

NORTHWATER

**Northwater Five-Year Market-Neutral Trust
September 30, 2005
Quarterly Portfolio Disclosure and Update**





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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 a fixed-for-floating interest rate swap by way of a forward purchase and sale agreement. Units of the Trust are traded on the Toronto Stock Exchange under the symbol NYF.UN. For the third quarter of 2005, the return of the Trust was -0.52%. During the same time period, the Scotia Capital Universe Bond Index rose by 0.12%, the TSX Composite Index rose by 11.63% and the S&P 500 rose by 3.60%. 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 1.42% as 4-year Canadian interest rates increased from 3.25% to 3.70% over the quarter. The Trust’s exposure to a portfolio of market-neutral hedge funds contributed positively to the overall return.

The broader U.S. equity markets registered respectable gains for the third quarter of 2005. A robust July was partially offset, however, by weaker returns in August and September as hurricane activity, high energy prices, and employment concerns dampened the resilience of the U.S. consumer.

Investment grade credit spreads were largely unchanged while the spreads on more speculative issues tightened during the quarter. Credit buyers returned to the market over the period after having digested the negative auto-sector credit news in the second quarter. Credit spread volatility remained low during the quarter.

The supply shocks brought on by hurricanes Katrina and Rita contributed to already volatile oil markets. West Texas Intermediate Crude Oil (Midland) prices set a new closing high of U.S.\$70.31 per barrel on August 30th, 2005. The storms also sent natural gas prices skyrocketing to all-time highs.

A tightening monetary policy environment provided strength to the U.S. dollar, which gained moderately against the Yen, Sterling, and Euro. Post-election political uncertainty in Germany contributed further to the Euro’s weakness against the U.S. dollar. On July 21st, 2005, China removed its peg to the U.S. dollar in favor of a peg to a basket of currencies, revaluing the Yuan upwards by 2.1 percent.

Overall, the Trust’s portfolio of market-neutral hedge funds experienced muted returns in the third quarter. Gains in the structured finance, merger arbitrage,

distressed securities, and multi-strategy funds were offset by losses in the energy relative value and re-insurance strategies.

Hurricanes Katrina and Rita had a two-pronged negative effect on Northwater's portfolios. The large economic toll caused by the storms precipitated losses for the re-insurance managers in the portfolio. The dislocation in energy prices resulting from the storms also led to a significant drawdown for one of our energy relative value managers.

A significant portion of the profits generated via structured finance strategies are directly related to floating rates; as such, higher interest rates, coupled with minimal credit losses, have contributed to strong returns in the strategy. Merger arbitrage and related event-driven strategies have been strong performers, driven primarily by increased deal flow in Europe due to wide-spread consolidation and restructuring. While distressed securities witnessed a shortage of new investment opportunities, selective exposure to operational distressed credits provided solid returns during the quarter. Multi-strategy funds also performed well, emphasizing their role as opportunistic allocators of capital.

During the third quarter of 2005, Northwater continued to actively manage its hedge fund portfolios. Several managers were removed from the Northwater hedge fund portfolios, most notably those pursuing convertible bond, capital structure, and fixed income arbitrage, because of a decline in return in those strategies. Several multi-strategy managers were also removed due to prolonged lackluster performance and an absence of investment innovation. One distressed securities manager was added, and we continue to see opportunities to increase allocations to both existing and new managers.

Northwater remains committed to market-neutral investing. The changes we have made to our portfolios are evidence of our commitment to find opportunities in the market in our search for reliable sources of alpha.



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



DAVID S. FINCH, CFA
Vice-President,
Northwater Capital Management Inc.

October 26, 2005

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statements of Net Assets
(in Canadian dollars)

	As at September 30, 2005 (unaudited)
Assets	
Cash	\$ 17,005
Common shares – at fair value (cost: 2005 – \$70,271,380)	70,392,757
Common share sales receivable	1,798,782
Forward contract	<u>4,301,929</u>
	<u>76,510,473</u>
Liabilities	
Professional, custody and other fees payable	159,141
Forward financing fee payable	214,141
Distribution payable	<u>1,413,125</u>
	<u>1,786,407</u>
Net assets and unitholders' equity	<u>\$74,724,066</u>
Number of units outstanding	<u>3,230,000</u>
Net asset value per unit	<u>\$ 23.13</u>

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statements of Operations
(in Canadian dollars)

	For the nine-month period ended September 30, 2005 (unaudited)
Investment income	
Interest	\$ 15,802
	<u>15,802</u>
Expenses	
Service fees	184,095
Forward financing fees	653,867
Management fees	92,767
Audit fees	32,106
Advisory board fees	15,000
Custodian fees	6,936
Legal fees	25,851
Security holder reporting costs	73,644
Loan interest and standby fees	13,564
Other fees	2,196
	<u>1,100,026</u>
Net investment loss	<u>(1,084,224)</u>
Realized and unrealized gain or loss on investments	
Net realized gain on:	
Common shares	2,447,865
Change in unrealized appreciation (depreciation) on:	
Common shares	(3,353,807)
Forward contract	<u>3,780,222</u>
Realized and unrealized gain on investments for the period	<u>2,874,280</u>
Net income from operations for the period	<u>\$ 1,790,056</u>
Net income from operations per unit for the period*	<u>\$ 0.55</u>

* Based on the average number of units outstanding for the period.

