



## FAIRWAY INVESTMENT GRADE INCOME FUND



### **Second Quarter Report**

*(Unaudited)*

Period ended June 30, 2005

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### Market Commentary

#### MARKET UPDATE

Despite the ninth consecutive increase in the Fed Funds rate on June 29th, interest rates across most maturities fell and the yield curve flattened by 42 basis points (bp) as the two-year Treasury yield fell 14 bp to 3.63% and the yield on the 30-year maturity decreased by 56 bp to 4.19%. The yield curve is at its flattest point since early 2001.

Investors seemed to believe that the Fed Funds rate could not go much higher citing factors such as a 22-year high for oil prices which impact consumer spending and manufacturing activity leading to slower worldwide economic growth.

Economic growth, however, remained healthy as Q1 gross domestic product (GDP) was revised up to 3.8% from 3.1%. This was due to an improving labour market, rising stock prices and moderate inflation data despite rising oil prices. In fact, inflation cooled slightly with the May Consumer Price Index (CPI) down 0.1% and the Producer Price Index (PPI) down 0.6%.

Corporate profits and margins continue to grow and expand with consumer spending and business investment increasing. Overall, earnings grew by 16% from a year ago while net profit margins expanded as employee wages, salaries and benefits were contained.

Volatility from the auto sector and LBO activity drove selected credit spreads wider. However, limited new issue supply and demand for spread product in this low yield environment kept overall spreads from widening dramatically. A modest flight to quality was driven by fears of a U.S. economic slowdown, slower world growth and the credits of GM and Ford being downgraded to junk bond status.

#### PORTFOLIO UPDATE

The Treasury market experienced a sell off at the beginning of April, however, from mid April to quarter end, preferreds rebounded as Treasuries rallied. As the Fed raised rates twice during the quarter, long term

Treasuries rallied both times. Record high oil prices also contributed to the rally as investors believed they would slow the economy.

Lower rates in the marketplace caused companies to issue a slew of new preferreds. The magnitude of new issuances caused preferreds not to rally as much as Treasuries but did give the fund managers an opportunity to add a number of new names to the portfolio at attractive prices.

Despite the downgrade of GM and Ford, auto preferreds bounced back nicely in May. In fact, the GM 7 3/8% security was one of the best performing securities. As well, higher coupon, public utility, oil & gas and financial preferreds performed well. Fully taxable preferreds sold off during June due to the large supply of these types of issuances within the market.

#### MARKET OUTLOOK

The Fed continues on a measured path of raising short term interest rates. But, with signs of moderating economic growth and contained inflation, we believe the Fed may be close to finished with its tightening campaign.

Several factors would suggest a favourable long term environment for preferreds. One of those is strong demand for high quality income-producing assets from an aging American population which should provide support for the group even if long bond yields rise. As well, despite the spurt of new issuance in response to market conditions, this may not be indicative of a long term trend towards increased supply.

In general, a slow, growth, low inflationary environment is a boon for preferreds yield advantage over Treasuries.

#### John Hancock Advisers LLC

*Investment Sub-Advisor, Global Preferred Trust*

## Market Commentary (continued)

### REVIEW

The Canadian Bond market outperformed the U.S. market in the front end of the curve while matching the decline in rates at the 10-year point. Ten-year yields in both countries declined about 56 basis points, while long rates fell 57 basis points in the States vs a Canadian long bond yield decline of 52 basis points. The strong rally in both countries was coupled with significant yield curve flattening particularly south of the border. Corporate spreads tightened modestly during the quarter.

The Fed picture remains unchanged. The Federal Reserve considers longer-term inflation expectations well contained while more immediate pressure on inflation is being addressed through “measured” increases. After 3 quarterly increases, as at quarter-end, the Fed Funds rate now stands at 3.25% while the Bank of Canada remains on hold with overnight rates fixed at 2.50%. Both markets continue to watch employment and inflation data carefully for clues to future market direction.

