Canadian dollar value of portfolio assets and liabilities denominated in foreign currencies.

Upon entering into a futures contract, the Trust is required to deposit an "initial margin" with a broker based on a certain amount per contract. Subsequent payments representing “variation margin” are made or received each day depending on the daily fluctuation in the value of the contract. These daily changes are recorded as gains or losses in the Statement of Operations. The settlement due on futures contracts represents the daily variation margin due to or owing by the Trust on the Valuation Date.

Futures contracts are valued at their settlement price, as published by the appropriate clearing house of the exchange, on each Valuation Date. In the absence of reported bid and offer quotations, the Manager may, from time to time, determine a value that more accurately reflects the fair value based on the current market value of the underlying interest. The notional values of the futures contracts are not recorded as assets in the Statement of Net Assets.

(d) Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Trust to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

4. Investment in Market-Neutral Hedge Funds

As part of its investment strategy, the Trust invests in a diversified portfolio of market-neutral hedge funds.

The following table summarizes hedge fund transactions during the year:

	2003	2002
Investments at cost - beginning of year	$ 90,571,350	95,889,455
Cost of investments purchased	46,944,412	22,699,542
Cost of investments sold	(55,287,955)	(28,017,647)
Investments at cost - end of year	82,227,807	90,571,350
Unrealized appreciation of investments	5,918,662	31,029,440
Market value of investments - end of year	$ 88,146,469	121,600,790
Proceeds of investments sold	$ 66,194,799	32,841,767
Cost of investments sold	(55,287,955)	(28,017,647)
Net realized gain on investments	$ 10,906,844	4,824,120

5. Units Issued and Outstanding

The authorized capital of the Trust consists of an unlimited number of non-redeemable units. Units are transferable and represent an equal, undivided interest in the net assets of the Trust. All units are of the same class with equal rights and privileges. Each unit is entitled to one vote at any meeting of unitholders and to equal participation in any distributions made by the Trust. Fractional units will not be issued. During 2003, under a normal course issuer bid and the Trust's quarterly market support obligation, the Trust purchased 106,800 units (2002: 345,300 units) for cancellation. Units purchased in the market pursuant to the distribution reinvestment plan during 2003 totalled 3,964 (2002: 1,477).

The following unit transactions took place during the year:

	2003	2002
Balance of units outstanding - beginning of the year	5,344,359	5,689,659
Units acquired and cancelled during the year	(106,800)	(345,300)
Balance of units outstanding - end of the year	5,237,559	5,344,359

6. Management Fees

The Manager provides the day-to-day administration, portfolio management and unitholder services to the Trust. In return for these services, the Manager receives an annual fee of 1.25% of the net assets of the Trust, calculated on the last Valuation Date of each fiscal quarter. The fee is paid quarterly in arrears, provided that distributions to unitholders are not in arrears. If distributions are in arrears, management fees are not paid nor payable until any shortfall has been made up to unitholders.

Management fees in arrears at December 31, 2003 amounted to $9,611,830 (2002: $8,356,051) or $1.84 (2002: $1.56) per unit. The management fees in arrears will only be paid or accrued to the extent that such payment or accrual will not prohibit the payment of distributions to unitholders. In the event that there remains arrears in distributions and/or management fees on the Trust's termination date, December 31, 2007, the management fees then owing will only be paid to the Manager to the extent that such payment does not result in the Trust's net asset value per unit falling below $18.79. The Manager will pay a portion of its fee to the Advisor in consideration of the Advisor's services to the Trust.

7. Bank Loan

The Trust has a revolving loan facility with a Canadian financial institution (the "Bank"). The facility entitles the Trust to borrow funds in Canadian or U.S. dollars up to an amount not exceeding 25% of the net asset value of the Trust for the purposes of making additional investments. In addition, the Trust may borrow, on a temporary basis, up to 10% of the net asset value of the Trust for the purposes of (i) effecting market purchases of units; (ii) maintaining liquidity to effect cash distributions; and (iii) settling currency hedging transactions. Borrowing limits for U.S. dollar loans are evaluated by converting to Canadian dollars using the Bank's notional conversion rates. Interest and stand-by fees are payable on a monthly basis. Interest rates are based on bank prime and/or Bankers' Acceptances for Canadian funds and bank prime and/or LIBOR for U.S. funds. A general security interest in the assets of the Trust has been provided in favour of the Bank. Loans outstanding as at December 31, 2003 were denominated in Canadian dollars and U.S. dollars.

