2006

Nunavut Trust

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Nunavut Katikhoivia

We are determined to keep all Inuit of Nunavut working

with us to maintain the success we have experienced so far.

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Akhugutikaktugun tamaeta Inoen Nunavumi

havakatigenageagani nakuhimageagani ukoa

kaoyimaliktavun uplumimun

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Message from the Trustees

"In 2007 we receive the last contribution from the federal government under the Nunavut Land Claim Agreement."

No matter how prepared you think you are for the arrival of a significant date, you never can fully know how you are going to feel when it is here. As we sit here in 2007, looking back on 2006, we wish to give you a sense of what we are feeling as we prepare for the last contribution from the federal government under the Nunavut Land Claim Agreement. There is a fulfilling mixture of pride in accomplishing our goal, confidence in our planning for the future and determination to keep all the Inuit of Nunavut working with us to maintain the success we have experienced so far. After May 2007 we must manage our operations together in a manner that recognizes that our investment earnings are our only means to grow our assets.

As Trustees, we have the difficult task of determining a maximum total funding level for all beneficiary organizations which allows the assets of the Trust to grow at least at the rate of inflation over the long term. The task becomes even more difficult because we must also try to smooth out the funding level so that it grows year by year because the funding needs of beneficiary organizations will grow as a result of inflationary pressures on the costs of the resources they use (employment, occupancy, supplies and services etc.). This part of our roles is particularly difficult because investment returns are quite variable over any short term. Without going into the mechanics, statistical analysis tells us that the range of expected returns for typical asset classes in 19 years out of 20 are shown in the table below:

In the remaining 1 year out of 20, the return will be outside the numbers shown in the table: higher than the typical high or lower than the typical low. It is the latter condition we hope not to see but we can not guarantee the markets can avoid it.

Fortunately, public and private endowments, foundations and charities have been operating successfully for well over 100 years. As a result, numerous studies have been carried out by academics, consultants, investment professionals, and government regulators to try to determine what a well managed institutional investor can actually afford to distribute to their beneficiaries after reserving sufficient assets to allow the capital base to grow to offset the ravages of inflation.

Recently, the federal government reduced the required disbursement quota for Canadian public and private foundations from 4.5% to a more manageable rate of 3.5%. Apparently, the formula that was used by the federal Department of Finance for the 2004 Budget was based on the current real rate of return minus 20% to cover administrative costs associated with managing an investment fund. The 2004 Budget also noted that if a registered charity is not able to meet the reduced 3.5% disbursement quota, it can still apply for approval to reduce the disbursement quota further.

At Nunavut Trust we acknowledge the enormity of the tasks faced by beneficiary organizations. We currently have adopted a more aggressive distribution target of 4% of the market value of the assets.

Asset Class	Typical Low Return	Typical High Return
91-day Treasury Bill	+0.5%	+6.9%
Canadian Bonds	-6.9%	+15.9%
Canadian Stocks	-21.0%	+37.0%
Foreign Stocks	-24.2%	+39.8%

This means that after taking a 3 1/2% long term inflation rate and using the same administrative costs assumption used by the federal Department of Finance, we will need to produce an average long term investment return of 8 1/2% per annum.

From a planning perspective, adopting a funding cap approach using a moving average formula allows the Trust to advise beneficiary organizations of the amount of funding that will be available prior to the start of their budgetary planning process. It is also the approach used by most foundations and endowments. Provided Trust assets continue to grow over the long term at the average rate of inflation, beneficiary funding should also grow at a rate equal to the long term rate of inflation. Since investment markets do not grow at a constant rate, there will be periods when the investment returns will be less than the level of funding provided to beneficiary organizations. When this occurs, the difference will be advanced as a loan to the main beneficiary. In years when the investment returns exceed the level of funding provided to beneficiary organizations, the excess will be used to repay the outstanding loan. In this way, beneficiary organizations will receive a reasonably steady funding stream that will hopefully grow year by year. To work properly, the averaging period should cover at minimum a full market cycle. If over time, it is found that the 4% level of funding is too high or too low, the rate will be adjusted so that the cash flow out of the Trust is maintained at level that will allow the Trust to grow its assets at a rate sufficient to offset inflation as required under the deed of trust.

