

# **Global Diversified Investment Grade Income Trust II**

Consolidated Financial Statements  
**June 30, 2006**  
(unaudited)

# Global Diversified Investment Grade Income Trust II

## Consolidated Statement of Net Assets

As at

	As at June 30, 2006 (unaudited) \$	As at December 31, 2005 (audited) \$
<b>Assets</b>		
Cash	258,065	409,414
Interest receivable on investments	7,460,980	6,027,227
Credit default swap receivable	17,464,470	11,597,327
Other accounts receivable	108,937	93,559
Prepaid expenses	13,669,623	14,455,233
Investments, at cost (note 3)	2,115,942,518	2,131,107,740
Credit default swap asset, at replacement cost (note 4)	(7,843,500)	-
Interest rate swap asset (note 4)	60,302	112,864
	<u>2,147,121,395</u>	<u>2,163,803,364</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	3,259,848	2,549,806
Brokers' commissions payable	92,155	86,063
Credit default swap payable	1,279,000	1,204,233
Commercial paper (note 5)	1,726,191,982	1,752,110,409
Floating rate notes (note 6)	275,000,000	250,000,000
Placement and structuring fee note (note 7)	14,119,320	14,756,610
Distributions payable	959,023	1,027,065
	<u>2,020,901,328</u>	<u>2,021,734,186</u>
<b>Net Assets representing Unitholder's Equity</b> (note 10)	<u>126,220,067</u>	<u>142,069,178</u>
<b>Number of units outstanding</b>	<u>13,959,575</u>	<u>14,950,000</u>
<b>Net assets per unit</b>	<u>9.04</u>	<u>9.50</u>

# Global Diversified Investment Grade Income Trust II

## Consolidated Statement of Operations

For the six month period ended June 30, 2006

---

	For the six-month period ended June 30, 2006 (unaudited) \$	For the period of March 2, 2005 to June 30, 2005 (unaudited) \$
<b>Investment income</b>		
Interest on investments	41,807,359	19,381,540
Income from credit default swaps	15,335,119	10,304,532
Interest on cash	4,118	6,155
Change in unrealized appreciation (depreciation) in value of credit default swap and interest rate swap asset (liability)	(7,896,062)	(700,000)
Gain on sale investments	102,952	-
	<u>49,353,486</u>	<u>28,992,227</u>
<b>Investment-related expenses</b>		
Expense on credit default swaps	7,165,383	4,505,372
Interest on interest rate swaps	308,489	5,244
Interest on commercial paper	32,980,753	15,165,467
Interest on floating rate notes	5,162,399	2,084,234
Interest on placement and structuring fee note	357,171	221,217
Brokers' commissions	541,511	747,376
Liquidity premiums	595,069	400,536
Financial service fees (note 8 (a))	2,385,610	1,444,573
Follow-up fees (note 8 (b))	285,795	320,845
	<u>49,782,180</u>	<u>24,894,864</u>
<b>Net investment income before administrative expenses</b>	<u>(428,694)</u>	<u>4,097,363</u>
<b>Administrative expenses</b>		
Audit fees	131,502	22,790
Legal fees	201,743	85,221
Directors fees	56,922	36,675
Administrative agent	30,428	24,695
Custodial fees	57,083	43,726
Communications	13,677	9,118
Regulatory fees	99,060	46,071
Insurances	22,987	39,126
Information technology fees	-	3,148
Bank fees	2,968	1,703
	<u>616,370</u>	<u>312,273</u>
<b>Net income (loss) for the period</b>	<u>(1,045,064)</u>	<u>3,785,090</u>
<b>Net income (loss) per unit</b>	<u>(0.07)</u>	<u>0.25</u>

# Global Diversified Investment Grade Income Trust II

Consolidated Statement of Changes in Net Assets

For the six month period ended June 30, 2006

---

	For the six-month period ended June 30, 2006 (unaudited) \$	For the period of March 2, 2005 to June 30, 2005 (unaudited) \$
<b>Net income (loss) for the period</b>	(1,045,064)	3,785,090
<b>Distributions to unitholders</b>		
Return of capital	(5,890,222)	(3,756,935)
<b>Equity transactions</b> (note 10)	<u>(8,913,825)</u>	<u>139,711,019</u>
<b>Increase in net assets for the period</b>	(15,849,111)	139,739,174
<b>Net assets – Beginning of period</b>	<u>142,069,178</u>	<u>-</u>
<b>Net assets – End of period</b>	<u>126,220,067</u>	<u>139,739,174</u>

