

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

NORTHWATER

**Northwater Five-Year Market-Neutral Trust
Report for the six-month period ended
June 30, 2008
(unaudited)**





BACKGROUND

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Northwater Five-Year Market-Neutral Trust (the “Trust”) is a closed-end investment trust established under the laws of the Province of Ontario. Financial statements of the Trust, denominated in Canadian dollars, for the six-month period ended June 30, 2008 are included in this report.

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MESSAGE TO UNITHOLDERS FROM THE INVESTMENT ADVISOR

MESSAGE TO UNITHOLDERS FROM THE INVESTMENT ADVISOR


The Northwater Five-Year Market-Neutral Trust (the “Trust”) is a closed-end fund traded on the Toronto Stock Exchange under the symbol NYF.UN 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 agreement. As at June 30, 2008, the net asset value of the Trust per unit was \$19.85. For the six-months ended June 30, 2008, the return of the Trust was -2.63% including distributions. During the same time period, the DEX Universe Bond Index returned 2.21 %, the S&P/TSX Composite Index rose by 5.99% and the S&P 500 in U.S. dollar terms, fell by 11.91% which translates to a loss of 9.45% in Canadian dollar terms. The Trust made distributions of \$0.875 per unit during the period.

In the first quarter of 2008 the hedge fund market continued to be challenged by systematic risk related to the credit crisis which continued unabated from last year. Hedge funds in a variety of strategies were impacted as the credit crisis rippled through various markets, causing hedge funds and banks to unload large positions or hedge “at all cost” as they continued to de-leverage their books and reduce risk. The bailout of Bear Stearns in March, mediated by the Federal Reserve Board, restored some confidence in the markets, leading to positive returns in most hedge fund strategies in the second quarter of 2008. However, the positive returns in the second quarter were not enough to carry hedge fund performance into positive territory.

The Trust’s exposure to the fixed-for-floating interest rate swap added to the return of the Trust, as swap rates decreased by 80 basis points over the first six months of the year.

The portfolio of market-neutral hedge funds managed by Northwater Fund Management Inc. (the “Manager”) to which the Trust has exposure, experienced negative returns over the six months ending June 30th 2008. Four of the nine strategies posted positive returns with statistical arbitrage, the lowest returning strategy in 2007, providing the highest positive contribution to the year-to-date return. The largest negative contribution came from the fixed income arbitrage strategy, which was negatively impacted by worldwide inflationary pressures and economic risks.

Although the current environment has caused stress in our portfolio, we believe the dislocations have also created attractive relative value market opportunities



and we expect that our current investments will benefit from market normalization. The Manager remains focused on its investments in managers employing market-neutral strategies that are expected to deliver strong risk-adjusted returns consistent with the investment objectives.

Northwater continues to actively manage the composition of the Trust's hedge fund portfolio. During the six-month period ended June 30, 2008, six funds were removed for declining strategy returns and ineffective implementation of their investment strategy.



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



DAVID S. FINCH, CFA
Managing Director and
Chief Operating Officer
Northwater Capital Management Inc.

August 8, 2008

MANAGEMENT REPORT OF FUND PERFORMANCE

MANAGEMENT REPORT OF FUND PERFORMANCE

This Management Report of Fund Performance contains financial highlights but does not contain the complete financial statements of Northwater Five-Year Market-Neutral Trust (the “Trust”). A copy of the financial statements of the Trust for the six-month period ended June 30, 2008 is attached to this report for your reference.

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

Northwater Five-Year Market-Neutral 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 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.

Adoption of New Accounting Standards

In December 2006, the Accounting Standards Board issued CICA Handbook Section 3862, “Financial Instruments – Disclosures (S. 3862) and Section 3863, “Financial Instruments – Presentation (S. 3863), which provides comprehensive disclosure and presentation requirements for financial instruments.

The requirements of S. 3862 and S. 3863 are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and have been reflected in the notes to the financial statements.



Investment Objective and Strategies

Investment Objectives


The investment objectives of Northwater Five-Year Market-Neutral Trust (the “Trust”) 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.

Investment Strategies

The Trust has invested the net proceeds of its offering in a portfolio of common shares of Canadian public companies (the “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. The Forward provides the Trust with 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. Pursuant to the Forward, 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 (the “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 June 30, 2008 was 137% (December 31, 2007 was 145%). 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. The Trust is expected to earn a blended fixed rate of 4.45% over its life plus the returns in excess of money market rates earned by exposure to the diversified portfolio of market-neutral hedge funds. 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 0.8%.

Investment Management Process

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

The Investment Advisor has developed a proprietary selection process to enable it to advise the 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 evolved and continue to evolve with the Investment Advisor's experience in market-neutral hedge fund investing and in managing complex derivative strategies.
2. the use of an established operational infrastructure necessary for managing complex fund of market-neutral hedge fund and derivative strategies. The Investment Advisor has built a team of investment professionals and developed robust portfolio and risk management systems and tools essential to managing a sophisticated fund of market-neutral hedge funds.

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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 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 plan.
 7. the construction of a diversified model portfolio across up to 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 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.

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 June 30, 2008, financial leverage employed by the Trust was nil (December 31, 2007 was nil).

Risks

The following tables present information for the period from inception and for the six-month period ended June 30, 2008 and 2007 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.

<u>Trust Statistics</u>	<u>For the period from inception to June 30, 2008</u>	<u>For the period from inception to June 30, 2007</u>
# of positive monthly returns	33	29
# of negative monthly returns	15	7
% of negative months	31.3%	19.4%
Average size of negative months	(1.12)%	(0.68)%
Worst monthly return	(4.29)%	(1.56)%

<u>Single Hedge Fund Statistics</u>	<u>Six-month period ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
# of hedge funds with positive returns ⁽¹⁾	15	30
# of hedge funds with negative returns ⁽¹⁾	17	2
Average annual hedge fund standard deviation ⁽²⁾	8.54%	3.93%
Average correlation between hedge funds ⁽²⁾	0.24%	0.10%

(1) Measured for hedge funds in the Hedge Fund Portfolio of the Fund as at June 30, 2008 and June 30, 2007, respectively.

(2) As measured over the past 24 months for hedge funds in the Hedge Fund Portfolio of the Fund as June 30, 2008 and June 30, 2007 respectively, excludes hedge funds with less than 24 months of historical returns.

No changes materially affecting the overall risk of investing in the Fund were made in the six-month period ended June 30, 2008. The risks of investing in the Trust remain as discussed in the Trust's prospectus. A copy of the prospectus of the Trust is available by visiting the SEDAR website at www.sedar.com.



