NORTHWATER

Northwater Market-Neutral Trust
December 31, 2007
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, 2007 are included in this report.

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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, 2007, the net asset value of the Trust per unit was $11.76. For the year ended December 31, 2007, the return of the Trust was 3.42% including distributions. During the same time period, the DEX Universe Bond Index returned 3.68%, the S&P/TSX Composite Index rose by 9.83% and the S&P 500 in U.S. dollar terms, rose by 5.49% which translates to a loss of 10.53% in Canadian dollar terms as the U.S. dollar weakened during the period. The Trust made distributions of $2.87 per unit during the period.

The deterioration in the U.S. sub-prime housing market was the dominant theme in the capital markets in 2007. Downgrades in securities with sub-prime exposure caused a chain reaction of events that affected several hedge fund strategies from merger arbitrage to credit relative value to statistical arbitrage, as markets generally became very illiquid. Most major banks took substantive write-downs in their holdings that had sub-prime exposure, resulting in downward pressure in the equity markets. In an attempt to restore investor confidence, the Federal Open Market Committee, which had held the Feds Fund rate at 5.25% during the first half of 2007, made three cuts to the rate totalling a full percentage point in the second half of the year. However, credit concerns trumped the injection of liquidity by the Fed, and by the end of the year US equity markets gave up a good part of the gains they had made in the first half of the year

The portfolio of market-neutral hedge funds managed by Northwater Fund Management Inc. (the "Manager") to which the Trust has exposure, experienced positive returns over the year with eight of the eleven strategies contributing. Distressed Securities managers were able to harvest company specific gains while staying clear of the sub-prime credit market woes. Re-insurance and Multi-strategy managers were able to execute their strategies effectively. The largest negative contributions came from the Statistical Arbitrage strategy, with most of these losses coming in August. We expect that when the technical forces driving many of the current market extremes are normalized, the portfolio will be well positioned to capitalize on the opportunities.

Northwater continues to actively manage the composition of the Trust's hedge fund portfolio. During the year ended December 31, 2007, seven funds were removed for declining strategy returns and ineffective implementation of their investment strategy, while four new funds were added. The Manager remains focused 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.

DAVID S. FINCH, CFA
Managing Director
Northwater Capital Management Inc.

March 14, 2008

MANAGEMENT REPORT OF FUND PERFORMANCE

This Management Report of Fund Performance contains financial highlights for the year ended December 31, 2007 but does not contain the complete financial statements of the investment fund. A copy of the financial statements of the investment fund is attached to this report for your reference.

Security holders may contact us using one of following methods and may, at no cost, 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 by calling toll-free 1-888-429-8774 or 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. You may also visit our website at *www.northwatercapital.com* or visit the SEDAR website at *www.sedar.com.*

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.

Adoption of New Accounting Standards

On April 1, 2005, the Canadian Institute of Chartered Accountants issued Section 3855, "Financial Instruments – Recognition and Measurement" of the CICA Handbook – Accounting, which establishes standards for the fair valuation of investments as well as the accounting treatment of transaction costs. Section 3855 applies to fiscal years beginning on or after October 1, 2006.

The adoption of Section 3855 has not resulted in any change in the valuation policies in the Trust's financial statements.

Investment Objectives and Strategies

Investment Objectives

The investment objectives of the Trust are to:

1. Make quarterly distributions equal to 2% of the reported net asset value per unit of the Trust as of the month end preceding the relevant calendar quarter end;
2. Steadily grow the net assets;
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.

Investment Strategies

Hedge Funds

The Trust is comprised of market-neutral hedge funds that 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 low volatility.

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.

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 evolved 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 fund of market-neutral hedge fund 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.

Leverage

The Trust employs leverage as it believes that leverage may enhance investment returns. The Trust is entitled to borrow up to 25% of the reported net asset value for investment purposes, and may borrow an additional 10% of the reported 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, 2007 was 23.39% (December 31, 2006: 24.08%).

Risks

The following tables present information for the periods from inception and for the years ended December 31, 2007 and 2006 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, 2007	For the period from inception to December 31, 2006
# of positive monthly returns	94	86
# of negative monthly returns	31	27
% of negative months	24.8%	23.9%
Average size of negative months	(1.05%)	(1.02%)
Worst monthly return	(11.78%) (Aug/98)*	(11.78%)(Aug/98)*

	Year ended December 31,	
Single Hedge Fund Statistics	2007	2006
# of hedge funds with positive returns(1, 2)	26	40
# of hedge funds with negative returns(1, 2))	8	0
Average annual hedge fund standard deviation(2)	7.19%	3.80%
Average correlation between hedge funds(2)	0.24	0.11

(1) Measured for hedge funds in the portfolio as at December 31, 2007 and December 31, 2006 respectively.

(2) As measured over the past 24 months for hedge funds in the portfolio as at December 31, 2007 and December 31, 2006 respectively, excludes hedge funds with less than 24 months of historical returns.

* A Russian debt crisis occurred during August 1998 and affected many investors, including many hedge funds. 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 with the second largest loss next to August 1998 was October 1997 with a return of -2.35%

No material changes affecting the overall risk of investing in the Trust were made in the year ended December 31, 2007. 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 the SEDAR website at www.sedar.com.

Results of Operations

During the year ended December 31, 2007, the Trust posted a return of 3.42% (year ended December, 2006: 10.39%) taking into account distributions made during the year. Distributions during the year ended December 31, 2007 totaled $13,270,597 or $2.87 per unit (for the year ended December 2006: $5,592,362 or $1.14 per unit). The distressed securities strategy contributed most positively to the Trust's return among all the strategies for the year ended December 31, 2007 while the statistical arbitrage strategy was the weakest performer.

