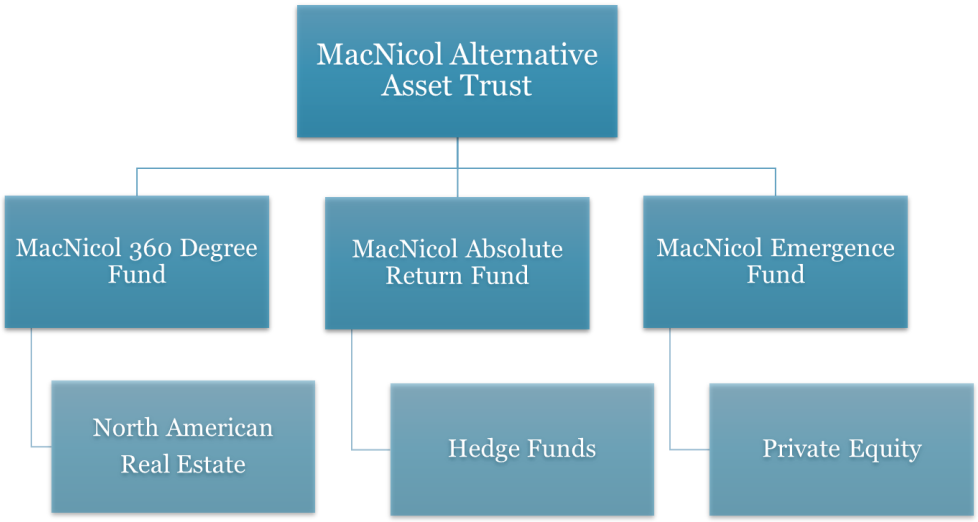
Alternative Asset Trust Second Quarter Report: June 30th, 2018

The MacNicol Alternative Asset Trust is a multi-strategy, alternative investment platform designed to generate positive and uncorrelated returns against the public stock and bond markets. The Trust, through its underlying limited partnerships, is invested in private real estate and mortgages, private equity and multi-strategy hedge funds. Combined, the Alternative Trust is invested in more than 150 separate real estate projects, mortgages, hedge funds and private securities. The advantage of combining different alternative asset classes and high yield investments into one Fund include tremendous diversification, enhanced liquidity, and a more predictable and less volatile pattern of returns when compared against the performance of the individual asset classes themselves.

Chart 1 – Investment Structure MacNicol Alternative Trust



Alternative Trust Review: The goals of the Alternative Trust are to generate positive "real" returns (after-taxes and inflation) each year, and to generate annualized nominal returns of 6%-8% over rolling five-year periods. We are pleased to report that as at June 30th, 2018 the Trust has met its primary goals by generating a positive 1-year return of 6.9% and a 5-year return of 10.6%.

The first half of 2018 concluded with markets around the world balancing the interplay between asynchronous global monetary policy and global trade rifts emanating principally from the United States. Scar tissue from the "February Flop" proved tender for investors

as the march higher resumed but at the pace of more of a tip toe. At the same time investors seemed to grow disinterested with daily trade rhetoric and instead focused their attention

