

PURPOSE

The iTrustIndex is intended to provide useful measures – meaningful indices and objectively quantifiable indicators – of potential investment performance for *income-investors* who are considering buying one or more income trust securities in light of the growing range of financial investments being formed and sold in public markets.

INDEX DESIGN

Comprehensive Equal-weight Dollar Value

The iTrustIndex includes a notional purchase of \$1000 in units for each and every income unit trading on the Toronto Stock Exchange.

An income unit is defined as a unit of ownership in an open-ended or closed-end legal trust, limited liability partnership and, in some cases, an investment company that issues securities with the explicit objective of distributing a significant portion of net earnings or cash flow from the business to unit owners.

These securities are legally structured to work within Canadian securities regulations and tax laws to provide the unit owner an interest in and responsibility for paying the tax on income from cash distributions from the business so that the business retains little or no net income for tax purposes.

The all-inclusive nature and equal weighting of that index portfolio can provide an investor with the means to see and reasonably compare the characteristic performance and features of trust issues on a dollar-for-dollar invested basis. In contrast to a market-weighted or seller-reflective index, our index includes all issues so that it more accurately reflects the reality of the buyer or investor who faces a growing range of alternative investments in public markets.

As a result, the iTrustIndex can be useful for investors who want objective data on the value of the trust sector or an issue within it rather than simply accepting the sellers' measurement of returns based more on the largest issues in the market – i.e. the most successfully sold issues – than the full range of investment alternatives and full range of performance by each business for which there is an issue.

In fact, recent studies published in the Journal of Certified Financial Analysts by researchers and fund managers at Quantum Funds in California showed that investment in an equal-dollar value index is more effective at providing investors better than average returns on investment than investment in traditional market-weight indices. This is because the largest securities by market capitalization, market value or issue size (measured as *outstanding units x price*) tend not to provide as fast a rate of growth or return as smaller issues that are simply not seen in size-oriented and representative (as opposed to all-inclusive) indexes.

An equal-weight and comprehensive index of a market like the iTrustIndex provides investors a particularly effective lens on the full depth, breadth and flow of money or values in a market.

Method of Base Valuation for Issues in the Index

Income units are added to the iTrustIndex as of the date the issue first trades on the Toronto Stock Exchange assume to be on or more recently than Sept. 1 2000.

For purposes of purchasing \$1000 of the issue for the index, the initial unit price is calculated for new issues as the average price between the price of the initial public offering (\$10 per unit for example) and the closing price on the first day of trade. This average pricing is an attempt to represent pricing as a function of both market demand and seller aspirations on the first day of trade.

Initial number of units in the iTrustIndex = \$1000 / initial unit price

For publicly owned companies that, by way of *Arrangement* exchange common equity shares into trust units to *convert* from equity to trust structure, the initial unit price for index inclusion is the closing price on the first day of trade for trust units.

Key Indicator from Index: Total Performance as Annualized Rate of Return

Total performance of an issue is the key indicator in our index measures as total annualized rates of return in terms of combining the [1] Annualized growth in unit price + [2] annual rate of cash distribution.

For example: If \$1000 of Unit "A" was purchased one year ago (100 units at \$10) and if those units now trade at \$12 with a total value of \$1200, and if it distributes \$100 per year (current "yield" of 10%), then Unit A would be reported as having an annual total performance of 30%. That represents the investor's experience of significant returns in terms of unit price appreciation of 20% over the year of ownership plus the 10% rate of cash income earned from distributions.

As a result, the annualized rate of performance or total return to investors on a unit is exaggerated for issues that have just recently entered the market because the length of time is short for prices and returns to be annualized.

Recognition of the age of an issue is necessary to understand the performance of one issue to the next. We find it useful to see the exaggeration, however, because it represents a very real context within which decisions to sell or buy units are made by active traders, new issue speculators and price-momentum players.

Unlike publishers of market-weighted indices, we do not rebalance the portfolio by adjusting the number of units from time-to-time. As a result, the total performance measure indicates average investor returns over the entire life or track record of the trust in the public market.

