

NORTHWATER

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

ANNUAL INFORMATION FORM

For the fiscal period ended December 31, 2006

As at
March 31, 2007

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GENERAL:

The information contained in this Annual Information Form is given as of March 31, 2007. All dollar amounts are stated in Canadian currency unless otherwise indicated.

NAME, FORMATION AND HISTORY OF THE TRUST:

Northwater Five-Year Market-Neutral Trust (the "Trust") is a closed-end investment trust established under the laws of Ontario pursuant to a declaration of trust dated as of June 18, 2004. Northwater Fund Management Inc. acts as Trustee. RBC Dexia Investor Services Trust, as successor custodian to The Royal Trust Company, acts as Custodian. The Trust began operations on June 30, 2004 when it completed its initial public offering. The Trust issued additional units on December 13, 2004 through a secondary offering. Northwater Fund Management Inc. is the manager of the Trust (the "Manager"). The Manager has appointed Northwater Capital Management Inc. as the investment advisor to the Trust (the "Investment Advisor").

The address of the Trust's principal and head office is Suite 4700, BCE Place, Bay Wellington Tower, 181 Bay Street, P.O. Box 794, Toronto, Ontario, M5J 2T3.

The beneficial interest in the net assets and net income of the Trust is divided into trust units of equal value (the "Units"). Holders of Units are referred to herein as Unitholders.

Investment Objectives

The Trust's investment objectives are to:

- 1) Distributions: to pay to Unitholders quarterly tax-efficient cash distributions of \$0.4375 per Unit (\$1.75 per annum to yield 7% on the subscription price of \$25.00 per Unit);
- 2) Low Correlation: to ensure that the performance of the Trust has a low correlation with major equity and fixed-income markets over the life of the Trust;
- 3) Low Volatility: to achieve a low volatility, which is expected to be similar to that of a mid-term bond portfolio and less than one-half that of major equity markets; and
- 4) Capital Repayment: to return to Unitholders at least the original subscription price of the Units of \$25.00 per Unit on or about June 30, 2009.

Investment Strategy

The Investment Advisor acts as adviser to Northwater Five-Year Market-Neutral Fund Limited (the "Fund"), which holds a broadly diversified portfolio of hedge funds that are either substantially market-neutral or well hedged with respect to major fixed-income and equity markets (the "Hedge Fund Portfolio"). The Hedge Fund Portfolio consists of 40 hedge funds as at December 31, 2006. The Hedge Fund Portfolio is diversified by strategy and is invested in market-neutral hedge funds across 14 distinct investment strategies. The Investment Advisor seeks out hedge funds that have a low correlation with one another. The Investment Advisor utilizes its Proprietary Selection Process (described below) that it

developed in advising other funds of market-neutral hedge funds to assist it in making investment recommendations for the Hedge Fund Portfolio.

The Trust has invested the net proceeds of the offering in a portfolio of common shares of Canadian public companies (the “Common Share Portfolio”). The Trust then obtains its exposure to the Hedge Fund Portfolio through a forward purchase and sale agreement (the “Forward Agreement”) with a U.S. Bank with a credit rating of at least AA- from Standard & Poor’s Corporation.

The Fund has also entered into an agreement to swap payments based on a floating Canadian money market rate with a U.S. Bank in return for receiving payments based on a fixed Canadian rate of 4.37% (the “Swap”). The Fund’s return is composed of the returns of the Hedge Fund Portfolio plus a return earned on the Swap. The value of the interest rate swap changes as mid-term interest rates change. The Trust has exposure to the Swap through the Forward Agreement.

The Hedge Fund Portfolio emphasizes hedge funds that invest in sectors of the capital markets that the Investment Advisor believes are relatively inefficient. The Investment Advisor believes that such sectors offer arbitrage or relative value opportunities and should reward insightful investment analysis. The following are examples of hedged, non-traditional investment strategies that may be included in the Hedge Fund Portfolio:

- Activist
- Asset-backed securities arbitrage
- Capital structure arbitrage
- Convertible bond arbitrage
- Distressed securities
- Energy relative value
- Fixed-income arbitrage
- Market-neutral equity
- Merger arbitrage
- Mortgage-backed security arbitrage
- Re-insurance
- Statistical arbitrage
- Structured finance
- Volatility arbitrage

The foregoing list is not exhaustive.

Each of the strategies included in the Hedge Fund Portfolio carries a certain amount of risk, however, the Investment Advisor believes, based on its experience with similar portfolios, that the volatility of investment returns for the Hedge Fund Portfolio will be substantially reduced by the enhanced level of diversification achieved by investing in hedge funds that have a very low level of correlation with one another. As a result, the risk of the Fund, as measured by standard deviation, is expected to be similar to the risk of a mid-term bond fund and less than one-half that of the major equity markets.

The Investment Advisor will continuously monitor and review the investment strategies of the hedge funds in which the Hedge Fund Portfolio is invested as well as the performance of the managers of each fund. In particular, the Investment Advisor reviews organizational changes made to these hedge funds and changes in policy relative to investment objectives, hedging strategy, degree of diversification, leverage and costs. In addition, the Investment Advisor continuously monitors the hedge fund industry and reviews new types of hedge funds being offered. Based on the regular application of its proprietary process, the Investment Advisor may from time to time recommend the reallocation of the Hedge Fund Portfolio's assets among funds with different investment strategies or among different hedge fund managers or recommend the investment in hedge funds with new investment strategies.

The Investment Advisor uses its best efforts to ensure that the Hedge Fund Portfolio maintains the level of liquidity reasonably required to satisfy the current liabilities of the Fund. As many of the hedge funds to which the Hedge Fund Portfolio is exposed have restrictions that limit the liquidity of the investment, the Investment Advisor maintains an appropriate level of liquidity by ensuring that the Hedge Fund Portfolio is also invested in hedge funds that have greater liquidity.

Proprietary Selection Process

The Investment Advisor uses its Proprietary Selection Process to advise with respect to the selection and monitoring of potential hedge fund investments made by the Hedge Fund Portfolio. The Proprietary Selection Process 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 with the Investment Advisor's experience in market-neutral hedge fund investing and in managing complex derivatives 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 Hedge Fund Portfolio'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 Hedge Fund Portfolio.
- 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. hedge fund manager reviews involve 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. The model portfolio serves as a target portfolio for the Trust and will be diversified across approximately 14 market-neutral strategies. This is a dynamic process.
- 8) A comprehensive due diligence process that typically must be completed before the Investment Advisor recommends an investment. This process includes on-site interviews 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 Hedge Fund Portfolio. This process includes regular discussions with the hedge fund manager, multiple on-site interviews each year, continual quantitative and qualitative assessments and monthly justification of the hedge fund's role within the Investment Advisor's model portfolio.

Distributions

The Trust endeavors to pay to Unitholders at the end of each quarter (the "Record Date") commencing September 30, 2004 cash distributions of \$0.4375 per Unit.

The Trust distributes annually in respect of each Unit a pro rata share of the net taxable income of the Trust. Such net income is included in the per Unit distribution, to the extent possible, and is paid to Unitholders regardless of the amount of the increase in the Net Asset Value per Unit of the Trust.

