NORTHWATER

Northwater Market-Neutral Trust
December 31, 2005
Annual Report

BACKGROUND

Northwater Market-Neutral Trust (the ''Trust'') is a closed-end investment trust established under the laws of the Province of Ontario. Financial statements of the Trust, denominated in Canadian dollars, for the year ended December 31, 2005 are included in this report.

CONTENTS

MESSAGE TO UNITHOLDERS FROM THE INVESTMENT ADVISOR

The Northwater Market-Neutral Trust (the ''Trust'') is a closed-end fund traded on the Toronto Stock Exchange under the symbol NMN.UN that delivers the return of a diversified portfolio of market-neutral hedge funds. As at December 31, 2005, the net asset value of the Trust per unit was $13.88. For the year, the net asset value per unit increased by 2.21%. During the same time period, the Scotia Capital Universe Bond Index rose by 6.46%, the S&P/TSX Composite Index rose by 24.13% and the S&P 500 rose by 4.91% in US dollar terms which translates to a gain of 1.82% in Canadian dollar terms as the US dollar weakened throughout the year. The trust made distributions of $1.16 per unit during the year.

The U.S. Federal Open Market Committee continued its tightening policy throughout the year as inflationary concerns were driven by strong economic data and rising energy prices. The Bank of Canada increased its key policy rate in each of the last three scheduled dates in 2005. These moves impacted short rates, causing both Canadian and U.S. yield curves to flatten.

The Trust's portfolio of market-neutral hedge funds experienced moderate returns for 2005. Mortgage-backed security arbitrage, structured finance, asset-backed securities arbitrage and distressed securities funds delivered consistently strong returns throughout the year. Manager skill combined with increased trading opportunities and a healthy credit market proved favorable to these strategies which represent over 40% of the portfolio. Multi-strategy managers were strong contributors due to their depth and breadth of talent, and ability to move capital quickly and opportunistically.

Re-insurance was a negative contributor during the year due to losses attributable to hurricanes Katrina, Rita and Wilma. Re-insurance pricing has become favorable in the wake of last year's hurricane season, and as such we have maintained our allocation to this strategy. Energy relative value and statistical arbitrage also delivered negative returns in 2005.

We continue to reduce our allocation to traditional strategies such as convertible bond arbitrage, merger arbitrage and fixed-income arbitrage in favor of structured finance and distressed securities funds.

Northwater remains committed to looking for new funds in non-traditional areas of the hedge fund universe and managers with proven track records and hedging skills in both the activist and energy relative value space.

During 2005, Northwater continued to actively manage the Trust's hedge fund portfolio. During the year, 13 funds were removed for both declining strategy returns and ineffective implementation while 15 new funds were added to strategies widely represented across the portfolio. Northwater continues to focus on improving the portfolio by refining its stable of managers and adding managers in market neutral strategies that are expected to deliver strong risk-adjusted returns consistent with the investment objectives.

DANIEL C.R. MILLS, CFA
Managing Director and
Chief Investment Officer,
Northwater Capital Management Inc.

PETER B. SCHENDEL, CFA
Vice-President,
Northwater Capital Management Inc.

February 28, 2006

ANNUAL MANAGEMENT REPORT OF FUND PERFORMANCE

This Annual Management Report of Fund Performance contains financial highlights but does not contain the complete annual financial statements of the investment fund. A copy of the annual financial statements of the investment fund has been attached to this report for your reference.

Securityholders may also contact us using one of following methods to request a copy of the investment fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure. You can contact us, and at no cost, by calling toll-free 1-888-429-8774, by writing to us at Northwater Fund Management Inc., Suite 4700, BCE Place, Bay Wellington Tower, 181 Bay Street, P.O. Box 794, Toronto, Ontario, M5J 2T3 or by visiting our website at *www.northwatercapital.com* or by visiting SEDAR at *www.sedar.com.*

Investment Objective and Strategies

The investment objectives of Northwater Market-Neutral Trust (the ''Trust'') are to:

1. Distribute quarterly 2% of the net asset value per unit of the Trust as of the month end preceding the relevant calendar quarter end;
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 comprised of market-neutral hedge funds that Northwater Capital Management Inc. (the ''Investment Advisor'') believes have strong expected risk-adjusted returns as well as performance histories that have a low correlation with major equity and debt markets. In establishing the hedge fund ''mix,'' the Investment Advisor seeks out strategies that also have a low correlation with one another, thereby increasing the benefits of diversification and reducing expected volatility. While there can be no assurance that the Trust's performance will exhibit strong risk-adjusted returns, the Investment Advisor believes that by constructing a well-diversified portfolio of market-neutral hedge funds, the returns of the Trust should have a low correlation with major equity and fixed income markets and a low 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 may borrow an additional 10% of the net asset value in order to re-purchase units under its buy-back programs, to effect cash distributions and to settle currency hedging transactions. The ability of the Trust to borrow will increase the risk to unitholders and may not enhance returns in the event that the securities purchased with the borrowed funds decline in value.

The financial leverage employed by the Trust to make investments as at December 31, 2005 was 21.90% (December 31, 2004: 20.97%).

Risks

The risks of investing in the Trust remain as discussed in the Trust's prospectus. A copy of the prospectus of the Trust is available by visiting Sedar at *www.sedar.com*. The below highlight the key risks of the Trust.

1. no assurance of achieving investment objectives and no guaranteed rate of return
2. fluctuation in net asset value and trading price of the Trust
3. reliance on key personnel by Northwater Capital Management Inc., the Investment Advisor of the Trust
4. potential conflicts of interest with respect to the Investment Advisor
5. taxation of the Trust and unitholders
6. fluctuation in prices and market movements in units or shares of offshore hedge funds
7. illiquid securities
8. legal and statutory rights
9. unitholder liability
10. hedge funds include fees
11. compliance and risk management systems
12. possible negative impact of regulation of hedge funds
13. status of the Trust
14. leverage
15. performance and marketability of hedge fund portfolio
16. no guarantee of market-neutrality
17. turnover

18. international investments
19. counterparty risk
20. risks of commodity futures
21. currency hedging
22. competition
23. general market history
24. overall investment risk
25. indemnification of hedge funds by the Fund

Results of Operations

During 2005, the Trust posted a return of 2.21% taking into account distributions made during the year. Distributions during 2005 totaled $6,066,507 or $1.16 Unit.

During 2005, the Trust placed investments with 15 hedge funds (consisting of four structured finance funds, three distressed securities funds, one re-insurance fund, one energy relative value fund, one statistical arbitrage fund, one multi-strategy fund, one capital structure arbitrage fund, one activist fund and two asset-backed securities arbitrage funds) and redeemed from 13 hedge funds (consisting of two convertible bond arbitrage funds, one energy relative value fund, one asset-backed securities arbitrage fund, one structured finance fund, two statistical arbitrage funds, three multi-strategy funds, two fixed-income arbitrage funds and one capital structure arbitrage fund).

