



Financial Statements

# **Marret IGB Trust**

December 31, 2010

## Marret IGB Trust - Annual Report 2010

### Statements of Net Assets

As at	December 31 2010	December 31 2009
<b>Assets</b>		
Investments, at fair value (note 11)	\$ 394,762,109	\$ 388,781,572
Cash and cash equivalents	50,874	758,362
Cash margin on swaps	507,246	-
Accrued interest receivable	5,342,721	4,308,986
Unrealized gain on foreign forward currency contracts (note 4)	377,341	-
<b>Total assets</b>	<b>401,040,291</b>	<b>393,848,920</b>
<b>Liabilities</b>		
Due to broker (note 6)	52,974,496	65,245,063
Investment - short position, at fair value (note 11)	33,068,572	2,882,775
Interest payable, short position	170,731	8,784
Accrued liabilities	135,512	145,974
Unrealized loss on credit default swap agreement (note 5)	158,639	-
<b>Total liabilities</b>	<b>86,507,950</b>	<b>68,282,596</b>
<b>Net Assets representing unitholder's equity</b>	<b>\$ 314,532,341</b>	<b>\$ 325,566,324</b>
<b>Units outstanding (note 7)</b>	<b>25,113,067</b>	<b>27,101,368</b>
<b>Net Assets per unit (note 3)</b>	<b>\$ 12.52</b>	<b>\$ 12.01</b>

Approved on behalf of the Trustee, Marret Asset Management Inc.

(signed)

(signed)

Barry Allan  
President & Chief Executive Officer

Marcus Spain  
Chief Financial Officer

See accompanying notes which are an integral part of these financial statements.

## Marret IGB Trust - Annual Report 2010

### Statements of Operations

For the year ended	December 31 2010	December 31 2009 <sup>(1)</sup>
<b>Income</b>		
Interest income	\$ 22,721,315	\$ 3,465,361
Loss from credit default swaps	(149,315)	-
<b>Total income</b>	<b>22,572,000</b>	<b>3,465,361</b>
<b>Expenses</b>		
Management fees (note 8)	1,383,244	246,176
Audit fees	19,837	13,125
Custodial fees	30,114	19,366
Legal fees	-	2,977
Regulatory fees	-	419
Interest expense	527,227	3,368
Securities borrowing fees	85,921	-
Interest expense, short positions	969,583	30,267
<b>Total expense</b>	<b>3,015,926</b>	<b>315,698</b>
<b>Net investment income / (loss)</b>	<b>19,556,074</b>	<b>3,149,663</b>
<b>Realized and unrealized gain (loss) on investments</b>		
Net realized gain / (loss) on sale of investments	448,247	801,706
Net realized gain / (loss) on credit default swaps	(199,191)	-
Net realized gain / (loss) on foreign forward currency contracts	(30,370)	-
Net realized gain / (loss) on foreign currency	1,743,099	(226,383)
Change in unrealized appreciation / (depreciation) on investments	10,543,179	(1,900,338)
Change in unrealized appreciation / (depreciation) on credit default swaps	(158,639)	-
Change in unrealized appreciation / (depreciation) on foreign forward currency contracts	377,341	-
Change in unrealized appreciation / (depreciation) on foreign currency	(175,799)	272,676
<b>Realized and unrealized gain (loss) on investments</b>	<b>12,547,867</b>	<b>(1,052,339)</b>
<b>Increase / (decrease) in net assets from operations</b>	<b>\$ 32,103,941</b>	<b>\$ 2,097,324</b>
<b>Increase / (decrease) in net assets from operations per unit<sup>(2)</sup></b>	<b>\$ 1.19</b>	<b>\$ 0.08</b>

<sup>(1)</sup> For the period from October 23, 2009, date of commencement, to December 31, 2009.

<sup>(2)</sup> Based on the weighted average number of units outstanding for the period.

See accompanying notes which are an integral part of these financial statements.

## Marret IGB Trust - Annual Report 2010

### Statements of Changes in Net Assets

For the year ended	December 31 2010	December 31 2009 <sup>(1)</sup>
<b>Net Assets, beginning of year</b>	\$ 325,566,324	\$ -
<b>Operations:</b>		
Increase / (decrease) in net assets from operations	32,103,941	2,097,324
<b>Unitholder transactions:</b>		
Distribution to unitholders		
Net investment income	(31,753,813)	(3,720,600)
Proceeds from issuance of units	-	325,269,000
Reinvested distribution	13,203,813	1,920,600
Payments on redemption of units	(24,587,924)	-
Total unit transaction	(43,137,924)	323,469,000
<b>Increase / (decrease) in Net Assets</b>	<b>(11,033,983)</b>	<b>325,566,324</b>
<b>Net Assets, end of year</b>	<b>\$ 314,532,341</b>	<b>\$ 325,566,324</b>

<sup>(1)</sup> For the period from October 23, 2009, date of commencement, to December 31, 2009.

