Flaherty & Crumrine

INVESTMENT GRADE FIXED INCOME FUND

2006 ANNUAL REPORT

Investment grade US fixed income securities actively managed by Flaherty & Crumrine.

Units of the Fund are currently rated P-2f by Standard & Poor's.

F F I . U N

Management Report of Fund Performance

March 8, 2007

This annual management report of fund performance for Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") contains financial highlights but does not contain the audited annual financial statements. The audited annual financial statements follow this report.

Unitholders may obtain a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure, at no cost, by calling 866-642-6001, or by sending a request to Brompton Funds, Suite 2930, P.O. Box 793, Bay Wellington Tower, BCE Place, 181 Bay Street, Toronto, Ontario, M5J 2T3.

The Fund

Flaherty & Crumrine Investment Grade Fixed Income Fund is a closed-end investment trust that is managed by Brompton Funds Management Limited (the "Manager"). The units of the Fund trade on the Toronto Stock Exchange ("TSX") under the symbol FFI.UN. Flaherty & Crumrine Incorporated (the "Portfolio Manager") is a leading North American specialist in managing preferred and debt securities and manages the Fund's portfolio. For a more detailed description of Flaherty & Crumrine and its Portfolio Manager's Report on the Fund, please see the "Portfolio Manager" section. The units of the Fund are currently rated P-2f by Standard & Poor's and the Fund is RRSP, DPSP, RRIF and RESP eligible.

Investment Objectives and Strategies

The Fund's investment objectives are to provide unitholders with a stable stream of monthly distributions, to mitigate the impact of significant and rapid long-term interest rate increases on the value of the portfolio through the use of the safety net hedge, and to preserve the net asset value per unit. To achieve these objectives, the Fund invests in a portfolio of fixed income securities consisting primarily of US dollar denominated corporate debt and hybrid preferred securities and various debt instruments of North American issuers. All securities purchased by the Fund are rated investment grade at the time of investment. Substantially all of the US dollar foreign exchange exposure of the Fund's portfolio is hedged to the Canadian dollar at all times. Also, under normal market conditions, 100% of the portfolio will be hedged using the safety net hedge strategy, which is intended to mitigate the impact of significant and rapid increases in long-term interest rates on the net asset value of the portfolio, while permitting the net asset value to appreciate when long-term interest rates decline.

Risks

Changes to the Fund over the financial year ended December 31, 2006 affected the overall risk associated with an investment in the Fund in the following ways:

(i) The Fund has borrowed amounts on a floating rate basis to invest in additional portfolio investments to increase the overall distributions of the Fund. If short-term interest rates increase during a period when leverage is utilized, increased interest costs will reduce income or cash available to be distributed. This occurred in 2006, as the United States continued its rate hike cycle with three increases in the Fed Funds rate during the first half of the year and then held it constant for the balance of the year.

(ii) During 2006, the percentage of the portfolio invested in preferred securities increased from 56% to 76%, which may increase the call risk exposure in the portfolio. Call risk is the risk that an issuer of a fixed income security held in the Fund's portfolio will exercise its right to repay the principal of the security prior to maturity. This may happen when there is a decline in interest rates and the issuer can refinance at a lower interest rate. Under these circumstances, the Fund may be unable to recoup all of its initial investment (if it paid a premium price over the call value) and may have to reinvest the proceeds from such security in lower yielding investments. Preferred securities frequently have call features that allow the issuer to redeem the security prior to its stated maturity. The Portfolio Manager actively manages the portfolio, including call risk, and it seeks to identify those preferred and debt securities that provide optimal return characteristics relative to risks. Using proprietary models, the Portfolio Manager evaluates the specific terms of each issue and is generally willing to forego high income over the short term to hold securities with more favourable call terms providing more sustainable income.

(iii) In 2006, $85.3 million of units were redeemed, representing 32.5% of the Fund's net assets at that time. In addition, $0.9 million of units were redeemed pursuant to the monthly redemption. As a result, the trading liquidity of the units may be reduced.

Risks associated with an investment in the units of the Fund are discussed in detail in the Fund's annual information form, which is available on the Fund's website at www.bromptongroup.com or on SEDAR at www.sedar.com.

Recent Developments

Implementation of Accounting Standard

In the management report of fund performance prepared for the six months ended June 30, 2006, it was reported that, starting January 1, 2007, the Fund would adopt the new accounting standard, Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855: Financial Instruments – Recognition and Measurement. This standard would cause the Fund to change the way it determines the value of securities it holds in its portfolio. In particular, securities traded in an active market are valued using the last available bid price rather than the closing price for exchange-traded securities or at the average of the latest bid and ask prices for securities traded over-the-counter. This change in determining net asset value would affect the following: (i) the valuation of the Fund's investments for its financial statements; (ii) the weekly posted net asset value per unit of the Fund; and (iii) pricing of the redemption amounts for the units.

Pursuant to requests from the investment fund industry, the Canadian Securities Administrators ("CSA") exempted investment funds, including the Fund, from applying CICA Section 3855 in the calculation of the weekly net asset values and the amount of the net asset value for redemption purposes until September 30, 2007. The exemption was requested to allow further study of whether the calculation and use of net asset value in accordance with the Canadian GAAP are appropriate for purposes other than financial statements.

Results of Operations

Distributions

The following table provides, on a per unit basis, an approximate breakdown of the components which affected cash flow available for distribution since inception of the Fund on December 15, 2004 to December 31, 2006 and for the period covering the year ended December 31, 2006. These are approximate figures and are calculated using the weighted average numbers of units outstanding for the different periods.

	From Inception[1] to Dec. 31, 2006	**Year Ended Dec. 31, 2006**
Income	$ 4.49	**$ 2.30**
Expenses		
Management and advisor fees	(0.50)	**(0.23)**
Interest and bank charges	(1.14)	**(0.69)**
Other expenses	(0.21)	**(0.09)**
Total expenses	(1.85)	**(1.01)**
Net investment income	2.64	**1.29**
Add: Management and advisor fees paid in units	0.35	**0.23**
Cash flow available for distribution	2.98	**1.52**
Distributions to unitholders	(3.16)	**(1.54)**
Cash flow available for distribution exceeding (less than) distributions available to unitholders	$ (0.18)	**$ (0.02)**

[1] The Fund commenced operations on December 15, 2004.

Since the commencement of the Fund, there have been three major factors that have put pressure on the Fund to sustain distributions at its original rate:

(i) Long-term interest rates were lower than the original plan during the period of investment. A margin for reduced spread was factored into the original economics, which helped mitigate the impact of lower long-term interest rates on distributable income;

(ii) Timing differences arising from the rapid decline in the US dollar exchange rate relative to the Canadian dollar, which reduced US dollar interest income in Canadian dollar terms. Over time, the Fund was able to mitigate a large amount of this impact by investing gains on its foreign currency hedges and redeploying the proceeds therefrom in additional fixed income securities; and

(iii) Short-term interest rates, which affect the cost of the Fund's borrowings, increased by 3.0% since the inception of the Fund (as a result of 12 increases in the Fed Funds rate). The cost of borrowing is still less than the return earned on the Fund's investment portfolio so that the leverage of the Fund continues to contribute to the amount of cash flow available for distribution; however, this contribution is less than the original contribution.

To mitigate these pressures on distributable cash flow the Manager and the Portfolio Manager agreed to take all of their fees in units of the Fund. Notwithstanding this step, the Fund had to reduce its monthly distribution rate in April 2006 from $0.1354 per unit to $0.125 per unit. At this new distribution level, the yield on the Fund units based on its December 31, 2006 closing price was 6.7%. For all of 2006, the cash flow available for distributions was less than distributions by $0.02 per unit. However, in the second half of the year, cash flow available for distribution exceeded distributions by $0.01 per unit. The Manager estimates, based on current borrowing costs, the current yield from the portfolio and the level of management and advisor fees taken in units, that the current level of distribution paid by the Fund is sustainable.

The Fund has a distribution reinvestment plan which allows participating unitholders to automatically reinvest monthly distributions in additional units of the Fund. For the year ended December 31, 2006, 8,350 units were acquired in the market pursuant to this plan at an average price of $20.99 per unit.

Changes in Net Asset Value

Investors who purchased units of the Fund at the time of the initial public offering paid a price of $25.00 per unit. On closing, a total of $1.37 per unit was paid for issue costs, resulting in an initial opening net asset value of $23.63 per unit. Issue costs included such items as agency fees, legal costs and printing costs.

From December 15, 2004 (commencement of operations) to December 31, 2006, the net asset value per unit decreased from $23.63 per unit to $22.08 per unit, which is a decline of 6.6%. The table below provides an approximate breakdown of the various factors which have contributed to the decline in net asset value per unit over this period. These are approximate figures as the factors are affected by different weighted average numbers of units outstanding for each period.