The Trust had borrowings in the amount of U.S. $13,500,000 during the year ended December 31, 2005 through a revolving loan facility with a Canadian financial institution. The financial leverage as at December 31, 2005 was 21.90% (December 31, 2004: 20.97%). The Trust has employed the loan as leverage to enhance its investment returns.

Related Party Transactions

Northwater Fund Management Inc., the Manager, is responsible for the day-to-day administration, portfolio management and unitholder services to the Trust. In return for these services, the Manager is entitled to an annual fee of 1.25% of the net assets of the Trust, calculated on the last Valuation Date of each month. The fee is paid monthly in arrears. The Manager will pay a portion of its fee to Northwater Capital Management Inc. (the Investment Advisor) in consideration of the Investment Advisor's services to the Trust. During the year ended December 31, 2005, the management fee expense was $1,010,270 and the amount payable by the Trust as at December 31, 2005 was $172,273.

Financial Highlights

The following tables show selected key financial information about the Trust and are intended to help understand the Trust's financial performance for the past 5 years. This information is derived from the Trust's audited annual financial statements.

The Trust's Net Asset Value (NAV) per Unit

	2005	2004	2003	2002	2001
Net Asset Value, beginning of year	$ 14.73	$ 15.81	$ 19.05	$18.59	$18.81
Increase (decrease) from operations:					
Total revenue	0.04	0.03	0.02	0.03	0.05
Total expenses	(0.35)	(0.52)	(0.12)	(0.15)	(0.29)
Realized gains (losses) for the period	0.28	1.83	6.69	1.21	1.51
Unrealized gains (losses) for the period	0.33	(0.57)	(4.79)	0.36	0.62
Total increase (decrease) from operations[1]	0.29	0.77	1.80	1.45	1.89
Distributions:					
From income (excluding dividends)	0.35948	0.00592	4.21072	—	—
From capital gains	—	—	0.82611	—	—
Return of capital	0.80052	1.84054	0.04317	1.08	2.17
Total Annual Distributions[2]	1.16	1.84646	5.08000	1.08	2.17
Net Asset Value at December 31 of year shown	$ 13.88	$ 14.73	$ 15.81	$19.05	$18.59

(1) Net asset value and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial period.

(2) Distributions were both paid in cash and reinvested in additional units of the Trust.

(3) It is not intended that the Trust's Net Asset Value per Unit table act as a continuity of opening and closing net asset value per unit.

Ratios and Supplemental Data

	2005	2004	2003	2002	2001
Net assets (000's)[1]	$ 71,507	$ 77,232	$ 82,788	$ 101,834	$ 105,773
Number of units outstanding[1]	5,150,015	5,243,585	5,237,559	5,344,359	5,689,659
Management expense ratio[2]	7.08%	7.94%	5.25%	5.43%	6.13%
Management expense ratio before waivers or absorptions[2]	7.08%	7.94%	5.25%	5.43%	6.13%
Portfolio turnover rate[3]	40.56%	26.96%	42.44%	18.76%	27.87%
Trading expense ratio[4]	0.00%	0.00%	0.00%	0.00%	0.00%
Closing market price or pricing NAV, December 31	$ 12.55	$ 15.06	$ 16.10	$ 17.34	$ 17.85

(1) This information is provided as at December 31 of the year shown.

(2) Management expense ratio is based on total expenses for the stated period and is expressed as an annualized percentage of month-end average net assets during the period. Please note that the management expense ratio includes not only the expenses of the Trust itself but also reflects expenses to which the underlying hedge funds were subject. The expense ratio of the underlying hedge funds included in the above ratios for 2005, 2004, 2003, 2002 and 2001 added 4.63% for each of the years to the expense ratio of the Trust.

The annualized expense ratio has been calculated using the total expenses of the underlying hedge funds, invested in by the Trust, per their annual audited financial statements. The 2001 to 2005 expense ratios reflect the expenses of the hedge funds for the year 2004 as they represent the most recent audited information available. The expenses together with estimates for hedge funds with year-ends other than December 31, 2004 have been prorated based on the relative percentage of the hedge funds held by the Trust at December 31, 2004. Performance fees incurred by the underlying hedge funds can vary significantly from period to period based on such factors as the market conditions, fund strategy and manager performance. As a result, the expense ratios of the underlying funds for the prior year, may be significantly different than the actual expenses incurred by these underlying hedge funds for the current period.

(3) The Trust's portfolio turnover rate indicates how actively the Trust's portfolio adviser manages its portfolio investments and rebalances its investments. A portfolio turnover rate of 100% is equivalent to the Trust buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a fund. Hedge fund trades do not result in trading costs.

(4) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of monthly average net assets during the period.

Management Fees

The Trust paid Northwater Fund Management Inc. management fees of $1,010,270 for the year ended December 31, 2005. The management fee is calculated as 1.25% per annum of the net asset value of the Trust, as of the close of business on each month-end valuation date. Northwater Fund Management Inc. performs the day-to-day administration, portfolio management, and unitholder services for the Trust.

For the year ended December 31, 2005, a portion of the management fee received from the Trust was paid to Northwater Capital Management Inc., for investment advisory services provided to the Trust.

Past Performance

General

With respect to the following information in the ''Past Performance'' section of this report, please note the following:

(a) the performance information shown assumes that all distributions made by the investment fund in the periods shown were reinvested in additional securities of the investment fund;

(b) the performance information does not take into account sales, and distribution charges that would have reduced returns or performance; and

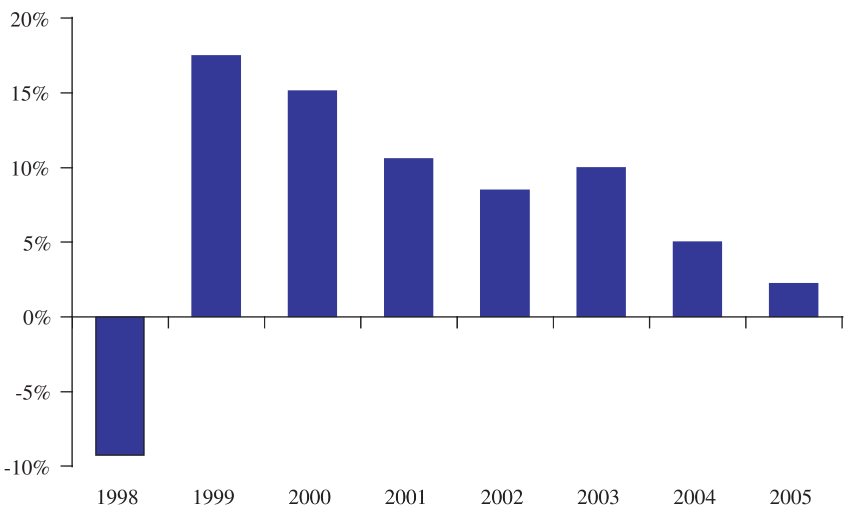
(c) how the investment fund has performed in the past does not necessarily indicate how it will perform in the future.