See accompanying notes which are an integral part of these financial statements.

## Marret IGB Trust - Annual Report 2010

### Statements of Cash Flows

For the year ended	December 31 2010	December 31 2009 <sup>(1)</sup>
<b>Cash flows provided by operating activities:</b>		
Net investment income / (loss)	\$ 19,556,074	\$ 3,149,663
Proceeds from settlement of foreign currency and foreign forward currency contracts	1,536,930	46,293
Proceeds from settlement of credit default swaps	(199,191)	-
Proceeds from investments	905,326,726	212,235,386
Proceeds from investments in short positions	875,075,873	68,155,615
Purchase of investments	(899,331,459)	(602,185,330)
Purchase of investments to cover short positions	(845,874,454)	(65,203,100)
Net change in working capital	(1,389,496)	(4,154,228)
<b>Cash used in operating activities</b>	<b>54,701,003</b>	<b>(387,955,701)</b>
<b>Cash flows used in financing activities:</b>		
Change in due to broker	(12,270,567)	65,245,063
Proceeds from issuance of units	-	325,269,000
Distributions paid to unitholders	(18,550,000)	(1,800,000)
Payments on redemption of units	(24,587,924)	-
<b>Cash provided by financing activities</b>	<b>(55,408,491)</b>	<b>388,714,063</b>
<b>Net increase in cash and cash equivalents</b>	<b>(707,488)</b>	<b>758,362</b>
<b>Cash and cash equivalents, beginning of the year</b>	<b>758,362</b>	<b>-</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 50,874</b>	<b>\$ 758,362</b>
<b>Supplemental Information</b>		
Cash paid for interest	527,227	3,368
Cash interest paid on short positions	807,636	21,483

<sup>(1)</sup> For the period from October 23, 2009, date of commencement, to December 31, 2009.

See accompanying notes which are an integral part of these financial statements.

