

**NORTHWATER**

**Northwater Five-Year Market-Neutral Trust  
March 31, 2005  
First Quarter Report**





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## MESSAGE TO UNITHOLDERS FROM THE INVESTMENT ADVISOR

The Northwater Five-Year Market-Neutral Trust (the “Trust”) is a closed-end investment trust that delivers the return of both a diversified portfolio of market-neutral hedge funds and of a fixed-for-floating interest rate swap by way of a forward agreement. Units of the Trust are traded on the Toronto Stock Exchange under the symbol NYF.UN. For the first quarter of 2005, the return of the Trust was 1.20%. During the same time period, the Scotia Capital Universe Bond Index rose by 1.09%, the TSX Composite Index rose by 4.36% and the S&P 500 declined by 2.15%. The Trust made distributions of \$0.4375 per unit during the quarter.

The Trust’s exposure to the fixed-for-floating interest rate swap had a negative impact on the quarterly return of approximately 0.41% as mid-term interest rates rose. The first quarter of 2005 saw the U.S. Federal Open Market Committee (FOMC) continue its measured tightening as the U.S. federal funds rate rose to 2.75%. A renewed concern over inflation rippled through the capital markets exacerbated by oil prices spiking above \$57 per barrel, increasing commodity prices, and a significant rise in producer prices. As a result, the yield curve rose across the entire term structure while uncharacteristically flattening and adversely impacting the performance of U.S. fixed income markets.

To further rattle an already irritable market, swap spreads continued to widen while credit quality worsened across the entire credit spectrum. This deterioration was followed by a rise in equity market volatility and a decline in fixed income volatility. U.S. Equity markets had a poor quarter as credit concerns were punctuated by the earnings disappointments and debt ratings concerns of large corporations, most notably General Motors. Unlike past quarters, currency movements were fairly benign as the US dollar gained in strength on the news of strong economic growth and steady unemployment rates in the U.S.

The hedge fund portfolio experienced mixed returns over the quarter. Strong performance from the Asset-Backed Securities Arbitrage, Mortgage-Backed Security Arbitrage, and Structured Finance strategies offset disappointing numbers from the Energy Relative Value, Convertible Bond Arbitrage and Capital Structure Arbitrage Strategies.

Fixed-Income Arbitrage reversed its poor fourth quarter performance and posted solid returns alongside the Re-Insurance, Statistical Arbitrage, and Distressed Securities strategies. Merger Arbitrage also had a strong quarter as deal flow was more robust as compared to the recent past.

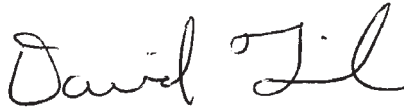
The first quarter also saw Northwater add five market-neutral managers to its portfolio including in the Energy Relative Value, Distressed Securities, and Capital Structure Arbitrage strategies.

Northwater continues to focus on improving the portfolio by refining its stable of managers and focusing on market-neutral strategies that are able to deliver strong risk adjusted returns consistent with the investment objectives.



DANIEL C.R. MILLS, CFA

Managing Director and  
Chief Investment Officer



DAVID S. FINCH, CFA

Vice-President

April 29, 2005

## MANAGEMENT DISCUSSION AND ANALYSIS

The Trust is managed by Northwater Fund Management Inc. (the “Manager”). The Manager is responsible for managing the business and administering the Trust pursuant to the provisions of the declaration of trust as well as for monitoring of the Trust’s investment portfolio. The Manager has retained Northwater Capital Management Inc. (the “Investment Advisor”) to provide investment advice and manage the Trust’s investment portfolio in accordance with the Trust’s investment objectives. In fulfilling its responsibilities, the Manager must ensure that appropriate information systems, procedures and controls are in place in order to ascertain that information used internally and disclosed to Unitholders is complete and reliable. The Manager takes this responsibility seriously and is satisfied that appropriate systems, procedures and controls are in place for the Trust.

All amounts noted throughout this report are in Canadian dollars unless otherwise specifically indicated.

### Investment Objectives

The Trust’s investment objectives are:

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.

The recent federal budget included a measure to eliminate the foreign property rule for pension funds and other tax deferred retirement plans. This proposed change will have no impact on the Trust if enacted as units of the Trust have always been eligible to be held in RRSPs and RRIFs as Canadian property.

### Investment Strategy

The Trust has invested the net proceeds of its offering in a portfolio of common shares of Canadian public companies (“Common Share Portfolio”). The Trust has entered into a forward purchase and sale agreement (the “Forward”) with a U.S. bank (the “Counterparty”) that has a long term credit rating of AA- to obtain exposure to the performance of Northwater Five-Year Market-Neutral Fund

Limited (the Fund), an exempt company formed under the laws of The Cayman Islands and advised by the Investment Advisor, in exchange for the return of the Common Share Portfolio. As part of the forward agreement, the Common Share Portfolio has been pledged to the Counterparty. The Trust's valuation is not affected by the change in the market value of the Common Share Portfolio as gains or losses are offset by the Forward. The Trust's return is based on its exposure, through the Forward, to the Fund.