Results of Operations

For the six-month period ended June 30, 2008, the Trust posted a return of -2.63%(six-month period ended June 30, 2007: 4.69%), taking into account the distributions made during the year. Distributions during the year totaled \$2,164,138 or \$0.875 per Unit.

The Fund's exposure to the Swaps had a positive impact on the performance of the Fund in six-month period ended June 30, 2008 (six-month period ended June 30, 2007: negative contribution). The mark-to-market valuation of the interest rate swaps held by the Fund increased by USD \$327,815 during the six-month period ended June 30, 2008 (six-month period ended June 30, 2007; decrease of USD \$792,543).

The Trust purchased 126,800 units under its repurchase and cancellation programs of the units of the Trust for the six-month period ended June 30, 2008 (six-month period ended June 30, 2007; 140,300 units were repurchased). Over the six-month period ended June 30, 2008, this program contributed 0.40% to the overall return of the Trust (six-month period ended June 30, 2007: 0.31% contribution).

Summary of Investment Portfolio⁽¹⁾

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 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 up to 14 broad investment strategies, which may include strategies to which the Fund is exposed through its investment in multi-strategy hedge funds. The hedge funds to which the Trust has exposure have been established in offshore jurisdictions and prepare annual audited financial statements, in accordance with U.S. or International generally accepted accounting principles (GAAP).

During the six-month period ended June 30, 2008, the Fund redeemed from six hedge funds (consisting of three structured finance and one fund in each of merger arbitrage, distressed securities and asset-backed securities) (six-month period ended June 30, 2007: the Fund placed investments with two new hedge funds and redeemed from six hedge funds).

The following table presents the return by investment strategy of the Hedge Fund Portfolio held by the Fund for the six-month period ended June 30, 2008 and June 30, 2007:

<u>Strategy</u>	<u>Six-month period ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Activist Investments	(9.40)%	10.49%
Asset-backed securities arbitrage	5.36%	7.86%
Distressed securities arbitrage	(2.46)%	9.34%
Fixed-income arbitrage	(12.00)%	2.73%
Merger arbitrage	—	(4.70)%
Mortgage-backed security arbitrage	(2.06)%	6.16%
Multi-strategy	1.57%	9.14%
Re-insurance arbitrage	2.16%	6.06%
Statistical arbitrage	6.03%	6.77%
Structured finance	(3.67)%	5.55%

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. The multi-strategy funds have not been allocated to any of the underlying hedge fund strategies set out in this table.

<u>Strategy</u>	<u>As at June 30, 2008</u>			<u>As at December 31, 2007</u>		
	<u>No. of Hedge Funds</u>	<u>Fair Value (in U.S. Dollars)</u>		<u>No. of Hedge Funds</u>	<u>Fair Value (in U.S. Dollars)</u>	
Activist investments	1	\$ 2,486,517	4%	1	\$ 2,744,536	3%
Asset-backed security arbitrage ..	3	7,362,028	12%	4	7,914,440	10%
Distressed securities arbitrage ...	4	8,654,463	14%	5	12,791,205	16%
Fixed-income arbitrage	3	4,740,970	8%	3	5,387,185	7%
Merger arbitrage	—	—	—	1	995,490	1%
Mortgage-backed security arbitrage	4	5,729,427	9%	4	9,305,743	12%
Multi-strategy	6	16,358,327	27%	6	17,072,702	21%
Re-insurance arbitrage	2	3,820,334	6%	2	4,407,933	6%
Statistical arbitrage	6	8,720,698	14%	6	10,854,126	14%
Structured finance	3	3,584,965	6%	6	8,039,314	10%
	<u>32</u>	<u>\$61,457,729</u>	<u>100%</u>	<u>38</u>	<u>\$79,512,674</u>	<u>100%</u>

The following table presents the largest individual hedge fund holding for each investment strategy of the Fund as a percentage of the total reported net asset value of the Trust as at June 30, 2008 and December 31, 2007.

<u>Strategy</u>	<u>As at June 30, 2008</u>	<u>As at December 31, 2007</u>
Activist investments	5.20%	4.95%
Asset-backed securities arbitrage	7.25%	6.17%
Distressed securities arbitrage	5.77%	6.71%
Fixed-income arbitrage	5.09%	4.47%
Merger arbitrage	—	1.80%
Mortgage-backed security arbitrage	5.69%	4.99%
Multi-strategy	7.84%	6.85%
Re-insurance arbitrage	5.76%	6.09%
Statistical arbitrage	6.44%	8.02%
Structured finance	3.44%	3.24%

The following table lists the largest 25 hedge funds by fair value to which the Trust has exposure through the Forward as at June 30, 2008. The Trust discloses the names of those hedge funds to which it has exposure that represent more than 5% of the net assets of the Trust at period-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 are used consistently in the Fund's reporting.

<u>Top 25 Investments</u>	<u>Type of Investment</u>	<u>Cost (In U.S. Dollars)</u>	<u>Fair Value (In U.S. Dollars)</u>	<u>Fair Value as a % of Net Assets</u>
D.E. Shaw Composite				
International Fund*	Participating shares	\$2,170,214	\$3,746,686	7.84%
Citadel Kensington Global				
Strategies Fund Ltd.*	Participating shares	2,000,000	3,740,002	7.83%
Mariner-Tricadia Credit				
Strategies, Ltd.*	Participating shares	1,610,068	3,463,377	7.25%
Oxam Quant Fund Limited*	Participating shares	2,655,729	3,078,543	6.44%
CRC Global Structured Credit				
Fund, Ltd.*	Participating shares	2,108,932	3,044,055	6.37%
Cerberus International, Ltd.*	Participating shares	1,589,887	2,757,696	5.77%
Palmetto Fund, Ltd.*	Participating shares	2,125,280	2,753,772	5.76%
Sorin Offshore Fund, Ltd.*	Participating shares	1,800,000	2,719,076	5.69%
Plainfield Special Situation				
Offshore Feeder Fund*	Participating shares	2,428,761	2,553,145	5.34%
Shephard Investments				
International Ltd.*	Participating shares	1,900,000	2,510,591	5.25%
Icahn Fund Ltd*	Participating shares	2,000,000	2,486,517	5.20%
Platinum Grove Contingent capital Offshore Fund,				
Ltd*	Participating shares	2,400,000	2,432,722	5.09%
HBK Offshore Fund Ltd.*	Participating shares	2,167,528	2,429,932	5.08%
Fund 146*	Participating shares	1,637,299	2,239,421	4.69%
Fund 101*	Participating shares	1,631,978	2,141,069	4.48%
Fund 216*	Participating shares	2,000,000	2,092,764	4.38%
Fund 103*	Participating shares	2,400,000	1,975,124	4.13%
Fund 211*	Participating shares	2,000,000	1,820,761	3.81%
Fund 116*	Participating shares	1,037,865	1,691,695	3.54%
Fund 108*	Participating shares	1,400,000	1,644,891	3.44%
Fund 140*	Participating shares	1,588,983	1,456,714	3.05%
Fund 212*	Participating shares	1,000,000	1,202,553	2.52%
Fund 195*	Participating shares	800,000	1,066,562	2.23%
Fund 187*	Participating shares	700,000	1,061,941	2.22%
Fund 226*	Participating shares	1,000,000	1,045,845	2.19%

* Held by other investment funds managed or advised by Northwater Fund Management Inc.