## Marret IGB Trust - Annual Report 2010

### Statement of Investment Portfolio

As at December 31, 2010

Par Value		Average Cost (\$)	Fair Value (\$)
<b>Canadian Bonds</b>			
3,000,000	Alliance Pipeline L.P., Callable, 4.928%, 2019/12/16	3,000,000	3,099,275
10,000,000	American Express Canada Credit Corp., 4.853%, 2014/10/03	10,102,200	10,507,867
15,000,000	Bell Aliant Regional Communications L.P., Callable, 5.520%, 2019/02/26	14,986,500	15,535,362
20,000,000	Bell Canada, Series 'M-17', Callable, 6.100%, 2035/03/16	18,602,750	20,322,840
3,000,000	Cameco Corp., Series 'D', Callable, 5.670%, 2019/09/02	3,127,440	3,212,726
5,000,000	Canadian Pacific Railway Co., Callable, 6.450%, 2039/11/17	5,096,680	5,420,169
16,500,000	Citigroup Finance Canada Inc., 4.350%, 2013/03/08	16,515,973	16,820,966
9,500,000	Cogeco Cable Inc., Callable, 5.950%, 2014/06/09	10,126,650	10,238,836
3,500,000	Cogeco Cable Inc., Callable, 5.150%, 2020/11/16	3,493,245	3,474,983
14,000,000	Consumers' Waterheater Operating Trust (The), Callable, 5.250%, 2013/03/15	14,000,560	14,117,849
15,000,000	Co-Operators Financial Services Ltd., Callable, 5.778%, 2020/03/10	14,994,300	15,018,443
16,000,000	First Capital Realty Inc., Series 'H', Callable, 5.850%, 2017/01/31	16,037,120	16,850,639
15,000,000	First National Financial Income Fund, Series 'I', Callable, 5.070%, 2015/05/07	15,000,000	15,208,454
10,000,000	Groupe Aeroplan Inc., Callable, 9.000%, 2012/04/23	10,676,000	10,582,931
1,900,000	Groupe Aeroplan Inc., Series '2', Callable, 7.900%, 2014/09/02	1,976,000	2,050,630
13,000,000	Husky Energy Inc., Callable, 5.000%, 2020/03/12	12,952,420	13,252,525
16,000,000	IGM Financial Inc., Callable, 6.000%, 2040/12/10	15,957,920	16,135,764
12,500,000	Inter Pipeline (Corridor) Inc., Callable, 4.897%, 2020/02/03	12,500,000	13,067,302
3,100,000	Loblaw Cos. Ltd., 6.050%, 2034/06/09	3,148,360	3,091,340
10,000,000	Loblaw Cos. Ltd., Callable, 5.220%, 2020/06/18	10,059,650	10,341,844
5,800,000	Molson Coors Capital Finance, Callable, 5.000%, 2015/09/22	6,090,000	6,129,985
12,000,000	Power Corp. of Canada, Callable, 7.570%, 2019/04/22	13,921,890	14,228,764
10,000,000	Rogers Communications Inc., Callable, 6.680%, 2039/11/04	10,098,470	10,682,677
17,000,000	Shaw Communications Inc., Callable, 5.650%, 2019/10/01	17,286,423	17,562,267
2,309,000	Shaw Communications Inc., Callable, 6.750%, 2039/11/09	2,340,035	2,276,676
17,000,000	Suncor Energy Inc., Callable, 5.390%, 2037/03/26	15,730,862	17,202,269
5,000,000	Suncor Energy Inc., Callable, 6.500%, 2038/06/15 (USD)	5,668,892	5,415,136
3,000,000	Teranet Holdings L.P., Callable, 3.531%, 2015/12/16	3,000,000	3,007,742
15,100,000	Thomson Reuters Corp., Callable, 6.500%, 2018/07/15 (USD)	17,945,754	17,509,202
10,816,000	TransAlta Corp., Callable, 6.400%, 2019/11/18	10,849,060	11,764,602
20,500,000	Viterra Inc., Callable, 5.950%, 2020/08/01 (USD)	21,066,602	19,454,396
21,574,000	Yellow Media Inc., Callable, 5.710%, 2014/04/21	21,294,049	22,160,748
<b>Canadian Corporate Bonds (116.28%, 2009: 100.44%)</b>		<b>357,645,805</b>	<b>365,745,209</b>
<b>Canadian Bonds - Short Positions</b>			
(485,000)	Government of Canada, 3.000%, 2015/12/01	(496,878)	(498,206)
(10,000,000)	Government of Canada, 3.500%, 2020/06/01	(10,342,000)	(10,315,875)
(1,325,000)	Government of Canada, 4.000%, 2041/06/01	(1,438,163)	(1,442,774)
<b>Government of Canada &amp; Guaranteed (-3.90%, 2009: 6.06%)</b>		<b>(12,277,041)</b>	<b>(12,256,855)</b>
<b>Total of Canadian Bonds (112.38%, 2009: 106.50%)</b>		<b>345,368,764</b>	<b>353,488,354</b>
<b>United States Bonds</b>			
30,000,000	Goldman Sachs Group Inc. (The), Variable Rate, Callable, 5.200%, 2022/04/19 (CAD)	29,663,960	29,016,900
<b>U.S. Corporate Bonds (9.23%, 2009: 12.03%)</b>		<b>29,663,960</b>	<b>29,016,900</b>
<b>United States Bonds - Short Position</b>			
(3,037,000)	United States Treasury Bond, Callable, 1.250%, 2015/08/31 (USD)	(3,115,675)	(2,938,716)
(4,445,000)	United States Treasury Bond, 3.500%, 2020/05/15 (USD)	(4,797,420)	(4,530,166)
(4,559,000)	United States Treasury Bond, 2.625%, 2020/08/15 (USD)	(4,737,774)	(4,300,227)
(4,150,000)	United States Treasury Bond, 4.375%, 2040/05/15 (USD)	(4,330,134)	(4,148,861)
(5,000,000)	United States Treasury Bond, 4.250%, 2040/11/15 (USD)	(5,001,025)	(4,893,747)
<b>U.S. Federal Bonds &amp; Guaranteed (-6.62%, 2009: 0.00%)</b>		<b>(21,982,028)</b>	<b>(20,811,717)</b>
<b>Total of U.S. Bonds (2.61%, 2009: 12.03%)</b>		<b>7,681,932</b>	<b>8,205,183</b>
<b>Investments (note 2)</b>		<b>387,309,765</b>	<b>394,762,109</b>
<b>Investments, short positions (note 2)</b>		<b>(34,259,069)</b>	<b>(33,068,572)</b>
<b>Total of Investments (114.99%, 2009: 118.53%)</b>		<b>353,050,696</b>	<b>361,693,537</b>
Due to broker (-16.84%, 2009: -20.04%)			(52,974,496)
Margin (0.16%, 2009: 0.00%)			507,246
Unrealized gain on foreign forward currency contracts (0.12%, 2009: 0.00%) (note 4)			377,341
Unrealized loss on credit default swaps (-0.05%, 2009: 0.00%) (note 5)			(158,639)
Other assets, less liabilities (1.62%, 2009: 1.51%)			5,087,352
<b>Total Net Assets (100.00%)</b>			<b>314,532,341</b>

See accompanying notes which are an integral part of these financial statements.