Changes in Net Asset Value on a Per Unit Basis

	From Inception[1] to Dec. 31, 2006	**Year Ended Dec. 31, 2006**
Opening net asset value per unit	$ 23.63	**$ 22.35**
Gains (losses) on portfolio investments[2]	(0.90)	**(0.40)**
Gain from (cost of) the safety net hedge	(0.55)	**0.62**
Distributions exceeding cash flow available for distribution	(0.18)	**(0.02)**
Foreign exchange	0.21	**(0.27)**
Reduction from management and advisor fees paid in units	(0.34)	**(0.23)**
Rounding, timing and capital adjustments	0.21	**(0.03)**
Total change	(1.55)	**(0.27)**
Ending net asset value per unit	$ 22.08	**$ 22.08**

[1] The Fund commenced operations on December 15, 2004.

[2] Excludes the impact of foreign exchange, which is included in the foreign exchange hedge.

For the year ended December 31, 2006, the long-term US Treasury rate increased slightly from 4.55% to 4.82% and these rising rates resulted in the Fund's net asset value per unit decreasing by approximately $0.40 per unit. Since inception to December 31, 2006, the net asset value of the Fund's units decreased by approximately $0.90 per unit, generally, as a result of changes in long-term interest rates.

While long-term interest rates remained relatively flat from the inception of the Fund to December 31, 2005, there were no benefits to be realized from the safety net hedge. During the first half of 2006, long-term interest rates rose quickly, and overall for the year, the safety net hedge provided some positive returns for the Fund which totalled approximately $0.62 per unit after all costs. Since inception of the Fund until December 31, 2006, the safety net hedge has been a net cost of approximately $0.55 per unit.

Since the commencement of operations, the Fund has distributed approximately $0.18 per unit more than its cash flow available for distribution. For the year ended December 31, 2006, the Fund's cash flow available for distribution was less than distributions by approximately $0.02 per unit. Please refer to the discussion in the section "Distributions" above.

Foreign exchange may impact the net asset value in two ways: the impact of foreign exchange movements between the Canadian and US dollar on the investment portfolio; and the impact of the foreign exchange hedging program. For the year ended December 31, 2006, the net impact cost the Fund $0.27 per unit in net asset value. However, since inception the net impact of these two activities contributed $0.21 per unit in net asset value.

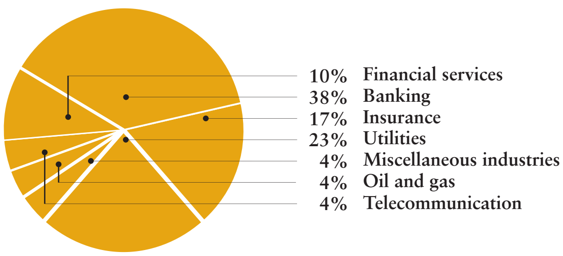
When the Manager and Portfolio Manager agree to take their fees in units of the Fund, additional cash is available for distributions. The Manager has been taking its fee in units since the inception of the Fund. At the end of 2005, the Portfolio Manager also agreed to take its fees in units to help offset the decline in cash flow available for distribution discussed above. The disadvantage of taking the management and advisor fees in Fund units is that the net asset value per unit declines over time due to the additional units outstanding. If the Manager and Portfolio Manager continue to take all of their fees in units for the next year, the net asset value per unit will decline from what it otherwise would be by about $0.23 per unit (1.05% of net asset value per annum). However, unitholders will receive an equivalent benefit of $0.23 per unit of additional distributable income.

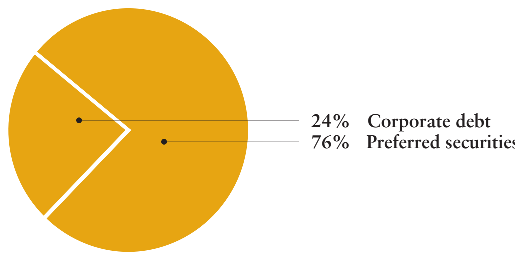
Although the net asset value per unit has declined by about $1.55 since inception, it is important for unitholders to remember that they have received $3.16 per unit in cash distributions over this period and the interest rate hedge has reduced the volatility of the net asset value of the Fund.

Investment Portfolio

All securities purchased by the Fund are rated investment grade at the time of investment. The portfolio is well diversified with 80 issues. Approximately 87% of the portfolio is invested in the banking, finance, insurance and utilities sectors, which are industries that are subject to regulatory oversight. The breakdown of the portfolio is shown in the accompanying pie charts. In keeping with the Fund's planned strategy to increase the yield from the portfolio, holdings of preferred securities increased over the year from 56% at the end of 2005 to 76% in 2006. Correspondingly, corporate debt holdings declined. The Fund's credit quality remains investment grade and its units are currently rated P-2f by Standard & Poor's.

Portfolio Sectors





Hedging Strategies

Foreign Exchange Hedge

Units of the Fund are purchased and valued in Canadian dollars, but the Fund invests in US dollar denominated fixed income securities. Substantially all of the US dollar foreign exchange exposure of the Fund's portfolio is hedged by the Manager to the Canadian dollar at all times. Since the Fund's inception and for the year ended December 31, 2006, the Canadian dollar has appreciated by 4.7% and by 0.7%, respectively.

Presently, about two-thirds of the portfolio is hedged using a combination of forward contracts with maturity dates of January 2007, January 2008 and January 2009, at approximately 22% each, and one-third of the portfolio is hedged naturally through the Fund's US dollar borrowings.

Safety Net Hedge

Due to the negative effect that a long-term interest rate increase can have on the value of a long-duration portfolio, the Portfolio Manager employs a safety net hedge strategy. The safety net hedge has two purposes. The first is to offset, in part, the decline in the value of the Fund's securities portfolio caused by a significant and rapid rise in long-term US interest rates. The Fund purchases out-of-the money put options on US Treasury futures whose price movements are correlated (albeit not perfectly) with those of the Fund's investments. During a period of rising long-term interest rates, the Fund will initially experience a reduction in net asset value as the hedge tightens and only partially offsets the decline in the value of the securities portfolio. However, as interest rates continue to increase, the hedge will offset an increasing proportion of the decline in the value of the Fund's investments. The safety net hedge worked well in 2006 as it helped insulate the Fund from a more significant decline in net asset value resulting from the rapid rise in long-term rates which occurred during the first half of the year.

The second purpose of the safety net hedge is to generate additional income following a rapid increase in long-term interest rates. This can be achieved by investing realized gains from the put options in additional income producing securities. The additional income to be earned as a result of the Fund's gains realized in 2006 will provide support for the Fund's current distribution rate, with any excess income being retained by the Fund to increase the net asset value.

Liquidity and Capital Resources

As of December 31, 2006, the Fund had total borrowings of $95.0 million (US$81.6 million), which represented 34.7% of total assets. The rate paid on these borrowings is adjusted monthly based on the London-Interbank Offered Rate ("LIBOR"). The borrowings have been used to invest in additional portfolio investments to enhance the distributions paid by the Fund. During the year ended December 31, 2006, the minimum and maximum amounts of borrowings of the Fund were $93.9 million and $151.0 million, respectively.

To provide liquidity, units of the Fund are listed on the TSX under the symbol FFI.UN. The Fund's normal course issuer bid allows it to purchase its units on the TSX when they trade below net asset value per unit. As a result, purchases under the issuer bid are accretive to the net asset value per unit of the Fund. A total of 398,900 units were purchased in the year ended December 31, 2006 under this program at an average price of $20.72 per unit. Investors may also redeem their units annually in accordance with their redemption provisions.

Related Party Transactions

Pursuant to a management agreement, the Manager provides management and administrative services to the Fund, for which it is paid a management fee equal to 0.35% per annum of the net asset value of the Fund, plus applicable taxes. In addition, Flaherty & Crumrine Incorporated, the portfolio manager for the Fund, and Brompton Capital Advisors Inc. are entitled to receive an additional fee equal to 0.70% per annum of the net asset value, plus applicable taxes. These fees may be paid in cash or units. To the extent that units are issued from treasury for this purpose, they are issued at the net asset value per unit. During the year ended December 31, 2006, 121,920 units were issued for the payment of these fees.

The Fund also pays to the Manager a service fee equal to 0.30% per annum of the net asset value of the Fund. The service fee is in turn paid by the Manager to the investment dealers in proportion to the number of units held by clients of each dealer at the end of each calendar quarter. For the year ended December 31, 2006, management, advisor and service fees amounted to $0.9 million, $1.8 million and $0.7 million, respectively.

Financial Highlights

The following tables show selected key financial information about the Fund and are intended to help readers understand the Fund's financial performance for the fiscal periods indicated. This information is derived from the Fund's audited annual financial statements. The information in the following tables is presented in accordance with National Instrument ("NI") 81-106 and, as a result, does not act as a continuity of opening and closing net asset value per unit. The increase (decrease) in net assets from operations is based on average units outstanding during the period, and all other numbers are based on actual units outstanding at the relevant point in time.