**MFC Global Investment Management (Canada)**  
***Investment Advisor, Fairway Diversified Income and Growth Trust***

## FAIRWAY INVESTMENT GRADE INCOME FUND


### Statement of Net Assets

(Unaudited)

As at  
June 30, 2005

<b>Assets</b> (Note 9)	
Investments, at market value ( <i>cost</i> – \$73,948,245)	\$ 75,854,200
Cash and cash equivalents (Note 3)	1,085,462
Accrued interest, dividends and distributions from trusts	316,125
Prepaid interest on loan	8,862
	77,264,649
<b>Liabilities</b>	
Loan facility payable (Note 9)	25,861,208
Due to brokers	102,040
Management fees payable (Note 5)	90,315
Accounts payable and accrued liabilities	44,008
Distributions payable	265,591
	26,363,162
<b>Net assets, at market value</b>	<b>\$ 50,901,487</b>
<b>Number of units outstanding</b> (Note 7)	<b>5,311,826</b>
<b>Net asset value per unit</b>	<b>\$ 9.58</b>

Approved on behalf of the Board of Directors of the Manager:



Andrew A. McKay  
Director



Paul Perrow  
Director

### Statement of Operations

(Unaudited)

April 1, 2005  
to June 30, 2005

February 25, 2005  
(Date of Inception)  
to June 30, 2005

<b>Investment income</b>		
Interest	\$ 312,663	385,478
Dividends and distributions	860,962	908,736
	1,173,625	1,294,214
<b>Expenses</b>		
Management fees (Note 5)	171,816	198,490
Administration	54,332	58,967
Interest expense (Note 9)	216,214	247,171
	442,362	504,628
<b>Net investment income</b>	<b>731,263</b>	<b>789,586</b>
<b>Realized and unrealized gain (loss) on investments</b>		
Net realized gain on sale of investments (Note 8)	408,811	795,842
Change in unrealized appreciation on investments	1,886,937	1,905,955
Realized foreign exchange loss	(1,520,219)	(1,743,091)
Change in unrealized appreciation on foreign currency	325,726	187,082
<b>Net gain on investments</b>	1,101,255	1,145,788
<b>Increase in net assets from operations</b>	<b>\$ 1,832,518</b>	<b>1,935,374</b>
<b>Increase in net assets from operations per unit</b>	<b>\$ 0.3475</b>	<b>0.3699</b>

The accompanying notes are an integral part of these financial statements

## Statement of Changes in Net Assets

(Unaudited)

	April 1, 2005 to June 30, 2005	February 25, 2005 (Date of Inception) to June 30, 2005
<b>Increase in net assets from operations</b>	\$ 1,832,518	1,935,374
<b>Distributions to unitholders</b>		
Income	(796,616)	(796,616)
	(796,616)	(796,616)
<b>Capital unit transactions</b> (Note 7)		
Proceeds from issue of trust units	3,100,000	53,100,000
Trust units issued under the Annual Management Fee (Note 5)	30,329	30,329
Issue costs	(155,000)	(3,355,000)
Redeemed trust units	(12,600)	(12,600)
	2,962,729	49,762,729
<b>Increase in net assets during the period</b>	3,998,631	50,901,487
<b>Net assets, beginning of period</b>	46,902,856	-
<b>Net assets, end of period</b>	\$ <b>50,901,487</b>	<b>50,901,487</b>

## Statement of Cash Flows

(Unaudited)

	April 1, 2005 to June 30, 2005	February 25, 2005 (Date of Inception) to June 30, 2005
<b>OPERATING ACTIVITIES</b>		
Increase in net assets from operations	\$ 1,832,518	1,935,374
Items not affecting cash:		
Gain on sale of investments	(497,480)	(884,611)
Change in unrealized appreciation on investments	(1,886,937)	(1,905,955)
	(551,899)	(855,192)
Net change in non-cash assets and liabilities	(655,127)	(190,664)
<b>Cash flows used in operating activities</b>	(1,207,026)	(1,045,856)
<b>FINANCING ACTIVITIES</b>		
Borrowing of loan indebtedness	861,624	25,861,208
Distributions paid to unitholders	(531,025)	(531,025)
Net proceeds from issuance of trust units	2,962,729	49,762,729
<b>Cash flows provided by financing activities</b>	3,293,328	75,092,912
<b>INVESTING ACTIVITIES</b>		
Proceeds from sale of investments	1,396,256	1,783,387
Purchases of investments	(33,803,560)	(74,744,981)
<b>Cash flows used in investing activities</b>	(32,407,304)	(72,961,594)
<b>Net increase (decrease) in cash during the period</b>	(30,321,002)	1,085,462
Cash and cash equivalents, beginning of period	31,406,464	-
<b>Cash and cash equivalents, end of period</b>	\$ 1,085,462	1,085,462