# **Marret IGB Trust - Annual Report 2010**

## **Notes to the Financial Statements**

December 31, 2010 and December 31, 2009

### **1. Fund Activities**

Marret IGB Trust (the "Trust") is an investment fund established under the laws of the Province of Ontario and is governed by a declaration of trust dated September 29, 2009. The Trust will issue units from time to time in reliance on exemptions from applicable prospectus and registration requirements.

The Trust's investment objectives are to maximize total returns for holders of units while reducing risk and preserving capital. The Trust has been established for the purposes of acquiring and holding investments focused primarily on investment grade bonds. The Portfolio is actively managed by Marret Asset Management Inc. ("Marret" or "the Manager") using an investment strategy designed to produce attractive risk-adjusted returns across the credit cycle through exposure to a portfolio of investment grade bonds. Over the course of a credit cycle, the investment strategy seeks to generate total returns in excess of the DEX Mid-Corporate Bond Index with less volatility.

Marret employs hedging strategies to protect the Portfolio against the risk of loss from currency fluctuations. It is intended that 100% of the Portfolio investments denominated in foreign currencies are hedged to the Canadian dollar.

The Trust is a vehicle to allow the Marret Investment Grade Bond Fund ("the Fund") to meet its investment objectives. The Fund used the net proceeds of its initial public offering to prepay its obligations under a forward purchase and sale agreement (the "Forward Purchase Agreement") with The Bank of Nova Scotia (the "Counterparty"). Such net proceeds were invested by the Counterparty into the Trust. The cash received from the Counterparty was used by the Trust to purchase the Portfolio.

### **2. Significant Accounting Policies**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements requires management to make estimates and assumptions that may impact the reported amounts of assets and liabilities at the date of the financial statements and income and expenses during the reporting period. Actual results could differ from these estimates. The significant accounting policies followed in the preparation of these financial statements are summarized below:

#### **Investments**

The Trust's investments are held for trading and are presented at fair value. Investments held that are traded in an active market through recognized public stock exchanges, over the counter markets, or through recognized investment dealers, are valued at their bid prices for securities held long and at their ask prices for securities held short. The cost of investments represents the amount paid for each security, and is determined on an average cost basis excluding commissions and other portfolio transaction costs, where applicable. The difference between fair value and the average cost of investments is recorded as unrealized appreciation/ (depreciation) of investments.

Investments for which reliable quotations are not readily available, or for which there is no bid price, are valued at fair value as determined using management's best estimates thereof pursuant to procedures established by the Manager. Short-term notes and treasury bills are valued at their fair value.

Investment transactions are recorded on a trade-date basis. Realized gains/(losses) on the disposition of the portfolio securities and unrealized appreciation/(depreciation) of portfolio securities are determined on an average cost basis.

#### **Translation of foreign currencies**

The fair value of foreign investments and other assets and liabilities are translated into Canadian dollars at the exchange rate prevailing on the valuation date. Purchases and sales of foreign securities and the related income are translated into Canadian dollars at the exchange rate prevailing on the respective dates of such transactions.

#### **Income Recognition**

Interest income, interest expense, securities lending income and security borrowing fees are recorded on an accrual basis.

#### **Increase (decrease) in net assets from operations per unit**

Increase (decrease) in net assets from operations per unit in the statements of operations represents the increase (decrease) in net assets from operations attributable to the Trust, divided by the weighted average number of units of the Trust outstanding during the period.

#### **Foreign forward currency contracts**

Foreign forward currency contracts entered into by the Trust are financial agreements to buy or sell a specific amount of an underlying currency for an agreed upon price at a future date. The fair value of these contracts is the gain or loss that would be recognized if the position was closed out on the valuation date, and is recorded as an unrealized gain (loss).