Net Asset Value per Unit

		2006		2005		2004[1]
Net asset value, beginning of year[2]	$	**22.35**	$	23.23	$	23.63
Increase (decrease) from operations:[3]						
Total revenue		**2.30**		2.14		0.07
Total expenses		**(1.01)**		(0.81)		(0.04)
Realized gain (loss) for the year		**(0.34)**		(0.11)		(0.11)
Unrealized gain (loss) for the year		**0.29**		(0.55)		(0.32)
Total increase (decrease) in net assets from operations	$	**1.24**	$	0.67	$	(0.40)
Distributions to unitholders:[2]						
From net investment income	$	**1.09**	$	0.22	$	—
From net realized gain on investments		**—**		0.82		—
Return of capital		**0.44**		0.59		—
Total distributions to unitholders	$	**1.53**	$	1.63	$	—
Net asset value, end of year	$	**22.08**	$	22.35	$	24.52

(1) Period from December 15, 2004 (commencement of operations) to December 31, 2004.

(2) Net asset value per unit and distributions per unit are based on the actual number of units outstanding at the relevant time.

(3) The increase (decrease) in net assets from operations is based on the weighted average number of units outstanding over the fiscal period.

Ratios and Supplemental Data

	2006	2005	2004[1]
Net assets (in 000s)	**$ 174,138**	$ 268,420	$ 345,726
Number of units outstanding (in 000s)	**7,886**	12,011	14,882
Management expense ratio ("MER")[1][2]	**4.47%**	3.45%	9.21%
MER excluding interest expense and issuance costs[1][3]	**1.44%**	1.48%	1.52%
Portfolio turnover rate[4]	**73.24%**	131.75%	N/A
Trading expense ratio[5]	**0.08%**	0.12%	N/A
Closing market price	**$ 22.37**	$ 21.40	$ 24.95

(1) Annualized for the period from December 15, 2004 (commencement of operations) to December 31, 2004.

(2) Management expense ratio is based on the requirements of NI 81-106 and includes the total expenses of the Fund for the stated period, including interest expense and issuance costs, and is expressed as an annualized percentage of the average net assets of the period.

(3) MER, excluding interest expense and issuance costs, has been presented separately as it expresses only the ongoing management and administrative expenses of the Fund as a percentage of average net assets.

(4) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio advisor manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher the Fund's portfolio turnover rate in a year, the greater the trading costs payable by the Fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of the Fund. The portfolio turnover rate is not provided when a fund is less than one year old. Portfolio turnover rate is calculated by dividing the lesser of the cost of purchases and the proceeds of sales of portfolio securities for the period, excluding cash and short-term investments maturing in less than one year, by the average market value of investments during the period.

(5) The trading expense ratio represents total commissions expressed as an annualized percentage of daily average net assets of the Fund during the period. This disclosure was a new requirement in 2005 under NI 81-106 and was not applied retroactively.

Expense Ratio

The MER of the Fund increased from 3.45% in 2005 to 4.47% in 2006. The major contributing factor to this increase was the rise in short-term interest rates as the Fed Funds rate increased by 23.5% over the year. The MER is exaggerated by the inclusion of interest expense on borrowings used to purchase additional portfolio investments to increase the distributions of the Fund.

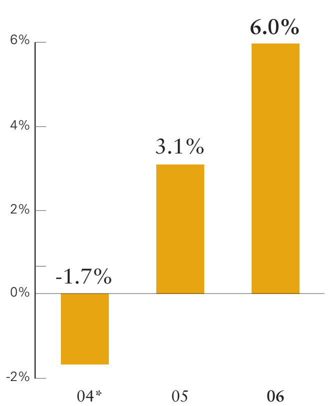
The MER, excluding interest expenses and issuance costs, declined from 1.48% in 2005 to 1.44% in 2006. This latter rate is more representative of the ongoing efficiency of the administration of the Fund.

Past Performance

The following chart and table show the past performance of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future. The information shown is based on net asset value per unit and assumes that distributions made by the Fund on its units in the periods shown were reinvested (at net asset value per unit) in additional units of the Fund.

The chart shows the Fund's return in each year since inception to December 31, 2006. The chart shows, in percentage terms, how an investment held on the first day of each fiscal period would have increased or decreased by the last day of the fiscal period.

Year-by-Year Returns



* Period from December 15, 2004 (commencement of operations) to December 31, 2004.

The following table shows the Fund's compound return for the year ended December 31, 2006 and the annual compound return since inception, compared with the return for the Lipper Domestic (US) Investment Grade Bond Funds ("Lipper Benchmark"). The Lipper Benchmark includes all US government bond, mortgage bond and term trust and investment grade bond funds in Lipper's closed-end fund database at each point in time and provides a fixed income fund benchmark for the Fund although, generally, the investment grade bond funds in the Lipper Benchmark do not hedge long-term interest rate exposure.

Annual Compound Returns

	1 Year	Since Inception(1)
Flaherty & Crumrine Investment Grade Fixed Income Fund(2)	6.0%	3.6%
Lipper Domestic (US) Investment Grade Bond Funds	5.9%	5.1%

(1) Period from December 15, 2004 (commencement of operations) to December 31, 2006.

(2) Based on net asset value per unit and assuming that distributions made by the Fund on its units in the periods shown were reinvested (at net asset value per unit) in additional units of the Fund.

During 2006, the Fund enjoyed strong returns of 6.0% in the face of relatively weak fixed income markets with long-term rates increasing 30–40 basis points over the course of the year. A large part of the Fund's outperformance versus the Lipper Benchmark in 2006 was due to the safety net hedge strategy. During the first half of the year, yields on the US 30-year Treasury did increase sharply from just over $4\frac{1}{2}\%$ to $5\frac{1}{4}\%$. Consequently, the put options on the 30-year Treasury came into the money. These gains largely offset the decline in net asset value due to higher long-term yields.

Since inception, the Fund has underperformed the Lipper Benchmark largely due to the cost of the safety net hedge. However, as the yield curve has flattened, the cost of purchasing the put options for the hedge has decreased.

Summary of Investment Portfolio

As at December 31, 2006

Total net asset value	$ 174,138,126

Portfolio Composition	% of Portfolio	% of NAV
Preferred securities:		
Banking	37.6%	58.4%
Utilities	14.3%	22.2%
Insurance	12.3%	19.2%
Financial services	6.0%	9.2%
Oil and gas	4.2%	6.5%
Telecommunication	1.1%	1.7%
	75.5%	117.2%
Corporate debt:		
Utilities	8.0%	12.5%
Insurance	5.0%	7.7%
Miscellaneous industries	4.4%	6.8%
Financial services	3.7%	5.8%
Telecommunication	2.7%	4.3%
Real estate investment trusts	0.2%	0.3%
Oil and gas	0.2%	0.3%
	24.2%	37.7%
Cash and short-term investments	0.3%	0.4%
Options	—	0.0%
Currency forward contracts	—	(1.3%)
Total investment portfolio	100.0%	154.0%
Other net liabilities		(54.0%)
Total net asset value		100.0%

Top 25 Holdings	% of Portfolio	% of NAV
Southern Union Company, *8.25% November 15, 2029*	4.9%	7.7%
PECO Energy Capital Trust IV, *5.75% June 15, 2033 Capital Security*	3.9%	6.0%
FPL Group Capital Inc., *6.6% Pfd., Series A*	3.8%	5.9%
Axis Capital Holdings Limited, *7.5% Pfd.*	3.5%	5.5%
Liberty Mutual Insurance Co., *7.697% October 15, 2097*	3.4%	5.3%
Morgan Stanley Capital Trust VI, *6.6% Pfd.*	3.3%	5.2%
Capital One Capital III, *7.686% August 15, 2036*	3.3%	5.2%
KN Capital Trust III, *7.63% April 15, 2028 Capital Security*	3.3%	5.2%
Banco Santander, *6.8% Pfd.*	3.2%	4.9%
Commonwealth Edison Co., *6.35% March 15, 2033*	2.8%	4.3%
Webster Capital Trust I, *9.36% January 29, 2027 Capital Security*	2.7%	4.2%
Comcast Corp., *7%, September 15, 2055*	2.6%	4.0%
Duquesne Light Holdings, Inc., *6.25% August 15, 2035, Senior Notes*	2.5%	3.9%
HBOS Capital Funding, *6.85% March 23, 2049*	2.4%	3.8%
GreenPoint Capital Trust I, *9.1% June 1, 2027 Capital Security*	2.3%	3.5%
First Empire Capital Trust II, *8.277% June 1, 2027 Capital Security*	2.3%	3.5%
Wachovia Capital Trust V, *7.965% June 1, 2027 Capital Security*	2.2%	3.4%
General Motors Acceptance Corporation, *8% November 1, 2031, Senior Bonds*	2.2%	3.4%
Citigroup Capital VIII, *6.95% Pfd.*	2.1%	3.3%
Barclays Bank PLC, *6.278% December 15, 2034*	2.1%	3.2%
RenaissanceRe Capital Trust, *8.54% March 1, 2027 Capital Security*	2.0%	3.2%
Washington Mutual Preferred Funding (Cayman) I Ltd., *6.534% March 15, 2011*	1.8%	2.8%
First Chicago NBD Capital Trust I, *7.75% December 1, 2026*	1.8%	2.8%
Farmer's Exchange Capital, *7.2% July 15, 2048*	1.5%	2.4%
RenaissanceRe Holding, *6.08% Pfd., Series C*	1.5%	2.4%

The investment portfolio may change due to ongoing portfolio transactions of the investment fund. Quarterly updates are available within 60 days of each quarter end.

