

MALACHITE AGGRESSIVE PREFERRED FUND

Monthly Report, May 2003

The fund recorded a return of +4.56% in May, continuing the excellent returns recorded in April. Performance greatly exceeded that indicated by the benchmark index, a turn of events that was particularly noteworthy in that the Bombardier shares held by the fund, which have been discussed to the point of weariness in these reports, actually underperformed the rest of the portfolio (although they, too, greatly outperformed the index!). Thus, the fund's outperformance can be ascribed to security selection and trading in general, without these accretive advantages being swamped on a monthly basis by the enormous volatility the Bombardier shares have shown since last summer.

Month	MAPF Total Return*	NB-50 Total Return	
June, 2002	+1.67%	+0.67%	<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>
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%	
January, 2003	+7.10%	+0.46%	
February	-0.57%	-0.43%	
March	-4.54%	-0.18%	
April	+6.84%	+1.01%	
May, 2003	+4.56%	+1.99%	
Last 12 Months	+6.49%	+7.84%	
Since Inception (March, 2001)	+25.11%	+8.75%	
<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 were a number of redemptions in May, mainly of US Dollar denominated issues (N.PR.U, RY.PR.V and TD.PR.U) but some Canadian Dollar issues were also called by their issuers (RY.PR.J and PWF.PR.C). With Current Yields of these issues (based on the redemption price) of 5.39%, 6.3%, 5.4% (USD), 7.1% and 7.0% (CAD), respectively, it is certainly not surprising that the issues were called.

The Bid-Yield-To-Worst (BYW) of the RY.PR.J issue for the past year is featured in this month's chart and compared to RY.PR.S. While the price of the former issue declined fairly steadily throughout the period (as the initial premium due to the high dividend was amortized), it is clear from the level of the BYW (fluctuating about 1% after tax – and going negative for some periods) that the redemption came as something of a surprise to many investors. It is clear that careful quantitative analysis of preferred shares, as offered by Hymas Investment Management Inc., is in somewhat short supply!

The base rate of the yield curve continued to decline in May, as the enormous rise in bond prices trickled down into the Preferred marketplace. This decline, of 24 basis points as measured on an after-tax basis, resulted in a very good month for preferred shares in general, with the NB-50 index returning 1.99% (pre-tax), its best performance since January 2002 (and was only worse by a whisker –

performance in that month was +2.01% - to find performance significantly in excess of this figure, one must return to March, 2000, with its pre-tax return of +3.64%). With the rise in prices came a decline in the premium prices bid for retractible issues as, perhaps, investors became less concerned about the ability to receive par value for their holdings and more convinced that call options will be exercised before retraction privileges become effective.

Curve Attribute	April 30, 2003 (After Tax Figures)	May 30, 2003 (After Tax Figures)
Base Rate	3.42%	3.18%
Short Term Premium	-3.56%	-3.44%
Short Term Decay Time	5.3 Years	5.9 Years
Long Term Premium	1.59%	1.18%
Long Term Decay Time	11.1 Years	11.3 Years
Interest Income Spread	0.61%	0.54%
Cumulative Div. Spread	-0.17%	-0.13%
Split-Share Spread	0.77%	0.83%
Retractability Spread	-0.64%	-0.55%
Floating Rate Spread	-0.97%	-0.86%
2 nd Tier Credit Spread	0.39%	0.35%
3 rd Tier Credit Spread	1.61%	1.58%
“High” Credit Spread	-0.17%	-0.05%
“Low” Credit Spread	0.13%	0.22%
<i>Note: Figures for April have changed somewhat from the previous report. This is due to additions of data.</i>		
<i>Note: Figures are reported on an after-tax basis, for an investor subject to Ontario’s highest marginal tax rate.</i>		

The recent decline in measured inflation, together with speculation (now confirmed as of June 6) of a European rate cut, have caused market expectations of further bank-rate increases in Canada to become less certain. This has resulted not only in a decline in the premium paid for floating-rate issues, but has led to quite marked underperformance by floating rate issues, some of which have become quite attractive on a risk-adjusted potential return basis.