#### **Credit default swaps**

Credit default swaps are agreements to mitigate credit risk exposure to certain issuing entities (“Referenced Entity”) held by the Trust or to increase credit risk exposure to the Referenced Entity by creating a notional investment position for the Trust. Where a notional investment position is created, the credit risk exposure of the Trust is comparable to the exposure that would have resulted if the Trust has invested directly in the Referenced Entity. Under a credit default swap agreement, the protection buyer, whose intention is to reduce its credit risk exposure to the Referenced Entity, pays a premium to the protection seller, who assumes the credit risk of a default of the bond of a Referenced Entity. This premium is paid at regular intervals over the term of the swap agreement. In return for the premium paid, the protection buyer is entitled to receive from the protection seller full payment for a loss arising from a credit default event of the Referenced Entity. A credit default event may be triggered by bankruptcy, failure to pay or restructuring of the Referenced Entity. If a credit default event occurs, the swap may be settled by either the physical delivery of the bond for proceeds equal to par value, or a cash payment equal to the loss amount. Credit default swaps are valued on a daily based on dealer-supplied valuations.

Changes in value of swap agreements are recorded as unrealized appreciation (depreciation). Premiums paid or received from swap agreements are included in investment income. When swap agreements expire or are closed out, gains or losses are included in net realized gain or loss on sale of swap agreements.

#### **Financial Instruments**

The Trust’s financial instruments include investments (long and short), cash, receivables for accrued interest, and for investments sold, payables for investments purchased, and payable for interest payable on short positions, due to broker, and other accrued expenses. Investments (long and short) are classified as held for trading and carried at fair value. Distributions and cash, receivables for accrued interest and for investments sold are designated as loans and receivables and reported at amortized cost. Payables for

investments purchased, interest payable on short positions, due to broker and other accrued expenses are designated as financial liabilities and reported at amortized cost.

### 3. Net Assets Per Unit

The Trust is required to calculate the net assets per unit for the purposes of the financial statements in accordance with Canadian generally accepted accounting principles (GAAP). The valuation principles and practices established by the Manager for the purpose of subscriptions and redemptions differ from Canadian GAAP primarily with respect to fair valuation of securities. Under Canadian GAAP, financial instruments that are quoted in active markets shall be measured based on the bid price for long positions and the ask price for short positions while under the Manager's valuation principles such securities shall be valued using close prices for listed securities and the average of the bid and ask prices for those securities traded through recognized investment dealers. As a result, the net assets per unit presented in the financial statements (the "Net Assets per Unit") may differ from the net asset value per unit for the purpose of redemption and purchase of units of the Trust (the "Net Asset Value per Unit"). A comparison between the net asset value per unit calculated for subscriptions and redemptions and the net assets per unit calculated for financial reporting is required to be disclosed in the financial statements.

	As at December 31, 2010	As at December 31, 2009
Net Asset Value per Unit	\$12.57	\$12.07
Net Assets per Unit	\$12.52	\$12.01

### 4. Foreign Forward Currency Contracts

The following foreign forward currency contracts were outstanding as at December 31, 2010:

As at December 31, 2010							
Settlement Date	Currency Buys	Notional Value	Currency Sells	Notional Value	Forward Rate	Current Rate	Unrealized Gain (Loss)
1/26/2011	CAD	17,398,513	USD	17,106,000	0.983	1.005	\$ 377,341
							<u>\$ 377,341</u>

**Counterparty** Bank of New York Mellon Corp. (The)

**Credit Rating for Counterparty**<sup>(\*)</sup> A1+

<sup>(\*)</sup> Standard and Poor's short term rating.

There were no foreign forward currency contracts outstanding at December 31, 2009

## 5. Credit Default Swaps

The following credit default swap was outstanding as at December 31, 2010:

**As at December 31, 2010**

<b>Credit Default Swap Contracts</b>	<b>Underlying Security Credit Rating (*)</b>	<b>Notional Amount</b>	<b>Expiry Date</b>	<b>Fair Value</b>
Pay 1.00% quarterly times the notional amount.				
Receive payment only upon a default event of Markit CDX NA IG S15 Index	B	25,000,000	12/20/2015	<u>(\$158,639)</u>
				<u><u>(\$158,639)</u></u>

**Counterparty:** JP Morgan Securities Inc.

**Credit Rating for Counterparty<sup>(\*)</sup>** A1

<sup>(\*)</sup> Standard and Poor's short term rating.

There were no capital default swaps outstanding at December 31, 2009

## 6. Leverage

The Trust may utilize various forms of borrowing, including a loan facility and margin purchases, up to 25% of the net asset value of the Trust at the time of borrowing. Accordingly, the maximum amount of leverage that the Trust could employ is 1.25:1.