# Global Diversified Investment Grade Income Trust II

## Consolidated Statement of Cash Flows

For the six month period ended June 30, 2006

	For the six-month period ended June 30, 2006 (unaudited) \$	For the period of March 2, 2005 to June 30, 2005 (unaudited) \$
<b>Cash flows from</b>		
<b>Operating activities</b>		
Net income (loss) for the period	(1,045,064)	3,785,090
Adjustments for:		
Change in unrealized (appreciation) depreciation in value of credit default swap and interest swap (asset) liability	7,896,062	700,000
Increase in interest receivable on investments	(1,433,753)	(4,698,100)
Increase in credit default swap receivable	(5,867,143)	(5,344,768)
Increase in other accounts receivable	(15,378)	(52,809)
Decrease in prepaid expenses	785,610	523,740
Increase in accounts payable and accrued liabilities	710,042	1,533,692
Increase in brokers' commissions payable	6,092	-
Increase in credit default swap payable	74,767	1,164,092
Interest on placement and structuring fee note	362,705	168,423
Decrease in distribution payable	(68,042)	-
Amortization of discount on commercial paper	32,980,753	15,165,467
Gain on sale of investments	(102,952)	-
	35,328,763	9,159,737
	34,283,699	12,944,827
<b>Investing activities</b>		
Purchase of investments	-	(2,140,000,000)
Proceeds from sale of investments	15,268,175	2,729,870
	15,268,175	(2,137,270,130)
<b>Financing activities</b>		
Proceeds from issuance of commercial paper	9,607,593,606	5,253,532,671
Maturities of commercial paper	(9,666,492,786)	(3,515,479,465)
Proceeds from issuance of Floating Rate Notes	25,000,000	250,000,000
Payments on placement and structuring fee note	(999,996)	(499,998)
Issue of Units	-	149,500,010
Unit Issue Expense	-	(9,788,981)
Units redeemed	(8,913,825)	(10)
Distributions paid to unitholders	(5,890,222)	(2,729,870)
	(49,703,223)	2,124,534,357
<b>Increase in cash for the period</b>	(151,349)	209,054
<b>Cash – Beginning of period</b>	409,414	-
<b>Cash – End of period</b>	258,065	209,054

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

## 1 Creation of Trust and nature of operations

Global Diversified Investment Grade Income Trust II (the “Trust”) is a limited purpose close-end income trust which was established under the laws of the Province of Ontario on February 28, 2005 by a trust agreement.

Global Digit II Management Inc. is the issuing trustee (the “Trustee”) of the Trust. Natcan Trust Company was engaged by the Trustee to act as administrative agent of the Trust, custodian of its assets and transfer agent and registrar of its units. Natcan Trust Company will also act as investment advisor of the Trust if so required by the Trustee. The promoter of the Trust is National Bank Financial Inc. and Natcan Trust Company, do not hold any voting securities in the Trustee and do not have a representative on its board.

The Trust provides its unitholders with an exposure to four portfolios (collectively, the “portfolio”) containing 149,208,195 and 553 securities (the “reference obligations”), the objective being to provide unitholders with a stream of monthly distributions and to redeem all of the outstanding units on or following March 2, 2010 (the “reset date”), or subsequent reset date on a multiple of five years. The maturity date will not be later than 40 years after initial execution. In order to meet its investment objectives, the Trust entered into credit default swap agreements with a creditworthy financial institution (the “Bank”).

Through to the maturity date, the redemption price of the Trust’s units and the net asset value of the Trust will vary depending on a number of factors such as the monthly distributions to be made on the units, interest rates, the rating of the reference obligations and the cumulative net losses incurred upon the occurrence of credit events in the portfolio. Credit events include bankruptcy, failure to pay and other specified loss events. However, the Trust will not be exposed to losses greater than the unitholders’ equity.

## 2 Significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies are the following.

### Consolidation

The consolidated financial statements include the assets and liabilities and the results of operations of the Trust and of Silverstone Trust, a variable interest entity of which the Trust is the main beneficiary, after elimination of intercompany transactions and balances.

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

## Investments

Investments are carried at cost.

## Prepaid expenses

Prepaid expenses consist of the placement and structuring fees paid in advance to National Bank Financial Inc. They are amortized on a straight-line basis over approximately seven years.

## Revenue recognition

Interest income, interest expense and income from the credit default swaps are recorded on an accrual basis.

## Accounting estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Trustee to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Trustee believes that the estimates used in preparing the consolidated financial statements are reasonable. Actual results may differ from those estimates.

## Fair value of financial instruments

The fair value of the financial instruments is determined as follows:

### Valuation of credit default swaps and interest rate swaps

The credit default swaps are presented at their net estimated replacement cost and the interest rate swaps are presented at their estimated fair value, with changes in the unrealized gain or loss of the period recorded in the consolidated statement of operations. Replacement cost is evaluated based on the quotation provided by the Bank. The calculated replacement cost reflects market conditions on a given date and for this reason may not be representative of future fair values. Also, the replacement cost does not necessarily reflect the value at which the credit default swaps could be liquidated.