Year-by-Year Returns

With respect to the following chart, please note the following:

(a) the bar chart shows the investment fund's annual performance for each of the years shown, and illustrates how the investment fund's performance has changed from year to year; and

(b) the bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the last day of each financial year.



Annual Compound Returns

This chart compares the historical annual compound returns of the Trust over the periods indicated relative to various market Indices.

	Since inception*	Past 5 years	Past 3 years	Past year
Northwater Market-Neutral Trust	6.92%	7.21%	5.69%	2.21%
S&P/TSX Composite Index	7.81%	6.63%	21.66%	24.13%
Scotia Capital 91 day T-Bill Index	3.72%	3.00%	2.60%	2.58%
Scotia Capital Universe Bond Index	6.85%	7.42%	6.77%	6.46%

* inception date of the Trust is July 30, 1997.

The S&P/TSX Composite Index is a broad index of Canadian common shares.

The Scotia Capital 91-day T-Bill Index shows how a portfolio of 3 month T-Bills would perform.

The Scotia Capital Universe Bond Index is a broad index of Canadian federal government, provincial government and corporate fixed income securities.

Summary of Investment Portfolio[(1)]

The following table presents the asset allocation by investment strategy, the number of hedge funds by investment strategy and the largest individual hedge fund holding for each investment strategy as a percentage of the total net asset value of the Trust as at December 31, 2005. The multi-strategy funds may invest in multiple investment strategies.

	Asset allocation by hedge fund strategy As at December 31, 2005			Largest individual hedge fund holding for each individual strategy As at December 31, 2005
Strategy	**No. of Hedge Funds**	**Fair Value**	**Percentage**	**Percentage of Net Assets of the Trust**
Activist	1	$ 2,008,147	3%	2.81%
Asset-backed securities arbitrage	6	11,478,407	15%	4.21%
Capital structure arbitrage	4	4,615,861	6%	4.05%
Convertible bond arbitrage	3	3,407,699	4%	2.70%
Distressed securities	6	10,210,013	13%	4.90%
Energy relative value	1	579,205	1%	0.81%
Fixed-income arbitrage	2	2,353,687	3%	1.81%
Merger arbitrage	2	2,589,267	3%	2.05%
Mortgage-backed security arbitrage	4	10,507,956	13%	6.48%
Multi-strategy	10	17,827,314	23%	4.75%
Re-insurance	2	4,925,915	6%	5.33%
Statistical arbitrage	—	—	0%	0.00%
Structured finance	6	8,419,804	11%	3.01%
	47	$78,923,275	100%	42.89%

The following table lists the largest 25 hedge funds by fair value held by the Trust as at December 31, 2005. The Trust will disclose the names of those hedge funds to which it holds that represent more than 5% of the net assets of the Trust at year-end. For hedge funds that represent less than 5% of the Trust's net assets, the Trust has adopted unique fund numbers as identifiers. These numbers will be used consistently in reporting going forward.

Top 25 Investments	Type of Investment	Cost	Fair Value	Percentage of Net Assets
New Ellington Overseas, Ltd. *	Participating shares	$4,426,840	$4,630,915	6.48%
Nephila Catastrophe Fund, Ltd. *	Participating shares	4,343,170	3,808,144	5.33%
Fund 109 *	Participating shares	1,627,922	3,501,338	4.90%
Fund 175 *	Participating shares	3,316,760	3,396,330	4.75%
Fund 115 *	Participating shares	1,400,393	3,016,426	4.22%
Fund 169 *	Participating shares	2,911,187	3,008,349	4.21%
Fund 101 *	Participating shares	2,788,843	2,911,778	4.07%
Fund 171 *	Participating shares	2,580,781	2,906,358	4.06%
Fund 170 *	Participating shares	3,013,327	2,893,343	4.05%
Fund 121 *	Participating shares	2,693,322	2,700,693	3.78%
Fund 146 *	Participating shares	2,482,873	2,324,497	3.25%
Fund 200 *	Participating shares	2,205,603	2,217,443	3.10%
Fund 189 *	Participating shares	2,094,240	2,156,216	3.02%
Fund 205 *	Participating shares	2,185,560	2,155,224	3.01%
Fund 211 *	Participating shares	1,975,060	2,008,147	2.81%
Fund 116 *	Participating shares	2,005,921	1,950,358	2.73%
Fund 125 *	Participating shares	1,692,258	1,931,254	2.70%
Fund 190 *	Participating shares	1,855,000	1,887,266	2.64%
Fund 183 *	Participating shares	1,797,460	1,861,589	2.60%
Fund 160 *	Participating shares	1,536,826	1,833,558	2.56%
Fund 196 *	Participating shares	1,832,000	1,796,165	2.51%
Fund 129 *	Participating shares	1,263,200	1,546,559	2.16%
Fund 102 *	Participating shares	1,133,722	1,466,110	2.05%
Fund 191 *	Participating shares	1,263,900	1,294,393	1.81%
Fund 108 *	Participating shares	1,078,686	1,229,152	1.72%

* held by other investment funds managed by Northwater Fund Management Inc.

(1) The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the investment fund. There are no non-arm's length relationships between the Trust or Northwater Fund Management Inc. and any of the hedge funds for which the Trust holds. On a quarterly basis, an updated listing of holdings will be available.

SUPPLEMENTARY INFORMATION

Northwater Market-Neutral Trust (the ''Trust'') is managed by Northwater Fund Management Inc. (the ''Manager''). The Manager is responsible for managing the business and administration of the Trust pursuant to the provisions of the trust agreement as well as monitoring the Trust's investment portfolio. The Manager has retained Northwater Capital Management Inc. (the ''Investment Advisor'') to provide investment advice and to manage the Trust's investment portfolio in accordance with the Trust's investment objectives. In fulfilling its responsibilities, the Manager must determine 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 Management Process

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

The Investment Advisor has developed a proprietary selection process to enable it to advise the Trust with respect to the selection and monitoring of potential hedge fund investments to be made by the Trust. The proprietary selection process is an integral part of the Investment Advisor's strategy for generating value over time and consists of:

1. The development of a multi-faceted set of investment beliefs, which serve as a framework for identifying appropriate market-neutral strategies and the managers that employ those strategies. These investment beliefs have and continue to evolve with the Investment Advisor's experience in market-neutral hedge fund investing and in managing complex derivative strategies.

2. The use of an established operational infrastructure necessary for managing complex market-neutral and derivative strategies. The Investment Advisor has built a team of investment professionals and developed robust portfolio and risk management systems and tools essential to managing a sophisticated fund of market-neutral hedge funds.

3. A progressive global search for market-neutral strategies consistent with the Investment Advisor's investment beliefs and the Trust's investment criteria of market-neutrality and strong risk-adjusted returns. The Investment Advisor's search focuses on managers who have demonstrated expertise in consistently implementing these strategies.

4. A comprehensive quantitative and qualitative assessment of hedge fund managers who employ market-neutral strategies that adhere to the Investment Advisor's investment beliefs and the objectives of the Trust.