8. Distributions

The Trust pays quarterly distributions to unitholders of $0.40 per unit to the extent that the net asset value per unit after giving effect to the distribution is greater than the net asset value on July 30, 1997 of $18.79. If less than $0.40 per unit is distributed in any quarter, the amount of the shortfall is carried forward and paid in the next quarter, or quarters, as long as the net asset value per unit after giving effect to the distribution remains greater than $18.79 per unit.

During the year ended December 31, 2003, distributions of $5.08 per unit and $26,606,800 in aggregate (2002: $1.08 per unit; $5,909,697 in aggregate) were made by the Trust. At December 31, 2003 there were no distributions (2002: $1.00 per unit; $5,344,359 in aggregate) in arrears.

Unitholders have the option of receiving distributions in cash, or in the form of additional units by way of the distribution reinvestment plan.

9. Futures Contracts

As at December 31, 2003, commercial paper with a face value of US $1,300,000 (2002: US $800,000) was deposited as margin for the futures contracts.

The Trust has entered into futures contracts to hedge the currency exposure of portfolio securities and liabilities denominated in foreign currencies.

At December 31, 2003, the Trust held the following currency futures contracts:

	Closing price	Notional contract value	Settlement due on futures contracts
1,016 March 2004 Canadian Dollar Futures Contracts	US $76.94	US $78,171,040	
		CDN $101,028,252	CDN $(118,177)

10. Income Taxes

The Trust qualifies as a "mutual fund trust" within the meaning of the Income Tax Act (Canada) (the "Tax Act"). As all of the net income of the Trust, including net realized gains from private investment funds and deemed income computed under Section 94.1 of the Tax Act, will be paid or payable to unitholders in each calendar year, no income tax will be payable by the Trust under the present provisions of the Tax Act. Such income is taxable in the hands of the unitholder. Occasionally, more income is distributed than is earned by the Trust for tax purposes. This excess distribution is called a "return of capital" and is not taxable to the unitholder but reduces the adjusted cost base of the unit for tax purposes.

Net taxable income may differ from net income for accounting purposes.

As at December 31, 2003 the Trust had no non-capital loss carryforwards (2002: $6,500,000) and no capital loss carryforwards (2002: $nil).

11. Indemnities

The Trust enters into various agreements that contain indemnity provisions, whereupon payment by the Trust may become due upon the occurrence of certain events including the following indemnities:

1) in priority to all and any rights of the Manager or of the unitholders, an indemnity to the trustee and each of its directors, officers, employees and agents, other than the Manager, in respect of any liability and all costs, charges and expenses sustained or incurred in respect of any action, suit or proceeding that is proposed or commenced and all other expenses, costs or charges, sustained or incurred in respect of the administration or termination of the Trust including any taxes, penalties and interest in respect of unpaid taxes and all other liabilities and charges of any nature whatsoever;

2) an indemnity to certain of the hedge funds in which the Trust invested, and to their administrators, for liabilities that may be incurred in the event that the Trust, in completing subscription agreements in making investments in such hedge funds, makes a misrepresentation in such subscription agreements resulting in losses or damages to such hedge funds or their administrators; and

3) an indemnity to the Trust's auditors with respect to any fraudulent acts or omissions by the Trust, or misrepresentations made or willful defaults caused by the Trust resulting in claims against the Trust's auditors and in connection with third party claims made against the Trust's auditors relating to the services provided to the Trust by its auditors except as such claims may have resulted from the intentional neglect, misconduct or fraudulent behaviour of the Trust's auditors.

Historically, there have been no payments made under these indemnities. The Trust estimates the current liability at zero. The indemnities entered into by the Trust can extend for an unlimited period of time. We are unable to estimate the maximum potential liability for these indemnities, as the agreements do not specify a maximum amount and the amounts that may be required to be paid are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time.