In the 2005 Annual Report, we reported that beneficiary organizations needed an additional $1.8 million in funding above the funding cap to meet their planned obligations. After meeting to discuss this situation with the beneficiary organizations, the

"We hope to **protect the settlement funds** for the Nunavut Inuit of future generations by proceeding with caution."

Trustees agreed to provide an additional $1.8 million of funding for one year provided beneficiary organizations agreed to undertake a global review of programs and operations and to develop a strategic plan that would limit the demands for funding requests from Nunavut Trust in 2006 at or below the 4% cap. After starting the global review process the beneficiary organizations asked the Trustees if they would as a good faith measure advance ½ of the transitional assistance and the trustees agreed. If the Nunavut Tunngavik Incorporated annual general meeting approved the 2007/08 budgets for beneficiary organizations with an aggregate requested funding from the Trust at or below the 4% cap then the remainder of the transitional assistance would be advanced. At this time, we cannot say for sure that beneficiary organizations have met our requirements. We firmly believe the key to beneficiary organizations being able to live within a funding cap environment lies in a revaluation of their mandate and the necessary structure to achieve it. The other ½ of the transitional assistance will not be advanced until we are satisfied our terms have been met.

As we entered 2006, most forecasters were predicting investment returns would be in the mid to high single digits with the most common expectation being 8% to 8 1/2% just enough for the Trust to meet its long term rate of return requirements. As the year progressed, we saw, the Canadian dollar continue to strengthen and most now call the Canadian dollar a petro currency. It was somewhat surprising to see that as in 2005, the ever escalating price for a barrel of oil did not seem to have as large an impact on markets as many had expected. As a result, the Trust had a reasonably good year producing an investment return of 12.3%. Compared to our peers, for 2006, we slightly underperformed the median manager who earned 12.6%. Looking at the annualized results achieved over the last ten years, the Trust earned 9.4% per annum, outperforming the same return produced by the median manager in our peer group.

The Trust Deed requires that the Trustees formally distribute 100% of the Trust's income for tax purposes to the beneficiary organizations. For 2006, this meant that $56.6 million of taxable income was distributed to the beneficiary organizations. Distributions below the funding cap will require additional loans be made to NTI while distributions in excess of the funding cap will be used to make repayments against the outstanding loans to NTI. A combination of under spending in their 2005/2006 fiscal year, a return to the Trust of $3,000,000 from the hospital projects and a distribution in excess of the funding cap for the year resulted in a $20,324,663 repayment against NTI's outstanding loan balance.

As 2007 continues to unfold, our own strategic planning is kicking into full gear. We are analyzing our entire portfolio to see how we can reduce our overall risk while earning an equal or higher return. Many new and different strategies exist that can help us to achieve this objective but each has its own set of complications. As in the past, we hope to protect the settlement funds for the Nunavut Inuit of future generations by proceeding with caution, full understanding and reasonable balance. We do not intend to put at risk the preservation of the Trust assets under any circumstances. There is just not enough certainty in the future investment markets to allow us to overspend at this time. Thank you for your support, your understanding, and your confidence in us to do our best on your behalf.

THE FUND

"The trustees adopted the **return objective of inflation plus 4% per annum** net of operating expenses."

Investment Philosophy, Policy and Criteria

The Trust Deed clearly defines the goals that are set for the Trustees to achieve. These are:

- To invest as a prudent person would
- To attempt to generate sufficient annual net income to allow the beneficiary corporations meet their responsibilities to the Inuit of Nunavut
- To attempt to ensure that the Net Capital of the Trust maintains its buying power for future generations.

For the purpose of long term financial planning, the Trustees adopted, as a long-term rate of return, the objective of inflation plus 4.0% per annum net of operating expenses. The selection of a real (after inflation) rate of return is critical given the requirement that the Trustees preserve the real buying power of trust capital for future generations.