The borrowings of the Trust fluctuated between $12,700,569 USD and $13,977,483 USD throughout the year ended December 31, 2007 through a revolving loan facility with a Canadian financial institution (year ended December 31, 2006 the borrowings of the Trust fluctuated between: U.S.$13,318,180 and U.S.$14,318,732). The financial leverage as at December 31, 2007 was 23.39% (December 31, 2006: 24.08%). The Trust has employed the loan as leverage to enhance its investment returns.

The Trust was able to capitalize on the share buy-back and cancellation program with 209,700 units of the Trust being repurchased and cancelled during the year ended December 31, 2007 (year ended December 31, 2006: 367,400 units) as the units were offered for sale at less than 92.5% of the reported net asset value. During the year ended December 31, 2007, this program contributed 0.36% to the overall return (year ended December 31, 2006: 0.60% contribution to overall return).

Summary of Investment Portfolio (1)

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, 2007, the Trust was invested in 37 hedge funds (December 31, 2006: 40 hedge funds) with 34 managers (December 31, 2006: 37 managers) engaged in nine 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 U.S. or International generally accepted accounting principles ("GAAP").

During the year ended December 31, 2007, the Trust placed investments with four hedge funds (consisting of one fixed income arbitrage, one statistical arbitrage and one structural finance and one multi-strategy) and redeemed from seven hedge funds (consisting of one asset-backed securities arbitrage, two multi-strategy, one capital structure arbitrage, two structured finance and one merger arbitrage) (year ended December 31, 2006, the Trust placed investments with eight new hedge funds and redeemed from 15 hedge funds).

The following table presents returns by investment strategy for the year ended December 31, 2007 and 2006.

	For the year ended December 31,	
Strategy	**2007**	**2006**
Activist investments	6.09%	24.75%
Asset-backed securities arbitrage	10.05%	12.51%
Capital structure arbitrage	—	7.01%
Convertible bond arbitrage	—	10.96%
Distressed securities arbitrage	16.51%	18.42%
Fixed-income arbitrage	2.24%	8.94%
Energy relative value	—	(6.37)%
Merger arbitrage	—	14.27%
Mortgage-backed security arbitrage	(0.90)%	9.88%
Re-insurance arbitrage	14.17%	11.75%
Statistical arbitrage	(8.45)%	12.50%
Structured finance	5.07%	11.93%
Multi-strategy	8.68%	8.23%

Asset Allocation by Investment Strategy

The following table shows the hedge fund holdings by strategy as at December 31, 2007 and December 31, 2006. The multi-strategy funds have not been allocated to any of the underlying hedge fund strategies set out in this table.

	As at December 31, 2007			As at December 31, 2006		
Strategy	**No. of Hedge Funds**	**Fair Value**		**No. of Hedge Funds**	**Fair Value**	
Activist investments	1	$ 1,705,001	3%	1	$ 2,512,588	3%
Asset-backed securities arbitrage	4	8,164,189	13%	5	10,060,961	12%
Capital structure arbitrage	—	—	—	1	450,256	1%
Distressed securities arbitrage	6	10,299,791	16%	6	13,819,434	17%
Fixed-income arbitrage	3	3,459,306	5%	2	2,571,727	3%
Merger arbitrage	—	—	—	1	1,284,879	2%
Mortgage-backed security arbitrage	4	8,043,885	12%	4	10,362,344	13%
Multi-strategy	6	12,128,061	19%	7	16,158,899	20%
Re-insurance arbitrage	2	3,060,925	5%	2	5,520,794	7%
Statistical arbitrage	5	7,371,132	12%	4	5,608,982	7%
Structured finance	6	9,270,327	15%	7	12,866,799	15%
	37	$63,502,617	100%	40	$81,217,662	100%

The following table presents the largest individual hedge fund holding for each investment strategy as a percentage of the total net assets of the Trust as at December 31, 2007 and December 31, 2006.

Strategy	As at December 31, 2007	As at December 31, 2006
Activist investments	3.17%	3.71%
Asset-backed securities arbitrage	6.66%	5.11%
Capital structure arbitrage	—	0.67%
Distressed securities arbitrage	4.85%	6.27%
Fixed-income arbitrage	2.31%	2.09%
Merger arbitrage	—	1.90%
Mortgage-backed security arbitrage	5.67%	5.68%
Multi-strategy	4.95%	5.33%
Re-insurance arbitrage	4.66%	6.31%
Statistical arbitrage	3.98%	3.02%
Structured finance	5.94%	5.23%

The following table lists the largest 25 hedge funds by fair value held by the Trust as at December 31, 2007. The Trust will disclose the names of those hedge funds which it holds that represent more than 5% of the net assets of the Trust at the end of the period. 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 are used consistently in reporting by the Trust.