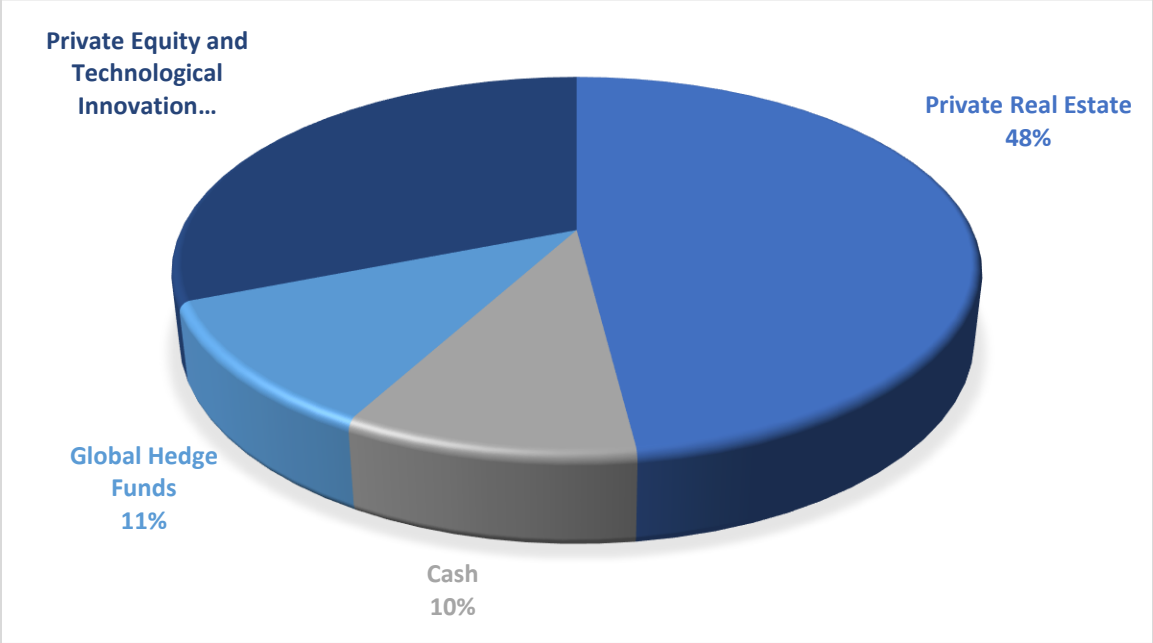
on the situation in Italy. The ensuing flight of capital out of the Euro sent the multination currency sharply lower in the 30 days ended May 18th, 2018, which was enough to easily erase gains made in December of 2017 and held over the holiday break. The US Dollar benefitted on its traditional perceived safe haven status (but we think this had more to do with the fact that the US economy is currently the only real "game in town") and this caused a rout in Emerging Markets. Given the re-weighting of risk in Emerging Markets we view them as an attractive opportunity inasmuch as investors can now pluck better deals on reform minded pro-business countries like India.

Back home in Toronto the record heat wasn't the only thinking scorching pavement: Toronto condo prices were juiced up by increased millennial demand for product and the cohorts new source of lending (baby boomer parents). The new Toronto lending "syndicate" (i.e. parents for down payments, banks for the rest) pushed real estate inflation into the east with cities like Whitby, Ajax and Oshawa experiencing material price increases for single family starter homes. Also during the quarter questions concerning the implications of things like $20 billion private equity "titan" funds and the "arms race" currently underway in the hedge fund world found their way into our inboxes, which if anything helped to make the quarter more entertaining.

At MAAM we avoid many common real estate pitfalls because while we do subscribe to the "location, location, location" adage we understand that there's a bit more to it than that. We also do not manage multi-billion dollar private equity funds for the world's uberelite. Our clients are ordinary Canadians who seek a safe harbor following a life well lived. And while our award winning MacNicol Absolute Return Hedge Fund is innovative it isn't something run by a team of Noble Laureates in a lab at MIT.

What's important to you is important to us, which is why we stick to our time-tested process of protecting your capital first and only then growing it prudently over time. Though many questions will remain unanswered no one can question our unwavering commitment to our clients and our unsurpassed reputation for personalized service.

Chart 2 – MacNicol Alternative Asset Trust Asset Mix June 30th, 2018



Alternative Trust Second Quarter 2018 Highlights

During the second quarter of 2018 the Alternative Trust rose by 1.7% which trailed developed equity markets but outperformed developed bond markets. What were problematic currency headwinds earlier in the quarter Currency headwinds shifted to supportive tailwinds Italian eurozone risk. Direct and indirect trade tensions influenced both the Canadian dollar and the Yen which were both lower versus the US Dollar. The trust's cash weight remained a material 10% though not for lack of activity by the investment team. Cash flows from new investors were deployed efficiently but at a pace that mirrored subscriptions to new investments. Asset class specific transactions within the trust are discussed in greater detail below. Not discussed below is our planned investment in the growing area of specialized memory care facilities. The team completed final due diligence on an opportunity in this space, but needed more time to grasp the implications of the new Ontario government on long-term care in the Province.