The Trust also has holdings in the following common shares as at June 30, 2008. 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>Fair Value as a % of Net Assets</u>
Celestica Inc	Common shares	4.97%
CGI Group Inc	Common shares	7.67%
Duvernay Oil Corporation	Common shares	9.80%
FNX Mining Inc.	Common shares	5.32%
Galleon Energy Inc.	Common shares	8.15%
Gildan Activewear Inc.	Common shares	5.84%
Great Canadian Gaming Corp.	Common shares	4.74%
Hudbay Minerals	Common shares	3.85%
Macdonald Dettwiler and Assoc.	Common shares	6.31%
Major Drilling Group Intl.	Common shares	7.08%
Martinrea International Inc.	Common shares	5.32%
Nortel Networks Corp.	Common shares	1.41%
Quadra mining Ltd.	Common shares	7.43%
Research In Motion Ltd	Common shares	20.36%
RONA Inc	Common shares	3.98%
Stantec Inc	Common shares	5.08%
Tristar Oil and Gas	Common shares	9.73%
Westjet	Common shares	4.89%

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

Financial Highlights

The following tables show selected key financial information about the Trust and are intended to assist in understanding the Trust's financial performance for the six-month period ended June 30, 2008 and the years ended December 31, 2007, 2006 and 2005, and for the period from June 30, 2004 to December 31, 2004.

The Trust's Net Assets per Unit⁽¹⁾

	For the six-month period ended June 30,	For the year ended December 31,			For the period from June 30 to December 31,
	2008	2007	2006	2005	2004
Net Assets, beginning of period	\$ 21.24	\$22.98	\$22.47	\$23.89	\$23.75
Increase (decrease) from operations:					
Total revenue	0.01	0.02	0.01	—	0.05
Total expenses	(0.22)	(0.41)	(0.41)	(0.46)	(0.22)
Realized gains (losses) for the period . . .	5.79	3.06	1.25	0.52	—
Unrealized gains (losses) for the period	(6.22)	(2.76)	1.29	0.24	1.52
Total increase (decrease) from operations⁽²⁾	(0.65)	(0.09)	2.14	0.30	1.36
Distributions:					
From income (excluding dividends)	—	—	—	—	—
From capital gains	—	—	—	—	—
Return of capital	0.8750	1.75	1.75	1.75	0.875
Total Annual Distributions ⁽³⁾	0.8750	1.75	1.75	1.75	0.875
Net Assets at end of period ⁽⁴⁾	\$ 19.82	\$21.24	\$23.07	\$22.47	\$23.89

- (1) This information is derived from the Trust's financial statements. The net assets per unit presented in the financial statements differ from the net asset value calculated for pricing purposes. An explanation of these differences can be found in the notes to the financial statements.
- (2) Net asset value and distributions are based on the actual number of units outstanding at the relevant time. The increase (decrease) from operations are based on the weighted average number of units outstanding over the financial period.
- (3) Distributions were paid in cash. For the six-month period ended June 30, 2008 the nature of the distributions will be determined at the end of the period.
- (4) It is not intended that the Trust's Net Asset Value per Unit table act as a reconciliation of opening and closing net asset value per unit.

Ratios and Supplemental Data

	For the six-month period ended June 30,				
	2008	2007	2006	2005	2004
Net asset value (000's) ⁽¹⁾	\$ 48,483	\$ 54,715	\$ 65,587	\$ 70,702	\$ 77,173
Number of units outstanding ⁽¹⁾	2,442,000	2,568,800	2,843,300	3,146,200	3,230,000
Management expense ratio ⁽²⁾	9.06%	8.72%	7.27%	11.75%	18.02%
Management expense ratio before waivers or absorptions	9.06%	8.72%	7.27%	11.75%	18.02%
Portfolio turnover rate ⁽³⁾	46.16%	9.49%	10.61%	62.33%	0.00%
Trading expense ratio ⁽⁴⁾	0.02%	0.02%	0.00%	0.00%	0.02%
Closing market price, end of period	\$ 17.41	\$ 19.50	\$ 20.56	\$ 20.50	\$ 26.40

- (1) This information is provided as at June 30, 2008 and as at December 31 of the years shown.
- (2) Management expense ratio is based on total expenses for the stated period and is expressed as an annualized percentage of month-end average net asset value during the period. Please note that the management expense ratio includes not only the expenses of the Trust and Fund itself but also reflects an estimate of expenses to which the underlying hedge funds were subject. The management expense ratio of the underlying hedge funds held by the Fund plus the expenses of the Fund included in the above ratios for the six-month period ended June 30, 2008 added 5.54% and for the year ended December 31, 2007 added 5.54% and the year-ended December 31, 2006 added 5.47 % (2005 added 9.80% and 2004 added 9.66%) to the expense ratio of the Trust. This annualized expense ratio has been calculated using the total expenses of the underlying hedge funds, invested in by the Fund, per their annual audited financial statements for the periods ended December 31, 2006, 2005 and 2004 respectively. These statements represent the most recent audited information available. The expenses together with estimates for hedge funds with year-ends other than December 31 have been prorated based on the relative percentage of the hedge fund held by the Fund at the end of the respective period. Performance fees incurred by the underlying hedge funds can vary significantly from period to period based on such factors as the market conditions, fund strategy, manager performance and the timing of redemptions. As a result, the expense ratio of the underlying funds for the prior year may be significantly different than the actual expenses incurred by these underlying hedge funds for the current period.
- (3) The Trust's portfolio turnover rate indicates how actively the Trust's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Trust buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a fund.
- (4) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of monthly average net asset value during the period.