Top 25 Investments	Type of Investment	Cost	Fair Value	Fair Value as a % of Net Assets
Mariner Tricadia Credit Strategies Fund, Ltd.	Participating shares	$2,205,603	$3,581,093	6.66%
CRC Global Structured Credit Fund, Ltd.	Participating shares	2,911,187	3,273,361	6.09%
D.B. Zwirn Special Opportunities Fund Ltd.	Participating shares	3,236,940	3,194,972	5.94%
New Ellington Overseas, Ltd.	Participating shares	3,365,499	3,050,427	5.67%
Fund 121*	Participating shares	2,693,322	2,660,604	4.95%
Fund 109*	Participating shares	1,012,154	2,609,081	4.85%
Fund 189*	Participating shares	2,094,240	2,606,391	4.85%
Fund 131*	Participating shares	1,631,280	2,506,951	4.66%
Fund 146*	Participating shares	2,482,873	2,329,518	4.33%
Fund 213*	Participating shares	2,905,050	2,142,505	3.98%
Fund 208*	Participating shares	2,013,840	2,046,746	3.81%
Fund 101*	Participating shares	1,741,339	2,035,429	3.78%
Fund 130*	Participating shares	1,912,500	1,983,847	3.69%
Fund 115*	Participating shares	812,462	1,975,727	3.67%
Fund 196*	Participating shares	1,832,000	1,804,203	3.35%
Fund 187*	Participating shares	1,687,130	1,765,709	3.28%
Fund 209*	Participating shares	1,486,652	1,705,001	3.17%
Fund 183*	Participating shares	1,642,847	1,700,294	3.16%
Fund 104*	Participating shares	2,106,150	1,661,278	3.09%
Fund 214*	Participating shares	1,424,258	1,611,619	3.00%
Fund 216*	Participating shares	1,692,900	1,479,545	2.75%
Fund 116*	Participating shares	1,483,184	1,478,073	2.75%
Fund 160*	Participating shares	1,536,826	1,243,786	2.31%
Fund 222*	Participating shares	1,377,349	1,241,943	2.31%
Fund 221*	Participating shares	1,255,280	1,206,488	2.24%

* 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 Trust. There are no non-arm's length relationships between the Trust or Northwater Fund Management Inc. and any of the hedge funds held by the Trust. On a quarterly basis, an updated listing of holdings will be available.

Financial Highlights

The following tables show selected key financial information about the Trust and are intended to assist in understanding the Trust's financial performance for the past five years.

The Trust's Net Assets per Unit

	For the year ended December 31,				
	2007	2006	2005	2004	2003
Net Assets, beginning of year	$14.15	$13.88	$14.73	$15.81	$19.05
Increase (decrease) from operations:					
Total revenue	0.05	0.05	0.04	0.03	0.02
Total expenses	(0.41)	(0.41)	(0.35)	(0.52)	(0.12)
Realized gains (losses) for the year	2.80	(0.02)	0.28	1.83	6.69
Unrealized gains (losses) for the year	(1.99)	1.70	0.33	(0.57)	(4.79)
Total increase (decrease) from operations[1]	0.45	1.32	0.29	0.77	1.80
Distributions:					
From income (excluding dividends)	1.71	0.04	0.36	0.01	4.21
From capital gains	—	—	—	—	0.83
Return of capital	1.16	1.10	0.80	1.84	0.04
Total Distributions for the year[2]	2.87	1.14	1.16	1.85	5.08
Net Assets, at end of year[3]	$11.76	$14.15	$13.88	$14.73	$15.81

(1) Net assets 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. For the year ended December 31, 2007, the nature of the distributions will be determined at the end of the year.

(3) It is not intended that the Trust's Net Assets per Unit table act as a reconciliation of the opening and closing of the net assets per unit of the Trust.

Ratios and Supplemental Data

	For the year ended December 31,				
	2007	2006	2005	2004	2003
Total Net asset value (000's)[1]	$ 53,778	$ 67,651	$ 71,507	$ 77,232	$ 82,788
Number of units outstanding[1]	4,572,915	4,782,615	5,150,015	5,243,585	5,237,559
Management expense ratio[2]	9.17%	6.60%	7.08%	7.94%	5.25%
Management expense ratio before waivers or absorptions[2]	9.17%	6.60%	7.08%	7.94%	5.25%
Portfolio turnover rate[3]	12.11%	22.97%	40.56%	26.96%	42.44%
Trading expense ratio[4]	0.03%	0.05%	0.00%	0.00%	0.00%
Closing market price or pricing NAV	$ 9.58	$ 13.00	$ 12.55	$ 15.06	$ 16.10

(1) This information is provided as at the end of the period 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 value 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 the year ended December 31, 2007 added 6.23% and for each of the years ended December 31, 2006, 2005, 2004 and 2003 added 3.72% 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 2003 to 2007 expense ratios reflect the expenses of the hedge funds for the year 2006. Management continues to receive the audited financial statements for the year 2007 and will reflect the total expenses of the underlying hedge funds once all of such information has been received. The expenses together with estimates for hedge funds with year-ends other than December 31, 2006 have been prorated based on the relative percentage of the hedge funds held by the Trust at December 31, 2007. 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, manager performance and the timing of redemptions. 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 generally 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 asset value during the period.

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 Trust in the periods shown were reinvested in additional securities of the Trust;

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

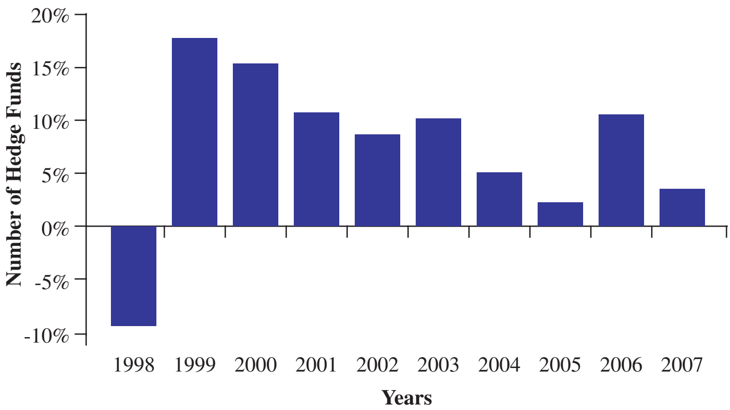
(c) how the Trust has performed in the past does not necessarily indicate how it will perform in the future.