2006 Tax Information

The following information is applicable to holders who, for the purpose of the Income Tax Act (Canada), are resident in Canada and hold Fund units as capital property outside of an RRSP, RRIF or DPSP. Unitholders should receive a T3 slip from their investment dealer providing this information.

T3 supplementary slips for holdings of the Fund will indicate Foreign Non-Business Income in Box 25, Other Taxable Income in Box 26, Capital Gains in Box 21 and Dividend Income in Box 23. Dividend income is subject to the standard gross-up and federal dividend tax credit rules.

The return of capital component is a non-taxable amount that serves to reduce the adjusted cost base of Fund units and is reported on the T3 supplementary slips in Box 42.

The following table outlines the breakdown of the Fund's distributions declared in 2006 on a per unit basis.

Record Date	Payment Date	Foreign Non-Business Income	Return of Capital	Total Distribution
Jan. 31, 2006	Feb. 14, 2006	$ 0.09622	$ 0.03918	$ 0.13540
Feb. 28, 2006	Mar. 14, 2006	0.09622	0.03918	0.13540
Mar. 31, 2006	Apr. 17, 2006	0.09622	0.03918	0.13540
Apr. 28, 2006	May 12, 2006	0.08883	0.03617	0.12500
May 31, 2006	June 14, 2006	0.08883	0.03617	0.12500
June 30, 2006	July 17, 2006	0.08883	0.03617	0.12500
July 31, 2006	Aug. 15, 2006	0.08883	0.03617	0.12500
Aug. 31, 2006	Sep. 15, 2006	0.08883	0.03617	0.12500
Sep. 29, 2006	Oct. 16, 2006	0.08883	0.03617	0.12500
Oct. 31, 2006	Nov. 14, 2006	0.08883	0.03617	0.12500
Nov. 30, 2006	Dec. 14, 2006	0.08883	0.03617	0.12500
Dec. 29, 2006	Jan. 15, 2007	0.08883	0.03617	0.12500
Total		**$ 1.08813**	**$ 0.44307**	**$ 1.53120**

Portfolio Manager

Flaherty & Crumrine Incorporated
Flaherty & Crumrine Incorporated is the oldest and most experienced firm specializing in preferred securities and has extensive additional experience in corporate debt instruments. Flaherty & Crumrine acts as Portfolio Manager for two Brompton funds – Flaherty & Crumrine Investment Grade Preferred Fund and Flaherty & Crumrine Investment Grade Fixed Income Fund, both of which invest in investment-grade corporate debt and preferred securities, primarily of US issuers. The firm uses intensive credit analysis, thorough analysis of securities' terms and structure and active portfolio management, exploiting pricing inefficiencies in the fixed income markets to provide attractive rates of return on its funds.

Portfolio Manager's Report

The Fund's investment portfolio delivered excellent performance during 2006 in the face of a relatively weak fixed income market as intermediate and long-term US Treasury yields increased 30 to 40 basis points on balance over the course of the year. While US Treasury bond yields ended the year only moderately higher, they experienced significant interest rate volatility over the course of the year.

The year began with the 30-year US Treasury bond yielding just above 4.50%; by the end of June 2006 the yield had increased to 5.75% as the long-term US Treasury bond declined *in price* by almost 10%. In this weak market environment, the Fund's safety net interest rate hedge performed extremely well, moderating the impact of sharply rising long-term rates and limiting the decline in the Fund's net asset value ("NAV"). During the second half of the year, the Fund's securities portfolio performed well as US Treasury bond yields generally declined, and the optionality inherent in the interest rate hedge limited its cost. On balance, the safety net hedging strategy made an important positive contribution as the Fund's investment portfolio earned a total return of 7.9% in 2006.

The US dollar denominated preferred market continues to be active, with over US$70 billion of new preferred securities issued during calendar 2006, including US$25 billion in the last quarter alone. The recently devised "enhanced" preferred security structure has been very popular with issuers and investors. Because certain dividend payment and redemption requirements provide the issuer with significant rating and regulatory advantages (the "enhancement"), it's not surprising that these issues comprise a large portion of the new supply. For us old-timers, it has been interesting to observe billion dollar deals become commonplace, with investors unable to attain enough product to satisfy their interest.

The Fund has benefited from the active new issue market – not only have we been able to pick and choose from a variety of issues and issuers, but the new supply has improved liquidity in older issues as well. Although the investor base for US dollar denominated preferred securities appears to have grown materially, the current pace of new issue supply has us wondering if the demand can keep up. The trend is healthy, but only time will tell if these new investors are in it for the long haul.

In a number of instances, the proceeds from new issues were used by the issuer to call older, more expensive (from the issuer's perspective) issues. Just like a homeowner may refinance a mortgage when there are savings to be had, issuers of preferred securities will replace older issues with newer ones when there are benefits in doing so. The benefit may be simply to lower the "payments," or the issuer may find additional benefits from adding some features that weren't available previously to enhance the structure.

We work hard to reduce call risk by anticipating which preferred or debt securities in the portfolio are likely to be redeemed. Typically, an issuer calls a security if they can reissue at a lower interest rate. Ultimately, this trend, if not anticipated, can reduce the income available for distribution to unitholders of the Fund. The best way to reduce call risk is to own securities that issuers either can't or don't want to redeem. We can also lessen the impact of redemptions by selling the security prior to the date it can be redeemed. This provides us with greater flexibility in replacing the position.

Forecasting call risk is a critical step in determining the distribution rate the Fund can pay its unitholders. It is inevitable that some securities held by the Fund will be called; therefore, a better understanding of the income the Fund will receive guides us in making recommendations to the Board of Directors regarding distribution policy.

Since distributions to unitholders are effectively driven by the *net* income of the Fund's portfolio, forecasting the Fund's expenses is also crucial in setting the distribution rate. The primary variable in the Fund's expenses is the cost of its use of leverage, which has been fairly unpredictable over the past several years. The Fund's leverage cost is directly impacted by the short-term interest rates set by the US Federal Reserve.

As the US Federal Reserve raised interest rates (an unprecedented 17 consecutive times between June 2004 and June 2006), the interest cost of the Fund's leverage increased from approximately 2.75% in December 2004 to 5.75% in December 2006. However, during this period the income earned on the portfolio increased only moderately. This additional cost of leverage relative to the Fund's investment income had a negative impact on the amount of income available to be distributed to the unitholders of the Fund, and was the primary reason for the reduction in the Fund's monthly distribution rate in April 2006.

Even in today's interest rate environment, however, the use of leverage continues to be a beneficial strategy for the Fund's investors. The preferred and debt securities in the portfolio continue to offer higher yields than the short-term interest rates the Fund pays for its leverage.

In August 2006, the US Federal Reserve finally gave the markets a reprieve from its relentless march higher in short-term interest rates, and now the market is unsure if the Federal Reserve will lower, increase or stabilize rates during the coming months. These decisions will impact the Fund's available distributable income. If the Federal Reserve maintains its current pause on short-term rates, and long-term rates do not decrease materially, the differential between these two rates should provide incremental income by the use of leverage similar to today. Of course, if the Federal Reserve lowers short-term interest rates, the Fund should see a greater benefit from its use of leverage and, consequently, have additional distributable income for its unitholders.

Flaherty & Crumrine Incorporated

Forward-Looking Statements

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may," "will," "should," "could," "anticipate," "believe," "expect," "intend," "plan," "potential," "continue," and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, we cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.

Management's Responsibility Statement

The financial statements of Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") have been prepared by Brompton Funds Management Limited (the "Manager" of the Fund) and approved by the Board of Directors of the Manager. The Manager is responsible for the information and representations contained in these financial statements and the other sections of the annual report.

The Manager maintains appropriate procedures to ensure that relevant and reliable financial information is produced. Statements have been prepared in accordance with accounting principles generally accepted in Canada and include certain amounts that are based on estimates and judgements. The significant accounting policies applicable to the Fund are described in Note 2 to the financial statements.

The Board of Directors of the Manager is responsible for ensuring that management fulfills its responsibilities for financial reporting and has reviewed and approved these financial statements. The Board carries out this responsibility through the Audit Committee, which is comprised of independent directors of the Board.

The Manager, with the approval of its Board of Directors, has appointed the external firm of PricewaterhouseCoopers LLP as the auditors of the Fund. They have audited the financial statements of the Fund in accordance with Canadian generally accepted auditing standards to enable them to express to unitholders their opinion on the financial statements. The auditors have full and unrestricted access to the Audit Committee to discuss their findings.