Unitholders will be entitled to receive declared distributions if they were Unitholders of record as of 5:00 p.m. (Toronto time) on the relevant Record Date. Distributions will be made within 15 days after the Record Date (a "Distribution Date").

Holders of Units who are non-residents of Canada are required to pay all withholding taxes payable in respect of any distributions of income by the Trust. The Trust will cause the withholding from the distributions and the remittance to the relevant tax authority of all amounts required by law to be withheld and remitted. Non-residents should consult their tax advisors regarding the tax consequences of investing in Units.

Purchases for Cancellation

Units of listed investment trusts such as the Trust may trade at a discount from net asset value. In recognition of the possibility that the Units may trade at a discount, the terms and conditions attaching to the Units have been designed to attempt to reduce or eliminate a market value discount from Net Asset Value.

To that end, the Trust Agreement provides that if at any time the price at which Unitholders are then offering their Units for sale on the Toronto Stock Exchange (or such other exchange or market on which the Units are then listed) is less than 95.0% of the Net Asset Value per Unit determined as at the close of business on the preceding Valuation Date, then subject to certain exceptions described herein and compliance with any applicable regulatory requirements, the Trust is obligated to purchase any such Units offered in the market at the then prevailing market price up to a maximum amount in any calendar quarter of 2.50% of the number of Units outstanding at the beginning of such calendar quarter.

In addition, the Trust has the right (but not the obligation) at any time, exercisable in its sole discretion, to purchase Units in the market whenever Unitholders offer their Units for sale at less than Net Asset Value, subject to any applicable regulatory requirements and limitations. It is expected that these purchases will be made as normal course issuer bids through the facilities and under the rules of the Toronto Stock Exchange (or such other exchange or market on which the Units are then listed).

Notwithstanding the foregoing, purchases will not be effected if: (a) in the opinion of the Manager such transactions, if consummated, could result in the marketability of the Units being severely impaired to the detriment of the Unitholders; (b) in order to fund the purchase, the Trust is not able to liquidate portfolio securities in an orderly manner consistent with the Trust's Investment Strategy or, alternatively, it is not in the best interest of the Unitholders to do so; or (c) there is, in the judgment of the Manager (i) any material legal action or proceeding instituted or threatened challenging such transactions or otherwise materially adversely affecting the Trust, or (ii) a suspension of or limitation on prices for trading securities generally on any exchange on which portfolio securities of the Trust are traded.

Units that have been purchased by the Trust are cancelled thereby reducing the total assets of the Trust. If the Trust must liquidate portfolio securities in order to purchase Units, the Trust may realize gains and losses, which gains will be paid or made payable to Unitholders in the year they are realized.

There can be no assurance that purchases of Units by the Trust will result in the Units trading at a price that is equal to the Net Asset Value of the Units. The Trust anticipates that the market price of the Units will in any event vary from Net Asset Value. The market price of the Units will, among other things, be determined by the relative demand for and supply of Units in the market, the Trust's investment performance, the Unit's yield and investor perception of the Trust's overall attractiveness as an investment as compared with other investment alternatives. Nevertheless, the fact that the Units may be purchased by the Trust may reduce the potential spread between market price and Net Asset Value that might otherwise exist.

Although it is anticipated that actual Unit purchases generally may have a favourable effect on the market price of the Units, it should be recognized that the acquisition of Units by the Trust will decrease the total assets of the Trust and therefore have the effect of increasing the Trust's expense ratio provided the total expenses do not change.

Termination of the Trust

The Trust will continue until June 30, 2009 and thereupon will terminate and the net assets of the Trust will be distributed to the Unitholders unless an alternative to termination is approved by the Unitholders as described below. Prior to the Termination Date, the Investment Advisor will, to the extent practicable, convert the assets of the Trust to cash. The Manager may, in its discretion and upon not less than 30 days prior written notice to the Unitholders, extend the Termination Date to September 30, 2009 if the Investment Advisor will be unable to convert all of the portfolio assets to cash and the Manager determines that it would be in the best interests of the Unitholders to do so.

Not less than 9 months nor more than 24 months prior to the Termination Date, the Manager may present a proposal to Unitholders providing an alternative to the dissolution of the Trust on the Termination Date. Such proposal could include, without limitation: (i) continuing the Trust; or (ii) exchanging the Units for units in one or more mutual funds or closed-end investment funds on or after the Termination Date. A meeting of Unitholders to consider such a proposal must be held at least 9 months prior to the Termination Date in order to give the Manager the opportunity to conduct an orderly liquidation of the assets of the Trust in the event that the Unitholders do not approve the proposal. In order to be implemented, such proposal would require the approval of Unitholders by Extraordinary Resolution (and for any such Extraordinary Resolution a quorum even at an adjourned meeting will consist of two or more Unitholders present in person or by proxy and representing not less than 10% of the Units then outstanding). Any such proposal may be conditional on such matters as the Manager considers are appropriate including, without limitation, obtaining any necessary regulatory approvals.

Loan Facility

The Manager, on behalf of the Trust, has entered into a loan agreement (the “Loan Agreement”) with a Canadian financial institution (the “Counterparty”) or an affiliate of the Counterparty that permits the Trust to temporarily borrow up to an amount not exceeding 10% of the NAV of the Trust, for the purpose of (i) effecting market purchases of Units, (ii) maintaining liquidity to effect cash distributions, and (iii) paying expenses of the Trust.

The Loan Agreement contains terms and conditions customary for agreements of this nature including a requirement that the Trust provide a security interest in its assets in favour of the Counterparty to secure such borrowings. In the event that the total amount borrowed by the Trust exceeds at any time 10% of the NAV of the Trust, the Manager will take appropriate steps with the Trust’s investment portfolio in order that the amount of the indebtedness does not exceed 10% of the NAV of the Trust, including liquidating certain of the Trust’s investments and using the proceeds thereof to reduce the Trust’s indebtedness.

In the event of a default by the Trust under the Loan Agreement, the Loan Agreement will provide that the Counterparty’s recourse under the Loan Agreement will be limited solely to the assets of the Trust.

INVESTMENT RESTRICTIONS:

The activities of the Trust are to be conducted in accordance with various investment restrictions including the following:

- (a) **Investment in Canadian Securities.** The Trust will restrict its investments to units or shares of Canadian listed income trusts or shares of the capital stock of corporations resident in Canada, each of which is a “Canadian security” for the purposes of section 39(6) of the *Income Tax Act* (Canada);
- (b) **Purchasing Securities.** The Trust will not purchase securities other than through normal market facilities unless the purchase price therefore approximates the prevailing market price or is negotiated or established on an arm’s length basis; and
- (c) **Mutual Fund Trust.** The Trust will manage its investments and affairs to ensure that it will be a “unit trust” and “mutual fund trust” for the purposes of the *Income Tax Act* (Canada).