Year-by-Year Returns

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

(a) the bar chart shows the Trust's performance for each of the periods shown, and illustrates how the Trust's performance has changed from period to period; and

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



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	6.91%	6.15%	5.28%	3.42%
S&P/TSX Composite Index	8.88%	18.32%	16.93%	9.83%
Scotia Capital 91 day T-Bill Index	3.82%	3.24%	3.66%	4.43%
Scotia Capital Universe Bond Index	6.27%	5.60%	4.73%	3.68%

* 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 three month T-Bills would have performed over the relevant period.

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

Management Fees and 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 exchange 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. During the year ended December 31, 2007, the management fee expense was $875,781 and the amount payable by the Trust as at December 31, 2007 was $199,571.

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.

Net Assets 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 assets 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 assets per unit is calculated and reported monthly. During the year ended December 31, 2007, the reported net asset value fluctuated between a low of $11.76 per unit and a high of $14.68 per unit (year ended December 31, 2006: low of $13.85 and a high of $14.27), 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 ended December 31, 2007, the daily closing price of the units fluctuated between $9.58 and $14.30 (year ended December 31, 2006: low of $12.30 and high of $13.80).

Distributions

During the year ended December 31, 2007, the Trust made distributions totaling $2.87 per unit ($13,270,597 was distributed in aggregate) compared to $1.14 per unit ($5,592,362 in aggregate) during the year ended December 31, 2006.

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.

The following table represents the distribution of the Trust for the year ended December 31, 2007.

Distribution History

Record date	Date distribution paid	Character of distribution for tax purposes	Amount per unit
March 31, 2007	April 30, 2007	Return of capital	0.11771
		Net income	0.17229
		Total	$0.29000
June 30, 2007	July 30, 2007	Return of capital	0.12177
		Net income	0.17823
		Total	$0.30000
September 30, 2007	October 30, 2007	Return of capital	0.11365
		Net income	0.16635
		Total	$0.28000
December 31, 2007	January 30, 2007	Return of capital	0.81181
		Net income	1.18819
		Total	$2.00000

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 reported net asset value per unit as at the close of business on the preceding valuation date.

On August 24, 2007, 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 467,051 of the units of the Trust during the period from August 30, 2007 to August 29, 2008, 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, 2007, the Trust purchased 209,700 units for total proceeds of $2,701,827 (year ended December 31, 2006: 367,400 units) for cancellation under this program. During the year ended December 31, 2007, this program contributed 0.36% to the overall return (year ended December 31, 2006: 0.60% 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 reported net asset value. If units of the Trust are trading at a price that is greater than their reported net asset value, new units will be issued at a price that is the greater of their reported 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, 2007 amounted to nil units while 37,815 units were purchased in the market (year ended December 31, 2006: nil units were purchased from treasury and 14,939 units were purchased in the market).

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.

NORTHWATER MARKET-NEUTRAL TRUST

INDEPENDENT REVIEW COMMITTEE REPORT

Dear Investor:

Effective November 1, 2007, the advisory board (the "Advisory Board") of Northwater Market-Neutral Trust (the "Trust") was designated as the independent review committee of the Trust (the "IRC") pursuant to the provisions of *National Instrument 81-107, Independent Review Committee for Investment Funds*.

This report is the IRC's first annual report to unitholders of the Trust under the requirements of National Instrument 81-107. However, the Advisory Board has reported annually to unitholders since March 10, 2006.

Our role as required by securities regulators is to review investment fund conflict of interest matters identified and referred to us by Northwater Fund Management Inc. (the "Manager") and to give our approval or recommendation with respect to such matters. The focus of our review of such conflict of interest matters is whether or not the Manager's proposed action achieves a fair and reasonable result for the Trust.

At least once per year, we will also review the Manager's policies and procedures relating to conflict of interest matters and will assess the adequacy and effectiveness of such policies and procedures in respect of the Trust.

In addition to the regulatory requirements for independent fund governance, we are also retaining our role as an advisory board and, as such, assisting the Manager on other issues relating to the management and operation of the Trust.

We look forward to continuing our open and effective relationship with the Manager for the benefit of the Trust.

Regards,

Jeffrey D. Francoz
Chair of the Independent Review Committee

Members of the Independent Review Committee		Length of Service on Advisory Board/IRC
Name	**Residence**	**First Appointed[1]**
Jeffrey D. Francoz . . . . Chair of the IRC	Toronto, Ontario	March 10, 2006[2]
Ann Marshall	Toronto, Ontario	March 10, 2006[2]
Peter Vesely	Toronto, Ontario	November 1, 2007

* There were no changes in the composition of the IRC during the period.

* Ann Marshall also serves as an independent review committee member for iShares funds managed by Barclays Global Investors Canada Limited. Jeffrey Francoz and Peter Vesely do not currently serve as independent review committee members for other investment funds other than those managed by the Manager.

(1) Each member of the IRC listed has been a member of the independent review committee since its inception on November 1, 2007.

(2) Since the inception of the original Advisory Board of the Trust.

Holdings of Securities

(a) The Trust

As at December 31, 2007, the percentage of units of the Trust beneficially owned, directly or indirectly, in aggregate, by all members of the IRC did not exceed 10%.