(Signed)

Raymond R. Pether
Chief Executive Officer
Brompton Funds Management Limited
March 8, 2007

(Signed)

Craig T. Kikuchi
Chief Financial Officer
Brompton Funds Management Limited

Auditors' Report to Unitholders

To the Unitholders of Flaherty & Crumrine Investment Grade Fixed Income Fund:

We have audited the statement of investments of Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") as at December 31, 2006, the statements of net assets as at December 31, 2006 and 2005 and the statements of operations and deficit, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Fund's Manager. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the investments of the Fund as at December 31, 2006, the net assets as at December 31, 2006 and 2005 and the results of its operations and deficit, changes in net assets and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed)

PricewaterhouseCoopers LLP
Chartered Accountants
Toronto, Ontario
March 8, 2007

Statements of Net Assets

As at December 31	2006	2005
Assets		
Investments, at market value[1]	**$ 269,763,889**	$ 398,873,529
Unrealized gain on forward contracts (note 7)	**—**	16,806,574
Option contracts purchased, at market value (note 8)	**653,670**	3,693,837
Cash and short-term investments	**638,627**	1,592,870
Income receivable	**2,540,793**	4,824,023
Other receivable	**—**	1,638,841
Deferred financing costs (note 10)	**—**	4,755
Total assets	**273,596,979**	427,434,429
Liabilities		
Option contracts written, at market value (note 8)	**626,396**	5,160,877
Unrealized loss on forward contracts (note 7)	**2,182,517**	—
Accounts payable and accrued liabilities	**648,264**	825,486
Distributions payable to unitholders (note 4)	**985,791**	1,626,317
Redemption payable to unitholders	**—**	394,182
Loans payable (note 10)	**95,015,885**	151,007,535
Total liabilities	**99,458,853**	159,014,397
Unitholders' equity		
Unitholders' capital (note 3)	**186,145,192**	283,742,681
Contributed surplus (note 3)	**10,338,838**	4,134,692
Deficit	**(22,345,904)**	(19,457,341)
Net assets representing unitholders' equity	**$ 174,138,126**	$ 268,420,032
Units outstanding (note 3)	**7,886,326**	12,011,203
Net asset value per unit	**$ 22.08**	$ 22.35

[1] Investments, at market value, exclude the value of derivative contracts which are disclosed separately on the Statements of Net Assets.

Approved on behalf of Flaherty & Crumrine Investment Grade Fixed Income Fund by the Board of Directors of Brompton Funds Management Limited, the Manager.

(Signed)

Peter A. Braaten
Director

(Signed)

James W. Davie
Director

The accompanying notes are an integral part of these financial statements.

Statements of Operations and Deficit

For the years ended December 31	2006	2005
Income		
Interest income	$ 18,291,820	$ 27,263,397
Dividends	8,146,698	3,969,144
	26,438,518	31,232,541
Expenses		
Advisor fees (note 5)	1,780,850	2,404,241
Management fees (note 5)	947,409	1,273,852
Service fees (note 5)	707,069	981,565
Audit fees	18,224	25,128
Director fees	41,116	45,000
Trustee fees	22,536	21,878
Custodial fees	53,082	74,851
Legal fees	26,094	1,251
Unitholder reporting cost	31,111	77,351
Other administrative expenses	135,830	201,585
Interest and bank charges (note 10)	7,900,730	6,778,885
	11,664,051	11,885,587
Net investment income	14,774,467	19,346,954
Net realized gain (loss) on investments and foreign currency transactions (note 6)	(22,837,043)	2,553,266
Net realized gain (loss) on forward contracts and options (note 6)	18,956,831	(4,111,165)
Net change in unrealized loss on investments and foreign currency transactions	17,193,353	(10,863,960)
Net change in unrealized gain on forward contracts and options (notes 7 & 8)	(13,851,169)	2,864,680
Increase in net assets from operations	14,236,439	9,789,775
Deficit, beginning of year	(19,457,341)	(5,847,309)
Distributions to unitholders (note 4)	(17,125,002)	(23,399,807)
Deficit, end of year	$ (22,345,904)	$ (19,457,341)
Increase in net assets from operations per unit[1]	$ 1.24	$ 0.67

[1] Based on weighted average number of units outstanding for the year (note 3).

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

For the years ended December 31	2006	2005
Cash flows from operating activities:		
Increase (decrease) in net assets from operations	**$ 14,236,439**	$ 9,789,775
Adjustments to reconcile net cash provided by (used in) operations:		
Net realized loss on sale of investments, options and foreign currency transactions	**22,848,281**	6,561,760
Net change in unrealized (gain) loss on investments and foreign currency transactions	**(22,329,661)**	10,864,371
Net change in unrealized (gain) loss on forward contracts and options	**18,989,091**	(2,864,680)
Amortization of deferred financing costs (note 9)	**4,755**	36,395
Decrease in income receivable	**3,922,071**	3,061,745
Decrease in accounts payable and accrued liabilities	**(177,222)**	(396,791)
Purchase of investments and options (note 6)	**(273,280,046)**	(663,217,731)
Proceeds from sale of investments and options (note 6)	**399,500,941**	749,292,803
Cash provided by operating activities	**163,714,649**	113,127,647
Cash flows from financing activities:		
Proceeds from issuance of units (note 3)	**2,655,334**	1,717,908
Agents' fees and issuance costs	**—**	4,453
Decrease in loans payable	**(55,115,840)**	(26,477,563)
Deferred financing costs paid	**—**	(7,785)
Distributions paid to unitholders	**(17,765,527)**	(21,773,490)
Proceeds from distribution reinvestment plan (note 4)	**—**	30,089
Repurchase of units (note 3)	**(8,264,113)**	(6,893,293)
Amounts paid for redemption of units (note 3)	**(86,178,746)**	(58,161,053)
Cash used in financing activities	**(164,668,892)**	(111,560,734)
Net increase (decrease) in cash and short-term investments	**(954,243)**	1,566,913
Cash and short-term investments, beginning of year	**1,592,870**	25,957
Cash and short-term investments, end of year	**$ 638,627**	$ 1,592,870
Supplemental information:		
Interest paid	**$ 7,972,857**	$ 6,617,307

The accompanying notes are an integral part of these financial statements.

Statements of Changes in Net Assets

For the years ended December 31	2006	2005
Net assets, beginning of year	**$ 268,420,032**	$ 345,726,142
Operations:		
Increase in net assets from operations	**14,236,439**	9,789,775
Unitholder transactions:		
Distributions to unitholders (note 4)		
Net investment income	**(12,169,073)**	(3,104,807)
Capital gains	**—**	(11,820,129)
Return of capital	**(4,955,929)**	(8,474,871)
Total	**(17,125,002)**	(23,399,807)
Proceeds from issuance of units (note 3)	**2,655,334**	1,717,908
Agents' fees and issuance costs	**—**	4,453
Proceeds from distribution reinvestment plan (note 4)	**—**	30,089
Repurchase of units (note 3)	**(8,264,113)**	(7,287,475)
Redemption of units (note 3)	**(85,784,564)**	(58,161,053)
Total unitholder transactions	**(108,518,345)**	(87,095,885)
Net decrease in net assets	**(94,281,906)**	(77,306,110)
Net assets, end of year	**$ 174,138,126**	$ 268,420,032
Distributions per unit	**$ 1.5312**	$ 1.6248

The accompanying notes are an integral part of these financial statements.