The Nunavut Trust investment portfolio reduces the overall portfolio risk by hiring a mix of external investment counselors each being given a portion of the overall portfolio to invest in their individual areas of specialization. Our investment counselors invest in fixed-income securities (bonds, short term investments and cash) as well as equity investments (Canadian stocks, foreign stocks, etc.). The fixed income investments provide a regular and predictable amount of income while the equity investments provide for future growth of our assets that would not be available in the fixed income asset class. Trust management, in consultation with the Investment Advisory Committee, reviews the results of the individual managers, their mandates and their roles within the Trust portfolio.

Nunavut Trust's risk profile was developed by the trustees at the outset of the first payment from the federal government and has evolved with help from specialists in investment consulting. To try to support higher levels of beneficiary organizations' spending and meet the requirements to grow trust assets, the consultants recommended that the trustees adopt a more aggressive risk profile by increasing the overall level of equity held within the portfolio. With this asset mix, we should expect the portfolio to under perform when markets are declining and outperform when markets are rising. We recognize this will create more volatility in the short term but offers the potential for better relative returns in a market that can be expected to produce substantially lower rates of return than those seen in the past 5 years. Our investment philosophy can be stated in the following manner:

- Our goal is to produce and distribute a positive amount of income for tax purposes each year. A negative result in any single year can be tolerated (if driven by market conditions) but we would not want to see two negative years in a row.
- Variability in investment return over the long term is not of concern unless it becomes significantly greater than the variability of the underlying investment markets themselves.
- There must be enough money available to allow for beneficiary organization spending at an annual level of no more than 4% of the 5 year moving average market value of trust assets.

We expect the investment counselors hired to invest Trust funds to add value relative to the performance of the markets within which they invest over the longer term.

In a recent study of the trust's assets by AON Consulting, a specialist in asset risk return analysis, we were pleased to discover that if we limit ourselves to invest solely in the traditional asset classes in our current portfolio mix, then at an asset class level our portfolio is on the efficient frontier. So let's look at where we were at December 31, 2006.

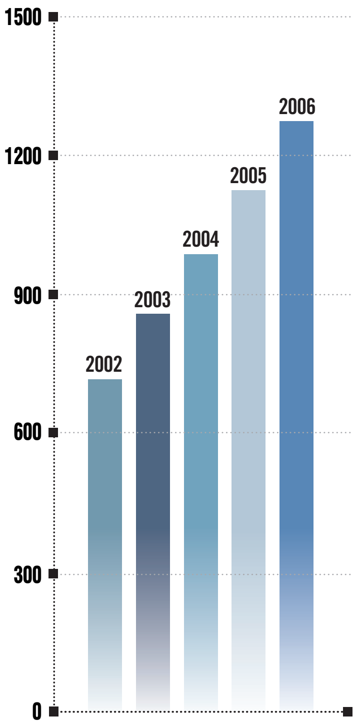
Portfolio Overview

The market value of the Nunavut Trust portfolio was $1.277 billion, an increase of $150 million above the market value at December 31, 2005. We have been educating the Inuit of Nunavut for years about the volatility of market valuations, but we take some comfort in noting that at year end 2006, the market value of Trust assets had exceeded the Trust's goal of having at least $1.140 billion in assets by the end of May 2007.