The accompanying notes are an integral part of these financial statements

# Statement of Investments

(Unaudited)

As at June 30, 2005

Number of Shares	Description	Average Cost (\$)	Market Value (\$)	% of Net Assets
<b>PREFERRED SECURITIES</b>				
<b>Bermuda</b>				
46,100	Renaissancere Holdings Limited 6.08% Series C	1,325,120	1,358,940	2.67
		<b>1,325,120</b>	<b>1,358,940</b>	<b>2.67</b>
<b>Canada</b>				
42,500	Nexen Inc. 7.35% Nov 01/43	1,361,685	1,373,673	2.70
		<b>1,361,685</b>	<b>1,373,673</b>	<b>2.70</b>
<b>Netherlands</b>				
20,000	ABN Amro Capital Funding Trust V 5.90%	584,800	596,426	1.17
33,000	ABN Amro Capital Funding Trust VII 6.08%	974,347	1,005,135	1.97
6,000	Aegon NV 6.38%	189,615	185,841	0.37
10,000	ING Groep NV 6.20%	301,878	310,470	0.61
41,000	ING Groep NV 7.05%	1,275,481	1,314,135	2.58
		<b>3,326,121</b>	<b>3,412,007</b>	<b>6.70</b>
<b>United Kingdom</b>				
15,900	Abbey National PLC 7.25%	495,544	502,807	0.99
5,000	Abbey National PLC ADR 7.38% Series B	159,843	164,244	0.32
20,000	Prudential PLC 6.75%	618,865	643,493	1.26
15,000	The Royal Bank of Scotland Group PLC ADR 5.75% Series L	434,912	447,135	0.88
36,200	The Royal Bank of Scotland Group PLC 6.40% Series M	1,113,436	1,143,424	2.25
		<b>2,822,600</b>	<b>2,901,103</b>	<b>5.70</b>
<b>United States</b>				
16,000	BAC Capital Trust I 7.00% Dec 15/31	492,410	506,165	0.99
5,000	BAC Capital Trust II 7.00% Feb 01/32	155,445	159,648	0.31
10,000	BAC Capital Trust IV 5.88% May 03/33	293,550	308,264	0.61
10,000	BAC Capital Trust V 6.00% Nov 03/09	298,225	310,593	0.61
10,900	BGE Capital Trust III 6.20% Oct 15/43	343,192	344,691	0.68
34,100	BNY Capital V 5.95% May 01/33 Series F	1,026,258	1,051,179	2.06
6,200	Citigroup Capital VII 7.13% Jul 31/31	192,726	197,127	0.39
16,300	Citigroup Capital IX 6.00% Feb 14/33	488,627	502,070	0.99
8,600	Citigroup Capital X 6.10% Sep 30/33	259,071	266,161	0.52
9,000	Citigroup Capital XI 6.00% Sep 27/34	270,641	277,106	0.54
600	Comerica Capital Trust 7.60% Jul 01/50	18,958	18,900	0.04
15,000	Corporate Backed Trust Certificates 6.25% Jul 15/97	449,185	464,234	0.91
18,000	Corporate Backed Trust Certificates 6.00% Feb 15/34 Series GS	531,313	540,534	1.06
7,400	DTE Energy Trust II 7.50% Jun 01/44	239,078	243,988	0.48
5,700	Duke Realty Corporation 6.63% Aug 25/08 Series J	167,930	178,680	0.35
7,600	Duke Realty Corporation 6.50% Series K	222,029	233,535	0.46
30,000	Duke Realty Corporation 6.60% Series L	887,511	920,379	1.81
5,000	Energy East Capital Trust I 8.25% Jul 31/31	158,674	160,873	0.32
27,600	Entergy Mississippi Inc. 7.25% Dec 01/32	885,240	889,542	1.75
7,300	Enterprise Capital Trust I 7.44% Mar 31/47 Series A	223,181	225,390	0.44
16,100	Enterprise Capital Trust III 7.25% Jun 30/47 Series C	493,141	494,923	0.97
11,000	Fleet Capital Trust IX 6.00% Aug 01/33	332,393	344,483	0.68
30,000	Ford Motor Company 7.50% Jun 10/43	850,509	775,868	1.52
10,000	Ford Motor Credit Company 7.38% Oct 15/31	288,270	266,467	0.52
68,800	FPC Capital I 7.10% May 13/39 Series A	2,106,336	2,125,914	4.18
49,300	FPL Group Capital Trust I 5.88% Mar 15/44	1,462,120	1,504,633	2.96
5,000	General Electric Capital Corporation 6.10% Nov 15/32	152,914	158,728	0.31
15,000	General Electric Capital Corporation 5.88% Feb 18/33	460,580	466,256	0.92
10,000	General Motors Corporation 7.25% Jul 15/41	254,271	248,940	0.49