(b) The Manager

As at December 31, 2007, no member of the IRC beneficially owned, directly or indirectly, any class or series of voting or equity securities of the Manager.

(c) Service Providers

As at December 31, 2007, no member of the IRC beneficially owned, directly or indirectly, any class or series of voting or equity securities of a company that provides services to the Trust or the Manager that could reasonably result in an actual or perceived loss of independence of the member.

The Advisory Board and, as of November 1, 2007, the IRC is pleased to report on its activities for the period ended December 31, 2007.

All of the members of the IRC are non-related and independent of management as were the members of the Advisory Board.

General

During the period ended December 31, 2007, the members of the Advisory Board, and subsequently the IRC (upon inception of the IRC on November 1, 2007), held four meetings. Mr. Francoz and Ms. Marshall attended all of the meetings held by the Advisory Board and the IRC during the period. Mr. Vesely attended all of the meetings held by the IRC during the period following his appointment as a member of the IRC.

During the period ended December 31, 2007, the Advisory Board, and subsequently the IRC, reviewed: (i) the mandate of the Advisory Board, (ii) the proposed Charter of the IRC, (iii) the reporting to unitholders as required by National Instrument 81-106, (iv) periodic reports on the performance and the composition of the investment portfolio of the Trust, (v) compliance with Investment Guidelines, (vi) the presentation of certain information in the quarterly and annual reports, and (vii) the implementation and actions necessary to comply with National Instrument 81-107. In addition, the IRC adopted its written Charter and reviewed the various policies and procedures of the Manager related to conflict of interest matters to determine their adequacy and effectiveness.

The Advisory Board and, effective as of November 1, 2007, the IRC, each report that management of the Manager has been open and cooperative, permitting the members to review such documents and speak to such members of management of the Manager as deemed necessary by the Advisory Board/ IRC in order to properly execute their responsibilities.

Compensation and Indemnities

The aggregate compensation paid by the Trust to the IRC for the two-month period from its inception on November 1, 2007 through December 31, 2007 was $3,667. The aggregate compensation paid by the Trust to the Advisory Board for the preceding 10 months of 2007 was $7,500.

No indemnities were paid to the IRC or the Advisory Board during the period.

The initial compensation of the IRC was set by the Manager. At least annually, the IRC will review their compensation giving consideration to the following:

1. the best interests of the Trust;
2. that compensation paid to the IRC by the Trust should fairly and reasonably reflect the general and specific benefits accruing to the Trust;
3. the recommendation of the Manager;

4. the nature and complexity of the Trusts business; and
5. the nature and extent of the workload of each member of the IRC.

Conflict of Interest Matters

No Conflict of Interest Matters were referred to the IRC during the period. Neither the IRC or the former Advisory Board is aware of any instance in which the Manager acted in a conflict of interest matter referred to the IRC (or the Advisory Board) for which the IRC (or the Advisory Board, as applicable) did not give a positive recommendation.

Furthermore, the IRC / Advisory Board is not aware of any instance in which the Manager acted in a conflict of interest matter but did not meet a condition imposed by the IRC / Advisory Board in its recommendation or approval.

The Manager relied on the following standing instructions of the IRC in the period. In each case, the standing instructions required the Manager to comply with its related policy and procedures and to report periodically to the IRC.

Standing Instructions

1. allowing transfers between the Trust and other Northwater-advised entities, provided that all such transfers will exclusively involve hedge fund investments transferred at an independently determined net asset value and must be consistent with the investment guidelines of the transferee; and
2. allowing Northwater and its affiliates to act in various capacities with respect to other entities, including without limitation in such capacities as manager, investment advisor, administrator or trustee, provided that Northwater and its affiliates shall in all cases act in accordance with its Procedures for Minimizing Potential Conflicts of Interest and its Code of Ethics.

The Manager also received positive recommendations and standing instructions with respect to the conflict of interest matters addressed by the following policies. In each case, the standing instructions required the Manager to comply with its related policies and procedures and to periodically report to the IRC.

Policies that address conflicts of interest matters

1. Statement of Policies Respecting Related and Connected Issuers and Procedures for Minimizing Potential Conflicts of Interest
2. Code of Ethics

3. Allocation of Trades Procedures
4. Selection of Brokers, Best Execution and Soft Dollar Procedures
5. Consistency of Client Portfolio with Client Investment Objectives
6. Personal Securities Transactions Policy
7. Insider Trading Policy
8. Cross Trading Procedures

We look forward to continuing to discharge our duties in 2008 for the benefit of the Trust.

Jeffrey D. Francoz
Chair of the IRC

Ann Marshall

Peter Vesely

MANAGEMENT’S RESPONSIBILITY

The accompanying financial statements have been prepared by Northwater Fund Management Inc (the “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.