The activities of the Fund are subject to certain investment restrictions contained in its constating documents. For purposes of the restrictions listed below, all percentage limitations apply only immediately after a transaction and any subsequent change in any applicable percentage resulting from changing values will not require elimination of any security from the Hedge Fund Portfolio. These investment restrictions provide, among other things, the following:

1. **Sole Undertaking.** The Fund will not engage in any undertaking other than the investment of the Hedge Fund Portfolio assets in accordance with the Investment Objectives and the Investment Strategy.
2. **Concentration.** The Fund will not purchase any security issued by any issuer (other than short-term debt securities issued or guaranteed by the Government of Canada or any Canadian province or municipality) if as a result more than 10% of its total assets would consist of securities issued by such issuer.
3. **Diversification.** The Hedge Fund Portfolio must be invested in a minimum of 25 underlying hedge funds and a minimum of 7 distinct investment strategies at all times.
4. **Fixed Price.** The Fund will not purchase any security that by its terms requires the Hedge Fund Portfolio to make a contribution in addition to the payment of the purchase price, other than a permitted derivative, provided that this restriction shall not apply to the purchase of securities that are paid for on an instalment basis where the total purchase price and the amount of all such instalments is fixed and set aside at the time the first instalment is paid.
5. **No Material Interest.** The Fund will not purchase securities from, sell securities to, or otherwise contract for the acquisition and disposition of securities with the Investment Advisor or any of its respective affiliates, any officer, director or shareholder of any of them, any person, trust, firm or corporation managed by the Investment Advisor or any of its respective affiliates or any firm or corporation in which any officer, director or shareholder of the Investment Advisor may have a material interest (which, for these purposes, includes beneficial ownership of more than 10% of the voting securities of such entity) unless, with respect to any purchase or sale of securities, any

such transaction is effected through normal market facilities and the purchase price approximates the prevailing market price or is effected at the then prevailing net asset value of the securities as determined by the issuer of the securities or its administrator.

6. **Restriction on Underwriting.** The Fund will not act as an underwriter except to the extent that the Fund may be deemed to be an underwriter in connection with the sale of securities in the Hedge Fund Portfolio.
7. **No Commodities.** The Fund will not directly purchase or sell physical commodities with the intention to make or take physical delivery.
8. **Related Party Transactions.** The Fund shall not knowingly make an investment in any class of securities of any issuer, other than those issued or guaranteed by Canadian governments,
 - I. for which the Advisor (a related party of the Fund) or any associate or affiliate of the Advisor (individually a “manager”) has acted as an underwriter in the distribution of such class of securities (except as a member of a selling group distributing 5% or less of the securities underwritten) for a period of at least 60 days following the conclusion of the distribution of the underwritten securities to the public; or
 - II. of which any partner, director, officer or employee of a manager or any partner, director, officer or employee of any affiliate or associate of such manager is an officer or director, provided that this prohibition will not apply where any such person does not:
 - i. participate in the formulation of investment decisions made on behalf of the Hedge Fund Portfolio;
 - ii. have access to the investment decision-making process of the Hedge Fund Portfolio prior to the implementation of investment decisions made on behalf of the Hedge Fund Portfolio; and
 - iii. influence (other than through research, statistical and other reports generally available to clients) the investment decisions made on behalf of the Hedge Fund Portfolio; or
 - III. in which a manager or any partner, director, officer or employee of a manager had a material interest (which for these purposes includes beneficial ownership of more than 10% of the voting securities of the issuer).
9. **Liquidity of Investment on Termination of the Hedge Fund Portfolio.** The Fund will not invest in securities that by their terms will not mature, terminate or be redeemable prior to the termination of the Hedge Fund Portfolio.

The investment restrictions applicable to the Hedge Fund Portfolio may only be changed if the approval of the Unitholders by an Extraordinary Resolution has been given.

DESCRIPTION OF THE UNITS OFFERED BY THE TRUST:

The Trust is a closed-end investment trust created pursuant to a declaration of trust and governed by the laws of the Province of Ontario. The Trust was authorized to issue transferable units of beneficial interest upon its initial public offering. Each Unit represents an equal, undivided interest in the net assets of the Trust.

Each Unit entitles the holder to the same rights and obligations as a holder of any other Unit and no Unitholder is entitled to any privilege, priority or preference in relation to any other Unitholders. Each Unitholder is entitled to one vote for each Unit held and is entitled to participate equally with respect to any and all distributions made by the Trust, including distributions of net income and net realized capital gains. On termination, the Unitholders of record holding outstanding Units are entitled to receive all of the assets of the Trust remaining after payment of all debts, liabilities and liquidation expenses of the Trust.

Meetings of Unitholders

The Trustee may, at any time, convene a meeting of the Unitholders and is required to convene a meeting on receipt of a request in writing of the Manager or of Unitholders holding, in aggregate, 10% or more of the Units outstanding.

Any matter to be considered at a meeting of Unitholders, other than certain matters requiring the approval of Unitholders by extraordinary resolution (an "Extraordinary Resolution") as discussed below, requires the approval of Unitholders by a resolution passed by holders of not less than 50% of the Units voting thereon at a meeting duly convened for the consideration of such matter. A quorum for any meeting convened to consider such matter consists of two or more Unitholders present in person or by proxy and representing not less than 10% of the Units outstanding. If a quorum is not present at a meeting within 30 minutes after the time fixed for the meeting, the meeting, if convened pursuant to a request of Unitholders, will be cancelled, but otherwise will be adjourned to another day, not less than 10 days nor more than 21 days later, selected by the Manager and notice will be given to the Unitholders of such adjourned meeting. The Unitholders present at any adjourned meeting will constitute a quorum. Each Unitholder is entitled to one vote per Unit held.

Notwithstanding the foregoing, certain matters will require the approval of Unitholders by Extraordinary Resolution. An Extraordinary Resolution is a resolution passed by holders of not less than 66 ²/₃% of the Units voting thereon at a meeting duly convened for the consideration of such matter. A quorum for any meeting convened to consider a matter requiring the approval of Unitholders by Extraordinary Resolution consists of two or more Unitholders present in person or by proxy and representing not less than 25% of the Units then outstanding except, in the case of a meeting convened to extend the term of the Trust which will require the approval of Unitholders by Extraordinary Resolution consisting of two or more Unitholders present in person or by proxy representing not less than 10% of the Units then outstanding. See "Termination of the Trust".

Acts Requiring Unitholder Approval

The Trust Agreement may be amended with the consent of the Unitholders given by Extraordinary Resolution. However, unless all of the Unitholders consent thereto, no amendment can be made to the Trust Agreement that would have the effect of reducing the interest in the Trust of the Unitholders, increasing the liability of any Unitholder or changing the right of a Unitholder to vote at any meeting. No amendment can be made to the Trust Agreement that would have the effect of reducing the fees payable to the Manager or the terms for terminating the Manager unless the Manager, in its sole discretion, consents.

Notwithstanding the foregoing, the Manager is entitled, without the consent of the Unitholders, to make certain amendments to the Trust Agreement that are for the purpose of adding any provisions that, in the opinion of the Manager, are for the protection or benefit of the Unitholders or the Trust, for the purpose of curing an ambiguity or for the purpose of supplementing any provision that may be defective or inconsistent with another provision, including without limitation, for the purpose of ensuring that the Trust Agreement and this prospectus are not inconsistent. The Manager must disclose such change in the next regularly scheduled report to Unitholders. Such amendments may be made only if they will not materially adversely affect the interest of any Unitholder or the Trustee.