In addition, the net exposure of the Trust should not exceed 125%, on a daily marked-to-market basis, with net exposure calculated as the value of long security positions, excluding cash and cash equivalents, minus the absolute value of short positions, divided by net asset value of the Trust.

The Trust has a credit facility which provides the ability to borrow i) Canadian dollars at a rate equal to the Bank of Canada overnight lending rate plus a fixed percentage, and ii) U.S. dollars at a rate equal to federal funds overnight rate plus a fixed percentage. The facility has been used by the Trust to invest in additional portfolio investments.

During the year ended December 31, 2010, the minimum and maximum amounts of net borrowings of the Trust were approximately \$3.4 million and \$105.6 million, respectively.

## 7. Unitholder's Capital

Pursuant to the declaration of trust, the Trust is authorized to issue an unlimited number of a single class of transferable redeemable units of beneficial interest, each of which represents a pro rata interest in the Trust. All units have equal rights and privileges. Each whole unit is entitled to one vote at all meetings of unitholders and is entitled to participate equally with respect to any and all distributions made by the Trust and distributions upon the termination of the Trust. The sole unitholder of the Trust is the Bank of Nova Scotia (the "Unitholder").

## Redemption of Units

Units may be redeemed at any time for a redemption price per unit equal to the net asset value per unit as at the Redemption Date. Units surrendered for redemption by a Unitholder on any Redemption Date will be redeemed as at such Redemption Date and the Unitholder will receive payment in respect of any units surrendered for redemption on or before the Redemption Payment Date.

The issued and outstanding units as at December 31, 2010 and 2009 consist of:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Units outstanding - beginning of year	27,101,368	-
Issued for consideration	-	27,101,368
Reinvestment of distribution	1,096,216	160,079
Redemption	(1,988,301)	-
Reduced by consolidation	(1,096,216)	(160,079)
Units outstanding - end of year	<b>25,113,067</b>	<b>27,101,368</b>

For units reconsolidated refer to Note 9.

## 8. Fees and Expenses

The Trust retained Marret Asset Management Inc., under an administration agreement dated September 29, 2009 to administer all of the ongoing operations of the Trust. In consideration for the services provided by the Manager, the Trust pays a management fee. The management fee is computed daily and payable monthly in arrears at the annual rate of 0.375%, plus applicable taxes, of the net asset value of the Trust. The total management fees earned by Marret Asset Management Inc. for the year ended December 31, 2010 were \$1,383,244 (December 31, 2009 – \$246,176) of which \$116,827 (December 31, 2009 - \$110,506) remained payable.

All other reasonable expenses in connection with the administration of the Trust are paid by the Trust. No trustee fees were charged during the year (2009 – nil).

## 9. Income Taxes

The Trust qualifies as a unit trust and a financial institution for purposes of the mark-to-market rules contained in the Income Tax Act (Canada). The Trust is subject to tax on its net investment income, including any net realized and unrealized capital gains on its mark-to-market property, which is not paid or payable to its Unitholder. The financial statements of the Trust do not include a provision for income taxes because under the terms of the declaration of trust, net investment income is distributed each year to its Unitholder.

Where the Trust realizes income for tax purposes which is in excess of any distributions paid or made payable to the Unitholder during the year, the declaration of trust provides that an additional distribution will be automatically payable in each year to the Unitholder on December 31. The additional distribution will be automatically reinvested in additional units of the Trust on December 31, following which the outstanding units of the Trust will be automatically consolidated on a basis such that the number of consolidated units is equal to the number of units outstanding immediately preceding the additional distribution. The amount of the additional distribution on December 31, 2010 was \$13,203,813 (December 31, 2009 - \$1,920,600).

## **10. Capital Management**

The Trust's capital consists of the Unitholder's equity. The Manager is responsible for managing the Trust's Portfolio in line with its mandate and the affairs of the Trust, including the receipt of revenues and the payment of distributions to the Unitholder.

In accordance with its investment strategies and risk management policies, the Trust endeavours to invest the subscriptions received and borrowings in appropriate investments while maintaining sufficient liquidity to meet redemptions and the repayment of borrowings. Capital movements are shown in the statements of changes in net assets.

## **11. Financial Instrument Risk Management**

In the normal course of business, the Trust is exposed to a variety of financial risks: market risk (including price risk, interest rate risk and currency risk), credit risk and liquidity risk. The Trust's overall risk management program focuses on compliance and execution of the Trust's investment objectives.

