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.

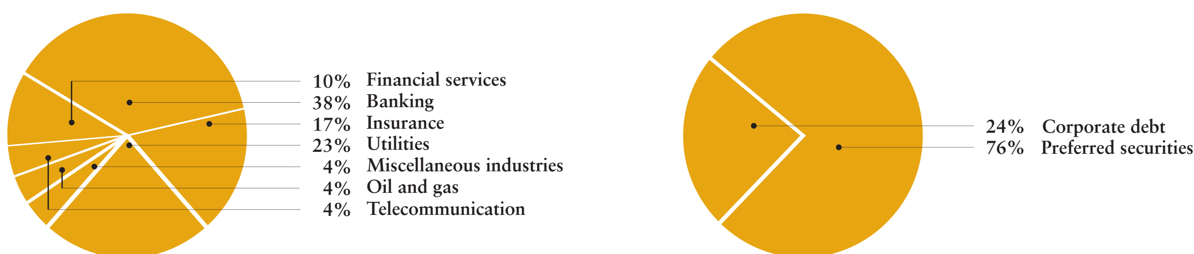
When the Manager and Portfolio Manager agree to take their fees in units of the Fund, additional cash is available for distributions. The Manager has been taking its fee in units since the inception of the Fund. At the end of 2005, the Portfolio Manager also agreed to take its fees in units to help offset 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.

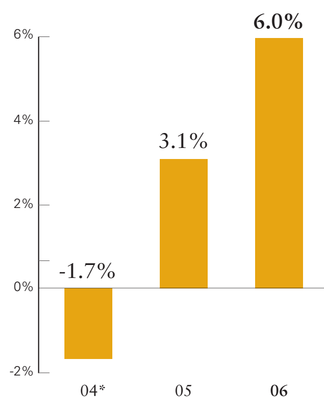
The MER, excluding interest expenses and issuance costs, declined from 1.48% in 2005 to 1.44% in 2006. This latter rate is more representative of the ongoing efficiency of the administration of the Fund.

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 4½% to 5¼%. 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.

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.