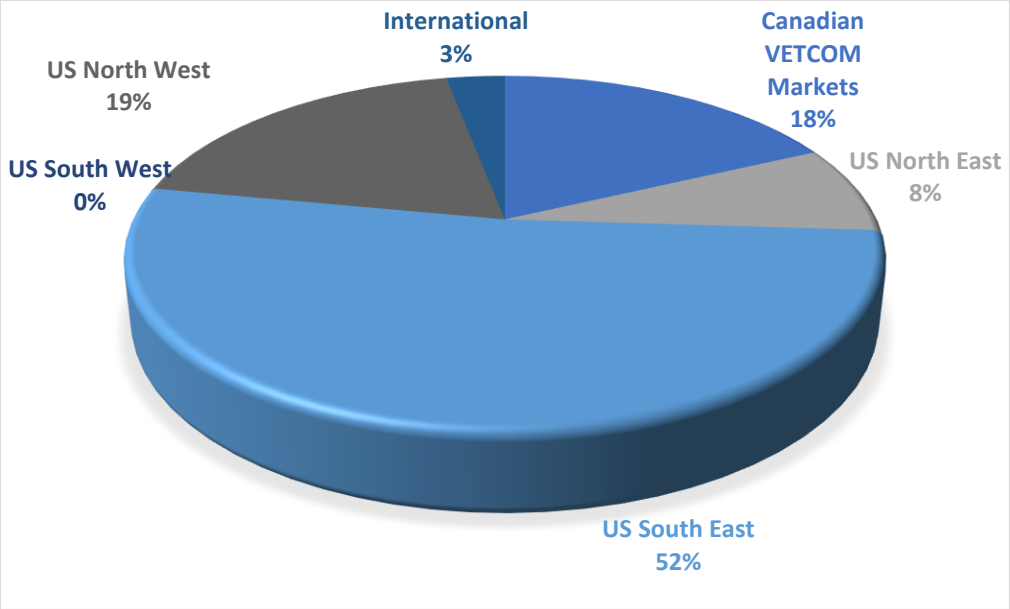
North American Private Real Estate: 360 Degree Realty Income Fund

The Alternative Asset Trust invests in North American real estate through the MacNicol 360 Degree Realty Income Fund. This fund focuses on value-added projects in the United

States and Canada. The Fund also invests in financing through the residential and commercial mortgage funds of carefully selected sponsor firms. All sponsors are chosen for their high degree of local experience in deal sourcing, finance, construction, and property management. The fund has exposure to more than 140 separate real estate projects and 6 different asset classes across North America. **Chart 3** highlights the regions of North America in which our real estate projects are located as at June 30th, 2018.

360 Fund Fourth Quarter Highlights: For the first quarter of 2018, the fund rose by 1.5% in base currency terms and 3.2% in local currency terms. A steady stream of distributions during the quarter confirmed that investment demand for quality product in tier 1 gateway cities remains healthy. Landlord friendly macroeconomics such as high occupancy and a US Fed confident in second half 2018 wage inflation support favorable price elasticity for rent increases. However, cash distributions would have been even higher (23% higher in certain product types) had capital improvement programs not gotten underway. The channeling of distributable cash flows to things like: stainless steel appliances, granite counter tops, premium quality flooring and better elevator and security system technology were things we support for two reasons. First the track record of value creation on the part of our partners in the United States and Canada is excellent. Second new product coming onto the market continues to "up its game" making transactions less frequent, more competitive but nevertheless still profitable. A selection of individual transactions is highlighted in the *Real Estate Portfolio Activity* section of this report.