Past Performance

General

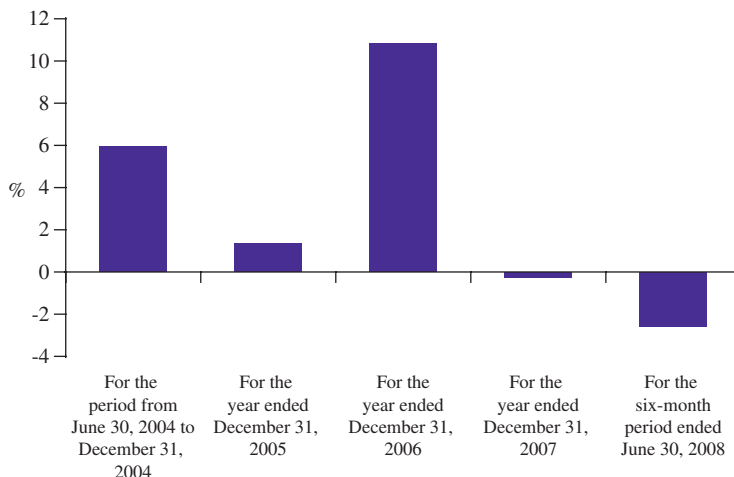
With respect to the following information in the “Past Performance” section of this report, please note the following:

- (a) the performance information shown assumes that all distributions made by the Trust in the periods shown were reinvested in additional securities of the Trust;
- (b) the performance information does not take into account sales and distribution charges that would have reduced returns or performance; and
- (c) how the Trust has performed in the past does not necessarily indicate how it will perform in the future.

Year-by-Year Returns

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

- (a) the bar chart shows the Trust’s performance for each of the periods shown, and illustrates how the Trust’s performance has changed from period to period; and
- (b) the bar chart shows, in percentage terms, how much an investment made on the first day of each financial period would have grown or decreased by the last day of each financial period.





Management Fees and Related Party Transactions

The Manager is responsible for the day-to-day administration, portfolio management and unitholder services to the Trust. In exchange for these services, the Manager is entitled to an annual management fee calculated as 0.15% per annum of the net asset value of the Trust, as of the close of business on each month-end valuation date. The fee is paid monthly in arrears.

The Trust also pays to the Manager a service fee of 0.30% per annum of the net asset value of the Trust, accrued monthly, and calculated based on the net asset value of the Trust on the last Valuation Date of each quarter. The service fee is 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.

During the six-month period ended June 30, 2008, the management fee and service fee expense were \$39,803 and \$78,380 respectively, and the management fee and service fee payable by the Trust as at June 30, 2008 were \$19,391 and \$36,481 respectively. (six-month period ended June 30, 2007, the management fee and service fee expense were \$51,011 and \$101,553 respectively.)

Other Fees

The Trust pays forward fees of approximately 0.55% per annum of the U.S. notional amount and 0.90% per annum of the Canadian notional amount to the Counterparty of the Forward that may vary based on the value of the Common Share Portfolio, calculated and paid quarterly in arrears.

Net Asset Value and Price Per Unit

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

The Trust's net asset value per unit is calculated and reported monthly. During the six-month period ended June 30, 2008, the net asset value of the Trust fluctuated between \$19.85 per unit and \$21.15 per unit after taking into account distributions (six-month period ended June 30, 2007: between \$23.17 per unit and \$23.65 per unit).

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 \$16.75 and \$19.89 during the six-month period ended June 30, 2008 (six-month period ended June 30, 2007: between \$20.65 per unit and \$23.00 per unit).

Distributions

During the six-month period ended June 30, 2008, distributions totaling \$0.875 per unit and \$2,164,138 in aggregate were declared (six-month period ended June 30, 2007: \$0.875 per unit and \$2,395,444 in aggregate). This represents a 7% return on the initial subscription price of \$25.00 per unit consistent with the targeted annual yield for the Trust of 7%.

The Trust is required to distribute all of its net income and net realized capital gains so that the Trust will not be liable to pay income tax under Part I of the Income Tax Act.

The character of the quarterly distributions for tax purposes has been determined at the end of the year in accordance with the declaration of trust and the tax laws then in effect. There can be no assurance that income tax laws will not be changed in a manner that adversely affects the Trust or distributions paid by the Trust and the Manager will continue to monitor any changes in the tax laws as they occur.

The following table presents the distribution history for the six-month period ended June 30, 2008

Distribution History

<u>Record Date</u>	<u>Date distribution paid</u>	<u>Character of distribution for tax purposes</u>	<u>Amount per unit</u>
March 31, 2008	April 15, 2008	To be determined	0.4375
June 30, 2008	July 15, 2008	To be determined	0.4375



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.

On August 24, 2007, 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 262,405 of the units of the Trust, representing 10% of the public float of the Trust then outstanding during the period from August 30, 2007 to August 29, 2008. 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 six-month period ended June 30, 2008, the Trust purchased 126,800 units for a total cost of \$2,409,020 for cancellation under this program (six-month period ended June 30, 2007: 140,300 units were repurchased)

MANAGEMENT'S RESPONSIBILITY

MANAGEMENT'S RESPONSIBILITY

The accompanying financial statements have been prepared by Northwater Fund Management Inc., the Manager of the Trust (the "Manager"), and approved by the Board of Directors of the Manager. The Manager is responsible for the information and representations contained in these financial statements and other sections of the annual report.

The Manager maintains appropriate processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and include certain amounts that are based on estimates and judgments. The significant accounting policies that management believes are appropriate for the Trust are described in note 2 to the financial statements.



SHAUNA CASSIDY, CFA
Vice-President

Northwater Fund Management Inc.

August 8, 2008



MARK STEFFLER, CA
Vice-President

Northwater Fund Management Inc.

STATEMENTS OF NET ASSETS

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statements of Net Assets (unaudited)

	As at June 30, 2008	As at December 31, 2007
Assets		
Cash and short term investments (cost: 2008 – \$2,924,561; 2007 – \$1,572,156)	\$ 2,930,255	\$ 1,571,991
Common shares – at fair value (cost: 2008- \$61,300,287; 2007 – \$53,455,776)	59,006,835	73,304,362
	<u>61,937,090</u>	<u>74,876,353</u>
Liabilities		
Unrealized loss on forward contract (note 6)	12,393,775	19,072,251
Audit, legal and custody fees payable	14,423	29,869
Service fees payable (note 7)	36,481	44,408
Management and advisory fees payable (note 7)	19,391	22,202
Advisory board fees payable	12,897	12,897
Distribution payable (note 9)	1,068,375	1,123,850
	<u>13,545,342</u>	<u>20,305,477</u>
Net assets	<u>\$ 48,391,748</u>	<u>\$54,570,876</u>
Net assets and unitholders' equity (note 5)		
Unit capital	\$ 57,552,495	\$60,540,890
Contributed Surplus	2,195,576	1,616,201
Deficit	<u>(11,356,323)</u>	<u>(7,586,215)</u>
Total	<u>\$ 48,391,748</u>	<u>\$54,570,876</u>
Number of units outstanding (note 5)	<u>2,442,000</u>	<u>2,568,800</u>
Net assets per unit	<u>\$ 19.82</u>	<u>\$ 21.24</u>

Signed on behalf of the Trustee,
Northwater Fund Management Inc.