The Manager seeks to minimize potential adverse effects of these risks on the Trust's performance by employing professional, experienced portfolio advisers, daily monitoring of the Trust's positions and market events and by diversifying the investment portfolio within the constraints of the investment strategy. To assist in managing risks, the Manager also uses internal guidelines that identify the target exposure for each type of risk, maintains a governance structure that oversees the Trust's investment activities and monitors compliance with the Trust's stated investment strategy and securities regulations.

### **Price Risk**

Price Risk is the risk that the value of financial instruments will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or currency risk), whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in a market or market segment.

The value of the investments can fluctuate on a daily basis as a result of factors outside of the Trust's control, including financial performance of the issuers of the underlying investments, operational risks relating to the specific business activities of the respective issuers, quality of assets owned by respective issuers, commodity prices, exchange rates, interest rates, environmental risks, political risks, issues relating to government regulation and taxation, composition of the investments and other financial market conditions.

As at December 31, 2010 and 2009, the Trust was not exposed to price risk as all of the investments were debt securities.

### **Interest Rate Risk**

Interest rate risk arises from changes in the prevailing levels of market interest rates, resulting in fluctuations in the value of interest bearing financial instruments.

The table below summarizes the Trust's net exposure to interest rate risks by remaining term to maturity.

	December 31, 2010			December 31, 2009		
	Long	Short	Net	Long	Short	Net
< 1 year	-	-	-	-	-	-
1 - 3 years	41,521,746	-	41,521,746	20,646,800	-	20,646,800
3- 5 years	69,304,262	(3,436,922)	65,867,340	60,378,927	-	60,378,927
> 5 years	283,936,101	(29,631,650)	254,304,451	307,755,845	(2,882,775)	304,873,070
<b>Total</b>	<b>394,762,109</b>	<b>(33,068,572)</b>	<b>361,693,537</b>	<b>388,781,572</b>	<b>(2,882,775)</b>	<b>385,898,797</b>

If interest rates had increased or decreased by 1% at December 31, 2010 (December 31, 2009 – 1%), with all other variables remaining constant, net assets would have decreased or increased by approximately \$24,965,909 or 7.94% (December 31, 2009 - \$29,557,858 or 9.08%). In practice, the actual results may differ from this sensitivity analysis and the difference could be material.

The Trust also has interest rate exposure on credit facility borrowings, as at December 31, 2010 the borrowings were \$52,974,496 (December 31, 2009 - \$65,245,063). If interest rates had increased or decreased by 1% at December 31, 2010 (December 31, 2009 – 1%), with all other variables remaining constant, run-rate interest expense would have decreased or increased on an annualized basis by approximately \$529,745 or 0.17% of net assets (December 31, 2009 - \$652,451 or 0.20%). In practice, the actual results may differ from this sensitivity analysis and the difference could be material.

### Currency Risk

Currency risk is the risk that the value of investments will fluctuate due to changes in foreign exchange rates. This risk arises when financial instruments (including cash and cash equivalents) are denominated in a currency other than Canadian dollars, which represents the Trust's functional currency.

The table below indicates the currencies to which the Trust had significant net exposure as at December 31, 2010 and 2009, on its monetary and non-monetary assets and liabilities as well as the underlying notional amount of foreign forward currency contracts..

#### As at December 31, 2010

	Currency risk Investments	Working Capital	Currency risk Due to broker	Forward Currency Contract	Net Exposure	As a % of Net Assets
U.S. Dollar	21,408,378	825,209	(5,267,612)	(17,021,171)	(55,196)	0.02%

#### As at December 31, 2009

	Currency risk Investments	Working Capital	Currency risk Due to broker	Forward Currency Contract	Net Exposure	As a % of Net Assets
U.S. Dollar	11,829,153	313,689	(11,923,520)	-	219,322	0.07%

As at December 31, 2010, had the Canadian dollar strengthened or weakened by 5% (December 31, 2009 – 5%) in relation to all currencies, with all other variables held constant, net assets would have increased or decreased, respectively, by approximately \$2,760 or 0.00% (December 31, 2009 - \$10,966 or 0.00%). In practice, the actual results may differ from this sensitivity analysis and the difference could be material.

### Credit Risk

Credit risk is the risk that the counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Trust. The main concentration of credit risk would be where a Trust invests in debt instruments and derivatives. The fair value includes consideration of the credit worthiness of the issuer and therefore represents the maximum credit exposure of the Trust. The Trust maintains all of its cash and cash equivalents at its custodian or in bankers' acceptances or term deposits with financial institutions having a minimum debt rating of A.