The Fund holds a diversified portfolio of market-neutral hedge funds ("Hedge Fund Portfolio"). The target exposure to the Hedge Fund Portfolio is equivalent to 150% of the net asset value of the Trust. The actual exposure as at March 31, 2005 was 150% (December 31, 2004 was 147%). In establishing the Hedge Fund Portfolio "mix," the Investment Advisor seeks out strategies that have a low correlation with one another, thereby increasing the benefits of diversification and reducing expected volatility. There can be no assurance that the Trust's performance will exhibit strong risk-adjusted returns. The Investment Advisor believes, however, that the Trust's exposure to the Fund, which holds a well-diversified portfolio of market-neutral hedge funds, should result in the returns of the Trust having a low correlation with major equity and fixed income markets and a low volatility. The additional exposure provided by the leverage in the Forward will increase the risk to unitholders and will not enhance returns in the event that the Hedge Fund Portfolio declines in value.

Through the Forward, the Trust also has exposure to interest rate swaps (the "Swaps") entered into by the Fund. As a result of the Swaps, the Trust is expected to earn a blended fixed rate of 4.30% over its life plus the returns in excess of money market rates earned by exposure to the diversified portfolio of market-neutral hedge funds through the exposure to the Swaps. The Trust has exposure to changes in mid-term interest rates. For example, if mid-term interest rates were to decrease (increase) by 1%, the value of the Trust would increase (decrease) by approximately 4.0%.

The Trust is entitled to borrow up to 10% of the net asset value for purposes of funding redemptions of units, purchases of units in the market and payment of expenses.

As at March 31, 2005, the Trust did not have any loans outstanding (December 31, 2004: no outstanding loans).

### **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 knowl-

edge 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 and the Hedge Fund Portfolio. The Investment Advisor conducts all of its investment research in-house and has developed all of its trading, risk management and valuation software systems internally.

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

1. The development of a multi-faceted set of investment beliefs, which serve as a framework for identifying appropriate market-neutral strategies and the managers that employ those strategies. These investment beliefs have and continue to evolve with the Investment Advisor's experience in market-neutral hedge fund investing and in managing complex derivative strategies.
2. The use of an established operational infrastructure necessary for managing complex market-neutral and derivative strategies. The Investment Advisor has built a team of investment professionals and developed robust portfolio and risk management systems and tools essential to managing a sophisticated fund of market-neutral hedge funds.
3. A progressive global search for market-neutral strategies consistent with the Investment Advisor's investment beliefs and the 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, 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 strat-

egy 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 plan.

7. The construction of a diversified model portfolio across 13 market-neutral strategies. This is a dynamic process.
8. Finally, a comprehensive due diligence process that typically must be completed before the Investment Advisor recommends an investment. This process 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 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 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 and the Fund. Client accounts with similar investment objectives are generally managed in a similar manner. Investment allocation decisions are subject to client guidelines and restrictions. Limited investment opportunities will be allocated to client accounts in a manner that the Investment Advisor determines is equitable to clients in the circumstances.

### Investment Portfolio and Activity

The Trust has obtained exposure to a portfolio of market-neutral hedge funds through the Forward. The Hedge Fund Portfolio emphasizes sectors of the capital markets that the Investment Advisor believes are relatively inefficient. The Investment Advisor believes that such sectors offer arbitrage opportunities and should reward insightful investment analysis.

The Hedge Fund Portfolio is invested in hedge funds that pursue non-traditional investment strategies and is, therefore, subject to the special risks of investing in these strategies. For this reason, the Investment Advisor seeks to diversify the Hedge Fund Portfolio across 13 broad investment strategies. The hedge funds that the Trust has exposure to are located in offshore jurisdictions and prepare annual audited financial statements, in accordance with US or International generally accepted accounting principles (GAAP).

During the three-month period ended March 31, 2005, the Fund placed investments with 5 new hedge funds.

As at March 31, 2005, the Hedge Fund Portfolio included investments in 48 hedge funds with 44 managers (December 31, 2004: 43 hedge funds with 39 managers) engaged in 13 unique market-neutral or hedged investment strategies. The Investment Advisor believes that this wide array of hedge fund investments has created broad diversification through which the Trust seeks to achieve its risk/return objectives and market neutrality.