# Statement of Investments (continued)

(Unaudited)

As at June 30, 2005

Number of Shares	Description	Average Cost (\$)	Market Value (\$)	% of Net Assets
<b>PREFERRED SECURITIES (continued)</b>				
<b>United States</b>				
30,000	General Motors Corporation 7.38% Oct 01/51	750,816	772,559	1.52
10,600	Georgia Power Capital Trust V 7.13% Mar 31/42	336,556	339,362	0.67
41,200	Georgia Power Capital Trust VII 5.88% Jun 15/44	1,237,595	1,270,046	2.49
39,000	Great Plains Energy Incorporated 8.00% Feb 16/07	1,284,324	1,344,201	2.64
19,900	Heco Capital Trust III 6.50% Mar 18/34	621,327	626,128	1.23
30,000	Household Finance Corporation 6.88%	943,572	968,916	1.90
15,000	HSBC Finance Corporation 6.00% Nov 30/33	449,403	461,660	0.91
41,500	J.P. Morgan Chase Capital X 7.00% Feb 15/32	1,285,574	1,322,531	2.60
10,000	J.P. Morgan Chase Capital XIV 6.20% Oct 15/34	305,322	308,386	0.61
24,200	KeyCorp Capital V 5.88% Jul 30/33	713,967	735,320	1.44
4,100	KeyCorp Capital VI 6.13% Dec 15/33	125,758	126,639	0.25
20,000	Kimco Realty Corp. 6.65% Series F	612,794	625,843	1.23
21,900	Lehman Brothers Holdings Capital Trust III 6.38% Series K	651,729	675,097	1.33
30,000	Lehman Brothers Holdings Capital Trust V 6.00% Apr 22/53	871,026	915,966	1.80
9,300	Lincoln National Capital VI 6.75% Sep 11/52 Series F	291,870	298,084	0.59
16,400	Merrill Lynch Capital Trust III 7.00%	514,722	528,468	1.04
40,000	Merrill Lynch Capital Trust V 7.28%	1,284,243	1,312,480	2.58
8,700	Morgan Stanley Capital Trust III 6.25% Mar 01/33	258,812	268,083	0.53
10,000	Morgan Stanley Capital Trust IV 6.25% Apr 01/33	301,087	308,264	0.61
35,000	Morgan Stanley Capital Trust V 5.75% Jul 15/33	1,001,983	1,018,864	2.00
40,000	National Rural Utilities Cooperative Finance Corporation 5.95% Feb 15/45	1,134,001	1,203,393	2.36
22,700	PLC Capital Trust V 6.13% Jan 27/34	678,340	698,367	1.37
35,000	Public Storage, Inc. 6.50% Series W	1,048,056	1,073,775	2.11
15,000	Public Storage, Inc. 6.45% Series X	442,241	458,718	0.90
40,000	Provident Financial Group, Inc. 7.75%	1,340,293	1,348,271	2.65
34,300	SLM Corporation 6.00% Dec 15/43	1,034,980	1,051,038	2.06
19,500	Southwest Gas Capital II 7.70% Sep 15/43	639,668	629,796	1.24
25,000	Structured Repackaged Asset-Backed Trust Securities for Dominion Resources, Inc. 5.90% Dec 15/32 Series D	747,390	752,274	1.48
2,700	Telephone & Data Systems, Inc. 7.60% Dec 01/41	84,242	85,217	0.17
40,900	Telephone & Data Systems, Inc. 6.63% Mar 31/45	1,248,718	1,250,271	2.46
45,600	The Phoenix Companies, Inc. 7.45% Jan 15/32	1,428,396	1,439,218	2.83
3,900	United States Cellular Corporation 7.50% Jun 15/34	126,299	127,776	0.25
60,000	USB Capital VI 5.75% Mar 09/35	1,739,754	1,794,426	3.52
2,200	Vectren Utility Holdings Inc. 7.25% Oct 15/31	68,399	69,005	0.13
25,000	Verizon New England Inc. 7.00% May 15/42 Series B	793,572	801,608	1.57
49,600	Virginia Power Capital Trust 7.38% Jul 30/42	1,592,296	1,612,277	3.17
30,000	Wachovia Funding Corp. 7.25% Series A	1,019,690	1,055,328	2.07
5,000	Wells Fargo Capital Trust IV 7.00% Sep 01/31	155,782	158,361	0.31
10,700	Wells Fargo Capital Trust VI 6.95% Apr 15/32	335,708	342,957	0.67
30,000	Wells Fargo Capital Trust VII 5.85% May 01/33	887,303	919,275	1.80
10,000	Wells Fargo Capital Trust IX 5.63% Apr 08/34	285,370	300,542	0.59
		<b>44,676,756</b>	<b>45,584,061</b>	<b>89.55</b>
<b>Total Preferred Securities</b>		<b>53,512,282</b>	<b>54,629,784</b>	<b>107.32</b>