12. Subsequent Event

On March 19, 2004, all unitholders were provided notice of a meeting to be held on April 19, 2004. The special resolution to be voted on by the unitholders at the meeting would permit the Trust to make regular quarterly distributions of 2% of the Trust's net asset value without regard to the original net asset value threshold of $18.79 per unit and would permit the Trust to pay the existing management fee of 1.25% of net asset value to the Manager on a current basis without regard to the Trust's original net asset value threshold of $18.79 per unit and without regard to the level of cumulative distributions. If this resolution is approved, the Manager will waive all deferred management fees for the period from the inception date to March 31, 2004. The proposal would also permit the Manager to extend the term of the Trust by two years to December 31, 2009 and permit the Trust to issue additional units to increase the assets of the Trust. Finally, the proposal would permit the Manager to terminate the Trust prior to December 31, 2009 if doing so were in the best interest of unitholders.

If the above-mentioned resolution is not passed by requisite majority, the unitholders will be asked to approve an extraordinary resolution to amend the trust agreement to give the Manager the power to wind-up the Trust prior to the termination date of the Trust.

13. Financial Highlights

Net asset value per unit - beginning of the year	
Net investment income (loss) per unit	
Net gain on investments	
Distribution per unit	
Return of capital	
From net realized gains	
From net income	
Effect of capital transactions over original cost	
Net asset value per unit - end of the year	

Ratios and supplemental information	
Net assets - end of the period	
Weighted-average net assets	
Ratio of expenses to weighted-average net assets	
Annual rate of return	

Net asset value per unit is computed by dividing the net asset value of the Trust by the total number of units of the Trust outstanding, as at the beginning or the end of the year.

Net investment income or loss per unit and net gain or loss on investments are based on the average number of units outstanding during the year. Distributions to unitholders per unit are based on the actual number of units outstanding on record date.

Weighted-average net assets are calculated as the average of the monthly net asset values of the Trust during the year.

The ratio of expenses to weighted-average net assets for the Trust is based on all expenses of the Trust, including interest, stand-by fees and GST, expressed as a percentage of the weighted-average net assets.

	2003	2002	2001	2000	1999
$	19.05	18.59	18.81	18.97	16.63
	(0.09)	(0.12)	(0.24)	(0.26)	0.02
	1.89	1.57	2.13	2.71	2.40
	(0.04)	(1.08)	(2.17)	(2.89)	(0.57)
	(0.83)	-	-	-	-
	(4.21)	-	-	-	-
	(5.08)	(1.08)	(2.17)	(2.89)	(0.57)
	0.04	0.09	0.06	0.28	0.49
$	15.81	19.05	18.59	18.81	18.97
$	82,788,506	101,834,209	105,773,541	111,140,383	121,925,046
$	98,855,903	104,515,541	109,436,120	117,409,394	123,106,315
	0.62%	0.80%	1.50%	2.03%	1.66%
	10.00%	8.47%	10.58%	15.12%	17.50%

Annual rate of return is calculated as the annualized geometric return of the monthly net asset values per unit of the Trust during the year, and takes into account distributions made by the Trust.

The effect of capital transactions over original cost represents calculational differences resulting from the use of a different base number of units outstanding in the various calculations as described above. This difference can be substantial if the Trust experienced significant cancellations of units during the year.

NORTHWATER CAPITAL MANAGEMENT INC.

Northwater is a leading investment management firm in Canada and the U.S., specializing in hedge fund strategies, synthetic indexing, and enhanced asset-class portfolios for pension plans and endowment funds. Wholly owned by its employees, Northwater is dedicated to providing clients with attractive risk-adjusted returns and first-class client service. The firm had assets under management and advisory responsibility of C$9.8 billion as at December 31, 2003. Northwater's clients include the pension funds of many of the largest corporations in Canada, the U.S. and Europe. Northwater also manages pension assets for a number of universities and public sector institutions.

Northwater is known as an innovator and a leader in applying derivatives and other quantitative strategies to create unique investment products for institutional clients. The Northwater Market-Neutral Trust is the first publicly-listed investment vehicle of its kind in Canada to invest in a diversified portfolio of hedge funds. As of December 31, 2003, Northwater had approximately C$4.6 billion under management and advisory responsibility in funds of market-neutral hedge funds, which Northwater believes makes it the largest such provider in Canada, and among the largest in the world.

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TSE Symbol: NMN.UN

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