Per: 

Per: 

The accompanying notes are an integral part of these financial statements

STATEMENTS OF OPERATIONS

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statements of Operations (unaudited)

	For the six-month period ended June 30,	
	2008	2007
Investment income		
Interest	\$ 15,306	\$ 13,161
	<u>15,306</u>	<u>13,161</u>
Expenses		
Service fees (note 7)	\$ 78,380	\$ 101,553
Forward financing fees (note 7)	277,811	311,271
Management fees (note 7)	39,803	51,011
Audit fees	42,213	38,390
Advisory board fees	10,810	3,694
Custodian fees	6,515	10,034
Legal fees	13,973	10,222
Security holder reporting costs	62,196	55,203
Loan interest and standby fees (note 8)	13,097	5,520
Transaction costs	7,886	2,053
	<u>552,684</u>	<u>588,951</u>
Net investment loss	<u>(537,378)</u>	<u>(575,790)</u>
Realized and unrealized gain (loss) on investments		
Net realized gain (loss) on:		
Common shares	14,394,970	4,508,087
Change in unrealized appreciation (depreciation) on:		
Common shares	(22,142,038)	4,305,832
Forward contract (note 6)	6,678,476	(5,491,693)
	<u>(1,068,592)</u>	<u>3,322,226</u>
Realized and unrealized gain (loss) on investments for the period	<u>(1,068,592)</u>	<u>3,322,226</u>
Increase (decrease) in net assets from operations for the period	<u>\$ (1,605,970)</u>	<u>\$ 2,746,436</u>
Increase (decrease) in net assets from operations per unit for the period*	<u>\$ (0.65)</u>	<u>\$ 1.00</u>

* Based on the average number of units outstanding of 2,486,943 (2007 – 2,737,650) for the period.

The accompanying notes are an integral part of these financial statements

STATEMENTS OF CHANGES IN NET ASSETS

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statements of Changes in Net Assets (unaudited)

	For the six-month period ended June 30,	
	2008	2007
Net assets – beginning of the period	\$54,570,876	\$65,069,109
Increase (decrease) in net assets from operations for the period	(1,605,970)	2,746,436
Unit transactions (note 5)		
Units purchased for cancellation	(2,409,020)	(3,056,935)
	(2,409,020)	(3,056,935)
Distribution to unitholders (note 9)		
Distributions	(2,164,138)	(2,395,444)
Net assets – end of the period	\$48,391,748	\$62,621,877

The accompanying notes are an integral part of these financial statements

STATEMENTS OF CASH FLOWS

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statements of Cash Flows (unaudited)

	For the six-month period ended June 30	
	2008	2007
Cash flows from operating activities		
Increase (decrease) in net assets from operations	\$ (1,605,970)	\$ 2,746,436
Items not affecting cash:		
Change in unrealized (appreciation) depreciation on common shares	22,142,038	(4,305,832)
Change in unrealized (appreciation) depreciation on currency forwards	(6,678,476)	5,491,693
Realized (gain) on common shares	(14,394,970)	(4,508,087)
Changes in non-cash working capital:		
Change in payables	(26,184)	(16,720)
Purchase of common shares	(30,309,734)	(11,603,581)
Proceeds on sale of common shares	36,860,193	21,051,433
	<u>5,986,897</u>	<u>8,855,342</u>
Cash flows from financing activities		
Repurchase of trust units	(2,409,020)	(3,056,935)
Distribution paid to trust unitholders	(2,219,613)	(2,456,825)
	<u>(4,628,633)</u>	<u>(5,513,760)</u>
Net increase (decrease) in cash and short term investments	<u>1,358,264</u>	<u>3,341,582</u>
Cash and short term investments at the beginning of the period	<u>1,571,991</u>	<u>1,211,636</u>
Cash and short term investments at the end of the period	<u>\$ 2,930,255</u>	<u>\$ 4,553,218</u>
Supplementary information:		
Interest paid	\$ 13,097	\$ 5,520

The accompanying notes are an integral part of these financial statements

STATEMENT OF INVESTMENT PORTFOLIO

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Statement of Investment Portfolio (unaudited)

As at June 30, 2008

	<u>Credit Rating</u>	<u>Maturity date</u>	<u>No. of shares/ Face value</u>	<u>Cost</u>	<u>Fair value</u>	<u>Fair value as a % of Net Assets</u>
Common share portfolio						
Celestica Inc			280,445	2,810,059	2,406,218	4.97%
CGI Group Inc			365,511	3,614,904	3,709,937	7.67%
Duvernay Oil Corporation			76,185	4,852,985	4,742,516	9.80%
FNX Mining Inc.			106,725	3,550,741	2,572,073	5.32%
Galleon Energy Inc.			191,479	3,117,278	3,942,553	8.15%
Gildan Activewear Inc.			108,872	3,750,640	2,827,406	5.84%
Great Canadian Gaming Corp.			253,026	3,117,268	2,294,946	4.74%
Hudbay Minerals			131,851	3,550,747	1,864,373	3.85%
Macdonald Dettwiler & Assoc.			80,791	3,550,764	3,054,708	6.31%
Major Drilling Group Intl ..			68,568	3,750,670	3,428,400	7.08%
Martinrea International Inc.			423,433	2,697,268	2,574,473	5.32%
Nortel Networks Corp			81,661	3,681,361	680,236	1.41%
Quadra Mining Ltd.			169,602	3,117,285	3,597,258	7.43%
Research In Motion Ltd			82,657	2,423,407	9,852,714	20.36%
RONA Inc			157,366	2,340,464	1,927,734	3.98%
Stantec Inc.			93,862	2,970,732	2,458,246	5.08%
Tristar Oil and Gas			228,482	4,852,958	4,709,014	9.73%
Westjet			188,369	3,550,756	2,364,030	4.89%
Common share portfolio				61,300,287	59,006,835	121.93%
Cash				81,795	81,795	0.17%
Banker's Acceptances*						
Bank of Nova Scotia	A-1+	July 7, 2008	2,400,000	2,393,688	2,398,536	4.96%
Royal Bank of Canada	A-1+	July 2, 2008	450,000	449,078	449,924	0.93%
Total cash and short-term investments				\$ 2,924,561	\$ 2,930,255	6.06%
Total investment portfolio					61,937,090	127.99%
Other net assets					(13,545,342)	(27.99)%
Net assets and unitholders' equity					\$ 48,391,748	100.00%

* Credit ratings as at June 30, 2008 as per Standard and Poor's rating agency.