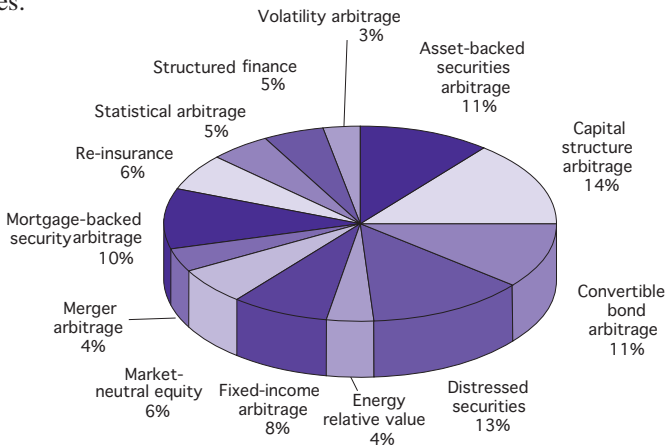
### Asset Allocation by Investment Strategy

The following table presents information regarding the Hedge Fund Portfolio held by the Fund to which the Trust has exposure through the Forward.

#### Hedge Fund Portfolio Exposure

Strategy	As at March 31, 2005		As at December 31, 2004	
	No. of Hedge Funds	Fair Value (in U.S. Dollars)	No. of Hedge Funds	Fair Value (in U.S. Dollars)
Asset-backed securities arbitrage	4	\$ 9,331,565	5	\$ 8,024,230
Capital structure arbitrage	5	8,721,234	3	5,660,546
Convertible bond arbitrage	3	7,231,202	3	4,352,578
Distressed securities	5	9,860,314	4	6,582,534
Energy relative value	3	2,908,575	2	1,940,669
Fixed-income arbitrage	4	6,971,716	4	4,803,193
Merger arbitrage	2	3,503,676	2	1,466,163
Mortgage-backed security arbitrage	4	8,845,291	4	5,793,546
Multi-strategy	11	20,444,285	9	12,531,886
Re-insurance	2	5,188,680	2	3,573,589
Statistical arbitrage	1	804,809	1	802,900
Structured finance	4	4,237,372	4	4,029,311
	48	\$88,048,719	43	\$59,561,145
		100%		100%

The chart below illustrates the hedge fund holdings by strategy of the Fund as at March 31, 2005. The Fund's multi-strategy hedge funds have been allocated to the various hedge fund strategies to reflect their exposure to their constituent strategies.



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

<b>Strategy</b>	<b>As at March 31, 2005</b>	<b>As at December 31, 2004</b>
Asset-backed securities arbitrage	3.85%	3.83 %
Capital structure arbitrage	3.89%	3.98 %
Convertible bond arbitrage	1.55%	2.24 %
Distressed securities	3.49%	3.18 %
Fixed-income arbitrage	1.87%	2.04 %
Energy relative value	1.21%	1.57 %
Merger arbitrage	1.86%	1.12 %
Mortgage-backed security arbitrage	5.00%	4.21 %
Re-insurance	2.90%	4.14 %
Statistical arbitrage	0.85%	1.20 %
Structured finance	1.63%	2.23 %
Multi-strategy	5.01%	4.48 %

### Risk Characteristics

The following tables present information for the period from inception and for the three-month period ended March 31, 2005 regarding elements of the risk profile of both the Trust and the Trust's exposure to the Hedge Fund Portfolio held by the Fund, which the Manager believes to be relevant.

<b>Trust Statistics</b>	<b>For the period from inception to March 31, 2005</b>
# of positive monthly returns	7
# of negative monthly returns	2
% of negative months	22.2%
Average size of negative months	-0.63%
Worst monthly return	-1.07%

<b>Single Hedge Fund Statistics of the Fund</b>	<b>Three-month period ended March 31, 2005</b>
# of hedge funds with positive returns (1)	38
# of hedge funds with negative returns (1)	10
Average annual hedge fund standard deviation (2)	3.34 %
Average correlation between hedge funds (3)	0.16

(1) Measured for hedge funds in the Hedge Fund Portfolio of the Fund as at March 31, 2005.

(2) As measured over the past 24 months for hedge funds in the Hedge Fund Portfolio of the Fund as at March 31, 2005, excludes hedge funds with less than 24 months of historical returns.

(3) As measured over the past 24 months for hedge funds in the Hedge Fund Portfolio of the Fund as at March 31, 2005, excludes hedge funds with less than 24 months of historical returns

## Review of Financial Results

### Performance

During the three months ended March 31, 2005, the Trust posted a return of 1.20%, taking into account the distributions made during the period. Exposure to the asset-backed securities arbitrage and structured finance strategies were key to the success of the Trust for the three months ended March 31, 2005. The Trust's exposure to the interest rate swap reduced the positive performance of the Trust in the three months ended March 31, 2005 by approximately 0.41%. The mark to market valuation of the interest rate swap held by the Fund decreased by U.S. \$266,104 during the three months ended March 31, 2005 due to an increase in mid-term interest rates.

The Trust was not required to make purchases of its units under its repurchase and cancellation program as the units of the Trust for the three months ended March 31, 2005 were not offered for sale at less than 95.0% of the net asset value. As a result, over the three months ended March 31, 2005, this program did not contribute to the overall return of the Trust.

