

MALACHITE AGGRESSIVE PREFERRED FUNDMonthly Report, September 2004

The fund finished another quarter of outperformance with a return in September of +0.88%, ahead of the index which returned +0.47%. Total return for the quarter was an entirely satisfactory +4.73%, handily outperforming the index which returned only +2.27%. It should be noted that the fund has achieved its performance while investing solely in high quality preferred shares and securities.

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>
October, 2003	+0.84%	+0.26%	
November	+1.99%	+0.35%	
December, 2003	+2.42%	+1.32%	
January, 2004	+2.03%	+1.74%	
February	+1.95%	+0.62%	
March	+2.57%	+0.83%	
April	-4.49%	-3.23%	
May	+1.23%	-0.02%	
June	+1.49%	+0.86%	
July	+2.51%	+1.39%	
August	+1.27%	+0.40%	
September, 2004	+0.88%	+0.47%	
Last 12 Months	+15.52%	+5.01%	
Last Two Years (annualized)	+23.44%	+6.11%	
Last Three Years (annualized)	+13.19%	+5.17%	
Since Inception (March, 2001)	+61.34%	+16.89%	
<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%
1Q03	+1.65%	-0.15%
2Q03	+14.24%	+3.85%
3Q03	+9.16%	+1.53%
4Q03	+5.34%	+1.94%
1Q04	+6.70%	+3.21%
2Q04	-1.87%	-2.41%
3Q04	+4.73%	+2.27%

Yield curve spreads were relatively quiescent during the month, the most notable exception to this rule being the continued tightening of the “retractability spread” which moved to –92 bp from the prior month’s level of –76bp. As has been noted in earlier reports, this tightening indicates that investors are expecting a hostile interest rate environment for preferred shares, but for the spread to exist at this level seems well beyond the bounds of reason.

It was also interesting to see the floating rate spread “widen” from August’s -128bp to a level of –120bp – this despite a 25bp in the (pre-tax) floating rate used in computation of the spreads. As may be seen from the table of

risk-factors vs. returns, floating rate issues significantly underperformed their peers during September, a trend which may be expected to continue as spreads should move to more rational levels.

Curve Attribute	August 31, 2004 (After Tax Figures)	September 30, 2004 (After Tax Figures)
Base Rate	3.11%	3.11%
Short Term Premium	-3.28%	-3.11%
Short Term Decay Time	4.6 Years	5.1 Years
Long Term Premium	1.35%	1.80%
Long Term Decay Time	20.5 Years	16.7 Years
Interest Income Spread	1.10%	1.25%
Cumulative Div. Spread	-0.26%	-0.28%
Split-Share Spread	0.47%	0.48%
Retractability Spread	-0.76%	-0.92%
Floating Rate Spread	-1.28%	-1.20%
2 nd Tier Credit Spread	0.23%	0.23%
3 rd Tier Credit Spread	0.57%	0.61%
“High” Credit Spread	-0.23%	-0.23%
“Low” Credit Spread	0.00%	0.00%
<i>Note: Figures for August 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)	Regression Coefficient*
Retractable	0.52%±1.31%	-0.03%±2.21%	+0.45%
Split Share Corp	0.29%±1.64%	0.25%±1.87%	+0.52%
Cumulative Dividends	0.32%±2.16%	0.16%±1.05%	+0.39%
Payments are Dividends	0.17%±1.85%	1.44%±0.72%	-0.81%
Floating Rate	-0.11%±2.36%	0.37%±1.59%	-0.59%
Credit Class 2	0.60%±1.13%	-0.11%±2.29%	+0.05%
Credit Class 3	0.12%±2.80%	0.29%±1.49%	+0.61%
Credit Class Modifier “High”	0.64%±0.80%	0.16%±2.00%	+0.80%
Credit Class Modifier “Low”	0.35%±2.02%	0.20%±1.67%	+0.73%
<i>*This is the coefficient produced by a multi-linear regression of monthly return vs. all risk factors – not just those reported here. R-Squared is 0.4367 after rejection of outliers.</i>			

As has been noted in previous reports, the Hymas Investment Management analytical system considers several different kinds of yield as part of the evaluation of preferred shares:

- **Current Yield:** The indicated dividend divided by the current price. No allowance is made for embedded options. Not surprisingly, this measure of yield has been determined to be of no value when evaluating preferred shares.
- **Yield-to-worst:** Commonly used within the industry, this measure is determined by considering the option exercise that will have the worst effect on the investor. While valuable and most conservative, this measure assigns a probability of 100% to the worst-case scenario, which is no more justifiable than the 0% assigned by the “current yield” method.
- **Portfolio Yield:** A proprietary measure that considers each instrument to be a portfolio of instruments, each element of the portfolio reflecting a possible option exercise. Weights of the elements are determined using proprietary statistical methods. The measure has some value, but is not as useful as:
- **Cost Yield:** In this proprietary technique, each instrument is considered to have a maturity at the point where option exercise is deemed to be a certainty, the actual maturity date of the instrument, or a deemed maturity thirty years in the future. The potential for option exercise is reflected as cash flows superimposed upon the normal dividend / tax / maturity cash flow schedule and the internal yield calculated from the union of these expectations.
- **Curve Yield:** This proprietary measure seeks to refine the costing of potential option exercise as approximated in the “cost yield” method, by considering the replacement value of the cash flows that will be lost thereby. This refinement is of limited utility.

This month’s graph plots “cost yield” against “yield-to-worst”, these having been found to be the most useful measures. The correlation coefficient, R-squared, is slightly below 50% with all data (of issues considered purchasable) taken into account.

TSE Ticker Symbol	Total Return, September 2004	Remarks (Valuation commentary based on Ontario’s highest marginal tax rate)
BBD.PR.C*	-10.34%	Bombardier’s woes continue ...
BBD.PR.D*	-6.06%	... will it be downgraded from its current DBRS Pfd-3(low) rating?
NTL.PR.F	-6.00%	Will Nortel ever publish its financial statements?
YLD.PR.B*	-5.91%	Still in default.
NTL.PR.G	-5.02%	Will Nortel’s financial statements have credibility once published?
...
BNN.PR.T	+3.28%	Brascan issues did very well in September ... its preferred securities...
BNF.PR.A	+3.56%	... its financial arm ...
BNA.PR.A	+3.93%	... a split share corporation holding its shares ...
BPP.PR.J	+4.77%	Floating rate, expensive at 24.15 – 24.25
BNN.PR.B	+5.12%	... and Brascan’s preferred shares ... all anticipating selling Noranda!
*indicates that the issue was also on last month’s best/worst performers table		

James Hymas
Portfolio Manager

Universe Properties as of 2004-09-30 (Purchaseable)

Tax Identifier: 7

Credit Class One
Credit Class Two
Credit Class Three

X-Axis: Yield-to-Worst (at Bid)
Y-Axis: YTM (Cost Method) at Bid