The accompanying notes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS

NORTHWATER FIVE-YEAR MARKET-NEUTRAL TRUST

Notes to Financial Statements (unaudited)

For the Six-month periods ended June 30, 2008 and 2007

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. Northwater Fund Management Inc. (the “Manager”) acts as Trustee of the Trust and RBC Dexia Investor Services Trust (“RBC Dexia”) acts as Custodian for the Trust. The Trust began operations on June 30, 2004 when it completed its initial public offering. The Northwater Five-Year Market-Neutral Fund Limited (the “Fund”) began operations on June 30, 2004. 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 (the “Common Share Portfolio”) are combined with a forward contract (the “Forward”) 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 (“GAAP”).

Adoption of New Accounting Standards

In December 2006, the Accounting Standards Board issued CICA Handbook Section 3862, “Financial Instruments – Disclosures (S. 3862) and Section 3863, “Financial Instruments – Presentation (S. 3863), which provides comprehensive disclosure and presentation requirements for financial instruments.

The requirements of S. 3862 and S. 3863 are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and have been reflected in the notes to the financial statements.



The following paragraphs outline the accounting policies of the Trust :

(a) Cash and Short-Term Investments

Cash consists of cash in interest bearing accounts. Short-term investments are valued at the bid price for such instruments on each Valuation Date. Interest income is accrued on a monthly basis.

(b) Investments

Investment transactions are accounted for on a trade date basis. Investments are valued on the last day of each month (“Valuation Date”) at closing bid prices.

The common shares listed on a public securities exchange are valued at their bid 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. Distribution income is recorded on ex-dividend date or ex-distribution date on a gross basis.


The fair 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 based on the change in valuation of Northwater Five-Year Fund Limited (“the Fund”), which invests primarily in a diversified portfolio of market-neutral hedge funds, and on the change in value of the Common Share Portfolio less the costs of leverage. The investments in market-neutral hedge funds held by the Fund are valued at fair value on the basis of the definitive net asset values reported by the administrators or the portfolio managers of the 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.

(c) Foreign Currency Translation

Assets and liabilities in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the end of the period. Revenues and expenses denominated in foreign currencies are translated using the average exchange rate for the period. Unrealized gains and losses arising from translation of the fund are included as currency translation.

(d) Use of Estimates

The preparation of financial statements in accordance with GAAP requires the Trust to make estimates and assumptions that affect the reported



amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(e) Transaction Costs

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

3. Financial Instrument Risk

The Trust's investment activities may expose it to a variety of financial risks including market price risk, currency risk, interest rate risk, and credit risk. The following provides an overview of these risks and describes actions taken by the Trust in an effort to mitigate the potential adverse impact of these risks on the performance of the Trust.

Market price risk

Market price risk is the risk that the future value of a financial instrument will fluctuate as a result of changes in its market price, whether caused by factors specific to the individual investment, its issuer, or any other market factor that may affect its price.

The Trust primarily invests in a portfolio of Canadian publicly traded common shares and through a forward agreement with a counterparty agrees to sell the common shares at a price based on the return of an underlying portfolio of hedge funds. As such the Trust has no exposure to the market price risk for the common shares held.

The Trust is exposed through a forward agreement to a portfolio of hedge funds. The process of fair valuing hedge fund investments for which no published market exists, is based upon the fair value of the underlying holdings of the hedge fund. These values may differ from values available had a ready market existed for such investments and may differ from the prices at which such investments may be sold.

The Advisor of the Fund attempts to mitigate market price risk through diversification of investments in hedge funds whose returns exhibit low correlation to the markets. In addition, the Advisor monitors the investments in order to ensure the decision to invest in a particular hedge fund strategy continues to be suitable for the Fund's portfolio. Special attention is paid to organizational changes made by the hedge fund managers and to changes in policy relative to their investment objectives, valuation, hedging strategy, degree of diversification, leverage and costs.

The following tables present information for the period from inception and for the six-month period ended June 30, 2008 and 2007 regarding 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.

<u>Trust Statistics</u>	<u>For the period from inception to June 30, 2008</u>	<u>For the period from inception to June 30, 2007</u>
# of positive monthly returns	33	29
# of negative monthly returns	15	7
% of negative months	31.3%	19.4%
Average size of negative months . . .	(1.12)%	(0.68)%
Worst monthly return	(4.29)%	(1.56)%

<u>Single Hedge Fund Statistics</u>	<u>Six-month period ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
# of hedge funds with positive returns ⁽¹⁾	15	30
# of hedge funds with negative returns ⁽¹⁾	17	2
Average annual hedge fund standard deviation ⁽²⁾	8.54%	3.93%
Average correlation between hedge funds ⁽²⁾	0.24%	0.10%

1. Measured for hedge funds in the Hedge Fund Portfolio of the Fund as at June 30, 2008 and June 30, 2007, respectively.
2. As measured over the past 24 months for hedge funds in the Hedge Fund Portfolio of the Fund as June 30, 2008 and June 30, 2007 respectively, excludes hedge funds with less than 24 months of historical returns.

No changes materially affecting the overall risk of investing in the Fund were made in the six-month period ended June 30, 2008. The risks of investing in the Trust remain as discussed in the Trust's prospectus.

The following table presents the standard deviations of returns by strategy for the Fund's investment in hedge funds and what the impacting change in net assets would be if the strategies returns were to change by this amount.

<u>Strategy</u>	<u>Standard Deviation*</u>	
	<u>(%)</u>	<u>(\$ USD)</u>
Activist Investment	11.07%	\$ 275,257
Asset-backed securities arbitrage	2.72%	200,247
Distressed securities arbitrage	4.41%	381,662
Fixed-income arbitrage	12.89%	611,111
Mortgage-backed security arbitrage	5.37%	307,670
Multi-strategy	4.50%	736,125
Re-insurance arbitrage	2.38%	90,924
Structured finance	4.69%	168,135
Statistical arbitrage	12.12%	1,056,949

* As measured over the past 24 months for hedge funds in the hedge fund portfolio as at June 30, 2008.



Currency risk

Currency risk arises from the Trust holding financial instruments denominated in a currency other than Canadian dollars, which is the Trust's functional currency.

As the Trust is exposed to hedge fund investments that are primarily denominated in U.S. dollars through a forward agreement, the value of such investments may fluctuate with the exchange rate. To manage its currency risk, the Trust attempts to hedge such currency fluctuations through the use of currency futures.