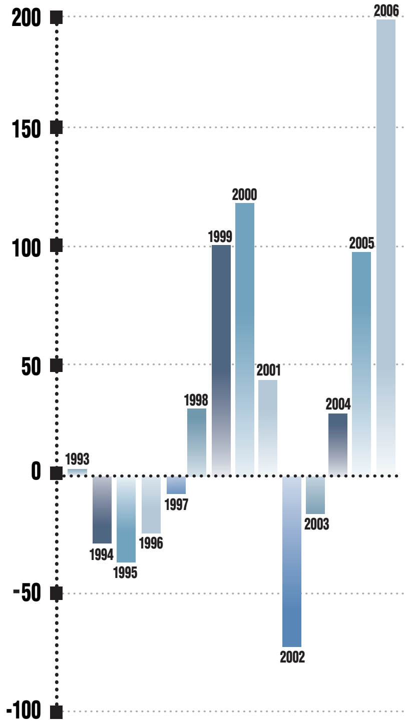
Although every market cycle has a different length, we know that if we average many market cycles, the average cycle is about 7 years. The most recent upward trend started in 2002 so we are now 5 years into the current cycle and many forecasters think that we may muddle through 2007 but could expect to see a market decline in 2008. In the United States, there have been several unfortunate incidents the most recent being the collapse of two significant hedge funds that were active in the sub-prime mortgage derivative markets. Analysts think that the collapse of these hedge funds is only the first of many that will fail. It is noteworthy that of the now 10,000 hedge funds in the United States, a large percentage invests in these derivatives and sub-prime based securities using leverage to support their holdings. If this were to intensify, there would be many hedge funds having to sell the liquid securities in their portfolios to cover the margin calls from their lenders. If many are trying to sell their liquid securities at the same time there would be few buyers and prices would fall. Of course, no-one knows if this will happen but the potential for a rather untidy market decline can not be discounted.

If the market value reserve, as shown in the following graph, is positive, the Trust will have some ability to absorb the effects of a market value decline and will still be able to meet its goals. If the market value reserve is negative, this indicates that the Trust is not achieving its goals. Should the market reserve be negative for an extended period of time action would be required to either increase investment returns (implying taking on a higher level of risk) and/or reduce the funding cap for beneficiary organizations. An all time high of $197 million for the market value reserve was achieved

Invested Assets and Accrued Investment Income
(at market)
$1,276,959,144



Market Value Reserve
(in millions of dollars)
$197,000,000



at the end of 2006. While this is good news, we must not forget that the portfolio risk, measured by the standard deviation of the portfolio, suggests that in one year out of three, normal market volatility could cause the market value to decline by $181 million. A positive market value reserve is comforting, but may not be enough in a sharp market correction. As the following charts show, Trust assets are diversified to reduce risk in two ways. First, assets are diversified by asset class and then assets are allocated to different investment counselors who invest using varied investment styles resulting in varied exposures to the many sectors in the investment markets.

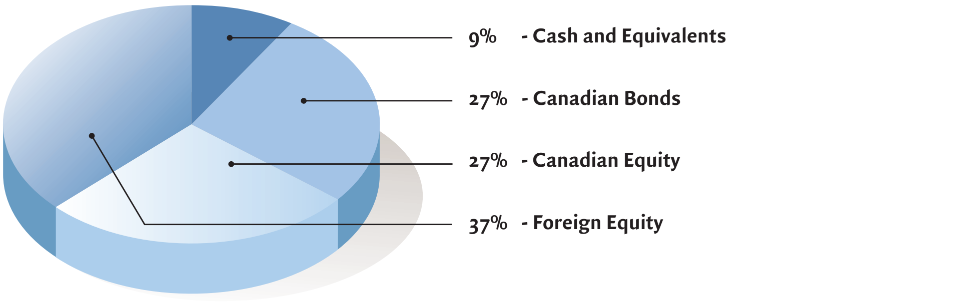
At December 31, 2006, the portfolio holdings, at market value, was sliced into 27% in bonds, 27% in Canadian equities, and 37% in foreign investments, with cash the remaining 9%.

Before 2005, income trusts were a specialized form of security usually purchased only by counselors with specific experience with these vehicles. With income trusts now comfortably included as a significant part of the investment marketplace and a component of the S&P TSX Index, we have seen Canadian Equity counselors starting to add income trusts into their Canadian Equity portfolios. With their benchmark for measuring their ability to add value through active management including these securities, they had to gain expertise in analyzing and selecting good income trusts for their portfolios. The Trust felt there was no compelling reason to maintain our specialty income trust mandate and the specialty manager was terminated.