### Financial instruments valued at book value

The book value of a number of short-term financial instruments presented in the consolidated statement of net assets approximates their fair value. These financial instruments include cash, interest receivable on investments, credit default swap receivable and payable, other accounts receivable, accounts payable and accrued liabilities, commercial paper and distributions payable.

### Investments and credit default swap receivable

The fair value of the floating rate term deposit approximates its book value. The estimated fair value of the fixed rate term deposit is determined by discounting the contractual cash flows at the interest rate on the term deposit and swap period.

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

Floating rate notes

The fair value of the floating rate notes approximates their book value.

### 3 Investments

Under the credit default swap agreements, the term note investments are pledged to the Bank. These investments are issued on an unsubordinated and unguaranteed basis by financial institutions. The investments mature in March 2010.

The amounts recoverable on the maturity date of the investments will be reduced by any loss incurred as a result of credit events.

A \$115,942,518 (2005- \$131,107,740) term note with a financial institution, having a long-term solvency rating of A from Standards & Poor's Rating Service ("S&P") as of the date of issuance, together with a credit default swap receivable of \$14,782,482 (2005- \$8,892,260) bear interest at a rate of 3.922%, payable monthly until on or about March 2, 2010 after which date their rate of return will be reset for five years as of each reset date until the maturity date. The fair value of the term note on June 30, 2006 was \$111,768,587 (2005- \$137,242,000).

A \$2,000,000,000 term note with a financial institution, having an S&P long-term solvency rating of AAA as of the date of issuance, bears interest at the rate of one-month bankers' acceptances plus a fixed margin, payable monthly until end of term.

### 4 Derivative instrument

The Trust has entered into three credit default swap agreements ("swap agreements A, B and C") with the Bank pursuant to which the Trust will pay the Bank if credit events occur in connection with the reference obligations until March 2010 or subsequent reset date on a multiple of five years. The maximum loss that may be incurred for credit events with respect to swap agreements A, B and C amounts to \$140,000,000. Under swap agreements A, B and C, a monthly payment, made by the Trust to the Bank corresponding to a contractual rate applied to the notional amount of the contracts and equal to the contractual interest rate applied to the investment pledged as security, is made, and the Bank will pay at term an amount equal to the excess of the notional amount of the contracts less net losses incurred on those contracts over the residual amount of the investments pledged as security. On a monthly basis, the Bank will acquire from the Trust a portion contractually determined of the note pledged as security; this portion is equal to the monthly payment for the month in consideration.

Moreover, through Silverstone Trust, the Trust has also entered into credit default swap agreements ("swap agreements D") with the Bank pursuant to which the Trust will pay the Bank if credit events occur in connection with the reference obligations until March 2010 or subsequent reset date on a multiple of five years. The maximum loss that may be incurred for credit events with respect to swap agreements D amounts to

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

\$2,000,000,000. The income from those contracts received by the Trust is equal to a contractual rate applied to the contract notional amount.

The funded aggregate notional amount of the four swap agreements (A, B, C and D) as at June 30, 2006 totalled \$2,140,000 for the reference obligations portfolio of \$80,000,000,000, which had an average S&P rating of AA/AA- as at June 30, 2006.

From time to time, the Trust enters into interest rate swap agreements with National Bank of Canada in order to manage interest rate spread risks relating to the commercial paper and the investments. These contracts have not been designated for hedge accounting. They had a total notional amount of \$107,866,637 as at June 30, 2006 and a fair value of \$60,302 (2005- nil).

## **Credit risk**

As a result of entering into the credit default swap agreements with the Bank, the Trust is exposed to credit risk with respect to the reference obligations included in the portfolio. Credit events (bankruptcy, failure to pay or other loss event) in relation to the reference obligations could result in a loss for the Trust. The maximum loss that could be borne by the Trust for credit events with respect to the reference obligations under swap agreements A, B and C amounts to \$130,725,000. Any loss from swap agreements D will be borne by the holders of the commercial paper and floating rate notes.

Additionally, the Trust is exposed to counterparty credit risk arising from any unrealized gain on the credit default swaps and interest rate swaps, plus any amount receivable from the counterparty. The Trustee believes that the probability of default is low.

## **Interest rate risk**

There is interest rate risk associated with the financial instruments. Market rates can vary and cause fluctuations in the fair value of financial instruments having a fixed rate at the signing of the contract.

