

VALUE
INTEGRITY
PERFORMANCE

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FFI.UN

Investment grade US preferred and fixed income securities actively managed by Flaherty & Crumrine. Units of the Fund are currently rated P-2f by Standard & Poor's.

Management Report of Fund Performance

August 12, 2010

This interim management report of fund performance for Flaherty & Crumrine Investment Grade Fixed Income Fund (the "Fund") contains financial highlights but does not contain the interim financial statements of the Fund. The interim financial statements follow this report. You may obtain a copy of the interim or annual financial statements, at no cost, by calling 866-642-6001 or by sending a request to Investor Relations, Brompton Funds, Bay Wellington Tower, Brookfield Place, 181 Bay Street, Suite 2930, P.O. Box 793, Toronto, Ontario, M5J 2T3, or by visiting our website at www.bromptongroup.com or SEDAR at www.sedar.com. Unitholders may also contact us using one of these methods to request a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record, independent review committee's report, or quarterly portfolio disclosure.

In accordance with investment fund industry practice, all figures presented in this management report of fund performance are based on the Fund's calculation of its weekly Net Asset Value ("Net Asset Value"), which is exempted from the application of Canadian Institute of Chartered Accountants ("CICA") Section 3855, except for the figures presented in the Net Assets per Unit table, which can be found under Financial Highlights. In accordance with National Instrument ("NI") 81-106, the figures in this table must be derived from the financial statements.

THE FUND

Flaherty & Crumrine Investment Grade Fixed Income Fund is a closed-end investment trust 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 specialist in managing preferred and debt securities, and it manages the Fund's portfolio. For a more detailed description of Flaherty & Crumrine and for the Portfolio Manager's Report on the Fund, see the Portfolio Manager section. The units of the Fund are currently rated P-2f by Standard & Poor's ("S&P"), and the Fund is RRSP, DPSP, RRI, RESP and TFSA 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, to preserve the Net Asset Value per unit and to enhance the total return per unit by actively managing the portfolio. To achieve these objectives, the Fund invests in a portfolio of fixed income securities consisting primarily of US dollar denominated corporate debt and preferred securities 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.

On November 25, 2008, the Fund announced that the Portfolio Manager had decided to suspend employment of the safety net hedging strategy due to abnormal market conditions. The Portfolio Manager will continue to review market conditions to determine if and when it will be appropriate to employ the safety net hedging strategy again.

RECENT DEVELOPMENTS

Warrants

On December 15, 2009, the Fund issued Class A warrants to unitholders on the basis of one-half of a Class A warrant for each unit held, with each Class A warrant entitling the holder to subscribe for one unit of the Fund at a subscription price of \$9.07. By the expiry date of June 15, 2010, all warrants were exercised and the offering was oversubscribed, with gross proceeds totaling \$39.2 million. The warrant offering was designed to provide the Fund with additional capital that can be used to take advantage of attractive investment opportunities, while also increasing the trading liquidity of the units and reducing the management expense ratio (“MER”) of the Fund.

Harmonized Sales Tax (“HST”)

Effective July 1, 2010, Ontario and British Columbia combined the provincial sales tax (“PST”) with the federal goods and services tax (“GST”) to create the HST. These provinces join Nova Scotia, New Brunswick and Newfoundland and Labrador as HST participants.

Prior to the implementation of the HST, management fees and most operating expenses on investment funds were subject only to the 5% GST. Effective with the second half of 2010, these costs are now subject to the higher HST rate, which will increase the management expense ratio. The HST rate payable by the Fund as of July 1, 2010 is a “blended” rate, which is based on the provincial residency of unitholders, the value of their investments in the Fund and whether their home province is an HST province. With this blended approach, the Fund is required to pay HST on expenditures regardless of the location of the source of its supplies. As at June 30, 2010, the Fund estimated that its blended HST rate for the second half of 2010 will be approximately 10.6%.

Future Accounting Changes

In June 2010, the Canadian Accounting Standards Board (“AcSB”) released an exposure draft to propose that investment companies may defer the adoption of International Financial Reporting Standards (“IFRS”), as published by the International Accounting Standards Board, from fiscal years beginning on or after January 1, 2011 until fiscal years beginning on or by January 1, 2012. The Fund will adopt IFRS by the deadline to be set out in the AcSB’s proposed amendment or such earlier time as may required by the Canadian Securities Administrators.

RISKS

Risks associated with an investment in the units of the Fund are discussed in the Fund’s 2009 annual information form, which is available on the Fund’s website at www.bromptongroup.com or on SEDAR at www.sedar.com. There were no changes to the Fund during the period that materially affected the risks associated with an investment in the units of the Fund.

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 for the six months ended June 30, 2010 and since inception. These are approximate figures and are calculated using the weighted average number of units outstanding for the period.

	For the Six Months Ended June 30, 2010	Since Inception ⁽¹⁾
Revenues	\$ 0.56	\$ 10.89
Expenses		
Management and Portfolio Manager fees	(0.04)	(1.01)
Other expenses	(0.02)	(0.46)
Interest and bank charges	(0.06)	(2.31)
Total expenses	(0.12)	(3.78)
Net investment income	0.44	7.11
Add: Management and Portfolio Manager fees paid in units	—	0.54
Cash flow available for distribution	0.44	7.65
Distributions to unitholders	(0.48)	(7.86)
Cash flow available for distributions in excess of (less than) distributions	\$ (0.04)	\$ (0.21)

⁽¹⁾ Period from December 15, 2004 (commencement of operations) to June 30, 2010.