Liquidity risk

Liquidity risk is the risk that the Trust will encounter difficulty in meeting its obligations associated with its financial liabilities. The financial liabilities of the Trust may consist of loans, distributions, settlement of futures contracts and obligations due to market support requirements.

The Trust primarily invests in a Common Share Portfolio of publicly traded Canadian securities. As such the investments are considered highly liquid. In addition, the Trust is exposed to hedge fund investments through a forward agreement for which there is no active secondary market. As such the investments are considered illiquid. The Fund is subject to redemption restrictions for each of the hedge funds forming part of its portfolio that are generally monthly, quarterly, semi-annually or annually. Notice periods for redemptions range from 30 days notice to 180 days notice. Redemptions may, in some cases, be subject to lock-up periods, gates, redemption suspensions and side pocket restrictions.

To assist the Trust in its ability to meet its financial obligations, a credit facility is available to provide liquidity within certain restrictions. In addition, the hedge fund portfolio is diversified and managed considering the Trust's termination date.

Credit risk

The Trust invests in debt obligations of both government and corporate issuers and is exposed to hedge fund investments through a forward agreement. These financial instruments involve the risk that the counterparty cannot or will not fulfill its obligations in respect of such financial instruments.

The Trust also assumes credit risk to its financial counterparties in connection with derivatives, loans and cash. In evaluating credit risk, the Manager will often be dependent upon information provided by the counterparty or a rating agency which may be materially inaccurate. As at June 30, 2008 the credit rating of the counterparty was as follows:

<u>Counterparty to:</u>	<u>Credit Rating*</u>
Cash	A-1+
Credit facilities	AA-
Forward contract	A-1+

For all debt securities purchased the debt issuer must have a credit rating of R-1 Mid or higher. For a listing of all current ratings by debt issuer see the Statement of Investment Portfolio.

Credit risk on hedge fund investments is mitigated through an extensive due diligence process which focuses on monitoring each hedge fund investment in order to ensure the decision to invest in a particular hedge fund strategy continues to be suitable for the Trust’s portfolio.

Interest rate risk

Interest rate risk is the risk that a change in interest rates will adversely affect the fair value of fixed income securities. The financial instruments which potentially expose the Trust to interest rate risk are short-term fixed income securities. Effective duration, a commonly used measure of interest rate risk, incorporates a security’s yield, coupon, final maturity, call features and other embedded options into one number expressed in years that indicates how price-sensitive a security is to changes in interest rates. The effective duration of a security indicates the approximate change in fair value expected for a 1% change in interest rates. The longer the duration, the more sensitive the security is to changes in interest rates. The Trust has minimal sensitivity to change in rates since fixed-income securities are usually held to maturity and short-term in nature.

4. Interest Rate Swap

The Fund has swapped an exposure to a floating money market rate with a U.S. Bank (the “Counterparty”) in return for receiving a fixed rate of 4.45%. As a result, if mid-term rates were to decrease (increase) by 1%, the value of the Fund would increase (decrease) by approximately 0.8%.

The Counterparty to the swaps has a credit rating of AA. The credit worthiness of the Counterparty was reviewed prior to entering into the swap and is monitored on a regular basis.

The notional amount of the interest rate swaps as at June 30, 2008 was \$57,500,000 CAD with a maturity date of June 30, 2009 (December 31, 2007: total \$ 60,516,000 CAD with a maturity date of June 30, 2009).

5. Unitholders' Equity

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

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 a normal course issuer bid and the Trust's quarterly market support obligation, the Trust purchased 126,800 units for a cost of \$2,409,020 during six-month period ended June 30, 2008 (six-month period ended June 30, 2007: 140,300 units were repurchased)

Unitholders' equity is comprised of unit capital and deficit. The following table shows the transactions for unit capital and deficit during six-month period ended June 30, 2008 and 2007:

<u>Six-month period ended June 30, 2008</u>	<u>Units Outstanding</u>	<u>Unit Capital</u>	<u>Contributed Surplus</u>	<u>Deficit</u>	<u>Unitholders' Equity</u>
Balance –					
December 31, 2007	2,568,800	\$60,540,890	\$1,616,201	\$ (7,586,215)	\$54,570,876
Increase (decrease) in net assets from operations for the period	—	—	—	(1,605,970)	(1,605,970)
Units cancelled during the period	(126,800)	(2,988,395)	579,375 *	—	(2,409,020)
Distributions	—	—	—	(2,164,138)	(2,164,138)
Balance –					
June 30, 2008	<u>2,442,000</u>	<u>57,552,495</u>	<u>2,195,576</u>	<u>(11,356,323)</u>	<u>48,391,748</u>

<u>Six-month period ended June 30, 2007</u>	<u>Units Outstanding</u>	<u>Unit Capital</u>	<u>Contributed Surplus</u>	<u>Deficit</u>	<u>Unitholders' Equity</u>
Balance –					
December 31, 2006	2,843,300	\$67,010,243	1,001,417	\$(2,683,840)	\$65,327,820
Increase (decrease) in net assets from operations for the period	—	—	—	2,746,436	2,746,436
Units cancelled during the period	(140,300)	(3,306,557)	249,622 *	—	(3,056,935)
Distributions	—	—	—	(2,395,444)	(2,395,444)
Balance –					
June 30, 2007	<u>2,703,000</u>	<u>\$63,703,686</u>	<u>\$1,251,039</u>	<u>\$(2,332,848)</u>	<u>\$62,621,877</u>

* represents the stated value in excess of the cost of units repurchased.

6. Forward Agreement

The Trust has entered into a forward agreement (the “Forward”) with a U.S. Bank (the “Counterparty”) to obtain exposure to a diversified portfolio of market-neutral hedge funds (the “Hedge Fund Portfolio”) and an interest rate swap held by an underlying fund, through the performance of the Fund, a Cayman Islands exempt company. The target exposure to the Hedge Fund Portfolio is equal to 150% of the net asset value of the Trust. The actual exposure as at June 30, 2008 was 137% (December 31, 2007 actual exposure was 145%). 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 leverage provided by the Counterparty in order to provide the exposure to the Fund less the related costs of leverage. As a result, the value of the Forward is determined based on the change in the valuation of the Fund and the Common Share Portfolio. The Forward matures on June 30, 2009.

The notional amounts of the Forward as at June 30, 2008 are in the amount of U.S. \$25,854,207 and Canadian \$38,708,688 (December 31, 2007: U.S. \$34,551,740 and Canadian \$46,352,081). During the six-month period ended June 30, 2008, the Counterparty redeemed 1,020 participating shares of the Fund for \$12,776,399 USD and paid \$ 6,550,459 CAD to the Trust as a result of a reduction in the notional amounts of the Forward and in return for partial settlement of the common share portfolio.