# Statement of Investments (continued)

(Unaudited)

As at June 30, 2005

Par Value (\$)	Description	Average Cost (\$)	Market Value (\$)	% of Net Assets
<b>BONDS</b>				
<b>Canada</b>				
883,000	Alberta Energy Company Ltd. 7.30% Sep 02/14	1,027,564	1,066,109	2.09
1,509,000	Bell Canada 5.00% Feb 15/17	1,465,871	1,551,790	3.05
998,000	BMO Capital Trust 5.47% Dec 31/14	1,018,290	1,073,702	2.11
1,454,000	CU Inc. 5.10% Nov 18/14	1,470,292	1,542,431	3.03
1,007,000	Enbridge Gas Distribution Inc. 5.16% Sep 24/14	1,023,045	1,075,451	2.11
536,000	Great-West Life Capital Trust 6.00% Dec 31/12	571,577	597,654	1.17
1,077,000	Hydro One Inc. 5.77% Nov 15/12	1,149,722	1,201,044	2.36
883,000	Loblaw Companies Limited 7.10% Jun 01/16	1,029,779	1,082,102	2.13
1,001,000	Manitoba Telecom Services Inc. 5.20% Sep 27/11	1,025,182	1,061,265	2.09
972,000	RBC Capital Trust II 5.81% Dec 31/53	1,017,183	1,070,148	2.10
529,000	Scotiabank Capital Trust 6.28% Jun 30/13	571,891	599,577	1.18
1,292,000	Sun Life Assurance of Canada 6.15% Jun 30/22	1,394,604	1,452,766	2.85
529,000	The Greater Toronto Airports Authority 6.25% Dec 13/12	571,471	598,274	1.18
566,000	The Thomson Corporation 5.20% Dec 01/14	572,612	603,105	1.18
543,000	The Toronto-Dominion Bank 5.69% Jun 03/18	570,623	598,051	1.18
975,000	Trans Canada PipeLines 5.65% Jan 15/14	1,019,532	1,069,697	2.10
1,121,000	Westcoast Energy 8.30% Dec 20/13	1,372,440	1,428,290	2.81
1,433,000	YPG Holdings Inc. 5.71% Apr 21/14	1,466,574	1,514,039	2.97
		<b>18,338,252</b>	<b>19,185,495</b>	<b>37.69</b>
<b>United Kingdom</b>				
1,200,000	HBOS Capital Funding L.P. 6.85% Mar 23/09	1,499,691	1,524,937	3.00
500,000	Prudential PLC 6.50% Dec 23/08	598,020	618,207	1.21
		<b>2,097,711</b>	<b>2,143,144</b>	<b>4.21</b>
<b>Total Bonds</b>		<b>20,435,963</b>	<b>21,328,639</b>	<b>41.90</b>
<b>FUTURES</b>				
<b>United States</b>				
47	U.S. 10 Year Treasury Note Future expiry date Sep 21/05	–	(104,223)	(0.20)
<b>TOTAL INVESTMENTS</b>		<b>73,948,245</b>	<b>75,854,200</b>	<b>149.02</b>
<b>Liabilities less other assets</b>			<b>(24,952,713)</b>	<b>(49.02)</b>
<b>NET ASSETS, AT MARKET VALUE</b>			<b>50,901,487</b>	<b>100.00</b>