Reporting to Unitholders

The Trust's fiscal year is the calendar year. A copy of the Trust's December 31, 2006 audited annual financial statements and an annual report will be mailed by the Manager to each Unitholder by March 31, 2007. In accordance with the provisions of National Instrument 81-106, the annual financial statements and annual reports of the Trust are required to be mailed to each Unitholder within 90 days following the end of the fiscal year. Within 60 days following June 30 of each year, an unaudited semi-annual report prepared in accordance with applicable regulatory requirements will be mailed to Unitholders.

In addition, the Manager shall, on or before March 31 of each year, cause to be forwarded to each Unitholder of record on any Record Date of the preceding year information in a suitable form to enable the Unitholder to comply with his or her income tax reporting obligations relating to his or her interest in the Trust.

The Manager must keep adequate books and records reflecting the activities of the Trust. A Unitholder or his or her duly authorized representative has the right to examine the books and records of the Trust during normal business hours at the offices of the Manager. Notwithstanding the foregoing, a Unitholder shall not have access to any information that, in the opinion of the Manager, should be kept confidential in the interests of the Trust.

VALUATION OF PORTFOLIO SECURITIES AND CALCULATION OF NET ASSET VALUE:

The total assets of the Trust are comprised of the aggregate value of the Common Share Portfolio and the Forward Agreement. As the value of the Forward Agreement is determined by reference to the Net Asset Value (“NAV”) of the Fund, the NAV of the Trust is in part driven by the NAV of the Fund.

The Manager, as valuation agent for the Trust, and the administrator of the Fund, as valuation agent for the Fund (each, a “Valuation Agent”), as of the last business day of each month (each, a “Valuation Date”) calculate the value of the Trust’s and Fund’s assets, as applicable, as follows:

- a) the value of cash, receivables, prepaid expenses, dividends and interest declared or accrued and not yet received, is deemed to be the face value unless the Valuation Agent, in its discretion, considers otherwise;
- b) the value of treasury bills and other money market instruments is the bid price for such instruments at the applicable exchange’s closing time on the Valuation Date;
- c) the value of any unit or share of a hedge fund is the definitive net asset value reported by that fund’s manager or administrator on the Valuation Date or, if not available, the most recent provisional net asset value based on the preliminary returns reported by such fund’s manager or administrator;
- d) the value of any asset measured in a foreign currency is valued at the rate of exchange current on the Valuation Date as determined by the Valuation Agent in its reasonable discretion;
- e) the value of derivatives traded on an exchange, if any, shall be the settlement price as published by the clearing house of the exchange on the Valuation Date;
- f) the value of forward agreements shall be the gain, if any, that would be realized if on such date the forward agreements were “closed out”, and the value of swaps, if any, shall be the gain, if any, that would be realized if on such date the swaps were “closed out” or terminated; and
- g) the value of all other property, including any property for which a third party valuation is not available, shall be the value the Valuation Agent determines, in its reasonable discretion, most accurately reflects its fair value.

The liabilities of the Trust and the Fund, as applicable, shall be deemed to comprise all liabilities of whatsoever kind and nature, including, for the avoidance of doubt, any accrued Management Fees and Advisory Fees, except liabilities represented by outstanding Units and surplus. In valuing the liabilities, the following are included: bills, amounts owing under any loan facility, accounts payable, fees and administrative expenses payable, contractual obligations for the payment of money or property, allowances for tax or contingencies and all other liabilities of any kind and nature. Without prejudice to the foregoing, the value of the liabilities of the Trust and Fund, as applicable, will be determined as follows:

- a) the value of all liabilities and contractual obligations is the value determined by the Valuation Agent to most accurately reflect fair value including the amount funded by a counterparty thereunder, and the loss, if any, that would be realized if on the Valuation Date forward agreements or swaps were closed out or terminated; and

- b) liabilities and contractual obligations payable in a foreign currency are valued at the rate of exchange current on the Valuation Date as determined by the Valuation Agent in its reasonable discretion.

If the Valuation Agent of either the Trust or the Fund determines, in its sole discretion, that the value provided for any of the assets or liabilities is not appropriate and does not fairly represent its market value, the Valuation Agent, in consultation with such industry professionals and other third parties as such Valuation Agent may reasonably determine, shall value such asset or liability as it reasonably determines and shall set forth the basis of such valuation in writing in the Trust's or Fund's records. Any such determination in respect of the Trust shall be subject to review by the Advisory Board. Any such determination in respect of the Fund shall be subject to review by its board of directors.

The Trust is not required to have valuations independently determined; however, the Valuation Agent is authorized and permitted, in appropriate circumstances, to utilize independent pricing services or appraisers to value its investments.

The process of valuing investments for which no published market exists is based on inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the investments and may differ from the prices at which the investments may be sold.

All values assigned to securities and other assets and liabilities by the Trust or Fund shall be final and conclusive as to all of the Unitholders.

PURCHASES OF UNITS:

The Units are listed and posted for trading on The Toronto Stock Exchange under the symbol NYF.UN.

RESPONSIBILITY FOR FUND OPERATIONS:

The Manager

Pursuant to the Declaration of Trust, Northwater Fund Management Inc. (the "Manager") has exclusive authority to manage the operations and affairs of the Trust, to make all decisions regarding the business of the Trust and has authority to contract on behalf of the Trust. The Manager may, pursuant to the terms of the Declaration of Trust, delegate its powers to third parties at no additional cost to the Trust where, in the discretion of the Manager, it would be in the best interests of the Trust to do so. The Manager is required to exercise its powers and discharge its duties honestly, in good faith and in the best interests of the Trust and to exercise the care, diligence and skill of a prudent and qualified person. Among other restrictions imposed on the Manager, it may not dissolve the Trust or wind up the Trust's affairs except in accordance with the provisions of the Declaration of Trust. The Declaration of Trust provides that the Manager may, in its sole discretion, terminate the Trust if the Manager believes that to do so is in the best interests of Unitholders due to a detrimental regulatory or tax change or if the net asset value of the Trust declines to a level where the Manager believes that proper diversification cannot be achieved.

The Manager's duties include, without limitation: maintaining accounting records for the Trust; authorizing the payment of operating expenses incurred on behalf of the Trust; calculating the amount of distributions by the Trust; preparing financial statements, income tax returns and financial and accounting information as required by the Trust; ensuring that the Unitholders are provided with financial statements and other reports as required from time to time by applicable law; ensuring that the Trust complies with regulatory requirements; preparing the Trust's reports to Unitholders and to the Canadian securities regulatory authorities; providing the Trustee with certain information and reports; and negotiating contracts with third-party providers of services, including, but not limited to, custodians, transfer agents, auditors and printers. The Manager provides office facilities and personnel to carry out these services, together with clerical services that are not furnished by the Trust's custodian or transfer agent.

The Declaration of Trust entitles the Manager, in payment for the services noted above, to receive a monthly management fee equal to one twelfth of 0.15% of the Net Asset Value of the Trust at month end calculated and paid monthly in arrears. The Manager is entitled to be reimbursed for all expenses and liabilities properly incurred by it in connection with the activities of the Trust.

The Manager is currently also manager of two other closed-end investment trusts, Northwater Market-Neutral Trust and Northwater Top 75 Income Trusts^{Plus}.