Specifically: Units with consistently stable prices will have a total performance measure that tends, over time, towards a total rate of return equal to just the distribution. Units with a consistent price history one way or another will have a total annualized return that is proportionately greater or less than the rate of distribution. And total returns for units with fluctuating unit prices will attribute significance to changes that are significant in the context of the issues entire trading history, such as a huge drop in price due to a reduction in rate of distribution for example.

Relevance of Annualized Rates of Return as Key to Investment Evaluation

With our history of using the iTrustIndex, we observe that on average, our Total Performance measure is a relevant indicator of value to investors in a number of significant ways.

For issues established in the market for more than 9 months to a year or more, top performing trusts measured in terms of high rates of total return on an annualized basis represent attractive investments:

Top performers are business out-performers: Consistently top performing units have a track record of price appreciation that generally appears to correlate with consistent reports of fundamental business strength and, particularly growth.

As a result, trust valuation is similar to equity valuation so that the rate of distribution can be useful to investors as an indicator of business health. Investors are increasingly informed about trusts sufficiently to price down units so that high yield is provided in terms of rate of distribution versus price for those issues of high relative business risk. And so too, investors are quite effective at pricing up units to diminish the relative yield from cash distributions when investors feel confident in their expectation that the business behind a trust unit can grow in fundamental ways.

Top performers distribute cash consistently: Top performing trusts according to our iTrustIndex have a track record of reliable distributions. The distribution generally indicates business health. Consistent distributions also reduce risk of return on investment because the regular and frequent cash serves as instant payback on risk.

Top performers provide high returns relative to price volatility: Consistently top performing units are priced to appreciate in a way that seems to correlate with positive rates of returns versus risk relative to the broader market. This finding comes from a study looking at risk measures geared to assessing unit returns and risk in terms of price volatility relative to the surrounding market quite apart from cash distributions.

This correlation was the initial finding of a study on all trusts using the RiskGrades system provided by RiskMetrics that we reported on to our members and subscribers in November 2004. Those initial findings were significantly confirmed in a focused reassessment of units in July 2005 looking at trusts we had identified as meeting Growth versus Income versus Speculative portfolio criteria.

We concluded that the iTrustIndex shows relative total returns – total performance – for income trust issues in a way that the Total performance factor serves as a proxy measure of returns relative to risk. It is, therefore, used as a key pre-screening factor in our selection of trusts for consideration by investors as part of our strategic portfolios offered as the iTrustModel Portfolio.

These findings are consistent with studies by others reporting that the reliability of return is enhanced relative to price risk or volatility, when a security pays out cash distributions. For example: A research report by the Calgary office of BMO Nestbitt Burns was published in June 2005 and suggested that the Sharpe Ratio for their income trust index was almost twice that of common equities, meaning that reliable returns were much greater for income trusts than equities compared to the risk of price volatility. the *Sharpe Ratio* looks at standard measures of reliability of income versus volatility of price and is used by some financial analysts and portfolio managers.

BACKGROUND

The iTrustIndex formalizes an information base that was initiated in 2001 as the TrustModel Portfolio, a self-made and independently maintained database of financial indicators and measures of return for and value of income trust and fund units.

Means to Track the Early-stage Growth of a Financial Securities Market

Following the financial failure of large blue-chip companies, the demand for income trust units grew quickly and so, therefore, did the number of new issues.

We wanted to better understand the returns and risks available in new forms of securities like trusts. And to do this, we needed a means to track growth of the overall market, and to track and benchmark financial performance of individual issues and categories of units or sectors of trust businesses.

With only limited indexing of trust units, we sought to create our own index of the market in order to see specific investment opportunities in the context of the emerging trust market and it against the backdrop of the more familiar and common equities market.

Means to Understand and Define Innovative Financial Securities

As the market emerged – and still to this day with continuing adaptation of legal structures and innovative forms of units – traditional publishers of information about financial markets failed to offer a standard definition of income trusts or funds, failing to differentiate them from other forms of units or securities for purposes of investors and, even for the benefit of understanding by, sellers.

We needed to create our own naming protocol as we discovered the market: To our surprise, fund managers who make their business the packaging and marketing of financial services as products in the form of mutual funds, funds of funds and diversified financial portfolios, sell their funds as if they are *income trusts*.