The following table presents the return by investment strategy of the Hedge Fund Portfolio held by the Fund for the three months ended March 31, 2005.

<b>Strategy</b>	<b>Three-month period ended March 31, 2005</b>
Asset-backed securities arbitrage	3.41%
Capital structure arbitrage	-0.54%
Convertible bond arbitrage	-1.65%
Distressed securities	0.73%
Energy relative value	-2.60%
Fixed-income arbitrage	2.48%
Merger arbitrage	1.29%
Mortgage-backed security arbitrage	2.93%
Multi-strategy	2.09%
Re-insurance	2.27%
Statistical arbitrage	0.59%
Structured finance	3.11%

### Net Asset Value and Price Per Unit

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

The Trust's net asset value per unit is calculated and reported monthly. During the

three-month period ended March 31, 2005, the net asset value of the Trust fluctuated between \$23.74 per unit and \$24.30 per unit 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. The daily closing price of the units fluctuated between \$24.55 and \$26.22 during the three-month period ended March 31, 2005.

## Distributions

During the three-month period ended March 31, 2005, distributions totaling \$0.4375 per unit and \$1,413,125 in aggregate were declared. This represents a 1.75% return on the initial subscription price of \$25.00 per unit.

The character of the quarterly distributions for tax purposes will be determined at 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 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.

## Distribution History

<b>Record date</b>	<b>Date distribution paid</b>	<b>Character of distribution for tax purposes</b>	<b>Amount per unit</b>
September 30, 2004	October 15, 2004	Return of capital	\$ 0.4375
December 31, 2004	January 14, 2005	Return of capital	\$ 0.4375
March 31, 2005	April 15, 2005	To be determined	\$ 0.4375

## Fees

Management fees of 0.15% per annum of the net asset value of the Trust are calculated and paid monthly in arrears by the Trust to the Manager.

The Trust will pay to the Manager a service fee of 0.30% per annum of the net assets of the Trust, accrued monthly, and calculated on the last Valuation Date of each quarter. The service fee will be applied by the Manager to pay a service fee 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. The fee is accrued monthly and calculated and paid quarterly in arrears.

The Trust will pay to the Counterparty of the Forward a financing fee of approximately 0.55% per annum of the book value of the Fund plus a fee that may vary based on

the book value of the Common Share Portfolio, calculated and paid quarterly in arrears. The Fund also pays to the Investment Advisor an advisory fee of 1.15% per annum of the net assets of the Fund calculated and accrued monthly, and paid monthly in arrears.

### Net Income from Operations

For the three-month period ended March 31, 2005, the Trust's net income from operations was \$921,021.

Consistent with the Trust's objectives, the key component of income from operations were the unrealized gains on the Forward Contract. The Trust's valuation is not affected by the change in the market value of the Common Share Portfolio as gains or losses are offset by the Forward. The Trust's return is based on its exposure, through the Forward, to the Fund.

The following table presents expense ratios for the three-month period ended March 31, 2005. The line of the table entitled "Total expenses" presents the ratio of total expenses to weighted average net assets. The following line presents an alternative measure that the Manager feels is of value to investors and that provides additional information with respect to the Trust's expenses.

<b>Ratio of expenses to weighted-average net assets</b>	<b>Three-month period ended March 31, 2005</b>
Total expenses *	1.80 %
Total expenses excluding financing fees *	0.68 %

\*annualized

### Purchases for Cancellation

Under its declaration of trust, the Trust is required to make purchases of units of up to 2.5% of the outstanding units per quarter if the price at which the units are offered for sale is less than 95.0% of the current net asset value per unit as at the close of business on the preceding valuation date.

In September 2004, the Trust filed a notice of intention to make normal-course purchases of units with the Toronto Stock Exchange. In its filing with the Exchange, the Trust indicated an intention to purchase up to 253,000 of the units of the Trust, representing 10% of the public float of the Trust then outstanding. In accordance with exchange rules and by-laws, the Trust may not pay more than the most recent market price for the units purchased. Units purchased under the bid are cancelled.

During the three-month period ended March 31, 2005, the Trust did not purchase any units for cancellation under this program.

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

## Statement of Net Assets

	As at March 31 2005 (unaudited)	As at December 31 2004 (audited)
<b>Assets</b>		
Cash and short-term investments (cost: 2005 – \$1,426,208, 2004 – \$3,800,027)	\$ 1,434,688	\$ 3,811,404
Common shares – at fair value (note 3) (cost: 2005 – \$73,493,150, 2004 – \$71,524,880)	73,296,581	75,000,065
Forward contract (note 8)	3,484,021	521,707
	78,215,290	79,333,176
<b>Liabilities</b>		
Professional, custody and other fees payable	120,885	121,874
Forward financing fee payable	-	163,552
Distribution payable (note 7)	1,413,125	1,413,125
Offering costs payable	-	461,241
	1,534,010	2,159,792
<b>Net assets and unitholders'</b>		
<b>equity (note 4)</b>	\$ 76,681,280	77,173,384
<b>Number of units outstanding (note 4)</b>	3,230,000	3,230,000
<b>Net asset value per unit</b>	\$ 23.74	\$ 23.89