Statement of Investments

Shares/Par Value $US	As at December 31, 2006 — Preferred Securities	Cost (USD)	Cost (CDN)	Market Value (USD)	Market Value (CDN)	% of Portfolio
	Banking					
$ 1,000,000	Astoria Capital Trust I, *9.75% November 1, 2029 Capital Security, Series B*	$ 1,170,000	$ 1,346,840	$ 1,114,270	$ 1,296,673	
47,168	BAC Capital Trust I, *7% Pfd.*	1,213,072	1,490,991	1,182,973	1,376,623	
10,800	BAC Capital Trust VIII, *6% Pfd.*	269,568	328,886	268,164	312,062	
38,860	BAC Capital Trust XII, *6.875% Pfd.*	968,485	1,100,508	1,022,795	1,190,224	
44,220	Bank One Capital Trust VI, *7.2% Pfd.*	1,129,580	1,334,034	1,121,861	1,305,507	
284,750	Banco Santander, *6.8% Pfd.*	7,118,750	8,047,786	7,366,483	8,572,356	
$ 5,000,000	Barclays Bank PLC, *6.278% December 15, 2034*	4,675,171	5,520,164	4,861,773	5,657,632	
92,600	Capital One Capital II, *7.5% June 15, 2066*	2,304,313	2,563,500	2,433,528	2,831,890	
$ 6,800,000	Capital One Capital III, *7.686% August 15, 2036*	6,897,693	7,831,552	7,725,684	8,990,358	
194,635	Citigroup Capital VIII, *6.95% Pfd.*	4,939,517	5,883,344	4,900,909	5,703,175	
65,200	Citigroup Capital XV, *6.5% Pfd.*	1,631,304	1,840,038	1,649,560	1,919,589	
117,500	Citizens Funding Trust I, *7.5% Pfd.*	2,943,625	3,296,959	3,055,000	3,555,095	
$ 4,000,000	First Chicago NBD Capital Trust I, *7.75% December 1, 2026*	4,290,000	5,210,611	4,161,300	4,842,494	
$ 5,000,000	First Empire Capital Trust II, *8.277% June 1, 2027 Capital Security*	5,471,800	6,765,080	5,246,225	6,105,018	
$ 745,000	First Midwest Capital Trust I, *6.95% December 1, 2033 Capital Security*	817,012	1,010,565	785,331	913,887	
$ 2,200,000	First of America Capital Trust I, *8.12% January 31, 2027*	2,383,700	2,895,229	2,291,916	2,667,096	
$ 75,000	First Union Capital II, *7.85% January 1, 2027 Capital Security*	78,666	92,032	78,036	90,810	
$ 900,000	Great Western Finance Trust II, *8.206% February 1, 2027 Capital Security, Series A*	970,920	1,181,125	938,448	1,092,069	
$ 5,000,000	GreenPoint Capital Trust I, *9.1% June 1, 2027 Capital Security*	5,712,500	7,032,673	5,277,975	6,141,965	
$ 2,000,000	Haven Capital Trust I, *10.46% February 1, 2027 Capital Security*	2,300,000	2,845,232	2,164,760	2,519,125	
$ 5,600,000	HBOS Capital Funding, *6.85% March 23, 2049*	5,803,000	7,101,685	5,684,560	6,615,107	
$ 2,750,000	HBOS PLC, *6.413% October 01, 2035*	2,413,593	2,714,555	2,740,458	3,189,063	
5,000	J.P. Morgan Capital Trust XI, *7% Pfd.*	107,800	120,516	120,000	139,644	
7,600	KeyCorp Capital VIII, *7% June 15, 2066*	188,556	209,730	199,272	231,892	
62,140	National City Capital Trust II, *6.625% November 15, 2066*	1,546,750	1,732,285	1,565,307	1,821,543	
$ 725,000	Mellon Capital II, *7.995% January 15, 2027 Capital Security*	795,688	977,695	754,783	878,339	
33,700	Sovereign Capital Trust V, *7.75% December 31, 2036*	855,980	953,600	901,475	1,049,044	
3,500	USB Capital VII, *5.875% Pfd.*	80,150	93,159	83,965	97,710	
52,897	USB Capital VIII, *6.35% Pfd.*	1,300,732	1,494,620	1,329,302	1,546,905	
10,000	USB Capital X, *6.5% Pfd.*	245,500	280,889	255,500	297,325	
$ 500,000	USB Realty Corp, *6.09% January 15, 2012*	499,980	578,426	499,584	581,365	
$ 4,830,000	Wachovia Capital Trust V, *7.965% June 1, 2027 Capital Security*	5,250,210	6,356,417	5,055,633	5,883,227	
$ 4,250,000	Washington Mutual Preferred Funding (Cayman) I Ltd., *6.534% March 15, 2011*	4,229,401	4,878,808	4,199,553	4,887,008	
$ 6,000,000	Webster Capital Trust I, *9.36% January 29, 2027 Capital Security*	6,696,000	8,351,210	6,292,200	7,322,217	
2,700	Wells Fargo Capital Trust IV, *7% Pfd.*	68,121	78,128	68,013	79,147	
		87,367,137	**103,538,872**	**87,396,596**	**101,703,184**	**37.7%**
	Financial Services					
52,100	Cabco – Goldman, *6% Series GS*	1,276,450	1,565,697	1,281,139	1,490,858	
60,000	Corporate Backed Trust Certificates Goldman Sachs Capital I, *6% Series 2004-4*	1,452,000	1,674,740	1,470,000	1,710,635	
82,450	Corporate Backed Trust Certificates, *6.3% Series GS*	2,081,863	2,553,617	2,088,871	2,430,813	
13,000	Morgan Stanley Capital Trust II, *7.25% July 31, 2031*	326,300	360,987	330,200	384,253	
38,600	Morgan Stanley Capital Trust V, *5.75% Pfd.*	875,416	1,038,678	921,343	1,072,165	
302,438	Morgan Stanley Capital Trust VI, *6.6% Pfd.*	7,589,948	8,718,589	7,742,413	9,009,825	
		13,601,977	**15,912,308**	**13,833,966**	**16,098,549**	**5.9%**

The accompanying notes are an integral part of these financial statements.

Statement of Investments (continued)

As at December 31, 2006		Cost (USD)	Cost (CDN)	Market Value (USD)	Market Value (CDN)	% of Portfolio
Shares/Par Value $US	**Preferred Securities**					
	Insurance					
107,200	ACE Ltd., *7.8% Pfd., Series C*	$ 2,816,144	$ 3,382,471	$ 2,776,480	$ 3,230,982	
$ 2,000,000	AON Capital Trust A, *8.205% January 1, 2027 Capital Security*	2,124,560	2,605,991	2,316,730	2,695,972	
29,750	Arch Capital Group Ltd., *8% Pfd.*	743,599	854,583	786,888	915,699	
31,389	Axis Capital Holdings Limited, *7.25% Pfd.*	765,650	889,421	810,150	942,769	
76,845	Axis Capital Holdings Limited, *7.5% Pfd.*	7,881,490	9,033,301	8,169,315	9,506,610	
63,500	Everest Capital Trust II, *6.2% Pfd., Series B*	1,492,362	1,837,945	1,516,380	1,764,607	
$ 4,545,000	RenaissanceRe Capital Trust, *8.54% March 1, 2027 Capital Security*	4,744,800	5,313,588	4,739,026	5,514,792	
148,970	RenaissanceRe Holding, *6.08% Pfd., Series C*	3,190,422	3,793,215	3,545,486	4,125,872	
15,400	Torchmark Capital Trust III, *7.1% June 1, 2046*	378,840	421,308	410,872	478,131	
119,662	W.R. Berkley Capital Trust II, *6.75% Pfd.*	2,971,203	3,559,845	3,009,499	3,502,146	
20,200	XL Capital Ltd., *8% Pfd., Series A*	515,908	593,578	510,050	593,544	
3,880	XL Capital Ltd., *7.625% Pfd., Series B*	104,751	128,580	99,328	115,588	
		27,729,729	**32,413,826**	**28,690,204**	**33,386,712**	**12.4%**
	Oil and Gas					
$ 8,275,000	KN Capital Trust III, *7.63% April 15, 2028 Capital Security*	9,426,527	11,567,814	7,708,287	8,970,112	
$ 1,895,000	Phillips 66 Capital II, *8% January 15, 2037*	1,976,675	2,220,509	1,971,785	2,294,560	
		11,403,202	**13,788,323**	**9,680,072**	**11,264,672**	**4.2%**
	Telecommunication					
2,176	Centaur Funding Corp. *9.08% April 21, 2020*	2,484,916	2,784,016	2,559,955	2,979,013	
		2,484,916	**2,784,016**	**2,559,955**	**2,979,013**	**1.1%**
	Utilities					
$ 7,500,000	Commonwealth Edison Co., *6.35% March 15, 2033*	7,707,750	9,404,627	6,447,788	7,503,273	
$ 3,268,000	Dominion Resources Capital Trust I, *7.83%, December 1, 2027*	3,431,410	3,889,684	3,406,580	3,964,227	
$ 2,000,000	Dominion Resources Capital Trust III, *8.4%, January 15, 2031*	2,370,220	2,835,259	2,447,580	2,848,242	
53,600	DTE Energy Trust II, *7.5% Pfd.*	1,404,320	1,738,751	1,399,228	1,628,278	
17,550	FPL Group Capital Trust I, *5.875% Pfd., Series A*	402,773	449,593	426,290	496,072	
346,439	FPL Group Capital Inc. *6.6% Pfd., Series A*	8,588,704	9,669,680	8,757,978	10,191,635	
$ 10,140,000	PECO Energy Capital Trust IV, *5.75% June 15, 2033 Capital Security*	9,910,532	12,116,601	8,987,690	10,458,950	
50,907	Virginia Power Capital Trust, *7.375% July 30, 2042*	1,306,106	1,519,043	1,302,201	1,515,368	
		35,121,815	**41,623,238**	**33,175,335**	**38,606,045**	**14.3%**
	Total Preferred Securities	**$ 177,708,776**	**$ 210,060,583**	**$ 175,336,128**	**$ 204,038,175**	**75.6%**

The accompanying notes are an integral part of these financial statements.