For some unsuspecting investors and those who rely on advisors or brokers, the definition of the market can be confusing as they aim to participate in the still unfamiliar realm, but increasingly popular market for investments called *income trusts*. Some business-specific trusts call themselves *income funds*. While some managed funds that an investor might reasonably call an exchange-traded *mutual fund* is called an income trust.

Hence, a benefit of undertaking the indexing exploration was that it compelled a clear understanding of the nature of units or income securities to effectively define their basic appropriateness for inclusion in an income trust index that was intended to be comprehensive. Our trust index helps to define the scope and depth of the market.

Yield as a Key Indicator of Potential Returns

The initial index was also designed as an exploration in response to the opinion that nominal yield was a key measure of unit value for income-seeking investors. While it was a common sales feature of new issues, it made little common or intuitive sense for those who cared to think about their investment.

The importance of yield as a *percentage measuring cash distribution compared to unit price* was often repeated without regard to context and without explaining the relationship between flexible rates of distribution and market-priced units in which there was inherent risk of net losses due from units having unit prices fluctuating with demand and supply in financial markets.

To accentuate the fallacy of yield as a key measure of value or indicator of potential return from owning a trust unit, many of the same experts fixed on the word *yield* to perpetuate the ill-informed myth that cash-yield from income trust units could be considered much like interest paid on fixed income debt issues.

Despite flexible rates of distribution and variable unit prices, many people made the problematic generalization that unit prices varied in an inverse relationship to government bond or bank interest rates.

Income Units as Equitable Ownership in Assets

We observed that income trust units trade along side equities in financial markets and, like common shares, income trust units represent some form of ownership in future returns. Income trust units, like equities, represent ownership in assets that attract an investor's risk capital by promising some future form of benefit.

The underlying premise of our experiment with indexing was that regardless of the extent to which an investor desires *income* or can be characterized as income-seekers, he or she ultimately finds reward and satisfaction by achieving *total overall performance* from their investments.

For the investor, this performance or total return fundamentally includes, per unit:

- 1) Cash income from distributions; plus
- 2) Capital gains from increasing unit prices.

Ideally, both forms of return can really increase over time for investors, providing rates of return that rise as faster than the rate or negative cost of inflation.

Trusts were viewed as vehicles of ownership that promised owners cash flow. And businesses often generate net cash flow when its operation is mature. So respected advisors, bankers and brokers in Canadian and, particularly, in the opinion-leading U.S. capital markets spread the notion that only mature, depreciating and effectively dying business assets were the kind of *cash cow* operations that insiders might want to sell assets off to others in return for cash, albeit at a diminishing rate of cash return over the long term on an aging asset.

Some income trusts were formed to sell off assets in which owners or managers could see reasonable cash returns without much reinvestment for purposes of growth. Hence trusts have a history as a form of ownership in long term or fixed cash-yielding assets like rental real estate and community infrastructure like utilities and pipelines.

But in Canada, there was also the legal flexibility in open-ended trusts and limited liability partnerships for managers to both pay out cash flow as distributions and yet retain cash -- or sell more units for cash -- to purchase new assets. Those acquisitions could enrich, refurbish or, in essence, grow the existing productive capacity of the business.

So despite having *reserves* with expected productive capacities of more than 5 or 10 years, oil and gas producers who sold units of ownership in the royalties or cash flow from sales, demonstrated the value of growth through capital expenditure programs to discover or make *accretive* acquisitions of new pools of oil and gas. Real Estate Investment Trusts had the flexibility to buy and sell properties.

In fact, there is some expectation that the unit price for a trust, like an equity share, represents a net present value of future cash flows plus the value of underlying assets in so far as those assets reside within an enterprise with managers or interested others who have the capacity to increase net cash flows in the future.

Income trusts were afforded the kind of financial and legal flexibility necessary to maintain or grow the business that was generating cash. And so a diverse and growing range of business trusts are being taken into the market.

Regular cash distributions from operational cash flow can indicate to owners the viability and potential for business steady operation or growth and the risk of failure.

There is an assumption that the market-based pricing of units would reflect investors' expectations and current valuations of units where both forms of opinion can be related to objective measures of success in the underlying enterprise.

For investors, the value of owning an income trust unit is much like the value of holding a common equity that pays a dividend or distribution. When setting up the original TrustModel Portfolio, some exploration considered the merit of using common business measures as a way to gauge returns from income trust investments.

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