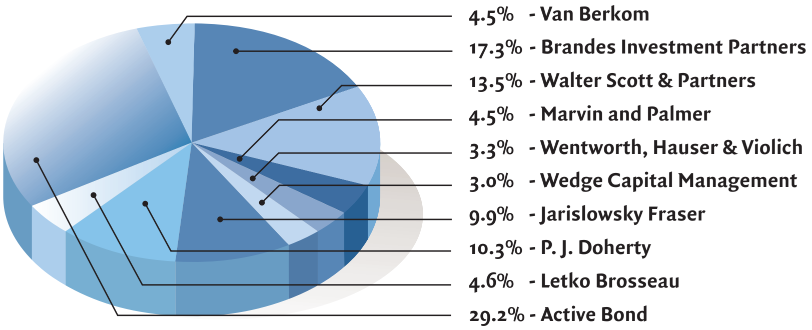
Within the foreign section of our portfolio, our large capitalization momentum manager continued to have difficulty delivering good returns. Looking forward to how we believe the investment markets will behave, we decided that this counselor's style carried more risk than we were willing to take and that investment mandate was terminated.

The following charts show the diversification of Trust assets.

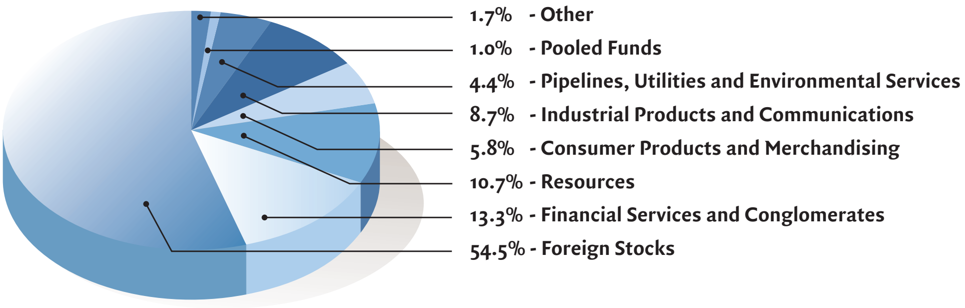
Portfolio by Asset Class



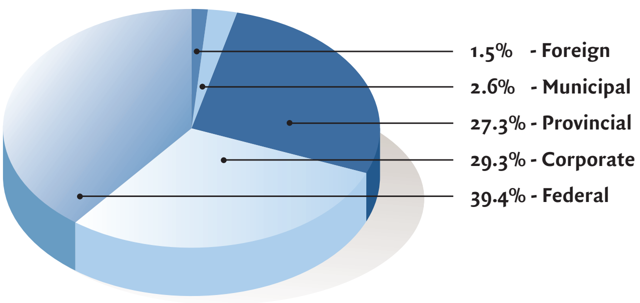
Diversification by Investment Manager and Style



Stocks by Industry Group



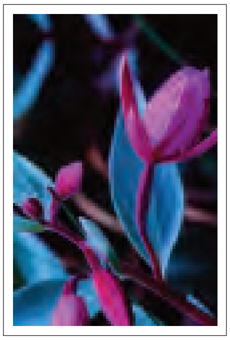
Bonds by Issuer



"Unfortunately, investment markets produce varying rates of return."

2006 saw the liquidation of our small holdings in two hedge funds. A great deal was learned about this investment vehicle during its time in our fund but we preferred to reallocate those funds to our traditional foreign managers.

Over the last few years a number of investment counselors who opened their investment firms 30 years or so ago are now starting to use various strategies for their founders to retire through the sale of their firms or the reduction in time at the office thereby letting the next generation of investment professionals run the businesses. Unless such transitions are handled carefully, they have the potential to change the way a firm operates, therefore changing the team the investor hired, the team that created the performance history. Key analysts and portfolio managers can become dissatisfied with the new operation and can leave the investment counselor's employ. Last year, two of our managers, entered this type of transition. We have done and will continue to do a thorough monitoring of the internal operations of these firms and their performance. In each case, only time will tell if transitional changes will make it possible for these firms to continue to produce the good results they have achieved in the past.