Statement of Investments (continued)

As at December 31, 2006			Cost (USD)	Cost (CDN)	Market Value (USD)	Market Value (CDN)	% of Portfolio
	Shares/Par Value $US	**Corporate Debt Securities**					
		Financial Services					
$	4,360,000	General Motors Acceptance Corporation, *8% November 1, 2031, Senior Bonds*	$ 4,203,510	$ 5,061,159	$ 5,020,148	$ 5,841,932	
	7,600	PreferredPLUS Trust Series GEC-1, *6.05% March 15, 2032*	195,700	240,829	188,404	219,245	
	141,450	SATURNS Goldman Sachs Group, Inc. Debenture Backed Series 2003-6, *6%*	3,161,013	3,508,813	3,461,282	4,027,884	
			7,560,223	**8,810,801**	**8,669,834**	**10,089,061**	**3.7%**
		Insurance					
$	3,500,000	Farmer's Exchange Capital, *7.2% July 15, 2048*	3,314,325	3,648,571	3,596,250	4,184,946	
$	7,774,000	Liberty Mutual Insurance Co., *7.697% October 15, 2097*	7,918,484	9,097,159	7,981,993	9,288,624	
			11,232,809	**12,745,730**	**11,578,243**	**13,473,570**	**5.0%**
		Oil and Gas					
$	500,000	Kinder Morgan Inc., *7.45% March 1, 2098*	429,325	473,482	469,098	545,887	
			429,325	**473,482**	**469,098**	**545,887**	**0.2%**
		Real Estate Investment Trust					
$	500,000	Realty Income Corp., *5.875% March 15, 2035, Senior Unsecured Notes*	484,320	583,265	473,030	550,464	
			484,320	**583,265**	**473,030**	**550,464**	**0.2%**
		Telecommunications					
	231,000	Comcast Corp., 7%, *September 15, 2055*	5,766,351	6,450,893	5,966,730	6,943,468	
	16,300	Corporate Backed Trust Certificates, *7% Sprint Capital Note-Backed Series 2003-17*	408,315	460,276	409,945	477,052	
			6,174,666	**6,911,169**	**6,376,675**	**7,420,520**	**2.8%**
		Utilities					
$	6,700,000	Duquesne Light Holdings, Inc., *6.25% August 15, 2035, Senior Notes*	6,626,220	7,925,673	5,903,002	6,869,307	
$	1,230,000	Southern Union Company, *7.6% February 1, 2024*	1,315,731	1,501,308	1,279,046	1,488,423	
$	10,343,000	Southern Union Company, *8.25% November 15, 2029*	13,036,720	16,150,766	11,500,589	13,383,204	
			20,978,671	**25,577,747**	**18,682,637**	**21,740,934**	**8.1%**
		Miscellaneous Industries					
	78,820	Corporate Backed Trust Certificates, *6.05% Series 2003-7*	1,832,565	2,048,360	1,934,243	2,250,873	
$	2,170,000	Pulte Homes Inc., *7.875% June 15, 2032*	2,651,621	2,660,580	2,790,882	2,784,803	
$	2,880,000	Pulte Homes Inc., *6.375% May 15, 2033*	2,344,477	3,347,736	2,393,065	3,138,732	
	107,507	Pulte Homes Inc., *7.375% June 1, 2046*	2,773,369	2,951,332	2,697,206	3,247,742	
	16,600	SATURNS BellSouth Debenture-Backed Series 2001-3, *7.125%*	416,494	479,197	415,166	483,128	
			10,018,526	**11,487,205**	**10,230,562**	**11,905,278**	**4.4%**
		Total Corporate Debt Securities	**$ 56,878,540**	**$ 66,589,399**	**$ 56,480,079**	**$ 65,725,714**	**24.4%**
		Total	**$ 234,587,316**	**$ 276,649,982**	**$ 231,816,207**	**$ 269,763,889**	**100.0%**

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

December 31, 2006 and 2005

1. OPERATIONS

Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") is a closed-end investment trust created under the laws of the Province of Alberta on November 25, 2004, pursuant to an amended and restated declaration of trust. Computershare Trust Company of Canada is the Trustee and Brompton Funds Management Limited is the Manager and is responsible for managing the affairs of the Fund. Flaherty & Crumrine Incorporated is the Portfolio Manager. RBC Dexia Investor Services Trust is the custodian of the Fund's assets and prepares the weekly valuations of the Fund. The Fund commenced operations on December 15, 2004.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and they include estimates and assumptions made by management that affect the reported amounts of assets and liabilities at the date of these financial statements and the reported amounts of income and expenses during the period for which the financial statements report. Actual results could differ from these estimates.

a) **Valuation of Investments**

The Fund's investments are presented at estimated market value. Investments that are publicly traded are valued at their closing price. If a closing price is not available, these investments are valued using an average of the latest bid and ask prices. Short-term investments are valued at cost which, when taken together with accrued interest income thereon, is an approximation of their market value. Listed options are valued at market values as reported on recognized exchanges. The value of any security which is traded over-the-counter will be priced at the average of the last bid and ask prices quoted by a major dealer in such securities.

b) **Investment Transactions and Income Recognition**

Investment transactions are recorded on trade date and any realized gains or losses are recognized using the average cost of the investments. Interest income is recognized on an accrual basis. Dividend income is recognized on the ex-dividend date. Net realized gains or losses on investments and options include net realized gains or losses from foreign currency changes.

Option premiums paid or received by the Fund are, so long as the options are outstanding, reflected as an asset or liability, respectively, in the Statement of Net Assets and are valued at an amount equal to the current market value of an option that would have the effect of closing the position.

c) **Foreign Currency Forward Contracts**

The Fund may enter into foreign currency forward contracts, which are agreements between two parties to buy and sell currencies at a set price on a future date. The market value of the contract will fluctuate with changes in currency exchange rates. The contract is marked-to-market and the change in market value is recorded as an unrealized gain or loss. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

d) **Income Taxes**

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada). Provided the Fund makes distributions in each year of its net income and net realized capital gains, the Fund will not generally be liable for income tax. It is the intention of the Fund to distribute all of its net income and net realized capital gains on an annual basis. Accordingly, no income tax provision has been recorded.

e) **Foreign Exchange**

The market values of investments and other assets and liabilities that are denominated in foreign currencies are translated into Canadian dollars at the noon rate of exchange on each valuation date. Purchases and sales of investments and income derived from investments are translated at the rate of exchange prevailing at the time of such transactions.

f) **Fair Value of Financial Instruments**

The fair value of the Fund's financial instruments, which are composed of cash and short-term investments, dividends and interest receivable, accounts payable and accrued liabilities and loans payable, approximates their book value.

Notes to the Financial Statements (continued)

3. UNITS OF THE FUND

Authorized

The Fund is authorized to issue an unlimited number of transferable, redeemable units of beneficial interest, each of which represents an equal, undivided interest in the net assets of the Fund. Each unit entitles the holder to one vote and to participate equally with respect to any and all distributions made by the Fund.

Units may be redeemed at the option of unitholders by tendering units of the Fund between 20 and 45 business days prior to the second last business day in November ("Redemption Valuation Date"). Redemption of tendered units will be settled based on the net asset value per unit on the Redemption Valuation Date less associated costs of the redemption, including brokerage costs. Units tendered for redemption will be redeemed effective the Redemption Valuation Date and will be settled on or before the tenth business day in December.

Units may also be tendered for redemption at the option of unitholders at least 10 business days prior to the second last business day of each month, except for the month of November. Unitholders whose units are redeemed will receive a redemption price per unit equal to the lesser of (i) 96% of the weighted average trading price of the units for the 10 trading days preceding the redemption date; and (ii) 100% of the closing market price of the units, less associated costs of the redemption, including brokerage costs.

Issued

	2006		2005	
	Number of Units	**Amount**	Number of Units	Amount
Units, beginning of year	**12,011,203**	**$ 283,742,681**	14,882,310	$ 351,573,451
Initial public offering, net	**—**	**—**	—	4,453
Units redeemed	**(3,847,897)**	**(90,832,337)**	(2,612,986)	(61,728,387)
Units repurchased pursuant to a normal course issuer bid	**(398,900)**	**(9,420,486)**	(332,500)	(7,854,833)
Units issued under the distribution reinvestment plan (note 4)	**—**	**—**	1,268	30,089
Issued for services (note 5)	**121,920**	**2,655,334**	73,111	1,717,908
Units, end of year	**7,886,326**	**$ 186,145,192**	12,011,203	$ 283,742,681

For the year ended December 31, 2006, the Fund issued 121,920 (2005 – 73,111) units in respect of its management and advisor fees.

On November 30, 2006, 3,823,421 units were redeemed at $22.30. Pursuant to the monthly redemption option, 24,476 units were redeemed at an average price of $20.79 per unit.

The Fund received approval from the Toronto Stock Exchange for a normal course issuer bid program for the period from December 22, 2005 to December 21, 2006. Pursuant to the issuer bid, the Fund could purchase up to 1,205,494 units for cancellation. The Fund renewed the issuer bid for the period from December 22, 2006 to December 21, 2007, which allows the Fund to purchase up to 781,200 units for cancellation. The Fund may only repurchase units when the net asset value per unit exceeds its trading price. For the year ended December 31, 2006, 398,900 (2005 – 332,500) units were purchased.

As at December 31, 2006, the Fund had accumulated contributed surplus of $10,338,838 (2005 – $4,134,692) since inception. Contributed surplus is recorded when units of the Fund are redeemed or repurchased at prices per unit which are below the average cost per unit of unitholders' capital.