Chart 3 – MacNicol 360 Degree Fund Geographic Mix: June 30th, 2018



Commercial Real Estate: Commercial real estate is fundamentally very stable at the property level. Tenants are benefitting from tax cuts and choosing to renew leases with a healthy appetite and at times with a focus on expanding their footprint. Private real estate equity markets continue to have strong inflows and it is this supply of equity capital that is dictating terms in more of today's transactions.

Multi-family Residential: Widely regarded as our preferred real estate product type, the multifamily residential space was not without a few looming questions in the quarter. For example pockets of Houston Texas underperformed while the Toronto condo market continued to experience the real estate version of debauchery. To be clear, the team's focus in the fund is on class B and C multifamily residential real estate. Everyone has to live somewhere and the US governments support of the multifamily residential space through agency financing is helping to achieve that. Supply that cannot meet long-term demand is another key factor in our thesis and while cap rates are strong (perhaps a little too much so) we feel that too much attention is being placed on the issue of cap rates and not enough on product absorption. Absorption really does depend on the quality and location of the product and once absorbed class B and C multifamily product tends to be populated with a longer-term tenant base that actually does live in the unit and work in the adjacent urban center. Luxury condos have definitely slowed and the fact that builders at the higher end of the market are able to turn down business signals to us that while a 2x4 doesn't care whether it is employed as a beam in a multi-million penthouse or 2-bedroom apartment investors probably should. We are certainly not calling for a collapse in luxury condos (they benefit from locational premiums) we simply suggest that IRRs on a go forward basis will be lower.

Industrial: Numerous tailwinds are blowing industrial assets back on the radar screens of investors. Tax law changes allow users of this type of space to expand and this is impacting leasing and sales activity. Manufacturing is stronger particularly in the US Midwest where we hold partnership stakes in a number of industrial assets. Logistics and just-in-time inventory support regional distribution hubs. Certain markets that have approved recreational cannabis are also very strong on the trend of pot producers pushing up rents and driving supply lower.

Office: We love office space but continue to view it as polarizing. On the one hand class A office space is pricey and tenant improvements can be expensive (hurting returns). Success in office means success in finding large markets with infill locations and finely detailed rent rolls.

Retail. Retail is oversold in many markets and investors are prudent to examine properties in large markets and submarkets with strong demographics. We have not transacted in this space recently but when we do valuations and proximity to rising wages will be key.

Real Estate Portfolio Activity

During the quarter the fund experienced several transactions, which welcome a discussion with you on. We highlight three of the larger transactions in the fund below.

Arium Inverness is a property in Birmingham, AL that the fund was a limited partner in. This property was initially acquired as a part of an off-market three property portfolio purchase in July 2014 because the property's size offered immediate scale and access to Birmingham Alabama's growth. Arium's cross promote was one of the larger deals we saw and continue to see and produced gross internal rate of return (IRR) of 19% with a 1.7x multiple on invested capital.

[Arium Inverness Apartments, Birmingham, AL]

The sale of 33 lots and in-progress homes to Mattamy Homes achieved a net IRR of 17% and 1.8x multiple of invested capital. Remaining units at adjacent Manor Parc continue their closing success and are on pace to deliver aggregate fund level multiple of 2x.

