

## MALACHITE AGGRESSIVE PREFERRED FUND

### Monthly Report, November 2002

The fund recorded a return of -1.26% in November vs. a presumed return on the index of +0.65%. Again, a large portion of the difference may be ascribed to the fund's holding of Bombardier preferred shares – and the specific issue held, BBD.PR.B, was among the month's worst performers, which offset a good many excellent trades between issues made by the fund. The poor performance of this issue continues to surprise: the issue will be exchangeable into a different series of Bombardier in August 1, 2007 and on that date will be identical to BBD.PR.D (created by those who exercised the previous conversion option last August). The BBD.PR.D have a fixed dividend of \$1.369 until that date, when it will be reset for another five years. As long as the BBD.PR.B trades below par (\$25.00) it may be assumed that the rate payable will be 100% of the prime rate, currently 4.5%, or \$1.125 per annum. The difference, therefore is currently \$0.244 p.a., for 4 ¾ years, implying a total undiscounted difference in income (assuming constancy of prime) of \$1.16: on November 29, the difference was \$2.10.

| Month  | MAPF Total Return* | NB-50 Total Return | <i>The "NB-50" is an index of preferred shares proprietary to BMO Nesbitt Burns. It is composed of 50 issues having good liquidity and credit quality.</i> |
|--|--------------------|--------------------|--|
| December, 2001   | -2.54%             | -0.14%             |  |
| January, 2002  | +5.43%             | +2.01%             |  |
| February   | +1.16%             | +0.17%             |  |
| March  | -0.08%             | -2.16%             |  |
| April  | +1.22%             | -0.65%             |  |
| May  | +0.01%             | +0.25%             |  |
| June   | +1.67%             | +0.67%             |  |
| July   | -2.19%             | +1.31%             |  |
| August   | -2.05%             | +0.39%             |  |
| September  | -7.48%             | +0.54%             |  |
| October  | +5.19%             | +0.13%             |  |
| November, 2002   | - 1.26%            | +0.65%             |  |
| <b>Last 12 Months</b>  | <b>-1.59%</b>      | <b>+3.15%*</b>     |  |
| <b>Cumulative since Inception (2001-03-31)</b>   | <b>+9.98%</b>      | <b>+4.61%*</b>     |  |
| <i>*MAPF total returns include reinvestment of dividends and are after fund expenses but prior to management fees. They are shown for illustrative purposes only and future returns are not assured.</i> |                    |                    |  |

There are two possibilities that would imply rationality in this respect by the market:

- The market expects the prime rate to decline significantly – to the 3.5% level or thereabouts (the recent low was 3.75%, held for 3 months).
- The market expects a dramatic increase in price of both issues to above par value, which would decrease the proportion of prime paid from 100% to potentially as little as 50%

Neither possibility seems too likely – or, at least, likely enough to account for the current price differential. Hymas Investment Management Inc. takes the view simply that retail simply does not want to put in a bid for Bombardier preferreds and that the irrational price differential will disappear at some point, as will the differential between this pair of issues and their peers. We may consider the very similar Noranda pair, NRD.PR.F and NRD.PR.G, in which the former has a similar ‘ratcheting floating rate’ dividend mechanism. This issue was quoted at \$21.95-\$22.26 on November 29, almost 40% higher

than the \$15.70-\$15.90 quote on BBD.PR.B, despite the fact that, at Pfd-3, the Norandas have a credit rating a full class below the BBD.PR.B (Pfd-2) as determined by DBRS.

The fund will stick to its guns and await happier days!

The overall yield curve was relatively quiet during the month – the item of most significance was a sharp decline in the “Long Term Premium”.

This figure continues to be large and positive, implying a marked “inversion” of the yield curve at the long end of the term structure – that is, longer term investments yield slightly less than shorter-term

| Curve Attribute  | October 31, 2002 (After Tax Figures) | November 29, 2002 (After Tax Figures) |
|--|--------------------------------------|---------------------------------------|
| Base Rate  | 3.44%                                | 3.55%                                 |
| Short Term Premium   | -3.55%                               | -3.55%                                |
| Short Term Decay Time  | 5.7 Years                            | 5.8 Years                             |
| Long Term Premium  | 1.91%                                | 1.66%                                 |
| Long Term Decay Time   | 14.0 Years                           | 13.1 Years                            |
| Interest Income Spread   | 0.60%                                | 0.53%                                 |
| Cumulative Div. Spread   | -0.31%                               | -0.30%                                |
| Split-Share Spread   | 0.85%                                | 1.00%                                 |
| Retractability Spread  | -0.63%                               | -0.58%                                |
| Floating Rate Spread   | -0.80%                               | -0.82%                                |
| 2 <sup>nd</sup> Tier Credit Spread   | 0.62%                                | 0.62%                                 |
| 3 <sup>rd</sup> Tier Credit Spread   | 1.24%                                | 1.24%                                 |
| “High” Credit Spread   | -0.62%                               | -0.62%                                |
| “Low” Credit Spread  | 0.00%                                | 0.00%                                 |
| <i>Note: Figures for October have changed somewhat from the previous report. This is due to additions of data.</i> |                                      |                                       |