5. The use of specific quantitative procedures, including screens that attempt to identify consistency and adaptability, market-neutrality, and portfolio fit, which are integral to the Investment Advisor's investment process. Various portfolio construction techniques are used, including mathematical optimization, statistical process control and factor analysis.

6. An ongoing qualitative assessment of existing and prospective hedge fund managers, including hedge fund manager reviews involving on-site interviews, monthly portfolio reviews and various industry references. The goal of this process is to fully understand the hedge fund manager's investment strategy and risk management processes. The Investment Advisor also seeks to ascertain the strength of a hedge fund manager's competitive advantage, its investment team and its business plans.

7. The construction of a diversified model portfolio across 14 market-neutral strategies. This is a dynamic process.

8. A comprehensive due diligence process that must be completed before the Investment Advisor recommends an investment. This process typically includes on-site interviews conducted by investment professionals from the Investment Advisor, an all-inclusive strategy and operational due diligence report, a legal review of the offering documentation, an analysis of the hedge fund's financial statements, an assessment of the fees charged by the hedge fund's manager and an examination of any administrative or other costs associated with making the investment. Rigorous monitoring and due diligence continues once a hedge fund is added to the Trust. This process includes regular discussions with the hedge fund manager, multiple on-site interviews each year, continual quantitative and qualitative assessments and monthly review of the hedge fund's role within the Investment Advisor's model portfolio.

The Investment 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 Investment Advisor determines is equitable to clients in the circumstances.

Investment Portfolio and Activity

The Trust invests in hedge funds that emphasize sectors of the capital markets that the Investment Advisor believes are relatively inefficient or present opportunities to generate uncorrelated returns. The Investment Advisor believes that such sectors offer arbitrage, relative value or absolute return 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. As at December 31, 2005, the Trust was invested in 47 hedge funds (December 31, 2004: 45 hedge funds) with 42 managers (December 31, 2004: 41 managers) engaged in 14 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. Some of these investment strategies are contained within multi-strategy funds. The hedge funds in which the Trust is invested have been established in offshore jurisdictions and prepare annual audited financial statements, in accordance with US or International generally accepted accounting principles (GAAP).

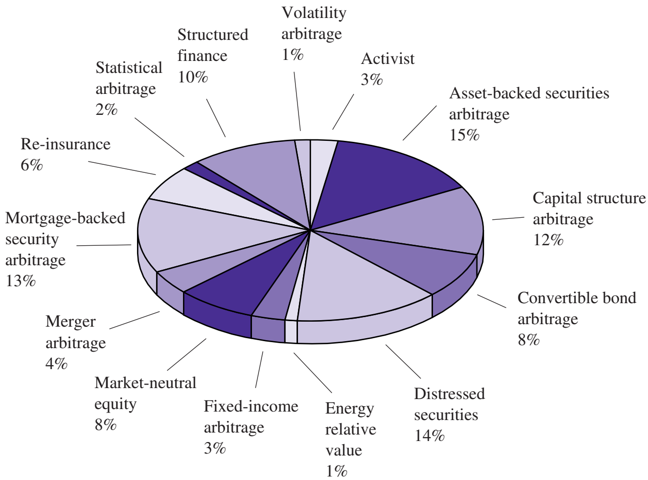
During the year ended December 31, 2005, the Trust placed investments with 15 hedge funds (consisting of four structured finance funds, three distressed securities funds, one re-insurance fund, one energy relative value fund, one statistical arbitrage fund, one multi-strategy fund, one capital structure arbitrage fund, one activists fund and two asset-backed securities arbitrage funds) and redeemed from 13 hedge funds (consisting of two convertible bond arbitrage funds, one energy relative value fund, one asset-backed securities arbitrage fund, one structured finance fund, two statistical arbitrage funds, three multi-strategy funds, two fixed-income arbitrage funds and one capital structure arbitrage fund) (year ended December 31, 2004, the Trust placed investments with 12 new hedge funds and redeemed from 9 hedge funds).

Asset Allocation by Investment Strategy

Hedge Fund Investments

	As at December 31, 2005			As at December 31, 2004		
Strategy	**No. of Hedge Funds**	**Fair Value**		**No. of Hedge Funds**	**Fair Value**	
Activist	1	$ 2,008,147	3%	—	—	—
Asset-backed securities arbitrage	6	11,478,407	15%	5	$ 9,529,640	11%
Capital structure arbitrage	4	4,615,861	6%	4	9,046,341	11%
Convertible bond arbitrage	3	3,407,699	4%	5	8,565,356	11%
Distressed securities	6	10,210,013	13%	3	8,676,560	11%
Energy relative value	1	579,205	1%	1	668,131	1%
Fixed-income arbitrage	2	2,353,687	3%	4	5,545,607	7%
Merger arbitrage	2	2,589,267	3%	2	2,257,182	3%
Mortgage-backed security arbitrage	4	10,507,956	13%	4	8,588,611	11%
Multi-strategy	10	17,827,314	23%	12	18,237,845	22%
Re-insurance	2	4,925,915	6%	1	4,212,276	5%
Statistical arbitrage	—	—	0%	1	2,011,913	2%
Structured finance	6	8,419,804	11%	3	4,122,177	5%
	47	$78,923,275	100%	45	$81,461,639	100%

The following chart illustrates the hedge fund holdings by strategy as at December 31, 2005. The multi-strategy hedge funds have been allocated to various hedge fund strategies to reflect their exposure to their constituent strategies. Strategy weights are dynamic and may change from period to period.



The following table presents the largest individual hedge fund holding for each investment strategy as a percentage of the total net asset value of the Trust as at December 31, 2005 and December 31, 2004.

Strategy	As at December 31, 2005	As at December 31, 2004
Activist	2.81%	—
Asset-backed securities arbitrage	4.21%	4.65%
Capital structure arbitrage	4.05%	4.08%
Convertible bond arbitrage	2.70%	2.91%
Distressed securities	4.90%	5.67%
Energy relative value	0.81%	0.87%
Fixed-income arbitrage	1.81%	3.37%
Merger arbitrage	2.05%	1.50%
Mortgage-backed security arbitrage	6.48%	3.32%
Multi-strategy	4.75%	3.62%
Re-insurance	5.33%	2.11%
Statistical arbitrage	0.00%	2.61%
Structured finance	3.01%	1.78%

Risk Characteristics

The following tables present information for the periods from inception and for the years ended December 31, 2005 and 2004 regarding the risk profile of both the Trust and the Trust's hedge fund holdings.

Trust Statistics	For the period from inception to December 31, 2005	For the period from inception to December 31, 2004
# of positive monthly returns	76	69
# of negative monthly returns	25	20
% of negative months	24.8%	22.5%
Average size of negative months	-1.00%	-1.26%
Worst monthly return	-11.78% (Aug/98)*	-11.78% (Aug/98)*

Single Hedge Fund Statistics	Year ended December 31, 2005	Year ended December 31, 2004
# of hedge funds with positive returns(1)	40	40
# of hedge funds with negative returns(1)	7	5
Average annual hedge fund standard deviation(2)	4.12%	3.60%
Average correlation between hedge funds(3)	0.141	0.179

(1) Measured for hedge funds in the portfolio as at December 31, 2005 and December 31, 2004 respectively.

