

MALACHITE AGGRESSIVE PREFERRED FUND

Monthly Report, January 2004

January was another fine month for the fund, with a gain of +2.03% marking the tenth consecutive month of positive returns by the fund, compared with index performance of +1.72%. This was also the tenth consecutive month in which the fund outperformed the index. This has been a very good run but clients should be aware that there is an element of risk in all investments and all an investment manager can do is improve the chances for success – there are no guarantees. The fund traded its portfolio actively during the month, in part due to the decision to sell the fund’s holdings in Bombardier Preferreds. This decision was made since the expected future total return on these shares has declined to the point at which it is worthwhile to realize the profits in order to free up the capital to take positions which have a greater chance of price appreciation – and in January there are 15 months to go until clients must pay the resultant capital gains tax.

Month	MAPF Total Return*	NB-50 Total Return	
February, 2003	-0.57%	-0.43%	<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>
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	+2.26%	+0.52%	
September	+3.10%	+1.31%	
October	+0.84%	+0.26%	
November	+1.99%	+0.35%	
December, 2003	+2.42%	+1.32%	
January, 2004	+2.03%	+1.72%	
Last 12 Months	+27.22%	+8.67%	
Last 2 Years (annualized)	+14.34%	+5.70%	
Total Since Inception (March, 2001)	+50.11%	+15.42%	
<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>			

While the Bombardier preferreds have performed well since the initial purchase of the name in July, 2002, their presence in the portfolio will not be missed. Market over-reactions to headlines made the value of the position extremely volatile while being too undervalued to be sold and, more importantly, their credit rating was lower than normally considered for the portfolio. In sum, however, they performed well and allowed the

deferral of capital gains tax since a swap between Bombardier issues at a point near their lows realized a capital loss for 2002, making no capital gains distributable for that year and reducing the distribution for 2003 despite gains throughout the rest of the portfolio and unrealized gains on the position.

The preferred share market as a whole has been performing well in recent months and most issues are now trading above their retraction price – this has been put forward as a possible reason why the “retractibility premium” on the yield curve has been declining and has reached -0.59% as of the end of January.

There is a certain logic to this behaviour – most investors focus exclusively on the potential for gains when making investment choices in the stock market, since those for whom limiting losses is a primary concern will stick to bank savings accounts and GIC’s since the losses there – in terms of buying power lost to

Curve Attribute	December, 2003 (After-tax figures)	January, 2004 (After-tax figures)
Base Rate	3.10%	3.00%
Short Term Premium	-3.15%	-3.09%
Short Term Decay Time	4.1 Years	4.6 Years
Long Term Premium	+0.48%	+0.48%
Long Term Decay Time	20.2 Years	22.4 Years
Interest Income Spread	1.04%	1.09%
Cumulative Div. Spread	-0.26%	-0.33%
Split-Share Spread	0.76%	0.88%
Retractability Spread	-0.60%	-0.59%
Floating Rate Spread	-1.10%	-1.19%
2 nd Tier Credit Spread	0.32%	0.38%
3 rd Tier Credit Spread	0.98%	1.00%
“High” Credit Spread	-0.08%	-0.12%
“Low” Credit Spread	0.13%	0.15%
<i>Note: Figures for December 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>		

Risk Factor	January 2004 Returns for “True” (Pre-Tax)	January 2004 Returns for “False” (Pre-Tax)
Retractable	1.24%±2.41%	2.81%±9.95%
Split Share Corp	1.64%±3.36%	2.06%±7.70%
Cumulative Dividends	2.46%±8.96%	1.25%±1.97%
Payments are Dividends	2.08%±7.39%	0.77%±0.80%
Floating Rate	2.29%±3.59%	1.88%±7.94%
Credit Class 2	0.87%±1.55%	3.26%±10.12%
Credit Class 3	1.88%±2.27%	2.01%±7.85%
Credit Class Modifier “High”	1.36%±1.43%	2.21%±8.26%
Credit Class Modifier “Low”	0.88%±1.44%	2.60%±8.77%

inflation, income lost to taxes and opportunity costs – are relatively invisible.

From the standpoint of Hymas Investment Management Inc., the presence of a retraction feature as an embedded

option is best modeled as a means whereby the cash flows of an instrument can be predicted with greater certainty: in almost all instances, a redemption privilege exists for the issuer at the time that the retraction feature for the holder becomes effective and

exercise of this redemption feature will result in a reduced return for the holder. Therefore, with the conservatism that has been built into the model throughout its workings, it is presumed that the issuer will exercise such an option prior to the retraction becoming effective. Therefore for analytical purposes, the instrument has an effective maturity date immediately prior to possible retraction, although of course the issue may be redeemed sooner. This provides greater certainty in the modeling of the predicted cash-flows from the issue – and modeling of cash flows underlies the investment philosophy.

This greater certainty is quantified through a parameter dubbed “optionDoubt” which examines the range of possible maturities of the instrument in question and their attendant probabilities of exercise. “optionDoubt” is the weighted standard deviation of these maturities in terms of years and a penalty is applied to the valuation of the instrument as determined by other measures at the time of trade. It is plainly apparent that the minimum value for “optionDoubt” is zero, for an instrument with one definite maturity date and no significant chance of embedded option exercise prior to that date.

Regression Result – Option Doubt vs. Retractable	January 31, 2003	January 30, 2004
Intercept (Zero = not retractible, One = retractible)	8.1	9.7
Slope – Credit Class 1	-7.1	-8.5
Slope – Credit Class 2	-5.2	-6.7
Slope – Credit Class 3	-5.1	-6.9
R-Squared	0.40	0.58

The table to the left shows the results of a regression of “Option Doubt” vs. “Retractable”, which is the topic of this month’s graph. “Option Doubt” is very much smaller for retractible issues, in general, than for non-retractibles and that the simple

question of retractibility accounts for a great deal of the variance observed in this attribute.

TSE Ticker Symbol	Total Return, January 2004	Remarks (Valuation commentary based on Ontario’s highest marginal tax rate)
W.PR.K	-3.61%	Retractable, short duration, low volume, Credit Class 2
GWO.PR.D	-3.23%	Retractable, short duration, low volume, Credit Class 2
STQ.E*	-2.52%	Retractable (due to maturity), Split Share, Credit Class 4
BNF.PR.A*	-2.11%	Perpetual, Floating Rate, Credit Class 2, expensive at \$23.20-25
DIV.PR.A	-1.81%	Retractable, Split-Share, Credit Class 2, potentially very short term
...
BPP.PR.G	+10.66%	Perpetual, Floating Rate, Credit class 3
NTL.PR.F	+12.74%	Nortel continues to perform ...
NTL.PR.G	+13.77%	... admirably!
YLD.PR.B	+15.13%	In default – but some seem to think not for much longer!
AR.PR.B*	+83.65%	Proposed Hollinger sale and preferred redemption resurrects Argus!
<i>*Indicates issue was also listed in December’s Best/Worst Returns list.</i>		

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Universe Properties as of 2004-01-30

Tax Identifier: 7

X-Axis: Retractable

Y-Axis: Option Doubt