The weighted average number of units for the year ended December 31, 2006 was 11,481,890 (2005 – 14,613,877).

4. DISTRIBUTIONS TO UNITHOLDERS

Distributions, as declared by the Manager, are made on a monthly basis to unitholders of record on the last business day of each month. The distributions are payable by the tenth business day of the following month. For the year ended December 31, 2006, the Fund declared total distributions of $1.5312 (2005 – $1.6248) per unit, which amounted to $17,125,001 (2005 – $23,399,807). Under the Fund's distribution reinvestment plan, unitholders may elect to reinvest monthly distributions in additional units of the Fund which may be issued from treasury or purchased on the open market. For the year ended December 31, 2006, no (2005 – 1,268) units were issued by the Fund pursuant to the reinvestment plan.

5. MANAGEMENT, ADVISOR AND SERVICE FEES

Pursuant to a management agreement, the Manager provides management and administrative services to the Fund, for which it is paid a management fee equal to 0.35% per annum of the net asset value of the Fund, plus applicable taxes. The management fee may be paid in cash or units at the option of the Manager. To the extent that units are issued from treasury for this purpose, they will be issued at the net asset value per unit. During 2006, the entire management fee was paid in units. Flaherty & Crumrine Incorporated, the portfolio manager for the Fund, and Brompton Capital Advisors Inc. are entitled to receive an aggregate fee equal to 0.70% per annum of the net asset value, plus applicable taxes. Both fees are calculated and payable monthly. During 2006, 121,920 units were issued for the payment of advisor fees. The Fund also pays to the Manager a service fee equal to 0.30% per annum of the net asset value of the Fund. The service fee is in turn paid by the Manager to the investment dealers in proportion to the number of units held by clients of each dealer at the end of each calendar quarter.

6. INVESTMENT TRANSACTIONS

Investment transactions for the years ended December 31 were as follows:

	2006	2005
Proceeds from sale of investments and options	**$ 399,500,941**	$ 749,292,803
Less cost of investments and options sold:		
Investments and options at cost, beginning of year	**424,592,441**	528,622,454
Investments and options purchased during the year	**273,280,046**	663,217,731
Investments and options at cost, end of year	**(276,315,950)**	(424,592,441)
Cost of investments and options sold during the year	**421,556,537**	767,247,744
Net realized loss on sale of investments and options	**$ (22,055,596)**	$ (17,954,941)

Brokerage commissions on investments purchased and sold during the period ended December 31, 2006 amounted to $201,101 (2005 – $420,549). For the years ended December 31, 2006 and 2005, there were no soft dollar amounts paid.

7. FOREIGN CURRENCY FORWARD CONTRACTS

The Fund uses foreign currency forward contracts to hedge foreign exchange risks associated with its US dollar investment portfolio. During 2006, the Fund realized gains in the amount of $17,333,738 (2005 – $5,852,572) on the close-out of certain contracts. At December 31, 2006, the Fund had entered into the following foreign currency forward contracts with a Canadian chartered bank:

Canadian Dollars Purchased	US Dollars Sold	Delivery Date	Forward Rate (USD/CAD)	Unrealized Gain (Loss)
$ 61,635,736	$ (53,925,000)	January 19, 2007	1.14299	$ (1,078,034)
(8,174,448)	7,200,000	January 19, 2007	1.13534	198,912
61,323,510	(53,925,000)	January 22, 2008	1.13720	(724,012)
60,962,213	(53,925,000)	January 22, 2009	1.13050	(579,383)
$ 175,747,011	$ (154,575,000)			$ (2,182,517)

At December 31, 2005

Canadian Dollars Purchased	US Dollars Sold	Delivery Date	Forward Rate (USD/CAD)	Unrealized Gain (Loss)
$ 27,782,930	$ 23,800,000	January 12, 2005	0.86	$ (8,797)
237,115,554	190,075,000	January 15, 2015	0.80	16,815,371
$ 264,898,484	$ 213,875,000			$ 16,806,574

Notes to the Financial Statements (continued)

8. OPTION CONTRACTS

The Fund uses put options on US Treasury bond futures to hedge rapid increases in long-term interest rates. The Fund may also write or purchase options to generate additional income for the Fund. At December 31, 2006, the Fund had the following option contracts outstanding:

Option Contracts Purchased

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Paid	Market Value
30-year T-Bond futures	650	Call	February 2007	$ 116	$ 0.078	$ 400,026	$ 59,094
30-year T-Bond futures	700	Put	March 2007	110	515.63	421,822	420,022
30-year T-Bond futures	1,200	Put	March 2007	108	0.125	200,376	174,554
						$ 1,022,224	$ 653,670

As at December 31, 2005

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Paid	Market Value
30-year T-Bond futures	825	Put	February 2006	$ 116	$ 2,062.50	$ (2,677,824)	$ 1,987,691
30-year T-Bond futures	2,150	Put	March 2006	110	218.75	(3,537,288)	549,398
30-year T-Bond futures	1,625	Call	March 2006	116	609.375	(1,151,082)	1,156,748
						$ (7,366,194)	$ 3,693,837

Option Contracts Written

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Received	Market Value
30-year T-Bond futures	650	Call	March 2007	$ 112	$ 0.828	$ 1,356,252	$ 626,396

As at December 31, 2005

Underlying Interest	No. of Contracts	Option Type	Expiration Date	Strike Price per Contract	Current Price per Contract (USD)	Premium Received	Market Value
30-year T-Bond futures	(1,625)	Call	March 2006	$ 112	$ 2,718.75	$ 4,056,617	$ (5,160,877)

9. SECURITIES LENDING

The Fund entered into a securities lending program in August 2006 with its custodian, RBC Dexia Investor Services Trust. The aggregate market value of the securities loaned by the Fund cannot exceed 50% of the assets of the Fund. The Fund will receive collateral of at least 102% of the value of the securities on loan. Collateral will generally be comprised of cash and obligations of, or guaranteed by, the Government of Canada or a province thereof, or by the United States government or its agencies, or a permitted supranational agency as defined in National Instrument 81-102. As of December 31, 2006, there were no securities on loan.

10. LOANS PAYABLE

Pursuant to an agreement with a Canadian chartered bank, the Fund maintains a 364-day renewable revolving credit facility. The revolving credit facility provides for maximum borrowings of $13.9 million for working capital purposes under one tranche and US$153.8 million under the second tranche for investment purposes. Both tranches can be availed at the prime rate of interest, the bankers' acceptance rate plus a fixed percentage, the LIBOR rate plus a fixed percentage or by US base rate borrowings. At December 31, 2006, the Fund had a US dollar loan equivalent to $95.0 million (US$81.7 million) outstanding under this facility. For the year ended December 31, 2006, the Fund realized a foreign exchange loss in the amount of $794,125 (2005 – $11,405,907) on the repayment of borrowings in US dollars, and borrowings in US dollars had an unrealized foreign exchange loss of $523,622 (2005 – $2,192,118). The credit facility is secured by a first-ranking and exclusive charge on all of the Fund's assets. During the year ended December 31, 2006, the minimum and maximum amounts of borrowings were $93.9 million (2005 – $150.1 million) and $151.0 million (2005 – $192.4 million), respectively.

Costs incurred to establish the credit facility are deferred and amortized over its term. For the year ended December 31, 2006, the Fund recorded amortization of these costs in the amount of $4,755 (2005 – $36,395).

The credit facility is used by the Fund for the purchase of additional investments and for general Fund purposes.

11. ADOPTION OF FUTURE ACCOUNTING STANDARDS

The Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA) recently issued a new suite of financial reporting standards that address the accounting and disclosure for financial instruments. Of particular relevance to investment funds are changes outlined in CICA Handbook Section 3855: Financial Instruments – Recognition and Measurement. The new financial reporting standards for financial instruments are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. These standards will change the way in which investments are measured for financial statement purposes and will result in differences between the net asset value per unit ("NAVPU") presented in the financial statements and the NAVPU that is published weekly. The Fund has a financial year ending December 31, 2006, and as such, these changes will not be reflected until the interim financial statements are prepared in June 2007. Such differences will primarily result from marketable securities being valued using bid prices for financial statements and closing prices for the weekly published NAVPU.

Corporate Information

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Arthur R.A. Scace, QC, CM

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Officers

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Chairman

Raymond R. Pether, BA, MBA
Chief Executive Officer

Mark A. Caranci, BComm, CA
President

Craig T. Kikuchi, BA, CA, CFA
Chief Financial Officer

David E. Roode, BA, CA, MBA
Senior Vice President

Moyra E. MacKay, BA
Vice President and Corporate Secretary

Lorne J. Zeiler, BA, MBA, CFA
Vice President

Jessica Leung, BComm, CA
Controller

Ann P. Wong, BA, CA, CPA (Delaware), CFA, Controller

Christopher Cullen, BASc, MBA, CFA
Assistant Vice President

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Trustee

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Custodian

RBC Dexia Investor Services Trust

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PricewaterhouseCoopers LLP

Banker

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