(2) As measured over the past 24 months for hedge funds in the portfolio as at December 31, 2005 and December 31, 2004 respectively, excludes hedge funds with less than 24 months of historical returns.

(3) As measured over the past 24 months for hedge funds in the portfolio as at December 31, 2005 and December 31, 2004 respectively, excludes hedge funds with less than 24 months of historical returns.

* The Russian debt crisis occurred during August 1998 and affected many investors. The return for the month of August for the S&P 500 Index was -14.46% and -20.41% for the TSX Index. The month of the second largest loss next to August 1998 was October 1997 with a return of -2.35%.

Review of Financial Results

Performance

During 2005, the Trust posted a return of 2.21% (2004: 5.00%) taking into account distributions made during the year. The merger arbitrage and structured finance strategies contributed positively to the Trust in 2005 while the energy relative value and statistical arbitrage strategies were the weakest performers.

The Trust was able to capitalize on the share buy-back and cancellation program as 105,100 units of the Trust during 2005 were repurchased and cancelled as the units were offered for sale at less than 92.5% of the net asset value. During 2005, this program contributed 0.22% to the overall return (2004: no contribution to overall return).

The following table presents the return by investment strategy for the years ended December 31, 2005 and 2004.

Strategy	Year ended December 31, 2005	2004
Activist	1.65%	—
Asset-backed securities arbitrage	8.35%	15.45%
Capital structure arbitrage	0.52%	5.96%
Convertible bond arbitrage	1.57%	0.72%
Distressed securities arbitrage	7.18%	11.23%
Fixed-income arbitrage	5.16%	-1.83%
Energy relative value	-13.77%	11.22%
Merger arbitrage	18.95%	8.89%
Mortgage-backed security arbitrage	9.25%	3.92%
Re-insurance arbitrage	-12.10%	2.93%
Statistical arbitrage	-13.59%	2.01%
Structured finance	9.87%	3.70%
Volatility arbitrage	—	-3.86%
Multi-strategy	6.97%	8.14%

Net Asset Value and Price Per Unit

The value of investments held by the Trust is affected by factors beyond the control of the Investment 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 net asset value of the hedge funds supplied by the administrators or managers of such 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, 2005, the net asset value of the Trust fluctuated between a low of $13.88 per unit and a high of $14.87 per unit (2004: low of $14.73 and a high of $16.27), after taking into account distributions.

The market price for units of the Trust is determined by the actions of buyers and sellers in the market. During the year, the daily closing price of the units fluctuated between $12.11 and $15.27 (2004: low of $14.45 and a high of $16.44).

Distributions

During the year, the Trust made distributions totaling $1.16 per unit ($6,066,507 was distributed in aggregate) compared to $1.85 per unit ($9,679,785 in aggregate) in 2004.

The Trust is 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.

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	$0.00637
		Other income	$0.62166
		Realized gain	$0.12197
			$0.75000
June 30, 2003	July 22, 2003	Return of capital	$0.00527
		Other income	$0.51391
		Realized gain	$0.10082
			$0.62000

Record date	Date distribution paid	Character of distribution for tax purposes	Amount per unit
September 30, 2003	October 24, 2003	Return of capital	$0.00034
		Other income	$0.03316
		Realized gain	$0.00650
			$0.04000
December 31, 2003	January 29, 2004	Return of capital	$0.03119
		Other income	$3.04199
		Realized gain	$0.59682
			$3.67000
May 31, 2004	June 25, 2004	Return of capital	$0.00103
		Other income	$0.31897
			$0.32000
June 30, 2004	July 29, 2004	Return of capital	$0.00101
		Other income	$0.31545
			$0.31646
September 30, 2004	October 29, 2004	Return of capital	$0.00099
		Other income	$0.30901
			$0.31000
December 31, 2004	January 28, 2005	Return of capital	$0.00289
		Other income	$0.89711
			$0.90000
March 31, 2005	April 28, 2005	Return of capital	$0.20703
		Other income	$0.09297
			$0.30000
June 30, 2005	July 29, 2005	Return of capital	$0.20013
		Other income	$0.08987
			$0.29000
September 30, 2005	October 28, 2005	Return of capital	$0.20013
		Other income	$0.08987
			$0.29000
December 31, 2005	January 30, 2006	Return of capital	$0.19323
		Other income	$0.08677
			$0.28000

Management Fees

Management fees of 1.25% per annum of the net asset value of the Trust are accrued and paid monthly by the Trust to the Manager.

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 are offered for sale is less than 92.5% of the current net asset value per unit as at the close of business on the preceding valuation date.

On November 25, 2005, the Trust filed a notice of intention to make normal-course purchases of its units with the Toronto Stock Exchange (the ''Exchange''). In its filing with the Exchange, the Trust indicated an intention to purchase up to 523,591 of the units of the Trust during the period from November 29, 2005 to November 28, 2006, 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, 2005, the Trust purchased 105,100 units (2004: no units were purchased) for cancellation under this program. During 2005, this program contributed 0.22% to the overall return (2004: no contribution to 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 issuance from Treasury.

Purchases from treasury made under this plan during the year ended December 31, 2005 amounted to 11,530 units while 7,387 units were purchased in the market (2004: 1,877 units were purchased in the market and 6,026 units were purchased from treasury).

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.

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 judgments. The significant accounting policies that management believes are appropriate for the Trust are described in note 2 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 24.

BENITA M. WARMBOLD, CA
Managing Director and
Chief Financial Officer

EVE N. JEDRZEJEWSKA, CA, CFA
Vice-President

March 10, 2006

AUDITORS' REPORT TO THE UNITHOLDERS OF NORTHWATER MARKET-NEUTRAL TRUST

We have audited the statement of investment portfolio as at December 31, 2005 and the statements of net assets of Northwater Market-Neutral Trust (the Trust) as at December 31, 2005, and 2004 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 financial position of the Trust as at December 31, 2005 and 2004 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
Toronto, Ontario
March 31, 2006

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Net Assets
As at December 31, 2005 and 2004

