

## MALACHITE AGGRESSIVE PREFERRED FUND

### Monthly Report, December 2002

The fund recorded a gain of +0.18% in December, underperforming the index and capping a rather disappointing year in which the total return was 1.17%. This performance may be ascribed to the market's irrational rejection of Bombardier Preferred shares, in which the fund holds a large position. However, the fund is quite happy holding this position, as the Bombardier preferreds are massively undervalued, as has been discussed in previous reports. Hymas Investment Management holds the view that eventually the discount on these share will be erased, resulting in equally irrational large gains.

Month	MAPF Total Return*	NB-50 Total Return	
January, 2002	+5.43%	+2.01%	<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>
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	-1.26%	+0.06%	
December, 2002	+0.18%	+1.65%	
<b>Last 12 Months</b>	<b>+1.17%</b>	<b>+4.39%</b>	
<b>Since Inception (March, 2001)</b>	<b>+10.17%</b>	<b>+5.72%</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>			

Quarter	MAPF Total Return	NB-50 Total Return
2Q01	+3.50%	-1.59%
3Q01	+7.50%	+2.12%
4Q01	-2.12%	+0.78%
1Q02	+6.57%	-0.02%
2Q02	+2.92%	+0.27%
3Q02	-11.35%	+2.25%
4Q02	+4.05%	+1.84%

Major changes took effect in the market's overall yield curve during the month in light trading – perhaps due to tax-loss selling and a repositioning of portfolios for the new year and the next RRSP season.

Most dramatically, the premium demanded for retractable issues (or the discount demanded for non-retractibles, whichever way one wishes to look at it) skyrocketed during the month, reaching almost 1%, as did the spread received on interest paying preferred *securities*. The latter case may be a mathematical artefact related to the inhomogeneous nature of the data: the currently extant preferred *securities* are not expected to mature until the late

2040's – therefore, their overall position to the yield curve will not have changed much given the sharp increase in the “Long Term Premium”. Note also the currently extant preferred *securities* are considered retractable, as they have a definite maturity date, albeit one that is some time in the future.

Curve Attribute	November 29, 2002 (After Tax Figures)	December 31, 2002 (After Tax Figures)
Base Rate	3.56%	3.37%
Short Term Premium	-3.55%	-3.48%
Short Term Decay Time	5.8 Years	4.9 Years
Long Term Premium	1.65%	2.12%
Long Term Decay Time	13.1 Years	12.1 Years
Interest Income Spread	0.56%	0.97%
Cumulative Div. Spread	-0.31%	-0.23%
Split-Share Spread	1.02%	0.88%
Retractability Spread	-0.57%	-0.97%
Floating Rate Spread	-0.83%	-0.80%
2 <sup>nd</sup> Tier Credit Spread	0.62%	0.55%
3 <sup>rd</sup> Tier Credit Spread	1.24%	1.12%
“High” Credit Spread	-0.62%	-0.53%
“Low” Credit Spread	0.00%	0.00%
<i>Note: Figures for November 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	0.88%±2.83%	0.80%±2.74%
Split Share Corp	0.68%±2.06%	0.89%±2.94%
Cumulative Dividends	0.52%±3.43%	1.34%±1.31%
Payments are Dividends	0.75%±2.90%	1.94%±0.46%
Floating Rate	-0.57% ±4.59%	1.28%±1.71%
Credit Class 2	1.18%±3.33%	0.51%±2.07%
Credit Class 3	-0.33%±2.58%	1.02%±2.79%
Credit Class Modifier “High”	1.71%±2.24%	0.73%±2.85%
Credit Class Modifier “Low”	0.82%±3.13%	0.89%±2.31%

Interest paying preferred *securities* outperformed this month, as may often be expected in the last month of each quarter when they record and pay their coupons. Research has noted that there is some correlation between

what may be described as “accrued dividends” and the following month's returns, although this factor alone is by no means sufficient to assure excess returns over time.

This month's graph shows the “zero-based accrued dividend proportion” of the instruments in the universe as of November 29 and plots these proportions against the returns observed in December. A regression was then performed against the data-set, treating the different credit classes separately, with the following results:

Intercept 0.0081±0.0247  
 Credit class 1 regression: 0.38±3.61  
 Credit class 2 regression: 0.77±2.74  
 Credit class 3 regression: -0.37±5.60  
 R-squared: 0.098  
 F-statistic: 3.15

It is notable that the regression for credit class 3 not only shows a negative slope, but has the largest standard deviation: results such as this may be expected, as returns for these lower-graded preferred will vary with a much greater reliance on the perception of the parent company, rather than due to any intrinsic qualities of their implied cash flows (which are less certain in any event, given credit considerations). It is for this reason that Malachite Aggressive Preferred Fund (and Hymas Investment Management in general) prefers to avoid issues of this quality in order to concentrate analysis on cash flow and overall yield curve considerations.

It should also be noted that regression analysis is a very blunt instrument to use in the course of securities selection, and while these data tend to confirm actual research, they do not form any part of the actual analysis. The research approach used recognizes that while “cheap” instruments should outperform “expensive” ones, there is no certainty as to how long this will take – each instrument varies in desirability vs. its peers at its own pace and no definite time limit, as is implied by the one month term in the above analysis, is appropriate.

TSE Ticker Symbol	Total Return, December, 2002	Remarks (Valuation commentary based on Ontario’s highest marginal tax rate)
BNN.PR.A*	-19.20%	Tiny volume, frequent dramatic shifts in quoted price
BPP.PR.M	-7.81%	Credit class 3, floating rate, very low volume
BBD.PR.B*	-7.63%	Floating rate exchangeable issue, MAPF holds, cheap at \$14.41
BPP.PR.J	-5.71%	Credit class 3, floating rate, very low volume
NTL.PR.F*	-5.34%	Extremely volatile, but a good alternative to the common stock
...	...	...
BNN.PR.H	+3.94%	Retractable, expensive at \$26.50
W.PR.J	+4.06%	Redeemable perpetual issue, expensive at \$24.55
NSI.PR.D	+5.93%	Low volume, very expensive at \$27.90
NSI.PR.C	+8.38%	Low volume, very expensive at \$27.00
MMF.PR.A*	+8.76%	Low volume, expensive at \$21.20
*indicates that the issue was also on last month’s best/worst performers table		

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# Universe Properties as of 2002-11-29

Tax Identifier: 7

X-Axis: Accrued Dividend Proportion (Zero-Based)

Y-Axis: Performance