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

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

## Statement of Operations

For the three-month period  
ended March 31, 2005  
(unaudited)

**Investment income**

Interest	\$ 12,743
	12,743

**Expenses**

Service fee (note 5)	61,522
Forward financing fee (note 5)	218,356
Management fee (note 5)	31,335
Professional and custody fees	20,549
Other fees	18,808
	350,570

**Net investment loss** (337,827)

**Realized and Unrealized gain on investments**

Net realized gain on:

Common shares	1,968,288
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Change in unrealized appreciation (depreciation) on:

Common shares	(3,671,754)
Forward contract	2,962,314

**Unrealized gain on investments for the period** 1,258,848

**Net income from operations for the period** \$ 921,021

**Net income from operations per unit for the period\*** \$ 0.29

\*Based on the average number of units of 3,230,000 outstanding for the period.

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

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

## Statement of Changes in Net Assets

	For the three-month period ended March 31, 2005 (unaudited)
<b>Net assets – beginning of the period</b>	\$ 77,173,384
<b>Net Income from operations for the period</b>	921,021
<b>Distribution to unitholders (note 7)</b>	(1,413,125)
<b>Net assets – end of the period</b>	\$ 76,681,280
<b>Distribution per unit for the period *</b>	\$ 0.4375

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

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

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

## Statement of Cash Flow

	For the three-month period ended March 31, 2005 (unaudited)
<b>Cash flow from operating activities</b>	
Net income from operations	\$921,021
Items not affecting cash:	
Change in unrealized appreciation in value of common shares	3,671,754
Change in unrealized appreciation in value of forward contract	(2,962,314)
Net realized gain on common shares	(1,968,288)
Changes in non-cash working capital:	
Change in payables	(164,541)
Purchase of common shares	(10,475,607)
Proceeds on sale of common shares	10,475,625
	(502,350)
<b>Cash flow from financing activities</b>	
Payment of distributions	(1,413,125)
Payment of offering costs	(461,241)
	(1,874,366)
Net decrease in cash and short-term investments	(2,376,716)
Cash and short-term investments at the beginning of the period	3,811,404
<b>Cash and short-term investments at the end of the period</b>	<b>\$ 1,434,688</b>

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

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

## Statement of Investment Portfolio

As at March 31, 2005

(unaudited)

	Maturity Date	No. of Shares Face/ Value	Cost	Fair/ Market Value	Percentage of Investment Portfolio
<b>Common share portfolio</b>					
Nortel Networks Corp*		1,170,704	\$ 5,274,900	\$3,851,616	4.92%
Research In Motion Ltd*		60,000	5,277,280	5,562,600	7.11%
Inco Ltd*		108,800	4,763,104	5,226,752	6.68%
Canfor Corp*		317,836	5,641,589	5,161,657	6.60%
ATI Technologies Inc*		224,400	4,763,672	4,685,472	5.99%
Celestica Inc*		229,100	4,771,783	3,725,166	4.76%
Cognos Inc*		103,100	4,770,426	5,248,821	6.71%
Biovail Corp *		234,000	4,770,272	4,258,800	5.44%
Precision Drilling Corp*		71,300	4,770,651	6,452,650	8.25%
Cott Corp *		128,800	4,770,162	3,785,432	4.84%
Angiotech Pharmaceuticals Inc*		212,500	4,771,539	3,963,125	5.07%
Kinross Gold Corp*		615,015	4,834,018	4,526,510	5.79%
Alimentation Couche Tard Inc*		332,800	4,772,482	5,840,640	7.47%
RONA Inc*		320,800	4,770,990	7,586,920	9.70%
Open Text Corp*		156,900	4,770,282	3,420,420	4.39%
			73,493,150	73,296,581	93.72%
Unrealized gain on forward contract (note 8)			-	3,484,021	4.45%
<b>Total Investments</b>			73,493,150	76,780,602	98.17%
<b>Cash</b>			35,180	35,180	0.04%
<b>Bankers' Deposit</b>					
HSBC Bank (Canada)	May 25, 2005	\$ 100,000	99,361	99,599	0.13%
<b>Commercial paper</b>					
Smart Trust	April 1, 2005	1,300,000	1,291,667	1,299,909	1.66%
<b>Cash and short-term investments</b>		\$ 1,400,000	1,426,208	1,434,688	1.83%
<b>Total investment portfolio</b>			\$ 74,919,358	78,215,290	100.00%
<b>Net liabilities</b>				(1,534,010)	
<b>Net assets and unitholders' equity</b>				\$ 76,681,280	

\* Securities held as part of forward agreement and pledged to counterparty

Short-term investments held at March 31, 2005 have yields ranging from 2.63% to 2.67%