The Investment Advisor

Northwater Capital Management Inc. (the "Investment Advisor"), an affiliate of the Manager, has been retained by the Manager to provide investment advisory and portfolio management services to the Manager for the benefit of the Trust pursuant to an investment management agreement (the "Investment Management Agreement") dated as of June 18, 2004.

The Investment Advisor, 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 seek to generate consistent returns in both normal and extreme markets, the Investment Advisor delivers a 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. The Investment Advisor's structuring technology then 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 over a ten year track record in fund of hedge funds, the Investment Advisor has steadily grown assets under management to approximately CDN \$10.6 billion total, including CDN \$5.1 billion invested in hedge funds as at December 31, 2006. The Investment Advisor has focused on developing, delivering and continuously improving its market-neutral fund of hedge fund portfolios since launching its first such portfolio in 1994.

The Investment Advisor advises institutional clients in Canada, the United States, the United Kingdom and other parts of Europe, as well as in Australia. The firm has offices in Toronto, New York and Chicago.

The Investment Advisor is engaged in a wide range of investment management, investment advisory and other business activities. The services of the Investment Advisor under the Investment Management Agreement are not exclusive and nothing in the Investment Management Agreement prevents the Investment Advisor or any of its affiliates from providing similar services to other investment funds and other clients (whether or not their investment objectives, strategies and restrictions are similar to those of the Trust) or from engaging in other activities. The Investment Advisor's investment decisions for the Trust will be made independently of those made for its other clients and independently of its own investments. However, the Investment Advisor may make the same investment for the Trust or the Hedge Fund Portfolio and for one or more of its other clients. If the Trust or the Hedge Fund Portfolio and one or more of the other clients of the Investment Advisor is engaged in the purchase or sale of the same security, the Investment Advisor will see to effect transactions on an equitable basis.

The Investment Management Agreement, unless terminated as described below, will continue until the termination of the Trust. The Manager in certain circumstances may, and the Manager upon the direction of the Unitholders authorized by an Extraordinary Resolution will, terminate the Investment Management Agreement upon six months' prior written notice. In the event of the termination of the Investment Management Agreement as a result of the passing of a resolution by the Unitholders as described above, no payments need be made by the Manager to the Investment Advisor or by the Investment Advisor to the Manager, except for amounts owing as of the date of termination. The Investment Advisor may terminate the Investment Management Agreement upon at least 20 business days' written notice given by the Investment Advisor to the Manager if the Manager is in breach or default of any material provision of the Investment Management Agreement and, if capable of being cured, the breach or default has not been cured within twenty business days of written notice of such breach or default given by the Investment Advisor to the Manager. In the event of such termination, no payments need be made by the Manager to the Investment Advisor or by the Investment Advisor to the Manager, except for amounts owing as of the date of termination.

In the Investment Management Agreement, the Investment Advisor covenants to act at all times on a basis that is fair and reasonable to the Manager, to act honestly and in good faith with a view to the best interests of the Manager and, in connection therewith, shall exercise the degree of care, diligence and skill that a reasonably prudent portfolio manager would exercise in comparable circumstances. The Investment Management Agreement provides that the Investment Advisor will not be liable in any way for any default, failure or defect in any of the securities comprising the investment portfolio of the Trust if it has exercised the degree of care, diligence and skill set forth above. The Investment Advisor will incur liability, however, in cases of willful misconduct, bad faith, gross negligence or disregard of its duties or the standard of care, diligence and skill set forth above.

In the event that the Investment Management Agreement is terminated as provided above, the Manager will appoint a successor investment advisor to carry out the activities of the Investment Advisor until a meeting of the Unitholders is held to confirm such appointment.

The Investment Advisor will receive a portion of the fee payable by the Trust to the Manager in consideration of the Investment Advisor's services to the Trust.

The Trustee

Northwater Fund Management Inc. is the Trustee of the Trust. The address of the Trustee is Suite 4700, BCE Place, Bay Wellington Tower, 181 Bay Street, P.O. Box 794, Toronto, Ontario M5J 2T3.

The Trustee or any successor trustee may resign upon 90 days' prior written notice to Unitholders and to the Manager or may be removed with the approval of a majority of the votes cast at a meeting of Unitholders called for such purpose with two or more persons present in person or by proxy representing not less than 10% of the Units then outstanding. Any such resignation or removal shall become effective only on the appointment of a successor trustee. If, after the resignation of the Trustee, no successor has been appointed within 90 days, the Trustee, the Manager or any Unitholder may apply to a court of competent jurisdiction for the appointment of a successor trustee.

The Declaration of Trust provides that the Trustee will not be liable in carrying out its duties under the Declaration of Trust except in cases of wilful misconduct, bad faith, negligence or disregard of its obligations and duties under the Declaration of Trust or in cases where the Trustee fails to act honestly and in good faith with a view to the best interests of the Unitholders or to exercise the degree of care, diligence and skill that a reasonably prudent trustee would exercise in comparable circumstances. In addition, the Declaration of Trust contains other customary provisions limiting the liability of the Trustee and indemnifying the Trustee in respect of certain liabilities incurred by it in carrying out its duties.

The Trustee is entitled to be reimbursed for all expenses and liabilities that are properly incurred by the Trustee in connection with the activities of the Trust.

Custodian

RBC Dexia Investor Services Trust, as successor custodian to The Royal Trust Company, was appointed as custodian of the securities comprising the investment portfolio of the Trust pursuant to an agreement made as of June 18, 2004.

Registrar and Transfer Agent

CIBC Mellon Trust Company acts as transfer agent and registrar for the Trust at 320 University Avenue, 5th Floor Toronto, Ontario, M5H 4A6. In addition to performing registrar and transfer agency services, CIBC Mellon Trust Company provides certain record-keeping, Unitholder reporting and general administrative services pursuant to the registrar and transfer agency agreement made as of June 18, 2004.

Auditors

The auditors of the Trust are PricewaterhouseCoopers LLP, Suite 3000, Box 82, Royal Trust Tower, Toronto Dominion Centre, Toronto, Ontario, M5K 1E6.

The Trust is a closed-end investment trust and, as such, has no officers or directors. Disclosure under this item is for the Manager and for the Investment Advisor.

Officers and Directors of the Manager

The name, municipality of residence, position with the Manager and principal occupation of each of the directors and officers of the Manager are as follows:

<u>Name and Municipality</u>	<u>Position with the Manager</u>	<u>Principal Occupation</u>
DAVID G. PATTERSON, M.B.A. Toronto, Ontario	Chairman, Chief Executive Officer and Director	Chairman and Chief Executive Officer, Northwater Capital Management Inc.
BENITA M. WARBOLD, CA. Scarborough, Ontario	Managing Director, Chief Financial Officer and Director	Managing Director and Chief Financial Officer, Northwater Capital Management Inc.
DANIEL C.R. MILLS, CFA. Mississauga, Ontario	Managing Director, Chief Investment Officer and Director	Managing Director and Chief Investment Officer, Northwater Capital Management Inc.
JAMES D. SINCLAIR, LL.B. Unionville, Ontario	Vice-President, Secretary and Director	Vice-President and Chief Legal Officer, Northwater Capital Management Inc.
DAVID S. FINCH, CFA. Toronto, Ontario	Vice-President	Vice-President, Northwater Capital Management Inc.
EVE N. JEDRZEJEWSKA, CA, C.F.A. Toronto, Ontario	Vice-President	Vice-President, Northwater Capital Management Inc.
SHAUNA L. CASSIDY, CFA Toronto, Ontario	Vice-President	Vice-President, Northwater Capital Management Inc.
JIENAN WANG, CFA Toronto, Ontario	Vice-President	Vice-President, Northwater Capital Management Inc.