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

SHAUNA CASSIDY, CFA
Vice-President

March 14, 2008

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

We have audited the statement of investment portfolio of **Northwater Market-Neutral Trust** (the Trust) as at December 31, 2007, the statements of net assets as at December 31, 2007 and 2006 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, 2007 and 2006 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,
Licensed Public Accountants
Toronto, Ontario
March 14, 2008

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Net Assets

	As at December 31, 2007	As at December 31, 2006
Assets		
Cash and short-term investments (cost: 2007 – $15,180,903; 2006 – $2,982,348)	$ 15,066,362	$ 1,831,019
Short-term investments held as margin deposited on futures contracts – at market value (note 4) (cost: 2007 – $1,602,674; 2006 – $1,151,819)	1,573,183	1,155,011
Hedge fund investments – at fair value (note 3) (cost: 2007 – $59,431,262; 2006 – $68,089,341)	63,502,617	81,217,662
Prepaid hedge fund investment	—	815,850
Hedge fund redemptions receivable	485,630	836,935
Other	7,664	—
	80,635,456	85,856,477
Liabilities		
Audit, legal and custody fees payable	$ 43,167	$ 39,441
Management fees payable (note 7)	199,571	225,338
Interest and standby fees payable	28,724	41,333
Settlement payable on currency futures (note 4)	603,183	267,879
Distribution payable	9,145,830	1,339,132
Bank loan (note 5)	12,578,644	16,289,420
Hedge fund sale in advance	4,258,720	—
Other	—	2,979
	26,857,839	18,205,522
Net assets	$ 53,777,617	$ 67,650,955
Net assets and unitholders' equity (note 6)		
Unit capital	98,502,805	102,443,133
Contributed Surplus	14,256,371	13,017,870
Retained earnings (deficit)	(58,981,559)	(47,810,048)
	$ 53,777,617	$ 67,650,955
Number of units outstanding (note 6)	4,572,915	4,782,615
Net asset per unit	$ 11.76	$ 14.15

Signed on behalf of the Trustee,
RBC Dexia Investor Services Trust

Per: ______________________

Per: ______________________

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

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Operations

	For the year ended December 31, 2007	2006
Investment income		
Interest income	$ 247,799	$ 235,796
Other income	1,824	16,537
	249,623	252,333
Expenses		
Management fees (note 7)	$ 875,781	$ 927,729
Audit fees	70,886	52,460
Advisory board fees	15,283	10,149
Custodian fees	13,590	15,034
Legal fees	—	7,676
Security holder reporting costs	84,239	108,259
Interest and standby fees (note 5)	858,494	851,936
Transaction costs	22,755	33,638
	1,941,028	2,006,881
Net investment loss	(1,691,405)	(1,754,548)
Realized and unrealized gain (loss) on investments		
Net realized gain (loss) on:		
Hedge fund investments	$ 622,265	$ (843,715)
Currency futures (note 4)	11,308,531	1,257,230
Change in unrealized appreciation (depreciation) on:		
Hedge fund investments	(9,056,966)	8,766,335
Currency futures (note 4)	(335,304)	(402,311)
Net gain (loss) on currency, excluding hedge fund investments	1,251,965	(527,486)
Net realized and unrealized gain on investments for the year	3,790,491	8,250,053
Increase (decrease) in net assets from operations for the year	$ 2,099,086	$ 6,495,505
Increase (decrease) in net assets from operations per unit for the year*	$ 0.45	$ 1.32

* Based on the average number of units outstanding for the year 2007 – 4,715,269 (2006 – 4,927,782).

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

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Changes in Net Assets

	For the year ended December 31,	
	2007	**2006**
Net assets – beginning of the year	$ 67,650,955	$71,507,578
Increase (decrease) in net assets from operations for the year	2,099,086	6,495,505
Unit transactions (note 6)		
Net assets of units reinvested on distribution	—	—
Issuance (cancellation) of units	(2,701,827)	(4,759,766)
	(2,701,827)	(4,759,766)
Distribution to unitholders (note 8)		
Return of capital	(5,386,622)	(5,393,646)
From net income	(7,883,975)	(198,716)
	(13,270,597)	(5,592,362)
Net assets – end of the year	$ 53,777,617	$67,650,955

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

NORTHWATER MARKET-NEUTRAL TRUST

Statements of Cash Flows

	For the year ended December 31, 2007	2006
Cash flows from operating activities		
Increase (decrease) in net assets from operations	$ 2,099,086	$ 6,495,505
Items not affecting cash:		
Change in unrealized depreciation (appreciation) in value of hedge fund investments	9,056,966	(8,766,335)
Change in unrealized depreciation (appreciation) in value of currency futures	335,304	402,311
Net realized loss (gain) on hedge fund investments	(622,265)	843,715
Changes in non-cash working capital:		
Change in payables and other assets	(45,293)	48,598
Purchase of hedge fund investments	(3,986,845)	(17,055,144)
Proceeds on sale of hedge fund Investments	18,693,064	21,241,386
Change in cash pledged as collateral on futures contracts	(418,172)	(232,573)
	25,111,845	2,977,463
Cash flows from financing activities		
(Repayment of)/proceeds from bank loan	(3,710,776)	629,074
Distributions paid	(5,463,899)	(5,695,235)
Repurchase of units	(2,701,827)	(4,759,766)
	(11,876,502)	(9,825,927)
Net increase (decrease) in cash and short-term investments	13,235,343	(6,848,464)
Cash and short-term investments at the beginning of the year	1,831,019	8,679,483
Cash and short-term investments at the end of the year	$ 15,066,362	$ 1,831,019
Supplementary information:		
Interest paid	$ 830,914	$ 865,852