The accompanying notes are an integral part of these financial statements

# Notes to Financial Statements

June 30, 2005 (Unaudited)

## 1. THE TRUST

Fairway Investment Grade Income Fund (the "Trust") is a closed-end investment trust established under the laws of the Province of Ontario by a Declaration of Trust dated February 25, 2005 ("Date of Inception").

The Manager and Trustee of the Trust is Fairway Advisors Inc. (the "Manager").

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. The following is a summary of significant accounting policies followed by the Trust in the preparation of its financial statements:

### **(a) Cash and cash equivalents**

Cash and cash equivalents consist of cash on deposit and short-term, interest bearing notes with a term to maturity of less than three months from the date of purchase.

### **(b) Valuation of Investments**

Investments in publicly traded securities are valued at the closing market price from the relevant exchange. Investments in securities for which closing market prices are not readily available are valued at the last reported sales price. If no sales price can be ascertained or if the securities are not quoted on an exchange, the value is based on the average of the last bid and ask prices quoted by a major dealer in such securities. Securities for which no such information is readily available are valued at fair value as determined by the Manager. The difference between market value and average cost, as recorded in the accounts, is shown as change in unrealized appreciation (depreciation) on investments.

Short-term investments, including notes and money market instruments, will be valued at cost plus accrued interest which approximates market value.

The value of any bonds, debentures and other debt obligations will be valued by taking the average of the bid and ask prices on the valuation date.

### **(c) Investment transactions and income recognition**

All investment transactions are accounted for on the trade date. Realized gains and losses from investment transactions and unrealized appreciation or depreciation in the value of investments are calculated on an average cost basis.

Interest income and expenses are recognized daily on an accrual basis.

Dividend income is recognized on the ex-dividend date.

Distributions from income trusts which are treated as dividend income, interest income, or capital gains for tax purposes are included as dividend income, interest income, or capital gains distributed from income trusts, as appropriate, in the statement of operations.

Distributions from income trusts which are treated as return of capital for income tax purposes reduce the average cost of the investment in the Trust on the statement of investments and are included as a reduction of "investments purchased during the period" in Note 8.

### **(d) Foreign currency translation**

Investments at market value and other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange applicable on the valuation date. Investment transactions and income and expenses are translated at the rate of exchange on the date of such transactions.

### **(e) Forward foreign currency contracts**

Forward foreign currency contracts are included in the statement of investments and are valued at current market value on each valuation day. Gains or losses incurred when forward foreign currency contracts entered into by the Trust, which are of the nature of a general hedge of the currency exposure of the underlying portfolio of investments, mature or are closed out are included in "realized foreign exchange gain (loss)" in the statement of operations.

### **(f) Futures contracts**

The value of a futures contract is the gain or loss that would be realized if, on the valuation date, the position in the futures contract was closed out. Margin paid or deposited in connection with futures contracts is reflected on the statement of investments. The unrealized gains or losses on futures contracts are reported as part of unrealized appreciation or depreciation of futures until the contracts are closed out. Realized gains and losses from futures contracts that are specific hedges are accounted for in the same manner as the underlying

# Notes to Financial Statements (continued)

June 30, 2005 (Unaudited)

instrument being hedged. All other realized gains and losses on futures contracts are accounted for as gains or losses.