All of the directors and officers of the Manager have held their current offices or other executive offices with the above companies or their affiliates for at least five years except for: Mr. Finch who prior to May 2002 was Vice-President, ING Investment Management Inc.

Officers and Directors of the Investment Advisor

The name, municipality of residence, position with the Investment Advisor and principal occupation of each of the directors and officers of the Investment Advisor are as follows:

<u>Name and Municipality</u>	<u>Position with the Investment Advisor</u>	<u>Principal Occupation</u>
DAVID G. PATTERSON, MBA Toronto, Ontario	Chairman, Chief Executive Officer and Director	Chairman and Chief Executive Officer
PAUL W. ROBSON, MBA, CFA. Mississauga, Ontario	Managing Director, President	Managing Director, President
BENITA M. WARMBOLD, CA Scarborough, Ontario	Managing Director, Chief Financial Officer and Director	Managing Director and Chief Financial Officer
DANIEL C.R. MILLS, CFA. Mississauga, Ontario	Managing Director and Chief Investment Officer	Managing Director and Chief Investment Officer
DENNIS G. COOK, C.M.C., C.H.R.P. Toronto, Ontario	Executive Vice-President	Executive Vice-President
JAMES D. SINCLAIR, LL.B. Unionville, Ontario	Vice-President, Chief Legal Officer and Chief Compliance Officer	Vice-President, Chief Legal Officer and Chief Compliance Officer
HEATHER L. BROUGHTON, MBA, CFA. Toronto, Ontario	Vice-President	Vice-President
SHAUNA L. CASSIDY, CFA. Toronto, Ontario	Vice-President	Vice-President
JOANNA CHRZANOWSKI, CA, MISSISSAUGA, Ontario	Vice-President	Vice-President
A. MICHAEL DERZKO New York, New York	Vice-President	Vice-President
DAVID S. FINCH, CFA. Toronto, Ontario	Vice-President	Vice-President
DAVID J. FLETCHER, CFA. Pickering, Ontario	Vice-President	Vice-President
STEPHEN M. FOOTE, CFA Oakville, Ontario	Vice-President	Vice-President
R. ANDREW HARRISON New York, New York	Vice-President	Vice-President
SCOTT C. HENSHAW, M.EC., MBA, CFA. Toronto, Ontario	Vice-President	Vice-President
CRAIG H. HIPPERN, CA, CPA.	Vice-President	Vice-President

Mississauga, Ontario		
ADRIAN HUSSEY, MBA, CFA Toronto, Ontario	Vice-President	Vice-President
TAHA JAFFER, PH.D. Toronto, Ontario	Vice-President	Vice-President
VIKASH JAIN, M.Sc., CFA Etobicoke, Ontario	Vice-President	Vice-President
EVE N. JEDRZEJEWSKA, CA, CFA Toronto, Ontario	Vice-President	Vice-President

<u>Name and Municipality</u>	<u>Position with the Investment Advisor</u>	<u>Principal Occupation</u>
MOHAMED S. KHAKI, A.S.A., CFA Toronto, Ontario	Vice-President	Vice-President
FRANCES KORDYBACK, CA Toronto, Ontario	Vice-President	Vice-President
ROBERT J. KULPERGER, J.D. Darrien, Connecticut	Vice-President	Vice-President
DANIEL S. LAWEE, MBA, CFA Toronto, Ontario	Vice-President	Vice-President
HOWARD M.H. LEE, M.Sc. Toronto, Ontario	Vice-President	Vice-President
IRENE C. MARKUS, LL.B. Toronto, Ontario	Vice-President	Vice-President
DAVID MARLEAU, F.S.A., F.C.I.A. Toronto, Ontario	Vice-President	Vice-President
SUSAN L. NAYLOR, CA Burlington, Ontario	Vice-President	Vice-President
HARRY R.L. PATTERSON., CFA Toronto, Ontario	Vice-President	Vice-President
CURT PETERS, MBA New York, New York	Vice-President	Vice-President
JONATHAN PIURKO, LL.B Toronto, Ontario	Vice-President	Vice-President

NEIL SIMONS, PH.D, MMF Unioville, Ontario	Vice-President	Vice-President
MARK P. SMITH, MBA New York, New York	Vice-President	Vice-President
MARK STEFFLER, CA Toronto, Ontario	Vice-President	Vice-President
JHENAN J. WANG, M.A., CFA Toronto, Ontario	Vice-President	Vice-President
KAI WANG, MBA, CFA Thornhill, Ontario	Vice-President	Vice-President
XIANG ZHANG, MMF, CFA Toronto, Ontario	Vice-President	Vice-President

All of the directors and officers of the Investment Advisor have held their current offices or other executive offices with the above companies or their affiliates for at least five years except for: Ms. Chrzanowski who between July 2002 and January 2005 was Senior Financial Consultant with The Canada Life Assurance Company, and prior July 2005 was Associate with the Investment Advisor; Mr. Cook who between March 2002 and June 2003 was Vice President with the Investment Advisor, and prior to February 2002 was Director, Deloitte & Touche LLP; Mr. Derzko who prior to February 2004 was Associate with the Investment Advisor; Mr. Finch who prior to May 2002 was Vice President, ING Investment Management Inc.; Mr. Foote who prior to March 2005 was Senior Consultant, Mercer Investment Consulting; Mr. Harrison who prior to February 2006 was Associate with Celtic House Venture Partners; Mr. Henshaw who between October 2003 and February 2004 was Associate with the Investment Advisor, and prior to October 2003 was Associate Director, UBS Securities Canada Inc.; Mr. Hippern who between January 2002 and June 2002 was associate with the Investment Advisor, and prior to January 2002 was Assistant Vice President, Bank of Butterfield; Mr. Hussey who prior to October 2002 was Vice President, Senior Portfolio Manager, Elliott and Page; Mr. Jaffer who prior to July 2004 was Associate with the Investment Advisor, between January 2002 and September 2002 was Investment Analyst, Capital Markets, MFC Global Investment Management, and prior to January 2002 was full time student at the University of Toronto; Mr. Jain who between October 2000 and November 2003 was Associate with the Investment Advisor; Mr. Khaki who prior to June 2003 was Senior Consultant, Frank Russell Canada Limited; Ms. Kordyback who between January 2003 and December 2004 was Managing Director, CCFL Parklea Capital Inc., and prior to December 2002 was Partner, Plaxton & Co. Limited; Mr. Kulperger who prior to October 2006 was Director, Credit Suisse. Mr. Lawee who between August 2002 and February 2004 was Associate with the Investment Advisor, and prior to August 2002 was Vice President, Foreign Exchange, TD Securities; Ms. Markus who between August 2000 and July 2004 was Vice-President, J.P. Morgan Securities Inc.; Mr. Marleau who prior to July 2003 was Assistant Portfolio Manager, ING Investment Management, Inc.; Mr. H. Patterson who between January 2001 and February 2004 was Associate with the Investment Advisor, and prior to January 2001 was Business Analyst, Geophysical Applications; Mr. Peters who between March 2005 and July 2006 was Associate with the Investment Advisor, and prior to March 2005 was Associate with Solomon Lewis LLC; Mr. Piurko who between September 2004 and July 2005 was Associate with the Investment Advisor and prior to September 2004 was an Associate at Blake, Cassels & Graydon LLP; Mr. Simons who prior to Prior to 2006, Mr. Simons was Senior