	2005	2004
Assets		
Cash and short-term investments		
(cost: 2005 – $8,668,749; 2004 – $14,365,097)	$ 8,679,483	$ 14,433,474
Hedge fund investments – at fair value (note 3)		
(cost: 2005 – $74,561,289; 2004 – $78,824,202)	78,923,275	81,461,639
Hedge fund redemptions receivable	210,794	939,803
Short-term investments held as margin deposited on futures contracts – at market value (note 8)		
(cost: 2005 – $919,965; 2004 – $1,314,421)	922,438	1,315,848
Settlement receivable on currency futures (note 8)	134,432	166,264
	88,870,422	98,317,028
Liabilities		
Audit, legal and custody fees payable	32,971	40,252
Management fees payable	172,273	97,849
Interest and standby fees payable	55,249	34,862
Distribution payable	1,442,005	4,719,227
Bank loan (note 6)	15,660,346	16,192,417
	17,362,844	21,084,607
Net assets	$ 71,507,578	$ 77,232,421
Net assets and unitholders' equity (note 4)		
Unit capital	$109,341,400	$111,146,377
Retained earnings / (deficit)	(37,833,822)	(33,913,956)
Total	$ 71,507,578	$ 77,232,421
Number of units outstanding (note 4)	5,150,015	5,243,585
Net asset value per unit	$ 13.88	$ 14.73

Signed on behalf of the Trustee,

The Royal Trust Company

Per:

Per:

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

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Operations

	For the years ended December 31, 2005	2004
Investment income		
Interest	$ 196,243	$ 149,523
Other	4,778	—
	201,021	149,523
Expenses		
Interest and standby fees	630,505	362,294
Management fees (note 5)	1,010,270	825,494
Audit fees	49,373	32,100
Custodian fees	14,142	15,534
Legal fees	6,172	6,530
Security holder reporting costs	92,784	113,951
Special meeting of unitholders	—	1,310,811
Other fees	34,974	53,256
	1,838,220	2,719,970
Net investment loss	(1,637,199)	(2,570,447)
Realized and unrealized gain (loss) on investments		
Net realized gain (loss) on:		
Hedge fund investments	(927,886)	2,447,265
Currency hedging of investments	1,531,370	6,760,577
Change in unrealized appreciation (depreciation) on:		
Hedge fund investments	1,724,549	(3,281,225)
Currency futures	(31,382)	284,441
Net gain (loss) on currency, excluding hedge fund investments	871,342	388,675
Net realized and unrealized gain on investments for the year	3,167,993	6,599,733
Increase in net assets from operations for the year	$ 1,530,794	$ 4,029,286
Increase in net assets from operations per unit for the year*	$ 0.29	$ 0.77

* Based on the average number of units of 5,240,774 (2004 – 5,241,173) outstanding for the year.

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, 2005	2004
Net assets – beginning of the year	$77,232,421	$82,788,506
Increase in net assets from operations for the year	1,530,794	4,029,286
Unit transactions (note 4)		
Net asset value of units reinvested on distribution	169,852	94,414
Cancellation of units	(1,358,982)	—
	(1,189,130)	94,414
Distribution to unitholders (note 7)		
Return of capital	(4,186,458)	(31,011)
From net income	(1,880,049)	(9,648,774)
	(6,066,507)	(9,679,785)
Net assets – end of the year	$71,507,578	$77,232,421

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, 2005	2004
Cash flows from operating activities		
Increase in net assets from operations	$ 1,530,794	$ 4,029,286
Items not affecting cash:		
Net realized loss (gain) on hedge fund investments	927,886	(2,447,265)
Change in unrealized appreciation in value of currency futures	31,832	(284,441)
Change in unrealized appreciation in value of hedge fund investments	(1,724,549)	3,281,225
Changes in non-cash working capital:		
Change in payables	87,530	84,888
Purchase of hedge fund investments	(30,780,833)	(23,555,882)
Proceeds on sale of hedge fund investments	34,844,869	41,630,737
	4,917,529	22,738,548
Cash flows from financing activities		
Repayment of bank loan	(532,071)	(3,032,656)
Distributions paid	(9,173,877)	(24,087,986)
Cancellation of units	(1,358,982)	—
	(11,064,930)	(27,120,642)
Net decrease in cash and short-term investments	(6,147,401)	(4,382,094)
Cash and short-term investments at the beginning of the year	15,749,322	20,131,416
Cash and short-term investments at the end of the year	$ 9,601,921	$ 15,749,322
Supplementary information:		
Interest paid	$ 610,118	$ 350,628

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

NORTHWATER MARKET-NEUTRAL TRUST

Statement of Investment Portfolio
As at December 31, 2005

	Maturity Date	Face Value	Cost	Fair/ Market Value	Percentage of Investment Portfolio
Hedge fund investments *					
Activist			$ 1,975,060	$ 2,008,147	2.27%
Asset-backed securities arbitrage			10,410,383	11,478,407	12.95%
Capital structure arbitrage			4,803,037	4,615,861	5.21%
Convertible bond arbitrage			3,598,436	3,407,699	3.84%
Distressed securities			8,393,365	10,210,013	11.52%
Energy relative value			658,350	579,205	0.65%
Fixed-income arbitrage			2,233,543	2,353,687	2.65%
Merger arbitrage			2,340,082	2,589,267	2.92%
Mortgage-backed security arbitrage			9,912,906	10,507,956	11.85%
Multi-strategy			16,383,404	17,827,314	20.10%
Re-insurance			5,583,726	4,925,915	5.56%
Structured finance			8,268,996	8,419,804	9.50%
Hedge fund investments			74,561,289	78,923,275	89.01%
Settlement receivable on currency futures contract (schedule 1 and note 8)			—	134,432	0.15%
Cash			1,497,181	1,497,181	1.70%
Treasury bills **					
Canada*	March 7, 2006	$ 929,680	919,965	922,438	1.04%
Commercial paper **					
Bank of Montreal *	Jan. 17, 2006	464,840	463,362	463,892	0.52%
PURE Trust *	Jan. 27, 2006	2,091,780	2,084,814	2,085,024	2.35%
Safe Trust *	Jan. 27, 2006	4,648,400	4,623,392	4,633,386	5.23%
Cash and short-term investments		$8,134,700	9,588,714	9,601,921	10.84%
Total investment portfolio			$84,150,003	88,659,628	100.00%
Liabilities over other assets				(17,152,050)	
Net assets and unitholders' equity				$ 71,507,578	

* These investments are denominated in U.S. dollars and have been converted to Canadian dollars at the prevailing period end rate.

** Short-term investments held at December 31, 2005 have yields ranging from 4.28% to 4.32%.

Schedule 1 – Currency futures contracts:

	Closing Price	Notional Contract Value	Settlement Receivable on Futures Contracts
723 March 2006			
Canadian Dollar Futures Contracts	US $86.20	US $ 62,322,600	
		CDN $72,425,093	CDN $134,432

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, 2005 and 2004

1. Establishment and Operations 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 ''Trust Agreement''). The Trust Agreement was further amended as a result of a special meeting of unitholders held on April 19, 2004. 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, 2009, 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.

The Trust seeks to achieve a return hedged to Canadian dollars, by investing the assets of the Trust in cash and short-term investments, a diversified portfolio of market-neutral hedge funds and currency futures contracts.