## **(g) Accounting estimates**

Allocations of distributions received from income trusts among dividends, interest and other income, capital gains, or return of capital are based on estimates of the categorization of distribution provided by those income trusts. These allocations may change once final categorizations of the distributions are received from the respective income trusts.

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Manager to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

## **(h) Net asset value per unit**

The net asset value per unit is computed by dividing the net assets of the Trust by the total number of units outstanding on the valuation date.

### **3. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents include \$135,728 that represents cash margin held by brokers for futures contracts entered into by the Trust. Accordingly, the use of this cash is restricted.

### **4. TAXATION**

The Trust qualifies as a “mutual fund trust” within the meaning of the Income Tax Act (Canada). The Trust is subject to applicable federal and provincial taxes on the amount of its net income for tax purposes for the period, including net realized taxable capital gains, to the extent such net income for tax purposes has not been paid or made payable to unitholders in the period.

No provision for income taxes has been recorded in the accompanying financial statements as all income and net realized capital gains are distributed to the unitholders.

### **5. EXPENSES OF THE TRUST**

#### **(a) Management fees**

Pursuant to the Declaration of Trust, the Manager provides all administrative services required by the Trust, including the appointment of investment advisors to the Trust.

Pursuant to the Declaration of Trust the Manager receives a monthly fee at the annual rate of 1.00%, plus applicable taxes, of the net asset value of the Trust (the “Annual Management Fee”), calculated and payable monthly in arrears. For the first three years of the life of the Trust, 30% of the Annual Management Fee, excluding applicable taxes, will be paid in units and 70% of the Annual Management Fee will be paid in cash. After the first three years, the Annual Management Fee may be paid in cash and/or units at the option of the Manager. The Trust has reserved 105,000 units to be issued from treasury to the Manager as payment for the Annual Management Fee for a period of 10 years.

The Manager is responsible for payment of the investment management fees of the Trust’s investment advisors out of its annual management fees.

#### **(b) Other expenses**

The Trust is responsible for all other expenses incurred in connection with its operation and administration, such as custody, valuation, transfer agent, reporting, audit and legal fees. Brokerage commissions paid on securities transactions are not considered to be part of total expenses. These commissions are included in the cost of purchasing, or netted out of the proceeds from selling securities. The Trust will pay to registered dealers an annual service fee equal to 0.30% annually of the net asset value of units held by clients of the sales representatives of such dealers, calculated and payable semi-annually in arrears.

# Notes to Financial Statements (continued)

June 30, 2005 (Unaudited)

## 6. UNITHOLDERS' EQUITY

The Trust is authorized to issue an unlimited number of voting, transferable, redeemable trust units of one class, each of which represents an equal, undivided interest in the net assets of the Trust. On termination of the Trust, which is expected to be August 31, 2015, unitholders will be entitled to receive their pro rata share of all of the assets of the Trust remaining after payment of all debts, liabilities and liquidation expenses. The Trust's units are listed on the Toronto Stock Exchange under the symbol FGF.UN.

The Trust will terminate operations on August 31, 2015 (the "Termination Date") and the net assets will be distributed pro rata to unitholders unless an alternative later termination date is approved by the unitholders.

Units may be surrendered for redemption not more than 45 days, and at least 20 business days, prior to the second last business day of August in any year. Unitholders will receive a redemption price per unit equal to the net asset value per unit of the Trust determined as of the valuation date.

Additionally, and in accordance with the Declaration of Trust, unitholders are entitled to a monthly redemption at a redemption price equal to the lesser of: (a) 95% of the average of the daily weighted unit trading price for the 10 business days prior to the second last business day of the month and (b) the closing unit market price on the second last business day of the month. Such redemption right must be exercised at least seven business days before month-end.