All transactions in listed securities are settled/paid for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is made only when the Trust has received payment. Payment is made on purchases once the securities have been received by the Trust. Should either party not meet its obligation, the trade will fail.

As at December 31, 2010 and 2009 the Trust invested in debt securities with the following credit ratings:

Debt securities by debt ratings	As a % of Net Assets					
	December 31, 2010			December 31, 2009		
	Long	Short	Net	Long	Short	Net
AAA	-	(10.51)	(10.51)	6.95	(0.89)	6.06
AA	-	-	-	-	-	-
A	36.20	-	36.20	36.05	-	36.05
BBB	89.30	-	89.30	76.42	-	76.42
<b>Total</b>	<b>125.50</b>	<b>(10.51)</b>	<b>114.99</b>	<b>119.42</b>	<b>(0.89)</b>	<b>118.53</b>

As at December 31, 2010 and 2009 the Trust invested in derivatives with the following counterparty ratings:

Counterparty Ratings	As a % of Net Assets	
	December 31, 2010	December 31, 2009
A1+	0.12	-
A1	(0.05)	-
<b>Total</b>	<b>0.07</b>	<b>-</b>

### Liquidity Risk

The Trust is exposed to cash redemptions and repayment of borrowings. The Trust invests a substantial portion of its assets in investments that are traded in an active market and can be readily disposed of. There can be no assurance that an adequate market for the investments will exist at all times, or that the prices at which the investment trade, accurately reflect their fair value. Low trading volumes of the investments will make it difficult to liquidate holdings quickly. All liabilities are due in less than 3 months, except for credit default swaps which have expiry dates as disclosed in Note 5.

### Fair Value Hierarchy

Canadian Institute of Chartered Accountants Handbook Section 3862 ("Section 3862"), Financial Instruments - Disclosures, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Inputs may be based on independent market data ("observable inputs") or they may be internally developed ("unobservable inputs"). The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three levels of the hierarchy are as follows:

Level (1) - quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level (2) - investments with inputs other than quoted prices that are observable for the asset or liability either directly or indirectly.

Level (3) - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Changes in valuation methods may result in transfers into or out of an investment's assigned level.

The following is a summary of the inputs used in valuing the Trust's investments and derivatives carried at fair values:

**As at December 31, 2010**

	Level 1		Level 2		Level 3		Total
Bonds - Long	\$	-	\$	394,762,109	\$	-	\$ 394,762,109
Forward Contracts				377,341			377,341
<b>Total Financial Assets</b>		-		<b>395,139,450</b>		-	<b>395,139,450</b>
Bonds - Short		-		(33,068,572)		-	(33,068,572)
Credit Swaps				(158,639)			(158,639)
<b>Total Financial Liabilities</b>		-		<b>(33,227,211)</b>		-	<b>(33,227,211)</b>
<b>Total Investments</b>	\$	-	\$	<b>361,912,239</b>	\$	-	\$ <b>361,912,239</b>

**As at December 31, 2009**

	Level 1		Level 2		Level 3		Total
Bonds - Long	\$	-	\$	388,781,572	\$	-	\$ 388,781,572
<b>Total Financial Assets</b>		-		<b>388,781,572</b>		-	<b>388,781,572</b>
Bonds - Short		-		(2,882,775)		-	(2,882,775)
<b>Total Financial Liabilities</b>		-		<b>(2,882,775)</b>		-	<b>(2,882,775)</b>
<b>Total Investments</b>	\$	-	\$	<b>385,898,797</b>	\$	-	\$ <b>385,898,797</b>

## 12. Transition to International Financial Reporting Standards

In January 2011, the Canadian Accounting Standards Board ("AcSB") announced that it will provide a deferral to International Financial Reporting Standards ("IFRS") for investment companies until January 1, 2013. The Trust will adopt IFRS by the deadline provided by the AcSB or by such earlier time as may be required by the Canadian Securities Administrators. Under the original general transition rules for publicly accountable enterprises the Trust would adopt IFRS for its fiscal period beginning January 1, 2011.

The Trust has developed a plan to meet the timetable published by Canadian Institute of Chartered Accountants for changeover to IFRS. Key elements of the plan include the determination of the qualitative impact and the quantitative impact, if any, on the Trust's financial statements in accordance with IFRS. Based on the current evaluation of the differences between Canadian GAAP and IFRS, the adoption of IFRS is expected to have no impact on the calculation of net assets or net asset value. IFRS is expected to affect the overall presentation of financial statements and result in additional disclosure in the accompanying notes. However, the Manager's assessment may change if new standards are issued or if the interpretations of current standards are revised.