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

NORTHWATER MARKET-NEUTRAL TRUST

Statement of Investment Portfolio
As at December 31, 2007

	Maturity date	Face value	Cost	Fair Value	Fair Value as a % of Net Assets
Hedge fund investments*					
Activist investments			$ 1,486,652	$ 1,705,001	3.17%
Asset-backed securities arbitrage			6,993,690	8,164,189	15.18%
Distressed securities arbitrage			7,723,252	10,299,791	19.15%
Fixed-income arbitrage			3,610,892	3,459,306	6.43%
Mortgage-backed security arbitrage			8,163,181	8,043,885	14.96%
Multi-strategy			11,019,524	12,128,061	22.55%
Re-insurance arbitrage			2,175,915	3,060,925	5.69%
Structured finance			8,921,660	9,270,327	17.24%
Statistical arbitrage			9,336,496	7,371,132	13.71%
Hedge fund investments			59,431,262	63,502,617	118.08%
Cash			$ 5,355,091	$ 5,355,091	9.96%
Treasury bills **					
Government of Canada (note 4)		1,633,291	1,602,674	1,573,183	2.93%
Banker's Acceptances					
Bank of Nova Scotia	January 29, 2008	2,700,000	2,690,442	2,690,145	5.00%
Toronto-Dominion Bank	January 8, 2008	499,800	497,376	494,705	0.92%
Toronto-Dominion Bank	January 15, 2008	407,540	405,775	395,419	0.74%
Toronto-Dominion Bank	January 22, 2008	1,503,675	1,496,984	1,481,529	2.75%
Toronto-Dominion Bank	January 29, 2008	981,000	976,762	986,825	1.84%
Bank of Montreal	January 4, 2008	3,769,845	3,758,473	3,662,648	6.81%
Cash and short-term investments			16,783,577	16,639,545	30.95%
Total investment portfolio			$76,214,839	$ 80,142,162	149.03%
Other net assets				(26,364,545)	(49.03)%
Total net assets and unitholders' equity				$ 53,777,617	100.00%

* 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, 2007 have yields ranging from 3.64% to 4.50%.

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

Schedule 1—Currency futures contracts:

	Bid Price	Notional contract value	Settlement receivable (payable) on futures contracts
603 March 2008 Canadian Dollar Futures Contract	$100.99	$ 60,896,970 USD	$ (603,183) CAD
		$ 60,312,359 CAD	

NORTHWATER MARKET-NEUTRAL TRUST

Notes to Financial Statements
For the year ended December 31, 2007 and 2006

1. Establishment and Operations of the Fund

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 amended 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. RBC Dexia Investor Services ("RBC Dexia") 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., then known as Newcastle 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, and 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 ("GAAP").

Adoption of new accounting standards

On April 1, 2005, the Canadian Institute of Chartered Accountants issued Section 3855, "Financial Instruments – Recognition and Measurement" ("Section 3855") of the CICA Handbook – Accounting, which establishes standards for the fair valuation of investments as well as the accounting treatment of transaction costs. Section 3855 applies to fiscal years beginning on or after October 1, 2006.

The provisions of this new standard have been applied prospectively (no restatement of prior periods). No adjustment was made to the financial statement.

The following paragraphs outline the accounting policies of the fund after the adoption of Section 3855.

(a) Cash and short-term investments

Cash and short-term investments including short-term investments held as margin consist of cash in interest bearing accounts at RBC Dexia, cash held with the futures broker and short-term investments with maturities generally 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.

(b) Investments in market-neutral hedge funds

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

Investments in market-neutral hedge funds are valued on the basis of the definitive reported 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 reported net asset values based on preliminary returns reported by the administrators or the portfolio managers of such funds. In determining the definitive or provisional reported 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.

(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 receivable or payable on futures contracts represents the daily variation margin owing or due to the Trust on the Valuation Date.

Futures contracts are valued at their bid price, as published by the clearing house of the relevant 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) 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.

(e) 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.

(f) Transaction Costs

Transaction costs are expensed and are included in the Statement of Operations. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an investment.

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 market-neutral hedge funds included in the Trust's portfolio are organized and domiciled in non-U.S. jurisdictions consisting primarily of the Cayman Islands, Bermuda, the British Virgin Islands and the 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 advisory fee, generally ranging from 1% to 2% annually, and a performance-based incentive fee, generally 20% of net profits earned above a high water mark. 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 generally from 30 days' notice to 180 days' notice and may be subject to lock-up and gating provisions.

The Manager of the Fund may from time to time, in very limited circumstances, affect the purchase or sale of certain hedge funds to other investment vehicles advised by Northwater Capital Management Inc. These transactions are executed at the monthly net asset value as reported by the hedge fund.

The following table shows the hedge fund holdings by strategy as at December 31, 2007 and December 31, 2006. The multi-strategy funds have not been allocated to any of the underlying hedge fund strategies set out in this table.

	As at December 31, 2007			As at December 31, 2006		
Strategy	**No. of Hedge Funds**	**Fair Value**		**No. of Hedge Funds**	**Fair Value**	
Activist investments	1	$ 1,705,001	3%	1	$ 2,512,588	3 %
Asset-backed securities arbitrage	4	8,164,189	13%	5	10,060,961	12 %
Capital structure arbitrage	—	—	—	1	450,256	1 %
Distressed securities arbitrage	6	10,299,791	16%	6	13,819,434	17 %
Fixed-income arbitrage	3	3,459,306	5%	2	2,571,727	3 %
Merger arbitrage	—	—	—	1	1,284,879	2 %
Mortgage-backed security arbitrage	4	8,043,885	12%	4	10,362,344	13 %
Multi-strategy	6	12,128,061	19%	7	16,158,899	20 %
Re-insurance arbitrage	2	3,060,925	5%	2	5,520,794	7 %
Statistical arbitrage	5	7,371,132	12%	4	5,608,982	7 %
Structured finance	6	9,270,327	15%	7	12,866,799	15 %
	37	$63,502,617	100%	40	$81,217,662	100 %

The following table shows the hedge funds held by the Trust as at December 31, 2007 and 2006 categorized by the size of each hedge fund.