## 7. NET CAPITAL TRANSACTIONS

Net capital transactions for the Trust for the period from Date of Inception to June 30, 2005, consisted of the following:

	Units	\$
Number of units outstanding, beginning of period	–	–
Subscriptions	5,310,000	53,100,000
Units issued under the Annual Management Fee (Note 5)	3,226	30,329
Redemptions	(1,400)	(12,600)
Issue expenses (including agents' fees)	–	(3,355,000)
<b>Number of units outstanding, end of period</b>	<b>5,311,826</b>	<b>49,762,729</b>

## 8. NET REALIZED GAIN (LOSS) ON SALE OF INVESTMENTS

For the period from Date of Inception to June 30, 2005, the net realized gain on the sale of investments for the Trust was as follows:

Proceeds from sale of investments	\$ 1,783,387
Cost of Investments sold:	
Cost of investments, beginning of period	–
Investments purchased during the period	74,847,021
	74,847,021
Less: Cost of investments, end of period, excluding short-term investments	73,948,245
Cost of investments sold during the period	898,776
Loss on futures contracts	(88,769)
<b>Net realized gain on sale of investments</b>	<b>\$ 795,842</b>

## 9. LOAN FACILITY

The Manager, on behalf of the Trust, has entered into a revolving term credit facility with The Bank of Nova Scotia ("BNS"). The aggregate amount of borrowings under the credit facility and other forms of leverage may not exceed 35% of the total assets of the Trust at the time the borrowing or other transaction is entered into. The Trust has entered into a general security agreement providing BNS with a first charge on the assets of the Trust as collateral for indebtedness arising out of the credit facility.

As at June 30, 2005, the Manager, on behalf of the Trust has drawn down loans in the aggregate principal amount of \$6,250,000 CAD and \$16,000,000 USD. The first loan was in the amount of \$4,125,000 CAD with an interest rate of 2.59%, and maturing on July 18, 2005. The second loan was in the amount of \$2,125,000 CAD with an interest rate of 2.62%, and maturing on July 18, 2005. The third loan was in the amount of \$5,500,000 USD with an interest rate of 3.59%, and maturing on July 18, 2005. The fourth loan was in the amount of \$10,000,000 USD with an interest rate of 3.64%, and maturing on July 18, 2005. The fifth loan was in the amount of \$500,000 USD with an interest rate of 3.73%, and maturing on July 29, 2005.

# Notes to Financial Statements (continued)

June 30, 2005 (Unaudited)

## 10. SECURITIES LENDING

In order to generate additional returns, the Trust may enter into securities lending agreements with borrowers deemed acceptable to the Trust. Under a securities lending agreement, the borrower must pay the Trust a negotiated securities lending fee, provide compensation to the Trust equal to any distributions received by the borrower on the securities borrowed and the Trust must receive collateral security of 102% for the loaned security.

There were no securities lending transactions during the period.

## 11. DISTRIBUTIONS

The Trust endeavours to make monthly cash distributions to unitholders consisting primarily of distributions received on securities in the investment portfolio and, in certain circumstances, of net realized capital gains from the investment portfolio. These monthly distributions will be paid to unitholders on or about the last business day of each month. The monthly distribution declared to unitholders of record, at the end of each month in the period, was \$0.05 per unit.

## 12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Trust's investment activities expose it to various types of risk associated with the financial instruments in which it invests directly. In addition to the risks of investing in equity, income trust, bond and preferred securities markets generally, the Trust is subject to other risks, including the following:

### *Currency risk*

The Trust invests in securities denominated in currencies other than its reporting currency, the Canadian dollar. Consequently, the Trust is exposed to risks that the exchange rate of the Canadian dollar relative to the other currencies may change in a manner which has an adverse effect on the reported value of that portion of the Trust's assets. The Trust manages its currency risk through foreign currency hedging strategies.

### *Interest rate risk*

The Trust invests in interest-bearing securities. The income of the Trust may be affected by changes in interest rates relevant to particular securities or as a result of the investment advisors being unable to secure similar returns on the expiry or sale of securities.

### *Credit risk*

Credit risk on financial instruments is the risk of a financial loss occurring as a result of the default of a counterparty on its obligation to the Trust. Credit risk is managed by dealing with counterparties the Trust believes to be creditworthy and by regular monitoring of credit exposures.

# Corporate Information

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Listed

**The Toronto Stock Exchange**

Ticker Symbol

**FGF.UN**

## About Fairway

Fairway is a specialized financial services firm focused on the creation, marketing, distribution and management of investment products in both traditional and alternative asset classes. Fairway's products are structured to provide yield enhancement, tax advantages and other benefits that complement the needs of Canadian investors. Fairway's principals are experienced investment professionals who share a strong track record as innovators in the Canadian securities industry.

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