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Summary of Investment Portfolio⁽¹⁾

As at September 30, 2005

(in Canadian dollars)

(unaudited)

The following table presents information regarding the hedge funds to which the Trust has exposure through a forward purchase and sale agreement including the asset allocation by investment strategy, the number of hedge funds by investment strategy and the largest individual hedge fund holding for each investment strategy as a percentage of the total net asset value of the Trust as at September 30, 2005. The multi-strategy funds may invest in multiple investment strategies.

Strategy	Asset allocation by hedge fund strategy As at September 30, 2005			Largest individual hedge fund holding for each individual strategy As at September 30, 2005
	No. of Hedge Funds	Fair Value (in U.S. dollars)	Percentage	Percentage of Net Assets of the Trust
Asset-backed securities				
arbitrage	4	\$ 8,817,131	10%	6.04%
Capital structure arbitrage . .	5	8,734,709	10%	5.69%
Convertible bond arbitrage . .	2	4,653,649	5%	2.37%
Distressed securities	5	10,332,458	12%	5.35%
Energy relative value	1	764,382	1%	1.19%
Fixed-income arbitrage	4	7,005,405	8%	2.85%
Merger arbitrage	2	3,924,269	4%	3.37%
Mortgage-backed security				
arbitrage	4	10,221,813	12%	7.80%
Multi-strategy	11	22,717,408	26%	7.85%
Re-insurance	2	3,129,688	4%	2.32%
Statistical arbitrage	1	779,704	1%	1.21%
Structured finance	5	5,774,274	7%	2.57%
	<u>46</u>	<u>\$86,854,890</u>	<u>100%</u>	<u>48.61%</u>

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

The following table lists the largest 25 hedge funds by fair value to which the Trust has exposure through a forward purchase and sale agreement as at September 30, 2005. The Trust will disclose the names of those hedge funds to which it has exposure that represent more than 5% of the net assets of the Trust at quarter-end. For hedge funds that represent less than 5% of the Trust's net assets, the Trust has adopted unique fund numbers as identifiers. These numbers will be used consistently in reporting going forward.

<u>Top 25 Investments</u>	<u>Type of Investment</u>	<u>Percentage of Net Assets</u>
D.E. Shaw Composite International Fund*	Trust units	7.85%
New Ellington Overseas, Ltd.*	Participating shares	7.80%
Ellington Credit Fund, Ltd.*	Participating shares	6.04%
CQS Capital Structure Arbitrage Feeder Fund Limited*	Participating shares	5.69%
Satellite Overseas Fund, Ltd.*	Participating shares	5.35%
Fund 169*	Participating shares	4.49%
Fund 146*	Participating shares	4.09%
Fund 125*	Participating shares	4.01%
Fund 122*	Participating shares	4.00%
Fund 160*	Participating shares	3.92%
Fund 140*	Participating shares	3.81%
Fund 172*	Participating shares	3.74%
Fund 158*	Participating shares	3.68%
Fund 184*	Participating shares	3.46%
Fund 175*	Participating shares	3.41%
Fund 109*	Participating shares	3.40%
Fund 102*	Participating shares	3.37%
Fund 130	Participating shares	3.36%
Fund 121*	Participating shares	3.31%
Fund 164*	Participating shares	3.21%
Fund 189*	Participating shares	2.97%
Fund 161	Participating shares	2.95%
Fund 191*	Participating shares	2.85%
Fund 181*	Participating shares	2.72%
Fund 180*	Participating shares	2.71%

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

The Trust also has holdings in the following common shares as at September 30, 2005. The Trust does not have economic exposure to these holdings as these common shares have been sold forward by the Trust for a price based on the return of a portfolio of hedge funds.

<u>Share Investments</u>	<u>Type of Investment</u>	<u>Percentage of Net Assets</u>
RONA Inc.	Common shares	9.86%
Western Oil Sands Inc.	Common shares	9.42%
Alimentation Couche Tard Inc.	Common shares	9.17%
Biovail Corp.	Common shares	8.49%
Kinross Gold Corp.	Common shares	7.35%
Precision Drilling Corp.	Common shares	7.19%
Cognos Inc.	Common shares	6.20%
Nortel Networks Corp.	Common shares	5.97%
Canfor Corp.	Common shares	5.93%
ATI Technologies Inc.	Common shares	4.83%
Angiotech Pharmaceuticals Inc.	Common shares	4.60%
Research in Motion Ltd.	Common shares	4.23%
Celestica Inc.	Common shares	3.99%
Cott Corp.	Common shares	3.53%
Open Text Corp.	Common shares	3.43%