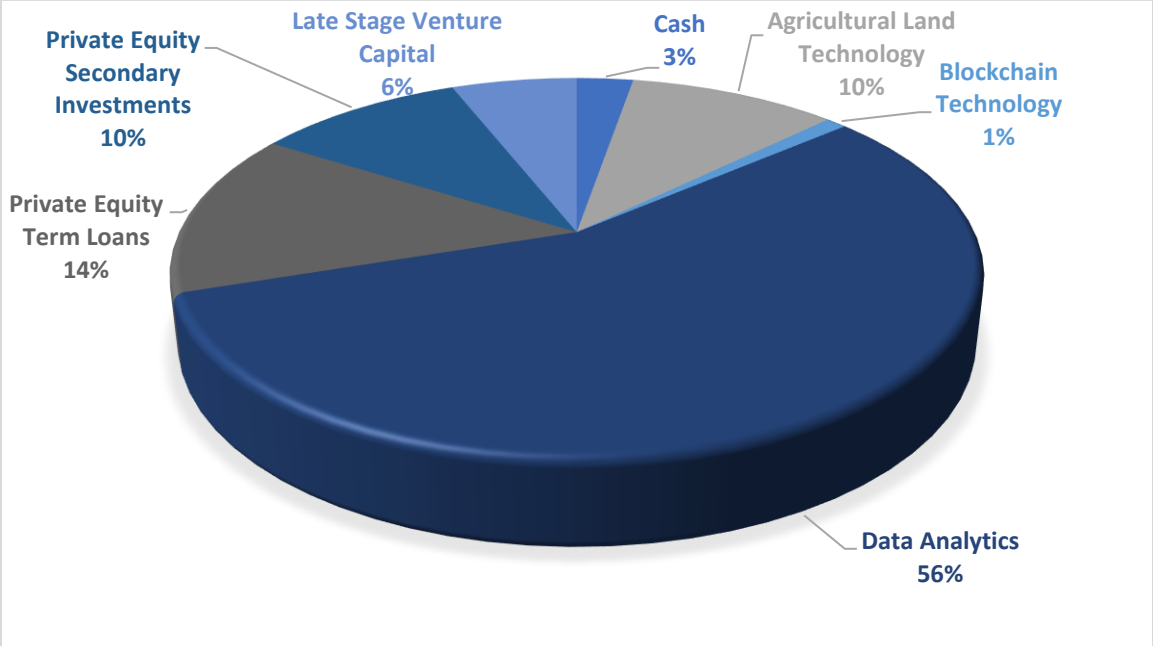
[Boynton Waters Sale to Mattamy Homes]

Station 650 was a 183-unit, multi-family property in Alexandria, VA. This property was a ground-up development completed in the first quarter of 2015. With the asset fully stabilized, it was listed in the third quarter of 2017. The sale was completed recently at a price of $66.85 million, or $365,300 per unit, and is expected to produce a 1.7x multiple on invested capital and a 16.3% fund level IRR.

Private Equity and Technological Innovation: MacNicol Emergence Fund

The investment objective of the Emergence Fund is to participate in technological innovation and growth capital for the purpose of generating capital gains and income. The Fund seeks opportunities in private equity where capital exit strategies are clearly defined, and are likely to occur within a 3-5 year time frame. The Emergence Fund invests in established private equity funds with a focus on companies with defensible franchises, high growth profiles and proven management. For the second quarter of 2018 the fund was rose by 1% and capital was allocated to investment in the application of data analytics to specialty rewards programs.