The creditworthiness of the Counterparty was reviewed prior to the transaction and is monitored on a regular basis pursuant to credit standards

established by the Manager. As at June 30, 2008 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 0.8%. The interest rate swap has a maturity date of June 30, 2009.

The following table presents information regarding the Hedge Fund Portfolio held by the Fund to which the Trust has exposure through the Forward. The multi-strategy funds have not been allocated to any of the underlying hedge fund strategies set out in this table.

Strategy	As at June 30, 2008			As at December 31, 2007		
	No. of Hedge Funds	Fair Value (in U.S. Dollars)		No. of Hedge Funds	Fair Value (in U.S. Dollars)	
Activist Investments	1	\$ 2,486,517	4%	1	\$ 2,744,536	3%
Asset-backed security arbitrage . .	3	7,362,028	12%	4	7,914,440	10%
Distressed securities arbitrage . . .	4	8,654,463	14%	5	12,791,205	16%
Fixed-income arbitrage	3	4,740,970	8%	3	5,387,185	7%
Merger arbitrage	—	—	—	1	995,490	1%
Mortgage-backed security arbitrage	4	5,729,427	9%	4	9,305,743	12%
Multi-strategy	6	16,358,327	27%	6	17,072,702	21%
Re-insurance arbitrage	2	3,820,334	6%	2	4,407,933	6%
Statistical arbitrage	6	8,720,698	14%	6	10,854,126	14%
Structured finance	3	3,584,965	6%	6	8,039,314	10%
	32	\$61,457,729	100%	38	\$79,512,674	100%

The following table shows the number of hedge funds held by the Fund as at June 30, 2008 and 2007 categorized by the size of each hedge fund.

Total Assets of each hedge fund in U.S.\$ Millions	2008	2007
< 100	1	4
100 – 250	5	6
250 – 500	4	8
500 – 750	3	3
750 – 1000	4	4
> 1000	15	11
	32	36

The following table shows the number of hedge funds held by the Fund as at June 30, 2008 and 2007 categorized by the years since inception of each hedge fund.


<u>Years</u>	<u>2008</u>	<u>2007</u>
< 3	2	9
3 – 6	11	13
6 – 9	11	8
9 – 12	3	3
12 – 15	3	2
> 15	2	1
	<u>32</u>	<u>36</u>

The following chart illustrates the number of hedge fund holdings of the Fund by jurisdiction of organization as at June 30, 2008 and 2007.

<u>Location</u>	<u>2008</u>	<u>2007</u>
Cayman Islands	28	30
British Virgin Islands	2	2
Bermuda	2	3
Bahamas	0	1
	<u>32</u>	<u>36</u>

7. Management, Advisory and Other Fees

The Trust retained the Manager under a management agreement dated June 18, 2004. Northwater Capital Management Inc. (the “Investment Advisor”), a Company formed under the laws of Ontario, Canada, 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 legislation 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 Manager is responsible for the day-to-day administration, portfolio management and unitholder services of the Trust. In exchange for these services, the Manager is entitled to an annual fee of 0.15% of the net asset value of the Trust, calculated on the last Valuation Date of each month. The fee is paid monthly in arrears.

A service fee of 0.30% per annum of the net asset value 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.

Forward fees of approximately 0.55% per annum of the U.S. notional amount and 0.90% per annum of the Canadian notional amount are payable to the Counterparty of the Forward, may vary based on the value of the Common Share Portfolio, calculated and paid quarterly in arrears. The leverage costs have been included in the Statement of Operations as part of the value of the forward contract (see note 6).

8. Bank Loan Facility

The Trust has a revolving loan facility with a U.S. 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.

During the six-month period ended June 30, 2008, the bank loan balance varied between nil and \$1,000,000 (year ended December 31, 2007: between nil and \$2,800,000).

The average rate of interest paid on the loan for the period was 3.94%.

9. Distributions

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

During the six-month period ended June 30, 2008, distributions of \$0.875 per unit and \$2,164,138 in aggregate were declared by the Trust (six-month period ended June 30, 2007: \$0.875 per unit and \$2,395,444 in aggregate).

10. Income Taxes

As at December 31, 2007, the Trust qualifies as a “mutual fund trust” within the meaning of the *Income Tax Act* (Canada) (the “Tax Act”). 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, 2007, the Trust had \$961,132 available in non-capital loss carryforwards (December 31, 2006: \$2,980,583) with expiry dates commencing in 2027 and no capital loss carryforwards (December 31, 2006: nil).

11. Reconciliation of Net Assets

With respect to the implementation of Section 3855, the Canadian securities regulatory authorities have granted relief to investment funds from complying on an interim basis with Section 3855 for the purposes of calculating and reporting the purchase and redemption net asset value or the “Reported NAV” of an investment fund for up to a one year period ending September 30, 2008. This relief is to permit further review of the suitability of this new pronouncement for the purpose of calculating the Reported NAV. Depending on the outcome of this review by the Canadian Securities authorities, the method by which the net assets is calculated as governed by Section 3855 may result in a change to the Reported NAV of an investment fund.

In accordance with the decision made by the Canadian securities regulatory authorities, a reconciliation between the Reported NAV and the net assets calculated in accordance with Section 3855 of the investment fund is required in the notes to the financial statements.


The below table reconciles the reported net asset value as at June 30, 2008 with the net assets as calculated in accordance with Section 3855.

	<u>Net asset value</u>	<u>Net asset value per unit</u>
Reported net asset value	\$48,483,274	\$19.85
Section 3855 adjustment	<u>(91,526)</u>	<u>(0.03)</u>
Net assets per the Statement of Net Assets	<u>\$48,391,748</u>	<u>\$19.82</u>

12. 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 as a result of the Counterparty holding 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.

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

NORTHWATER CAPITAL MANAGEMENT INC.

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

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

With more than ten years of experience in fund of hedge funds, Northwater has steadily grown exposure under management to approximately \$14.0 billion CAD in total, including \$4.5 billion USD invested in hedge funds as at June 30, 2008. Northwater has focused on developing, delivering and continuously improving its market-neutral fund of hedge fund portfolios since launching its first such portfolio in 1994.

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

Northwater also acts as an advisor to the following two closed-ended funds listed on the TSX:

- Northwater Market-Neutral Trust, the first publicly-listed investment vehicle of its kind in Canada to invest in a diversified portfolio of market-neutral hedge funds, which was launched in 1997; and
- Northwater Top 75 Income Trusts ^{Plus}, launched in 2005.



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