Total Assets of each hedge fund in U.S.$ Millions	**2007**	**2006**
< 100	0	2
100-250	2	6
250-500	0	9
500-750	3	6
750-1000	1	3
> 1000	31	14
	37	40

The following table shows the number of hedge funds held by the Trust as at December 31, 2007 and 2006 categorized by the years since inception of each hedge fund.

Years	2007	2006
< 3	4	10
3 – 6	14	23
6 – 9	11	3
9 – 12	3	1
12 – 15	3	2
> 15	2	1
	37	40

The following chart illustrates the number of hedge funds held by the Trust by jurisdiction of organization as at December 31, 2007 and 2006.

Location	2007	2006
Cayman Islands	33	37
British Virgin Islands	2	2
Bermuda	2	1
Bahamas	0	0
	37	40

4. 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, 2007, short-term investments with a face value of $1,600,000 USD ($1,633,291 CAD) (December 31, 2006: $1,000,000 USD; $1,151,819 CAD) were deposited as initial margin for currency futures contracts.

5. 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 reported 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 reported 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 U.S. dollars.

Throughout the year ended December 31, 2007, the bank loan fluctuated between $12,700,569 USD and $13,977,483 USD (year ended December 31, 2006 the loan varied between: $13,318,180 USD and $14,318,732 USD throughout the year). The average rate of interest paid on the loan for the period was 5.92%.

6. Unitholders' Equity

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.

On August 24, 2007, 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 467,051 of the units of the Trust during the period from August 30, 2007 to August 29, 2008, 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.

Under a normal course issuer bid and the Trust's quarterly market support obligation, the Trust purchased 209,700 units for cancellation for cash of $2,701,827 during the year ended December 31, 2007 (year ended December 31, 2006: 367,400 units were purchased for cash of 4,759,766).

Pursuant to the distribution reinvestment plan, no units were issued from Treasury during the year ended December 31, 2007 while 37,815 units were purchased in the market (2006: no units were issued from Treasury and 14,939 units were purchased in the market).

Unitholders' equity is comprised of unit capital and deficit. The following table shows the transactions for unit capital and deficit during the relevant years:

Year ended December 31, 2007	Units Outstanding	Unit Capital	Contributed Surplus	Deficit	Unitholders' Equity
Balance – December 31, 2006	4,782,615	$102,443,133	$13,017,870	$(47,810,048)	$ 67,650,955
Increase (decrease) in net assets from operations for the year	—	—	—	2,099,086	2,099,086
Units issued during the year	—	—	—	—	—
Units cancelled during the year	(209,700)	(3,940,328)	1,238,501	—	(2,701,827)
Distributions	—	—	—	(13,270,597)	(13,270,597)
Balance – December 31, 2007	4,572,915	$ 98,502,805	$14,256,371	$(58,981,559)	$ 53,777,617

Year ended December 31, 2006	Units Outstanding	Unit Capital	Contributed Surplus	Deficit	Unitholders' Equity
Balance – December 31, 2005	$5,150,015	$109,341,400	$10,879,369	$(48,713,191)	$ 71,507,578
Increase (decrease) in net assets from operations for the year	—	—	—	6,495,505	6,495,505
Units cancelled during the year	(364,400)	(6,898,267)	2,138,501	—	(4,759,766)
Distributions	—	—	—	(5,592,362)	(5,592,362)
Balance – December 31, 2006	4,782,615	$102,443,133	$13,017,870	$(47,810,048)	$(67,650,955)

7. 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 quarterly 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.

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.

8. Distributions

The Trust pays quarterly distributions to unitholders equal to 2% of the reported net asset value per unit as of the month end preceding the given calendar quarter.

During the year ended December 31, 2007, distributions of $2.87 per unit and $13,270,597 in aggregate (year ended December 31, 2006: $1.14 per unit and $5,592,362 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.

9. Income Taxes

As at December 31, 2007, 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, 2007, the Trust had no non-capital loss carryforwards (2006: $nil) and $2,716,191 in capital loss carryforwards (2006: $8,758,000).

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 is 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 Trust'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. The Trust is 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 Capital Management Inc., a leader in financial innovation since January 1989, offers customized portfolio solutions to the global investment community through the firm's Portfolio Platform™, a proprietary platform that incorporates the flexibility and scalability necessary to meet a variety of investor needs.

The firm's established indexing capability allows investors to access global equity and fixed income markets on a cost-effective basis. In addition, utilizing its expertise in constructing market-neutral fund of hedge fund portfolios that seek to generate consistent returns in both normal and extreme markets, Northwater seeks to deliver a reliable source of alpha, or excess return. Northwater's structuring technology combines these two components in a portable alpha framework that seeks to achieve an investor's return/risk objectives in an efficient, cost-effective manner.

With more than ten years of experience in fund of hedge funds, Northwater has steadily grown exposure under management to approximately CDN $14.1 billion total, including $4.8 billion USD invested in hedge funds as at December 31, 2007. 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, Australia, the United Kingdom and the rest of Europe. The firm has offices in Toronto, New York and Chicago.

Northwater also acts as an advisor to the following two closed-ended funds listed on the TSX, in addition to Northwater Market-Neutral Trust:

- Northwater Five-Year Market-Neutral Trust, launched in 2004; and
- Northwater Top 75 Income Trusts ^{Plus}, launched in 2005.

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 reported net asset value update call: 1 (888) 429-8774

TSE Symbol: NMN.UN

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