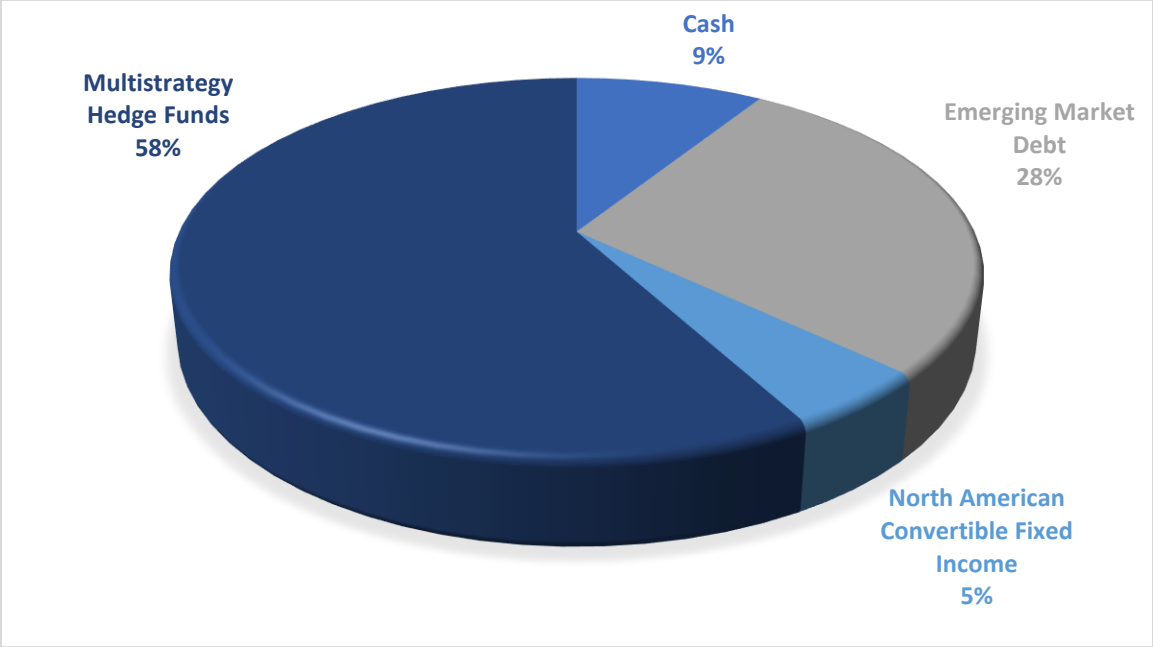
Chart 4 – MacNicol Emergence Fund Industry Mix, June 30th, 2018



The fund also expanded its partnership in Scribble Live. Scribble Live is a content marketing software that uses mathematical analytics to improve the way companies manage the lifecycle of their content across their buyers' purchase plans.

The objective of the MacNicol Absolute Return Fund is to generate positive returns under most market and economic conditions, and to have little or no correlation to the US and Canadian stock markets. In order to achieve its objectives, the Absolute Return Fund invests in several value-added strategies managed by experienced and successful Canadian, US and U.K. hedge fund managers. The fund's strategy mix is described below.

Chart 5 – MacNicol Absolute Return Fund Strategy Mix, June 30th, 2018



During the second quarter of 2018 our hedge fund strategy largely flat earning just 25 basis points. The performance of our emerging market strategy was hampered by US dollar strength in the quarter as many of our positions in the debt market pay loans configured with a variable rate US dollar peg. A small price to pay for access to the world's largest credit market. The MAAM team studied emerging markets closely and determined that the majority of the sell-off had concluded shortly after the quarter ended. We are determining currently whether additions to the emerging market space are warranted here and will report on any updates in subsequent editions of this report.

The fund initiated a position in a diversified basket of convertible bonds during the quarter. While the team feels convertible bonds have performed well, we view their optionality as a premium many investors won't give up soon due to the backdrop of an increasingly polarizing argument over whether stocks or bonds are overvalued. A convertible bond is a

type of debt security that can be converted into a predetermined amount of the underlying company's equity at certain times during the bond's life, generally at the discretion of the bondholder.

Closing Comments

We are pleased that the trust continues to move forward at a measured and direct pace. We are also pleased that gains in the trust's portfolio occurred broadly across its three underlying asset classes. With developed markets like the S&P500 and Dow Jones clearing the psychologically important 2,800 and 25,000 point barriers respectively, they now stand at an interesting precipice. On the one hand positive earnings reports continue to greet investors at a steady clip. On the other hand multiple levels of resistance stand ahead of most public equity markets. We feel that at this time many investors will do their own analysis and conclude that their portfolios are incomplete without the inclusion of alternative investments. Fortunately the entire MAAM investment team stands ready to avail themselves to investors when the decision to move forward is made.

Sincerely,

MacNicol & Associates Asset Management Inc.