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

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

### Notes to Financial Statements

For the three-month period ended March 31, 2005  
(unaudited)

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#### 1. Establishment and Operations of the Trust

The Northwater Five-Year Market-Neutral Trust (the "Trust") is a closed-end investment trust established under the laws of the Province of Ontario pursuant to a declaration of trust made as of June 18, 2004. Northwater Fund Management Inc. acts as Trustee. The Royal Trust Company ("Royal Trust") 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 31, 2004 through a secondary offering. The Trust's units are listed on the Toronto Stock Exchange under the symbol NYF.UN. The Trust will terminate on or about June 30, 2009 (the "Termination Date"), 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 assets of the Trust, invested in cash, short-term investments and common shares ("Common Share Portfolio") are combined with a forward contract to achieve a return based on a diversified portfolio of market-neutral hedge funds.

#### 2. Summary of Significant Accounting Policies

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. No comparative amounts for results for the three-month period ended March 31, 2005 have been provided as the Trust commenced operations on June 30, 2004.

##### (a) Investments

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

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

The common shares listed on a public securities exchange are valued at

their closing sale price on each Valuation Date. Common shares not traded on that date are valued at the average of the closing bid and ask or the latest available sale price. Realized gains and losses are calculated using the average cost.

The value of the forward contract is the gain or loss, if any, that would be realized if, on the Valuation Date, the forward contract was “closed out”. The difference between fair value and cost is shown as an unrealized gain or loss on investments. The value of the forward contract is determined based on the change in valuation of Northwater Five-Year Market-Neutral Fund Limited, which invests in a diversified portfolio of market-neutral hedge funds. These investments in market-neutral hedge funds are valued on the basis of the definitive net asset values reported by the administrators or the portfolio managers of such funds on the Valuation Date or, if not available, the most recent provisional net asset values based on preliminary returns reported by the administrators or the portfolio managers of such funds.

#### (b) 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.

### 3. Investment in common shares

The following table summarizes investment transactions during the period:

	<b>Three-month period ended March 31, 2005</b>	
<b>Common shares at cost</b>		
- beginning of the period	\$	71,524,880
Cost of common shares purchased		10,475,607
Cost of common shares sold		(8,507,337)
<b>Common shares at cost</b>		
- end of the period		73,493,150
Unrealized depreciation on common shares		(196,569)
<b>Market value of common shares</b>		
- end of the period	\$	73,296,581
Proceeds of common shares sold	\$	10,475,625
Cost of common shares sold		(8,507,337)
<b>Net realized gain on common shares</b>	\$	1,968,288

#### 4. Units Issued and Outstanding

The authorized capital of the Trust consists of an unlimited number of non-redeemable units. Units are transferable and represent an equal, undivided interest in the net assets of the Trust. All units are of the same class with equal rights and privileges. Each unit is entitled to one vote at any meeting of unitholders and to equal participation in any distributions made by the Trust. Fractional units will not be issued.

The Trust, through its initial offering in June 2004, realized gross proceeds of \$63,250,000 based on the issuance of 2,530,000 units. Agents' fees of \$3,320,600 and issue costs of \$850,000 were incurred in connection with the offering.

A secondary offering in December 2004 realized gross proceeds of \$18,200,000 based on the issuance of 700,000 units. Agents' fees of \$955,500 and issue costs of \$200,000 were incurred in connection with the offering.

Under the declaration of trust, the Trust is required to make purchases of units of up to 2.5% of the outstanding units per quarter if the price at which the units offered in the market is less than 95.0% of the net asset value per unit as at the close of business on the preceding Valuation Date. In addition, the Trust may purchase units whenever they are offered for sale at less than their net asset value. Under the Trust's quarterly market support obligation, the Trust did not purchase any units during the three-month period ended March 31, 2005.

The following unit transactions took place during the three-month period:

	<b>Three-month period ended March 31, 2005</b>
<b>Balance of units outstanding</b>	
- beginning of the period	3,230,000
Units issued during the period	-
Units cancelled during the period	-
<b>Balance of units outstanding</b>	
- end of the period	2,530,000

Unitholders' equity is comprised of unit capital and retained earnings. The following transactions for unit capital and retained earnings/(deficit) took place during the three-month period ended March 31, 2005:

	<b>Three-month period ended March 31, 2005</b>
<b>Unit capital - beginning of the period</b>	\$ 76,123,900
Gross proceeds from units issued during the period	-
Cost of units cancelled during the period	-
<b>Unit capital - end of the period</b>	<b>\$ 76,123,900</b>
	<b>Three-month period ended March 31, 2005</b>
<b>Retained earnings - beginning of the period</b>	\$ 1,049,484
Net income from operations for the period	921,021
Distribution to unitholders	(1,413,125)
<b>Retained earnings/(deficit) - end of the period</b>	<b>\$ 557,380</b>

## 5. Management, Advisory and Other Fees

The Trust retained Northwater Fund Management Inc. (the "Manager") under a management agreement dated June 18, 2004. Northwater Capital Management Inc. (the "Investment Advisor") acts as the advisor for 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 legislations in these provinces. The Investment 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 Investment Advisor is a member of the U.S. National Futures Association (the "NFA").