Manager, Enterprise Market Risk Reporting and Analysis; Mr. Steffler who prior to September 2006 was Senior Manager, Finance, Royal and Sun Alliance between March 2004 and September 2006 and prior to March 2004 was as Senior Consultant, Treasury for Canada Life; and prior to March 2003, Assistant Controller, First Capital Realty Inc.; Mr. Smith who between July 2002 and February 2004 was Associate with the Investment Advisor and between September 2000 and May 2002 was a full time student at Columbia Business School; and Mr. Zhang who between August 2003 and July 2005 was Associate with the Investment Advisor, and prior to August 2003 was Senior Investment Analyst and Assistant Portfolio Manager at MFC Global Investment Management Corporation.

POTENTIAL CONFLICTS OF INTEREST:

The Manager, the Investment Advisor, their respective directors and officers and their respective affiliates and associates may engage in the promotion, management or investment management of, or may render advice to, any other account, fund, corporation, partnership or trust that invests primarily in funds of market-neutral hedge fund securities. The Investment Advisor may have a conflict of interest in rendering advice to the Trust or the Fund because the benefit the Investment Advisor and its principals may receive from managing some other accounts may exceed the benefit from managing the Trust's or the Fund's account, and, therefore, may provide an incentive to favour such other accounts.

Although none of the directors or officers of the Manager or the Investment Advisor will devote his or her full time to the business and affairs of the Trust, the Fund or the Manager, each will devote as much time as is necessary to supervise the management of (in the case of the directors) or to manage (in the case of officers) the business and affairs of the Manager, the Trust and the Fund. Although officers, directors, members and professional staff of the Investment Advisor will devote as much time to the Fund as the Investment Advisor deems appropriate to perform its duties in accordance with the Investment Advisory Agreement, the staff of the Investment Advisor may have conflicts in allocating its time and services among the Hedge Fund Portfolio and the other portfolios of the Investment Advisor.

Neither the Investment Advisor nor any of its affiliates is under any obligation to offer investment opportunities of which they become aware to the Fund or to inform the Fund of any investment before offering any investments to other funds or accounts that the Investment Advisor and/or its affiliates manage or advise. Furthermore, the Investment Advisor and/or its affiliates may make an investment on their own behalf or on behalf of any account that they manage or advise without offering the investment opportunity or making any investment on behalf of the Fund.

In addition, the Investment Advisor and/or its affiliates, in connection with their other business activities, may acquire material non-public confidential information that may restrict the Investment Advisor from purchasing assets or selling assets for itself or its clients (including the Fund) or otherwise using such information for the benefit of its clients or itself. As a result of investments for other clients, the Investment Advisor may be unable for legal, regulatory or other reasons to effect a particular transaction on behalf of the Fund that it would otherwise effect. The Investment Advisor is expected to advise the Fund with respect to the purchase of securities for the Hedge Fund Portfolio in privately negotiated transactions and

such securities may or may not include securities in which the Agents have participated in the distribution or of issuers to which the counterparties or their affiliates are lenders.

Members of the Board of the Fund may also act as directors of some of the hedge funds in which the Hedge Fund Portfolio Invests.

FUND GOVERNANCE:

The Manager has appointed an advisory board (the “Trust Advisory Board”) consisting of two members. The members of the Trust Advisory Board are Jeffrey D. Francoz and Ann Marshall. Both members of the Trust Advisory Board are independent of the Manager, the Investment Advisor and the Trust.

The Trust Advisory Board will provide independent advice to the Manager in connection with its role as manager of the Trust, including with respect to conflicts of interest, potential conflicts of interest and related party transactions identified by the Manager, and will receive and review periodic reports about the investment of the Trust’s assets. The Manager will report to the Trust Advisory Board on the financial statements and performance of the Trust on at least a quarterly basis, including with respect to compliance with the investment guidelines and restrictions of the Trust.

The members of the Advisory Board will act honestly and in good faith in the best interests of the Trust and the Unitholders and in connection with that duty will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

National Instrument 81-107 Independent Review Committee for Investment Funds came into force on November 1, 2006 and the Manager and the Trust Advisory Board are currently working together to ensure that the Trust Advisory Board takes on the responsibilities of the Independent Review Committee and complies with the requirements of National Instrument 81-107.

FEES AND OTHER EXPENSES:

The Manager is responsible for the ongoing business of the Trust and monitoring the investment portfolio of the Trust. In consideration for these and other services and pursuant to the terms of the Trust Agreement and the Management Agreement, the Trust will pay to the Manager a monthly management fee equal to one-twelfth of 0.15% of the Net Asset Value at month end, paid monthly in arrears, plus applicable taxes. The Manager may pay a portion of the foregoing fee to the Investment Advisor in consideration of the Investment Advisor's services to the Trust.

The Trust pays for all expenses incurred in connection with the operation and administration of the Trust. These expenses include, without limitation: mailing and printing expenses for periodic reports to Unitholders; fees payable to the Trustee for acting as trustee of the Trust; fees payable to the Custodian (as hereinafter defined) for acting as custodian of the assets of

the Trust; fees payable to the registrar and transfer agent for performing certain financial, record-keeping, Unitholder reporting and general administrative services; fees payable to the auditors, valuers, and legal advisors of the Trust; debt service fees (including set-up and commitment fees); ongoing regulatory filing fees and listing and other fees; any reasonable out-of-pocket expenses incurred by the Manager or its agents in connection with their ongoing obligations to the Trust; and any expenditures that may be incurred upon the termination of the Trust.

Pursuant to the Investment Advisory Agreement, in exchange for its services provided to the Fund with respect to the Hedge Fund Portfolio, the Advisor will receive from the Fund an annual fee, calculated and paid monthly in arrears, of 1.15% of the NAV of the Hedge Fund Portfolio calculated as of the Valuation Date that coincides with or immediately precedes the date of accrual. For this purpose the NAV used will be before deduction of such fees.

The Trust will pay to the Manager a service fee (accrued monthly, calculated quarterly and paid as soon as practicable after the end of each calendar quarter) of 0.30% per annum of the NAV of the Units held at the end of the relevant quarter by clients of dealers, plus applicable taxes. The service fee will be paid by the Manager to registered dealers for services they provide to Unitholders, including investment advice and account statements, based on the number of Units held by clients of such dealers at the end of the relevant quarter.