ADDITIONAL PORTFOLIO INFORMATION

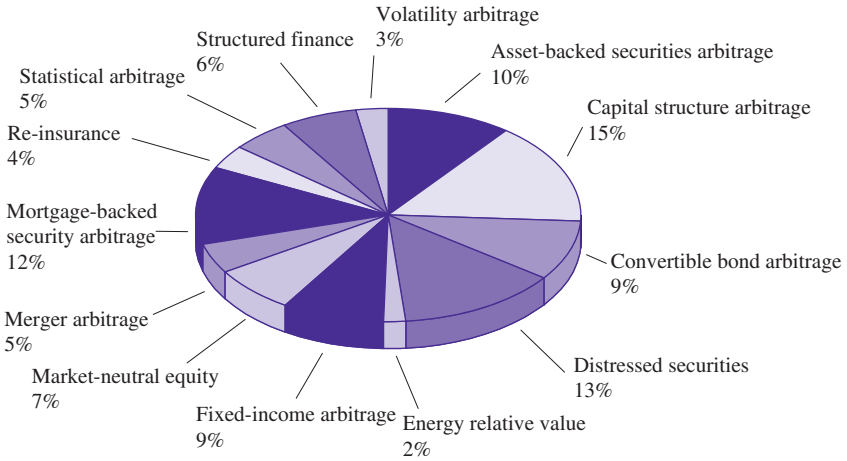
Investment Portfolio and Activity

The Trust has obtained exposure to a portfolio of market-neutral hedge funds (the Hedge Fund Portfolio) held by Northwater Five-Year Market-Neutral Fund Limited (the Fund), a Cayman Islands exempt company, through a forward purchase and sale agreement (the Forward) with a U.S. bank. The Hedge Fund Portfolio emphasizes sectors of the capital markets that Northwater Capital Management Inc. (the Investment Advisor) believes are relatively inefficient or present opportunities to generate uncorrelated returns. The Investment Advisor believes that such sectors offer arbitrage, relative value or absolute return opportunities and should reward insightful investment analysis.

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 have been established in offshore jurisdictions and prepare annual audited financial statements, in accordance with US or International generally accepted accounting principles (GAAP).

During the nine-month period ended September 30, 2005, investments were placed with 7 new hedge funds (consisting of two structured finance funds, two multi-strategy funds, one energy relative value fund, one capital structure arbitrage fund and one asset-backed securities arbitrage fund) and redemptions were made from 4 hedge funds (consisting of two energy relative value funds, one asset-backed securities fund and one convertible bond arbitrage fund).

The following chart illustrates the hedge fund holdings by strategy as at September 30, 2005. The multi-strategy hedge funds have been allocated to various hedge fund strategies to reflect their exposure to their constituent strategies. Strategy weights are dynamic and change from period to period.



Investment Portfolio Risk Characteristics

The following tables present information for the period from inception and for the nine-month periods ended September 30, 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.

Trust Statistics

# of positive monthly returns	12
# of negative monthly returns	3
% of negative months	20%
Average size of negative months	-0.84%
Worst monthly return	-1.27%

For the period from inception to September 30, 2005

12
3
20%
-0.84%
-1.27%

Single Hedge Fund Statistics of the Fund

# of hedge funds with positive returns ⁽¹⁾	34
# of hedge funds with negative returns ⁽¹⁾	12
Average annual hedge fund standard deviation ⁽²⁾	3.69%
Average correlation between hedge funds ⁽³⁾	0.136

Nine-month period ended September 30, 2005

34
12
3.69%
0.136

Notes:

(1) Measured for hedge funds in the Hedge Fund Portfolio of the Fund as at September 30, 2005.

- (2) As measured over the past 24 months for hedge funds in the Hedge Fund Portfolio of the Fund as at September 30, 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 September 30, 2005 excludes hedge funds with less than 24 months of historical returns.

Hedge Fund Performance

The following table presents the return by investment strategy of the Hedge Fund Portfolio held by the Fund for the nine month period ended September 30, 2005.

<u>Strategy</u>	<u>Nine-month period ended September 30, 2005</u>
Asset-backed securities arbitrage	8.33%
Capital structure arbitrage	-0.39%
Convertible bond arbitrage	-3.21%
Distressed securities	5.59%
Energy relative value	-13.13%
Fixed-income arbitrage	2.97%
Merger arbitrage	13.45%
Mortgage-backed security arbitrage	6.95%
Multi-strategy	6.13%
Re-insurance	-4.81%
Statistical arbitrage	-2.55%
Structured finance	7.52%

Distributions

The following table presents the distribution history for the Trust since inception.

Distribution History

<u>Record date</u>	<u>Date distribution paid</u>	<u>Character of distribution for tax purposes</u>	<u>Amount per unit</u>
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
June 30, 2005	July 15, 2005	To be determined	\$0.4375
September 30, 2005	October 15, 2005	To be determined	\$0.4375

NORTHWATER CAPITAL MANAGEMENT INC.

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

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

With over a ten year track record in fund of hedge funds, Northwater has steadily grown assets under management to approximately CDN \$10.4 billion total, including CDN \$4.5 billion invested in hedge funds. Northwater has focused on developing, delivering and continuously improving its market-neutral fund of hedge fund portfolios since launching its first such portfolio in 1994.

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

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

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TSE Symbol: NYF.UN

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