The Manager is responsible for the day-to-day administration, portfolio management and unitholder services of the Trust. In return for these services, the Manager is entitled to an annual fee of 0.15% of the net assets of the Trust, calculated on the last Valuation Date of each month. The fee is paid monthly in arrears.

The Fund (as defined below) also pays to the Investment Advisor an advisory fee of 1.15% per annum of the net assets of the Fund calculated and accrued monthly, and paid monthly in arrears. For the three-month period ended March 31, 2005, the advisory fee charged was in the amount of U.S. \$273,767.

A service fee of 0.30% per annum of the net assets of the Trust, is payable to the Manager calculated on the last Valuation Date of each quarter. The service fee will be applied by the Manager to pay a service fee to registered dealers for services they provide to unitholders. The fee is accrued monthly and calculated and paid quarterly in arrears.

A financing fee of approximately 0.55% per annum of the book value of Northwater Five-Year Market-Neutral Fund Limited, is payable to the Counterparty of the Forward (as defined below) which the Trust has exposure through a forward purchase and sale agreement, plus a fee that may vary based on the value of the Common Share Portfolio, calculated and paid quarterly in arrears.

## 6. Bank Loan

The Trust has a revolving loan facility with a Canadian financial institution (the "Bank"). The facility entitles the Trust to borrow funds in Canadian dollars up to an amount not exceeding the lesser of \$6,000,000 or 10% of the net asset value of the Trust for the purposes of funding the redemptions of units, purchases of units in the market and payment of expenses. 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. A general security interest in the assets of the Trust has been provided in favour of the Bank.

For the three-month period ended March 31, 2005, no loan was outstanding.

## 7. Distributions

The Trust pays quarterly distributions to unitholders of \$0.4375 per unit.

During the three-month period ended March 31, 2005, distributions of \$0.4375 per unit and \$1,413,125 in aggregate were declared by the Trust.

## 8. Forward Contract

The Trust has entered into a forward agreement ("Forward") with a U.S. Bank (the "Counterparty") to obtain exposure to a diversified portfolio of hedge funds (the "Hedge Fund Portfolio") and an interest rate swap through the performance of Northwater Five-Year Market-Neutral Fund

Limited (the “Fund”), a Cayman Islands company. The target exposure to the Hedge Fund Portfolio is equivalent to 150% of the net asset value of the Trust. The exposure as at March 31, 2005 was 150% (December 31, 2004 was 147 %). The Trust has purchased and pledged to the Counterparty the Common Share Portfolio listed on the Statement of Investment Portfolio. The Trust has agreed to deliver the Common Share Portfolio to the Counterparty, on or about the Termination Date, in exchange for the redemption proceeds of the Fund less the financing costs incurred by the Counterparty. As a result, the value of the Forward is determined based on the change in the valuation of the Fund.

The notional amounts of the Forward as at March 31, 2005 were in the amount of Canadian \$71,499,998 and U.S. \$35,785,713 (December 31, 2004: Canadian \$71,499,998 and U.S. \$35,785,713).

The Trust’s net asset value is not affected by the changes in the market value of the Common Share Portfolio as any decrease (increase) in the value of the Common Share Portfolio will be offset by a corresponding increase (decrease) in the value of the Forward.

As at March 31, 2005, the Trust had exposure, through the Forward, to hedge funds in the following strategies; 10.12% (December 31, 2004: 11.53%) asset-backed securities arbitrage, 9.46% (December 31, 2004: 8.13%) capital structure arbitrage, 7.84% (December 31, 2004: 6.25%) convertible bond arbitrage, 9.59% (December 31, 2004: 9.46%) distressed securities, 7.56% (December 31, 2004: 6.90%) fixed-income arbitrage, 3.16% (December 31, 2004: 2.79%) energy relative value, 3.80% (December 31, 2004: 2.11%) merger arbitrage, 10.70% (December 31, 2004: 8.32%) mortgage-backed security arbitrage, 5.63% (December 31, 2004: 5.13%) re-insurance, 0.87% (December 31, 2004: 1.15%) statistical arbitrage, 4.59% (December 31, 2004: 5.79%) structured finance and 22.18% (December 31, 2004: 18.01%) multi-strategy. As at March 31, 2005, the Fund’s portfolio consisted of 95.50% (December 31, 2004: 85.57%) hedge fund investments, 3.33% (December 31, 2004: 12.5%) cash holdings and 1.17% (December 31, 2004: 1.93%) interest rate swap.