2. Summary of Significant Accounting Policies

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

(a) Investments

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. In determining the definitive or provisional net asset values, certain hedge funds may be required to make estimates and assumptions that affect the reported net asset values. Actual results could differ from those estimates. The difference between fair value and cost is shown as an unrealized gain or loss on hedge fund 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 end of the period. Transactions in currencies other than Canadian dollars during the period are translated at the rates of exchange prevailing on the respective dates of such transactions. Foreign exchange gains and losses are recognized in the Statements 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 securities 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 Statements of Operations. The settlement due on futures contracts represents the daily variation margin owing or due to 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 Statements 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.

(e) Comparative Figures

Certain of the 2004 comparative figures have been reclassified to conform to the 2005 financial statement presentation.

3. Investment in Market-Neutral Hedge Funds

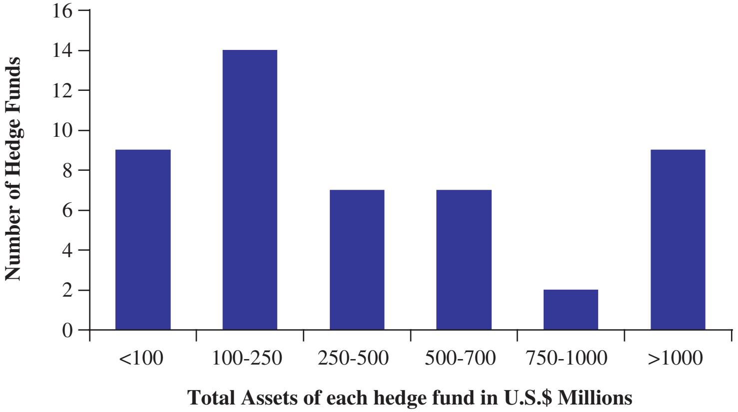
As part of its investment strategy, the Trust invests in a diversified portfolio of market-neutral hedge funds.

The following table summarizes hedge fund transactions during the relevant years ended December 31:

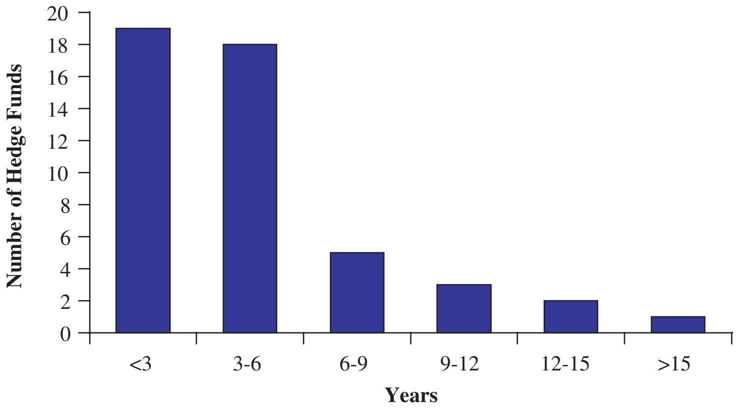
	2005	2004
Investment at cost – beginning of the year	$ 78,824,202	$ 82,227,807
Cost of investments purchased	30,780,833	23,555,882
Cost of investments sold	(35,043,745)	(26,959,487)
Investment at cost – end of the year	74,561,289	78,824,202
Unrealized appreciation of investments	4,361,986	2,637,437
Market value of investments – end of the year	$ 78,923,275	$ 81,461,639
Proceeds of investments sold	$ 34,115,860	$ 29,406,752
Cost of investments sold	(35,043,745)	(26,959,487)
Net realized gain (loss) on investments	$ (927,886)	$ 2,447,265

The market-neutral hedge funds included in the Trust's portfolio are organized and domiciled in non-U.S. jurisdictions primarily consisting of Cayman Islands, Bermuda, British Virgin Islands and Bahamas. These market-neutral hedge funds are managed by independent portfolio managers who are compensated for their services by the respective market-neutral hedge funds they manage. Such compensation generally consists of an asset-based management fee, ranging from 1% to 2% annually, and a performance-based incentive fee, generally ranging from 10% to 20% of net profits earned. Compensation paid to independent portfolio managers of the market-neutral hedge funds is not separately computed and disclosed by the Trust but rather is reflected in the valuation of each market-neutral hedge fund. Redemption provisions for the market-neutral hedge funds vary ranging from 30 days' notice to 180 days' notice and may be subject to lock-up provisions.

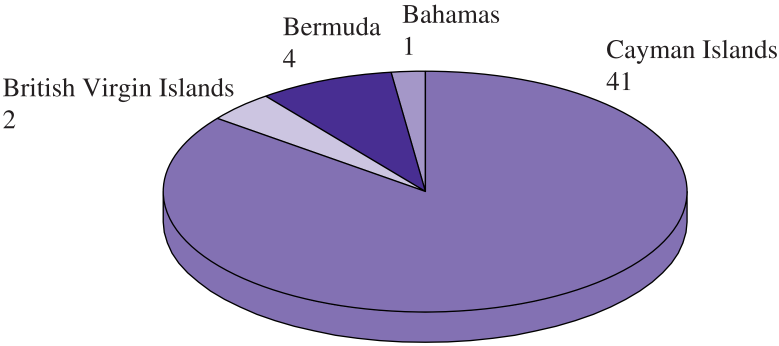
The following table shows the hedge funds held by the Trust as at December 31, 2005 categorized by the December 31, 2005 size of each hedge fund.



The following table shows the hedge funds as at December 31, 2005 categorized by the years since inception of each hedge fund.



The following chart illustrates the hedge fund holdings by jurisdiction of organization as at December 31, 2005.



4. 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.

Under a normal course issuer bid and the Trust's quarterly market support obligation, the Trust purchased 105,100 units for cancellation during the year ended December 31, 2005 (year ended December 31, 2004: no units were purchased).

Pursuant to the distribution reinvestment plan, 11,530 units were issued from Treasury during the year ended December 31, 2005 while 7,387 units were purchased in the market (year ended December 31, 2004: 6,026 units were issued from Treasury while 1,877 units were purchased in the market).

The following unit transactions took place during the relevant years:

	2005	2004
Balance of units outstanding – beginning of the year	5,243,585	5,237,559
Units issued during the year	11,530	6,026
Units cancelled during the year	(105,100)	—
Balance of units outstanding – end of the year	5,150,015	5,243,585

Unitholders' equity is comprised of unit capital and retained earnings. The following transactions for unit capital and retained earnings/(deficit) took place during the relevant years:

	2005	2004
Unit capital – beginning of the year	$111,146,377	$111,051,963
Units issued on distribution	169,852	94,414
Stated value of units repurchased	(1,974,829)	—
Unit capital – end of the year	$109,341,400	$111,146,377

	2005	2004
Retained earnings/(deficit) – beginning of the year	$ (33,913,956)	$ (28,263,457)
Increase in net assets from operations for the year	1,530,794	4,029,286
Stated value in excess of cost of units repurchased	615,847	—
Distribution to unitholders	(6,066,507)	(9,679,785)
Retained earnings/(deficit) – end of the year	$ (37,833,822)	$ (33,913,956)

5. Management Fees

Northwater Fund Management Inc., the Manager, is responsible for the day-to-day administration, portfolio management and unitholder services to the Trust. In return for these services, the Manager is entitled to an annual fee of 1.25% of the net assets of the Trust, calculated on the last Valuation Date of each month. The fee is paid monthly in arrears. The Manager will pay a portion of its fee to the Investment Advisor in consideration of the Investment Advisor's services to the Trust.