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

## 5 Commercial paper

Commercial paper as at June 30, 2006, including accrued interest of \$6,588,770 is \$1,726,191,982 (2005-\$ 1,752,110,409), mature between July and January 2007, as shown in the table below:

<b>Maturity date</b>	<b>Interest rate</b>	<b>Amount \$</b>
July 2006	3.79% to 4.49%	1,066,829,931
August 2006	4.22% to 4.59%	318,566,958
September 2006	4.35% to 4.63%	240,232,390
October 2006	4.36% to 4.64%	89,917,233
January 2007	4.31%	10,645,470
		<hr/>
		1,726,191,982

## 6 Floating rate notes

<b>Maturity date</b>	<b>Interest rate</b>	<b>\$</b>
September 2006	CDOR – 1 month + 0.15%	75,000,000
March 2007	CDOR – 1 month + 0.17%	25,000,000
March 2007	CDOR – 3 months + 0.17%	100,000,000
April 2007	CDOR – 1 month + 0.16%	50,000,000
October 2007	CDOR – 3 months + 0.17%	25,000,000
		<hr/>
		275,000,000

## 7 Placement and structuring fee note (“PSF Note”)

The Trust issued a PSF Note, having a fair value of \$ 20,000,000 in consideration of \$ 15,712,210 pursuant to a Financial Services Agreement dated August 27, 2005 between National Bank Financial Inc. and the Trust. The principal sum of \$ 20,000,000 will be paid in equal monthly instalments of \$ 166,667 consisting of capital and interest of 5%.

The maturity date of the PSF Note is March 3, 2015.

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

## 8 Operating expenses

- a) The trust pays financial services fees of up to 0.35% per annum of the funded initial amount of the swap contract entered into by the Trust. These fees include the placement and structuring fee and the performance fee.
- b) The Trust pays to investment advisors a servicing fee equal to 0.40% annually of the outstanding amount on a per unit basis held by clients of such investment advisors.

## 9 Income taxes

The Trust qualifies as a unit trust within the meaning of the Income Tax Act (Canada). The Trust is subject to income taxes under this Act on the amount of taxable income for the period and can deduct in computing its income tax for all amounts paid or payable to the Trust's unitholders in determining its income for tax purposes.

Any amount payable under the credit default swaps is considered to be payable under the swap agreements and is taxable as such. According to the terms of the swap agreements, the amount will be determinable only on the maturity date and therefore the swap payment to the Trust should only be taxable as income at that date only.

## 10 Unitholders' equity

### Authorized units

The Trust is authorized to issue in series an unlimited number of transferable and redeemable units, each of which represents an equal, undivided interest in the net assets of the Trust.

All units have equal rights and privileges. Each whole unit entitles the holder to one vote and to participate equally with respect to any and all distributions made by the Trust.

Units may also be surrendered for redemption at any time but will be redeemed only on a quarterly basis on the last business day of each of the months of February, May, August and November (the "redemption date") for an amount equal to the redemption price of the units determined as of such redemption date.

The redemption price will be equal to the lesser of:

- (a) 95% of the daily weighted average trading price per unit on the principal exchange on which the units are listed for the five trading days following the redemption date; and
- (b) an amount equal to:
  - (i) the closing price of the units on the principal exchange on which the units are listed; or

# Global Diversified Investment Grade Income Trust II

Notes to Consolidated Financial Statements

June 30, 2006

---

- (ii) the average of the highest and lowest prices of the units if the exchange or other markets on which the units are listed provides only the highest and lowest trading prices; or
- (iii) the average of the latest bid and ask prices on the principal exchange on which the units are listed if there was no trading on such redemption date.

Units may be surrendered for redemption at any time but will be redeemed only on an annual basis on the last business day of each month of February (the “annual redemption date”) for an amount equal to the unwind price of swap agreements A, B and C determined as of such annual redemption date. The unwind price will be an amount equal to the sum of (i) the bid price received by the Trust to terminate the applicable tranche of swaps agreements A, B and C and (ii) the market value of the tranche of the Trust’s \$130,725,000 term deposit, less applicable unwind costs.

On March 14, 2006; 990,425 units were redeemed at \$9.00 for redemption value of \$8,913,825. Concurrent with the redemption of units, a partial unwind of credit default swap and of permitted investment occurred for the nominal amount of \$9,275,000.

## Monthly distributions

Distributions to unitholders constitute partial capital reimbursement at the issue price of the units and may fluctuate from month to month depending on the occurrence of credit events in the portfolio. In the event that no credit default occurs, the Trust expects distributions to be made until March 2010 at an annual fixed rate of 8.25%, after which they will be equal to the applicable five-year Government of Canada bond rate plus 4.0 to 4.5%.

The distributions declared by the Trust are accounted for once declared but are payable on the 10<sup>th</sup> business day of the following month.

## 11 Comparative figures

To conform to the presentation adopted in the current year, certain amounts from the prior year have been reclassified.