MALACHITE AGGRESSIVE PREFERRED FUND

Monthly Report, August 2003

August was another very good month for the fund, with a total gain of +2.26% greatly outperforming the index gain of only 0.52%. Trading was relatively quiet, but those trades that did become possible during the month added greatly to the returns enjoyed by the fund – a situation often encountered in both August and the latter half of December, as the lack of liquidity makes trades harder to accomplish, but also increases the volatility of prices which makes certain swaps attractive.

Month	MAPF Total Return*	NB-50 Total Return
September, 2002	- 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	+4.56%	+1.99%
June	+2.27%	+0.81%
July	+3.54%	-0.30%
August, 2003	+2.26%	+0.52%
Last 12 Months	**+18.37%**	**+6.41%**
Last 2 Years (annualized)	**+12.63%**	**+4.82%**
Total Since Inception (March, 2001)	**+35.46%**	**+9.87%**

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.

**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.*

There was very little activity in the market originating from the issuers, which is no great surprise. The Canadian Imperial Bank of Commerce redeemed the $200-million issue of CM.PR.L at the start of the month and has announced (on September 4) a $300-million new issue of perpetuals which will bear a coupon of 5.60% ($1.40 annually on a par value of $25). This conjunction of events is of some interest, since the redeemed issue had a coupon of 5.95% ($1.4875 annually on a par value of $25), was redeemed at $26, was retractible July 31, 2006 (into common shares, with a value for analytical purposes of $26.04) and became redeemable at $25.00 commencing July 31, 2005.

There are a number of interesting observations to be made about this pair of transactions:

- **The redemption could have been delayed.** By waiting for two more years, the bank could have reduced the redemption price by $1.00, meaning that the effective coupon in the interim was only about 4%. Note, however, that the bank would be paying this coupon with after-tax profits and that marketable CIBC debentures with a term of 2.5 years are quoted with an ask yield of 3.75% - with the coupon paid with pre-tax funds. Clearly, this issue was expensive to redeem relative to the preferred share market, but was even more expensive relative to alternative funding for the bank.
- **The funds are being replaced with a perpetual issue.** As the bank has no obligation to repay the issue price, it is entitled to consider the funds received as equity for capital-ratio purposes. However, since the redeemed issue was only retractable by conversion into common, this aspect of the pair of transactions is a wash. It would appear that the bank does not wish to issue new common equity, or to deal with the uncertainty inherent in granting the holders a retraction privilege.
- **A conversion into common would be dilutive to the current shareholders.** The issue redeemed had a coupon of 5.95%. Division by 0.95 (as conversion is at a 5% discount to market) gives an equivalent "cost" to extant shareholders of about 6.25%. This in turn corresponds to a P/E ratio on issuance of about 16, somewhat below the current P/E on the common stock of 16.3.

There were clearly many factors involved in the decision to undertake this pair of transactions! Hymas Investment Management considers only the internal consistency of the preferred share market and usually avoids such quagmires by purchasing only issues for which a lengthy period of time exists prior to possible redemption dates.

Curve Attribute	July 31, 2003 (After Tax Figures)	August 29, 2003 (After Tax Figures)
Base Rate	3.32%	3.25%
Short Term Premium	-3.32%	-3.31%
Short Term Decay Time	4.9 Years	4.2 Years
Long Term Premium	0.51%	0.41%
Long Term Decay Time	11.6 Years	15.0 Years
Interest Income Spread	0.59%	0.68%
Cumulative Div. Spread	-0.31%	-0.36%
Split-Share Spread	0.84%	0.96%
Retractability Spread	-0.45%	-0.53%
Floating Rate Spread	-0.92%	-0.93%
2nd Tier Credit Spread	0.42%	0.43%
3rd Tier Credit Spread	1.45%	1.32%
"High" Credit Spread	-0.13%	-0.05%
"Low" Credit Spread	0.19%	0.23%
Note: Figures for July have changed somewhat from the previous report. This is due to additions of data.		
Note: Figures are reported on an after-tax basis, for an investor subject to Ontario's highest marginal tax rate.		

Of particular interest in considering these transactions is the fact that there is another CIBC issue, CM.PR.M, which has virtually the same terms as the redeemed CM.PR.L issue, shifted by one year – becoming redeemable at $26.00 on July 31, 2004. On August 29, CM.PR.M was quoted with a bid price of $26.60 (and a coupon of 5.65% on a par-value of $25.00), resulting in

Risk Factor	Returns for "True" (Pre-Tax)	Returns for "False" (Pre-Tax)
Retractable	0.64%±1.48%	1.06%±1.53%
Split Share Corp	0.84%±1.54%	0.83%±1.51%
Cumulative Dividends	1.03%±1.54%	0.54%±1.44%
Payments are Dividends	0.85%±1.57%	0.64%±0.64%
Floating Rate	1.13%±1.82%	0.74%±1.39%
Credit Class 2	0.63%±1.39%	1.03%±1.61%
Credit Class 3	1.92%±1.66%	0.63%±1.40%
Credit Class Modifier "High"	0.96%±1.45%	1.19%±1.53%
Credit Class Modifier "Low"	0.43%±1.26%	1.19%±1.64%

a yield-to-worst of only 2.16% (after tax, Ontario investor in the highest marginal tax bracket). There are many better issues available, one of them being CM.PR.R – which has a yield-to-worst of 2.95% (after tax, consistent calculation with previous figure) if redeemed at $25.00 in April 2013. This was the worst performing issue in August, which boosted its attractiveness. The fund has not (yet!) purchased this issue, due largely to the fact that the issue's trading volume is slightly below desirable levels – but $26.35 is an attractive price for this issue for an investor looking for a strong credit and for whom institutional-level liquidity is not a major concern.

In view of the discussion of the redemption of the CIBC issues, it is interesting to look at recent trends in the retractibility premium derived from yield curve analysis. This premium measures the amount investors are willing to pay, in terms of an after-tax yield give-up, in order to hold retractible issues and is calculated after accounting for the most probable cashflows according to Hymas Investment Management methodology. The premium declined for most of this year … these issues were extremely expensive in January but became steadily cheaper until mid-July. This trend appears to have reversed – perhaps an indication that investors are expecting generally higher interest rates, perhaps merely an indication that at current price levels, investors are not so interested in embedded options to retract.

TSE Ticker Symbol	Total Return, August 2003	Remarks (Valuation commentary based on Ontario's highest marginal tax rate)
CM.PR.R	-2.95%	Inexpensive at $26.35
BNN.PR.A*	-2.31%	Vanishingly low volume – not recommended
CM.PR.T	-2.12%	Non-institutional liquidity, but attractive at $27.65
BNN.PR.I	-1.74%	Non-institutional liquidity, but attractive at $26.04
STQ.E	-1.70%	DBRS Downgraded from PFD-3 (low) to PFD-4 in June 2003
…	…	…
BBD.PR.D*	+4.20%	Investors are coming to believe Bombardier is a going concern!
BNA.PR.A	+4.25%	Credit class 2, very expensive at $26.46
BT.PR.E	+4.60%	Tiny liquidity, expensive at $22.75
NRD.PR.G	+4.68%	Credit class 3, expensive at $24.15
NTL.PR.F	+5.00%	Nortel may also be a going concern!
**Indicates issue was also listed in July's Best/Worst Returns list.*		

James Hymas
Portfolio Manager

Yield Curve Data : Period (inclusive) from 2002-08-30 to 2003-08-29

Tax Identifier: 7

X-Axis: Date

PREMIUM - RETRACTIBLE : Spot Rate   Y-Axis: Yield as fraction (positive implies cheaper th