Effective as of the April 19, 2004 unitholder meeting, the Manager waived all deferred management fees for the period from the inception date of the Trust to March 31, 2004. Management fees in arrears at March 31, 2004 that were subsequently waived amounted to $9,877,307 or $1.88 per unit.

Northwater Capital Management Inc. (the ''Investment Advisor''), a Company formed under the laws of Ontario, Canada, acts as the advisor to the Trust. The Investment Advisor is registered in Canada as an advisor 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 advisor in the category commodity trading manager under the *Commodity Futures Act* (Ontario), as amended. The Investment Advisor is registered as a securities advisor under the *Securities Act* (Quebec), as amended. The Investment 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 advisor 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'').

6. 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 exchange 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 the relevant period end dates were denominated in Canadian dollars and U.S. dollars.

During the year ended December 31, 2005, the bank loan outstanding throughout the year was in the amount of $13,500,000 USD (year ended December 31, 2004: the bank loan varied between $12,500,000 USD and $14,500,000 USD).

7. Distributions

The Trust pays quarterly distributions to unitholders equal to 2% of the net asset value ($0.40 prior to April 19, 2004) per unit as of the month end preceding the given calendar quarter. Prior to April 19, 2004, distributions were paid to the extent that the net asset value per unit after giving effect to the distribution was greater than the initial net asset value on July 30, 1997 of $18.79. If less than $0.40 per unit was distributed in any quarter, the amount of the shortfall was 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 remained greater than $18.79 per unit.

During the year ended December 31, 2005, distributions of $1.16 per unit and $6,066,507 in aggregate (year ended December 31, 2004: approximately $1.85 per unit and $9,679,785 in aggregate) were made by the Trust.

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

8. Futures Contracts

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

As at December 31, 2005, short-term investments with a face value of US $800,000 (December 31, 2004: US $1,100,000) were deposited as margin for currency futures contracts.

During the year ended December 31, 2005, total commissions and other transaction costs paid or payable to dealers by the Trust was in the amount of $47,841 (year ended December 31, 2004: $46,386).

9. Income Taxes

As at December 31, 2005, 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 taxable 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 may be 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, 2005, the Trust had no non-capital loss carryforwards (2004: $2,695,000) and $5,910,000 in capital loss carry forwards (2004: $529,444).

The recent change in the rules for pension funds and other tax deferred retirement plans has eliminated the foreign property rule for these plans. Although the units of the Trust have always been RRSP and RRIF eligible, as foreign property, this change means Unitholders of the Trust are no longer constrained in their holdings as the 30% limit on foreign holdings no longer is applicable.

10. 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;

3) an indemnity to the Trust's futures broker with respect to any and all losses, costs and reasonable attorney's fees incurred by it in connection with the Trust's trading of futures contracts;

4) an indemnity to the Fund's Manager from all claims, costs, charges and expenses in connection with the execution of the duties of the Manager and from all other costs, charges and expenses the Manager may sustain or incur in relation to the affairs of the Trust;

5) 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; and

6) an indemnity to its soliciting dealer for the April 19, 2004 unitholder meeting by the Trust with respect to any losses, expenses, claims, actions, damages and liabilities arising out of any action, suit, proceeding, investigation or claim made by any person arising out of or based upon, directly or indirectly, the engagement.

Historically, no payments have been required to be 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.

NORTHWATER CAPITAL MANAGEMENT INC.

Northwater, a leader in financial innovation since January 1989, offers customized portfolio solutions to the global investment community by providing stable, diversified alpha and precise, low-cost market exposure.

Utilizing its expertise in constructing market-neutral portfolios that generate consistent returns in both normal and extreme markets, Northwater delivers a reliable source of alpha that can be tailored to meet an investor's active risk budget. In addition, the firm's established indexing capability allows access to the global equity and fixed income markets to complement an investor's unique asset/liability profile. Northwater's proven structuring technology then combines these two components in a portable alpha framework that achieves an investor's return/risk objectives in an efficient, cost-effective manner.

With over a ten year track record in fund of hedge funds, Northwater has steadily grown assets under management to approximately CDN $10.9 billion total, including CDN $4.5 billion invested in hedge funds as at December 31, 2005. Northwater has focused on developing, delivering and continuously improving its market-neutral fund of hedge fund portfolios since launching its first such portfolio in 1994.

Northwater advises institutional clients in Canada, the United States, the United Kingdom and the rest of Europe. The firm has offices in Toronto and New York.

Northwater Market-Neutral Trust which was launched in 1997 and is also advised by Northwater was the first publicly-listed investment vehicle of its kind in Canada to invest in a diversified portfolio of market-neutral hedge funds. Northwater also advises Northwater Five-Year Market-Neutral Trust and Northwater Top 75 Income Trusts^{Plus}, two additional publicly-listed vehicles.

NORTHWATER MARKET-NEUTRAL TRUST

Suite 4700, BCE Place
Bay Wellington Tower
181 Bay Street, P.O. Box 794
Toronto, Ontario M5J 2T3
Telephone: (416) 360-5435
Fax: (416) 360-0671
E-mail: mpt@northwatercapital.com

INVESTMENT MANAGER

Northwater Fund Management Inc.
Suite 4700, BCE Place
181 Bay Street, P.O. Box 794
Toronto, Ontario M5J 2T3
Telephone: (416) 360-5435
Fax: (416) 360-0671
E-mail: mpt@northwatercapital.com

INVESTMENT ADVISOR

Northwater Capital Management Inc.
Suite 4700, BCE Place
181 Bay Street, P.O. Box 794
Toronto, Ontario M5J 2T3
Telephone: (416) 360-5435
Fax: (416) 360-0671
E-mail: mpt@northwatercapital.com

LEGAL ADVISORS

McCarthy Tétrault LLP
Suite 4700, Box 48
Toronto Dominion Bank Tower
Toronto, Ontario M5K 1E6

AUDITORS

PricewaterhouseCoopers LLP
Suite 3000, Box 82
Royal Trust Tower, Toronto Dominion Centre
Toronto, Ontario M5K 1G8

DISTRIBUTION REINVESTMENT PLAN AGENT

CIBC Mellon Trust Company
P.O. Box 7101
Adelaide Street Postal Station
Toronto, Ontario M5C 2W9
Answerline: 1-800-387-0825

FOR FURTHER INFORMATION PLEASE CONTACT:

Mohamed Khaki or Stephen Foote
Telephone: (416) 360-5435
Fax: (416) 360-0671
E-mail: mpt@northwatercapital.com

For most recent net asset value update call: 1 (888) 429-8774

TSE Symbol: NMN.UN

Aussi disponible en français