In the last few years, some funds have been experimenting with new non-traditional investments that offer the possibility of either reducing the level of portfolio risk while maintaining a constant level of investment return, or conversely increasing the rate of return for the same level of risk. These non-traditional investments have their own unique set of complications and opportunities and require a very thorough due diligence review. Throughout 2007, we plan to investigate a number of these non-traditional investments to see if we can improve our risk return profile.

Income Distribution to Beneficiary Organizations

For 2006, the Excess of Revenue over Expenditures was $77.2 million, an increase of $22.4 million over the 2005 comparable figure. This year, in addition to market conditions, transitions in investment managers created more active trading and consequently our realized gains on sales of investments increased to $47.5 million up from $28.4 million a year ago. Growth in realized gains as shown on the Statement of Revenue and Expenditures are not directly correlated with growth in assets as shown on the Balance Sheet.While the market value of the portfolio grew by a larger amount, the market gains are not recognized as income until the investment managers sell their holdings.

Nunavut Trust distributes all of its net taxable income to beneficiary organizations as required under our trust deed. For 2006, the income distribution was $56.6 million. A total of $427.3 million of income has been distributed to beneficiary organizations since our inception. Although the calculation of the net taxable income is complex a rough estimate can be determined by taking the income reported on the financial statement and subtracting ½ the gains on the sales of investments. When Excess of Revenue over Expenditures is greater than the Net Income for Tax Purposes, the difference is retained in the Trust to generate more income and offset the effect of inflation that would otherwise erode the buying power of the Trust capital. In 2006, the distribution of income to beneficiary organizations was a little higher than the 4% funding limit for the year. As a consequence, the excess was used to reduce the level of the capital loans to beneficiaries from $113.6 million at year end 2005 to $96.2 million at year end 2006. The goal over time is to reduce the outstanding loan balance to zero. It will take a number of years before this goal can be achieved. As the loan balance declines, the assets of the trust will grow. The additional assets will be invested to produce an investment return increasing the income earned and the amount that can be distributed to the beneficiary organizations.

Spending Cap

Beneficiary organizations need to receive a steady annual cash flow that grows year by year at the rate of inflation or more. Unfortunately, investment markets produce varying rates of return that can be positive in most years but negative in others. As a result, a mismatch exists between the revenue and the disbursement streams. It is the Trustees role to establish a policy that will provide beneficiary organizations with the steady stream of income they need year by year with one key constraint. The level of funding must be set at a level that can be sustained over the long term. In the short term, however, there will be periods when the annual income distribution will be less than the required level of funding and other periods when the distribution will exceed the funding level. As a result, there will be periods when the beneficiary organizations will need to borrow trust capital on a temporary basis and make repayments when the income distribution exceeds the funding level. Based upon historical analyses, the level of beneficiary funding has been set at 4% of a five year moving average of the market value of the Trust's assets.

Return on Investment

2006 was a much better year than most forecasters expected. Although we expected to see returns in the order of 8%-8 ½%, we actually earned 12.3%. Given that 2005 was also one of higher than expected returns, many pension funds and endowments have been able to significantly improve their funding needs. As we look ahead, however, we know that high oil and commodity prices will eventually take its toll and we will see a slowing economy and we will also likely see an increasing inflation risk. Currently, all the indicators suggest that we will be lucky to make just a coupon return on our bonds and at current valuations, it will be difficult to see significant price increases on our stocks. This has created a demand for new products and services focused on identifying ways to increase investment returns along with tools to help identify and understand the risks that accompany the adoption of new strategies. At Nunavut Trust, we believe our current mix of assets will allow us to achieve our goals; however there may be better ways to structure the portfolio to either reduce the level of risk and/or increase returns. As a result we will be reviewing our investment policy and risk profile as well as the overall portfolio composition over the next year or two.