The creditworthiness of the Counterparty was reviewed prior to the transaction and is monitored on a regular basis pursuant to the credit standards established by the Manager. As at March 31, 2005 the credit rating of the counterparty was AA-. The Trust is exposed to monies to be received from the Counterparty at the maturity of the Forward. The Forward provides for the Trust’s ability to terminate the Forward if the credit rating of the

Counterparty goes below a certain threshold.

The Trust, through its exposure to the interest rate swap in the Fund, has exposure to changes in mid-term interest rates. For example, if mid-term interest rates were to decrease (increase) by 1%, the value of the Trust would increase (decrease) by approximately 4%. The interest rate swap has a maturity date of June 30, 2009.

## 9. Income Taxes

The Trust qualifies as a "mutual fund trust" within the meaning of the *Income Tax Act* (Canada) (the "Tax Act"). In determining its income for tax purposes, the Trust intends to treat gains or losses on the disposition of securities in the Common Share Portfolio under the Forward as capital gains and losses. As all of the net taxable income of the Trust, including net realized gains from its investment, 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, 2004, the Trust had \$230,000 available in non-capital loss carryforwards with expiry dates commencing in 2011 and no capital loss carryforwards.

The recent federal budget included a measure to eliminate the foreign property rule for pension funds and other tax deferred retirement plans. This proposed change will have no impact on the Trust if enacted as units of the Trust have always been eligible to be held in RRSPs and RRIFs as Canadian property.

## 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 the transfer agent against any and all actions and suits against any and all losses, damages, costs, charges, counsel fees, payments, expenses and liabilities arising directly or indirectly out of its agency relationship to the Trust;
- 3) an indemnity to the Counterparty against any costs, claims, expenses, liabilities, demands, damages, losses, actions or proceedings of any kind arising from the Counterparty being a holder of the common share portfolio;
- 4) an indemnity to the custodian, its affiliates, subsidiaries and agents, and their directors, officers and employees against all legal fees, judgments and amounts paid in settlement, actually and reasonably incurred arising in connection with custodial or sub-custodial services provided except to the extent incurred as a result of breach of the standard of care;
- 5) an indemnity to the trustee, a manager, an affiliate of the trustee or manager or a unitholder, against all liabilities and expenses reasonably incurred in connection with any action, suit or proceeding to which any such person may be made a party by reason of being or having been an indemnified party;
- 6) an indemnity to the Bank and its officers, directors, employees and agents against any reasonable costs, charges and expenses incurred or any claim or losses suffered arising out of (i) the preparation, execution and delivery of preservation of rights, refinancing, renegotiation or restructuring of the loan documents and any related amendment, waiver or consent (ii) any advice of counsel as to the rights and duties of the Bank with respect to the administration of the credit facility (iii) a default of the Trust under any loan document and (iv) any proceedings brought against the Bank due to its entering into any of the loan documents and performing its obligations, and
- 7) 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 behavior of the Trust's auditors.

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

## **NORTHWATER CAPITAL MANAGEMENT INC.**

Northwater is a Canadian-based investment advisor known as an innovator and leader in applying derivative and other quantitative strategies to create sophisticated investment products. Northwater was incorporated on January 4, 1989 as Newcastle Capital Management Inc. and amalgamated with related entities on July 4, 1994 and July 31, 2001 to form Northwater. As at March 31, 2005, Northwater had approximately \$10.2 billion in assets under management, including \$4.5 billion in funds of market-neutral hedge fund assets, which Northwater believes makes it the largest such provider in Canada, and among the largest in the world. Northwater has offices in Toronto and New York.

Northwater has been managing assets using derivative instruments since 1989. Northwater launched its first fund of hedge funds in 1994, establishing NewQuant Trust I, which Northwater believes was the first investment vehicle of its kind in Canada. Northwater Market-Neutral Trust launched in 1997 is the first publicly-listed investment vehicle of its kind in Canada to invest in a diversified portfolio of hedge funds.

Clients of Northwater include the pension funds of many of the largest corporations in Canada, including the Canadian subsidiaries of a number of Fortune 500 companies. Currently Northwater manages or advises a number of other funds of market-neutral hedge funds for its European, American and Canadian clients. Northwater also acts as adviser to a number of sophisticated U.S. and European institutional investors as well as pension and endowment funds of a number of universities and other public sector institutions.

## NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

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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](mailto:mpt@northwatercapital.com)

## INVESTMENT MANAGER

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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](mailto:mpt@northwatercapital.com)

## INVESTMENT ADVISOR OF NORTHWATER FIVE-YEAR MARKET-NEUTRAL FUND LIMITED

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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](mailto:mpt@northwatercapital.com)

## LEGAL ADVISORS

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

## AUDITORS

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

FOR FURTHER INFORMATION PLEASE CONTACT:

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Mohamed Khaki or Bahi Kandavel  
Telephone: (416) 360-5435  
Fax: (416) 360-0671  
E-mail: [mpt@northwatercapital.com](mailto:mpt@northwatercapital.com)

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

TSE Symbol: NYF.UN

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