| Risk Factor                  | Returns for “True” (Pre-Tax) | Returns for “False” (Pre-Tax) |
|------------------------------|------------------------------|-------------------------------|
| Retractable                  | 0.69%±3.38%                  | 0.63%±7.77%                   |
| Split Share Corp             | 1.05%±3.28%                  | 0.58%±6.02%                   |
| Cumulative Dividends         | 0.56%±5.47%                  | 0.82%±5.83%                   |
| Payments are Dividends       | 0.72%±5.87%                  | 0.09%±0.79%                   |
| Floating Rate                | 2.20%±10.72%                 | 0.19%±2.03%                   |
| Credit Class 2               | 0.07%±3.49%                  | 1.27%±7.11%                   |
| Credit Class 3               | -1.23%±2.08%                 | 0.93%±5.92%                   |
| Credit Class Modifier “High” | -1.23%±2.47%                 | 0.99%±5.95%                   |
| Credit Class Modifier “Low”  | 0.18%±3.09%                  | 1.26%±7.58%                   |

investments (once the yield curve maximum, which occurs at about the 16-year mark, has been passed). It should be noted that this assertion is subject to unavoidable inhomogeneities in the data: there are

no retractible issues for which retraction first becomes exercisable in more than 15 years, for example; and there are no interest-paying preferred *securities* with a maturity date of less than 15 years hence.

The effect of such inhomogenities is observed when comparing the change in the calculated yield-curve spreads with the matrix of returns for the month.. Split-share corporations outperformed markedly, although the spread increased; interest-paying preferred *securities* underperformed although the spread remained the same; floating rate issues performed very well, although the spread on such issues moved only slightly. This is an artifact of the different data sets used in constructing the tables: low-rated securities, which tend to be very volatile in price, are not included in the yield curve calculation, while they do form part of the risk-return matrix calculation.

Regular readers of these reports will remember the issue of the Normal Course Issuer Bid for GT.A, and the letters to the TSE ([www.himivest.com/activism/TSE021022.pdf](http://www.himivest.com/activism/TSE021022.pdf)) and OSC ([www.himivest.com/activism/021106.pdf](http://www.himivest.com/activism/021106.pdf)). The OSC has answered; they will not be getting involved as the company's plan does not violate the terms of the firm's trust agreement. On the "public interest" issue, they are deferring to the TSE. The fund will be very cautious when considering the purchase of securities controlled by Mulvihill!

This month's chart shows the changes over the past year in the "Long Term Premium" of the yield curve, which quantifies the adjustment the market makes to interest rates for long term investments; it is currently large and positive, implying a long term "inversion" of the yield curve. Issues which are highly sensitive to changes in this spread include GWO.PR.E, CM.PR.R, BNN.PR.I, PWF.PR.D and IGI.PR.A – a decrease in the premium will be unfavourable for these securities. Issues virtually insensitive to this measure include BCE.PR.P, LON.PR.D, LON.PR.E, BNN.PR.A and ION.PR.A.

| TSE Ticker Symbol  | Total Return, September, 2002 | Remarks (Valuation commentary based on Ontario's highest marginal tax rate) |
|--|-------------------------------|---|
| MMF.PR.A   | -8.04%                        | Low volume, but inexpensive at \$19.68                                      |
| BBD.PR.B*  | -6.34%                        | Extremely cheap at \$15.70. MAPF holds position                             |
| NRD.PR.F   | -5.43%                        | Credit Class 3, low volume, fixed/floater                                   |
| IPS.PR.A   | -5.23%                        | DBRS downgraded issue to Pfd-3 (from Pfd-3H) October 23, 2002               |
| POW.PR.B   | -4.72%                        | Good volume and credit, cheap at \$23.20, MAPF bought in Nov.               |
| ...  | ...                           | ...   |
| GT.PR.A  | +8.71%                        | Split share issue, dividends in default.                                    |
| YLD.PR.B   | +13.51%                       | Poor credit, low volume   |
| BNN.PR.A*  | +24.88%                       | Volume tiny, redeemable and retractable below current bid.                  |
| NTL.PR.F*  | +36.28%                       | Market perceptions of Nortel's chances change often ...                     |
| NTL.PR.G*  | +43.95%                       | ... and very violently! (nb: Comments held over from last month!)           |
| *indicates that the issue was also on last month's best/worst performers table |                               |   |

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# Yield Curve Data : Period (inclusive) from 2001-11-30 to 2002-11-29

Tax Identifier: 7

X-Axis: Date

LONG TERM PREMIUM : Spot Rate

Y-Axis: Yield as fraction (positive implies inversion)