Investment returns are calculated quarterly by an independent outside performance measurement service, the RBC Dexia Investor Services. At the end of 2006, the returns reported by the Benchmark Service were as follows:

Annual Time Weighted Portfolio Rates of Return (TWRR)

	2000	2001	2002	2003	2004	2005	2006
Actual	9.33%	-2.00%	-6.64%	13.14%	10.70%	11.21%	12.32%
Benchmark	3.04%	-5.13%	-9.55%	12.17%	9.72%	11.26%	13.32%
Median	12.44%	2.12%	-4.17%	13.89%	9.30%	11.75%	12.60%

Annualized Time Weighted Portfolio Rates of Return (TWRR)

	Last 10 Years	Last 5 Years	Last 3 Years	Last 1 Year
Actual	9.45%	7.86%	11.39%	12.32%
Benchmark	7.11%	7.01%	11.42%	13.32%
Median	9.45%	7.83%	11.22%	12.60%

The Trustees, Committees and Administration

“The trustees are men and women from varied backgrounds who carry a large burden of responsibility.”

Trustees

Each of the three regions in Nunavut appoints two trustees to the Nunavut Trust. The boards of each Regional Inuit Association are solely responsible for selecting who they believe will best represent the interests of all Inuit in Nunavut from applicants in their regions. Current good governance practices indicate that it is highly recommended that trustees of the Nunavut Trust have experience in investment, business, economics or financial management. The Trustees have the overall management and administrative responsibilities defined in the Nunavut Trust Deed, including the determination of the overall portfolio asset mix and ranges of variability, investment policies and objectives, establishment of performance measurement standards used to measure progress against long term goals and objectives and the approval of the selection of investment counselors. They appoint the independent auditor and assess management’s performance. As a group they try to define complex issues such as “How risky should an investment be?” or “Is there an industry or a country I do not believe it is best for our fund to buy into?” These men and women from varied backgrounds carry a huge burden of responsibility because they represent all Nunavut Inuit past, present and future. As a result they adhere to a strict code of conduct requiring them to understand their fiduciary duties, fearlessly ask the difficult questions and forcefully distance themselves from local or personal issues and political pressures. The trustees themselves appoint their chairperson through secret ballot.

On December 31, 2006, the trustees were:

James Arreak,
Chairperson & Qikiqtani Trustee

Nutarajuk Arnauyumayuq,
Qikiqtani Trustee

Dorothy Gibbons,
Vice-Chairperson & Kivalliq Trustee

Peter Tapatai,
Kivalliq Trustee

Bill Lyall,
Kitikmeot Trustee

Jack Kupeuna,
Kitikmeot Trustee

Investment Advisory Committee

To assist the Trustees, a committee consisting of experienced investment professionals well known within the institutional investment community was established to recommend investment policies, strategies and investment counselors to the Trustees.

The external members of the Investment Advisory Committee include:

Bonita Then, *Chairperson*
Roger Chiniara,
Arthur Donner
Robert Rabinovitch

Asset Custody

Although the investment counselors are given the authority to determine the selection of individual companies in which Nunavut Trust invests and the weights that each will have within their mandates, they do not physically hold Trust assets within their accounts. Instead, to provide a segregation of duties, Nunavut Trust employs the services of one or more major trust companies specializing in the settlement of security transactions. Based on trading instructions provided by the investment counselor, the Custodian effects the investment transactions and holds the securities of the Trust in segregated investment accounts.

Administration

A small office staff of three carried out the administrative duties on behalf of the Trustees during fiscal 2006. Trust staff is responsible for the strategic planning, forecasting, accounting, reporting and support activities associated with trust operations. In-house staff included a Chief Executive Officer, a Chief Financial Officer, and an Administrative Assistant. Staff members are supported by external professionals including legal advisors from the firm Drache, Buchmayer LLP and chartered accountants from KPMG the firm responsible for the annual external audit of Trust financial statements and the review of income tax returns.