INCOME TAX CONSIDERATIONS:

This summary is applicable to a Unitholder who is an individual (other than a trust) and who, for the purposes of the *Income Tax Act* (Canada) (the “Tax Act”) is resident in Canada, deals at arm’s length with and is not affiliated with the Trust and holds Units as capital property. Generally, Units will be considered to be capital property to a holder provided that the holder does not hold the Units in the course of carrying on a business of buying and selling securities and has not acquired them in one or more transactions considered to be an adventure in the nature of trade. Certain persons who might not otherwise be considered to hold their Units as capital property may, in certain circumstances, be entitled to have them treated as capital property by making the election permitted by subsection 39(4) of the Tax Act.

The Trust currently qualifies as a “mutual fund trust” under the Tax Act. Investors are encouraged to refer to the disclosure under the heading “Canadian Federal Income Tax Considerations” in the Trust’s prospectus for a more complete discussion of tax considerations.

If, contrary to the advice of counsel to the Trust or as a result of a change of law, upon physical settlement of the Forward Agreement the character and timing of the gain under the Forward Agreement were other than a capital gain on the sale of the securities thereunder, after-tax returns to Unitholders could be reduced and the Trust could be subject to non-refundable income tax from such transactions.

There can be no assurance that Canadian federal income tax laws respecting the treatment of mutual fund trusts will not be changed in a manner that adversely affects the Unitholders. If the Trust ceases to qualify as a “mutual fund trust” under the Tax Act, the income tax

considerations described under the heading “Canadian Federal Income Tax Considerations” in the prospectus would be materially and adversely different in certain respects.

MATERIAL CONTRACTS:

Material contracts that have been entered into by the Trust since its formation or prior to Closing, other than contracts entered into in the ordinary course of business, are as follows:

1. the Declaration of Trust Agreement referred to under “Management of the Trust – The Trustee”;
2. the Agency Agreement made among the Manager on behalf of the Trust, the Manager and the Agents referred to under “Plan of Distribution”;
3. the Forward Agreement;
4. the custodian agreement made among the Manager on behalf of the Trust and The Royal Trust Company referred to under “Auditors, Custodian and Registrar and Transfer Agent”; and
5. the registrar and transfer agency agreement among the Manager on behalf of the Trust and CIBC Mellon Trust Company referred to under “Auditors, Custodian and Registrar and Transfer Agent”.

LEGAL AND ADMINISTRATIVE PROCEEDINGS:

Neither the Manager, the Investment Advisor or the Trustee of the Trust are aware of any legal or administrative proceedings involving the Trust.

OTHER MATERIAL INFORMATION:**Selected Consolidated Financial Information**

The following summary of financial information has been derived from the financial statements of the Trust. This information should be read in conjunction with the Financial Statements specifically incorporated herein by reference. There have been no changes in accounting policies and no changes in the investment strategy of the Trust. The Trust commenced operations on June 30, 2004.

Distribution History:

YEAR	TYPE	PER UNIT	TOTAL
2006	Return of Capital	\$1.7500	\$5,170,332
2005	Return of Capital	\$1.7500	\$5,615,838
2004	Return of Capital	\$ 0.8750	\$ 2,520,000

For a full discussion of the Trust's distribution policy, please see page 4.

	<u>For the year ended December 31, 2006</u>	<u>For the six month period ended June 30, 2006</u>
(All Figures in Canadian Dollars)		
Total income	24, 177	255,154
Net income (loss) from operations	6,349,085	1,701,701
Net income (loss) per unit *	2.14	0.56
Total assets	78,972,007	96,730,898
Bank loan	-	900,000
Net assets and unitholders' equity	65,586,531	66,474,199

* based on average number of
Units outstanding for the period

(All figures in Canadian dollars)	For the year ended	For the quarter ended		
	<u>December 31, 2005</u>	<u>September 30, 2005</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>
Total income	12,151	2,076	983	12,743
Net income (loss) from operations	960,212	(396,357)	1,265,393	921,021
Net income (loss) per unit *	0.30	(0.12)	0.39	0.29
Total assets	73,103,101	76,510,473	78,294,489	78,215,290
Bank loan	599,840	-	199,531	-
Net assets and unitholders' equity	70,701,618	74,724,066	76,533,548	76,681,280

* based on average number of Units outstanding for the period

(All figures in Canadian dollars)	For the Period from June 30, 2004 (date of commencement of operation) to	
	<u>December 31, 2004</u>	<u>September 30, 2004</u>
Total income	141,463	110,739
Net income from operations	3,569,484	932,376
Net income per unit*	1.36	0.37
Total assets	79,333,176	60,367,918
Net assets and unitholders' equity	77,173,384	58,904,901

* based on average number of Units outstanding for the period

The monthly Net Asset Value per Unit for the Trust was as follows:

Net Asset Value Per Unit (since inception)

(in Canadian dollars)

	Jan. 31st	Feb. 28th	Mar. 31st	Apr. 30th	May 31st	June 30th	July 31st	Aug. 31st	Sept. 30th	Oct. 31st	Nov. 30th	Dec. 31st
2006	22.85	22.91	22.65	22.76	22.77	22.23	22.53	22.87	22.63	22.93	23.30	23.07
2005	24.30	24.44	23.74	23.80	23.81	23.69	23.75	23.88	23.13	22.77	22.74	22.47
2004							23.42	23.76	23.28	23.54	24.12	23.89

Risk Factors

An investment in Units of the Trust involves certain risks. Investors should consider the risk factors as set out in the prospectus of the Trust before purchasing Units.

EXEMPTIONS AND APPROVALS:

Pursuant to an order dated October 11, 2005 under the securities legislation of each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia, Newfoundland and Labrador, Yukon, Northwest Territories and Nunavut (collectively, the “Jurisdictions”), the local securities regulatory authority in each of the Jurisdictions granted an exemption to the Trust from certain provisions of National Instrument 81-106 Investment Fund Continuous Disclosure (“NI 81-106”).

Generally, the Trust has received exemptive relief from the following provisions of NI 81-106:

- (a) the requirement in paragraph 3.5(1)1 of NI 81-106 to include in the statement of investment portfolio for the Trust the name of the issuer of each portfolio asset; and
- (b) with respect to the preparation of both management reports of fund performance under Part 4 of NI 81-106 and quarterly portfolio disclosure under Part 6 of NI 81-106, both required to be prepared in accordance with Form 81-106F1 or parts thereof (the Summary of Investment Portfolio), the requirement in Item 5(2)(b), Part B of Form 81-106F1 to disclose the names of the top 25 positions held by the Trust.

The relief requested has been granted subject to various conditions imposed by the regulators in the Jurisdictions. The Trust complies with the interim and annual disclosure requirements imposed on it by the regulators pursuant to the exemptive relief order granted to the Trust.

ADDITIONAL INFORMATION:

The Annual Report, including Management's Discussion and Analysis and the audited financial statements of the Northwater Five-Year Market-Neutral Trust for the year ended December 31, 2006 and the notes thereto (collectively referred to as the "Financial Statements") are hereby incorporated by reference.

Copies of the Annual Report, including the financial statements of the Trust and MD&A, may be obtained upon request from the Secretary of the Manager, James D. Sinclair, at the offices of the Trust. In addition, you can get a copy of the Trust's financial statements, including a statement of portfolio transactions, at no cost by calling toll-free 1-800-422-1867. The financial statements and other information about the Trust, such as information circulars and material contracts, are also available at www.sedar.com and certain information is available on the Investment Advisor's Internet site at www.northwatercapital.com.