It may also be seen from the comparison of returns by risk-factor that retractible issues

Risk Factor	Returns for “True” (Pre-Tax)	Returns for “False” (Pre-Tax)
Retractable	+2.40%±2.13%	+2.97%±2.97%
Split Share Corp	+3.12%±2.79%	+2.56%±2.50%
Cumulative Dividends	2.45%±2.92%	2.97%±1.91%
Payments are Dividends	2.71%±2.66%	2.04%±0.74%
Floating Rate	1.74%±3.03%	2.98%±2.30%
Credit Class 2	2.16%±2.05%	3.13%±2.90%
Credit Class 3	3.32%±3.86%	2.52%±2.16%
Credit Class Modifier “High”	2.81%±2.62%	2.63%±2.55%
Credit Class Modifier “Low”	2.45%±2.28%	2.85%±2.78%

underperformed during the month, reinforcing the view outlined above, that with the increase in prices, the market is putting less of a premium on the ability to receive par value at some point in the future for share-holdings

and, perhaps, more convinced that issuer’s embedded call options will be exercised first in any event.

As an adjunct to this month's chart comparing the Bid-Yield-to-Worst of RY.PR.J and RY.PR.S, it is interesting to consider the changes in the analysis of the call probabilities for the latter issue since year-end. This issue is callable at declining prices commencing in 2006 – the analysis engaged in by Hymas Investment Management Inc. uses an approach based on Black-Scholes option pricing theory to determine the probabilities of calls at the various dates of interest in order to be able to consider the issue as a portfolio of issues with known maturity dates – the characteristics of the components of this portfolio, particularly the weights, vary with time and the price of the issue.

Call Date	Call Price	Evaluation 02-12-31, Price \$27.00		Evaluation 03-05-30, Price \$28.05	
		Yield (After Tax)	Probability	Yield (After Tax)	Probability
2006-08-24	\$26.00	3.32%	49.25%	2.10%	61.82%
2007-08-24	\$25.75	3.32%	2.48%	2.36%	1.22%
2008-08-24	\$25.50	3.33%	2.36%	2.53%	1.40%
2009-08-24	\$25.25	3.33%	2.35%	2.65%	1.57%
2010-08-24	\$25.00	3.34%	2.39%	2.74%	1.75%
Further Future	\$25.00	3.85%	41.17%	3.57%	32.24%

It may easily be seen that the rise in price of this issue over the past five months has, in accord with intuition, decreased the yield of the Yield-to-Worst scenario while raising its probability in the analysis. It should also be noted that this reflects a great strength of the analytical methodology created by Hymas Investment Management Inc.: most attempts at a quantitative analysis, when performed at all, will only consider the yield-to-worst (or yield-to-first-call) scenario, although there is clearly more certainty that such options will be exercised when the issue trades at higher prices above the call price. Note also that the Yield-to-Worst is used in the final valuation of the instrument, as is the weighted average of the various derived yields (the "Portfolio Yield"), among other measures of yield, and the reliability of each measure as a predictor of future relative returns determined through simulation of portfolios using market data with no "look-ahead" capability.

TSE Ticker Symbol	Total Return, May 2003	Remarks (Valuation commentary based on Ontario's highest marginal tax rate)
BPP.PR.G	-4.85%	Credit class 3, floating rate issue, very low volume
BNF.PR.C	-1.68%	Credit class 3, floating rate issue, small volume, inexpensive at \$17.60
BNF.PR.A	-1.58%	Credit class 2, floating rate issue, OK volume, inexpensive at \$18.70
IPS.PR.A	-1.23%	Credit class 3, slightly downgraded by DBRS in early June.
YLD.PR.A	-0.93%	Credit class 2, split-share issue
...	...	
NTL.PR.G*	+10.20%	The recovery of the Nortel Floating Rate Issues ...
NTL.PR.F	+10.62%	... continues to astound!
STQ.E	+10.80%	Credit class 3, split-share issue
BT.PR.E	+11.25%	Credit class 3, fixed rate, very low volume, expensive at \$21.75
BBD.PR.C*	+11.42%	Credit class 3, fixed rate, good volume, expensive at \$22.35

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R.Y.PR.J Period (inclusive) from 2002-05-31 to 2003-05-23

Tax Identifier: 7

R.Y.PR.S

X-Axis: Date

Bid Yield-To-Worst : Spot Rate

Y-Axis: Yield as Fraction