For the six months ended June 30, 2010, the distribution rate was maintained at \$0.08 per unit per month. During the interim period, distributions paid to unitholders exceeded cash flow available for distributions slightly, by \$0.04, primarily as a result of uninvested warrant proceeds not yet earning income prior to distributions being paid on the new units that were issued. Based on the June 30, 2010 closing price of the Fund, the distribution rate of \$0.08 represented a yield of 10.6% at the end of the period.

The Fund has a distribution reinvestment plan which allows participating unitholders to automatically reinvest monthly distributions in additional units of the Fund. For the six months ended June 30, 2010, 5,901 units were acquired in the market pursuant to this plan at an average price of \$9.28 per unit.

Changes in Net Asset Value

During the six months ended June 30, 2010, the Net Asset Value per unit increased by 3.9%, from \$9.18 per unit to \$9.54 per unit. This increase was due to the improvement in the US non-government fixed income securities market. During the period, the value of the investments in the Fund's portfolio (including realized and unrealized gains) increased by approximately \$0.69 per unit.

The table below provides an approximate breakdown of the various factors which contributed to the change in Net Asset Value per unit over the period. These are approximate figures calculated using the weighted average number of units outstanding.

Changes in Net Asset Value on a Per Unit Basis

	For the Six Months Ended June 30, 2010	Since Inception ⁽¹⁾
Opening Net Asset Value	\$ 9.18	\$ 23.63
Gains (losses) on portfolio investments ⁽²⁾	0.69	(10.36)
Cost of the safety net hedge	—	(1.16)
Cash flow available for distribution	0.44	7.65
Distributions to unitholders	(0.48)	(7.86)
Cost of foreign exchange hedge	(0.02)	(0.45)
Reduction from management fees being paid in units	—	(0.54)
Dilution due to warrant exercise	(0.27)	(1.43)
Rounding/timing adjustments	—	0.06
Total change	0.36	(14.09)
Closing Net Asset Value	\$ 9.54	\$ 9.54

⁽¹⁾ Period from December 15, 2004 (commencement of operations) to June 30, 2010.

⁽²⁾ Excludes the impact of foreign exchange, which is included in the foreign exchange hedge.

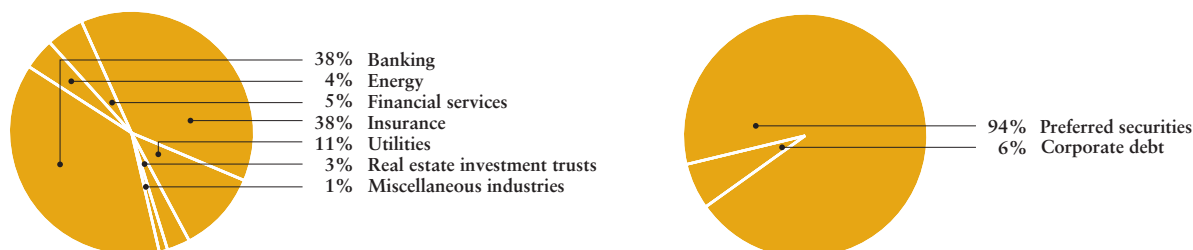
There were no costs associated with the safety net hedge as the Portfolio Manager did not employ the strategy during the period. The Fund has a hedging program in place for the Fund's foreign exchange risk. Substantially all of the US dollar foreign exchange exposure of the Fund's portfolio is hedged by the Fund to the Canadian dollar at all times. As of June 30, 2010, about two-thirds of the portfolio was hedged using a combination of forward contracts maturing in August 2010, November 2010, and February 2011, and the balance of the portfolio was hedged through the Fund's US dollar borrowings. For the six months ended June 30, 2010, the Fund incurred a cost of \$0.02 per unit under the hedging strategy.

Investment Portfolio

All securities purchased by the Fund are rated investment grade at the time of investment. The portfolio is well diversified with 71 issues as of June 30, 2010. The breakdown of the portfolio is shown in the accompanying pie charts. The Portfolio Manager is comfortable with the credit quality of all the securities held in the portfolio. The Portfolio Manager believes that most securities included in the portfolio that are below investment grade offer significant upside potential and generally are underrated by the credit rating agencies. The Fund's credit quality remains investment grade and its units are currently rated P-2f by S&P.

At June 30, 2010, the Fund held \$20.0 million in cash from proceeds of the warrants issue which expired on June 15, 2010. The Portfolio Manager is in the process of deploying the proceeds into the Fund's portfolio.

Portfolio Sectors



Credit Quality

As of June 30, 2010, the Fund invested in debt and preferred securities with the following credit ratings. Credit ratings are obtained from Standard & Poor's.

Portfolio by Rating Category

	% of Portfolio
A	2%
A-	13%
BBB	51%
BBB-	13%
Below BBB-	21%
	100%

Liquidity and Capital Resources

As of June 30, 2010, the Fund had total borrowings of \$68.6 million, which represented 34.7% of total assets, or 56.2% of Net Asset Value. The rate paid on these borrowings is adjusted regularly 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 six months ended June 30, 2010, the minimum and maximum amounts of borrowings were \$45.8 million and \$68.7 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 program allows it to purchase its units on the TSX for cancellation if 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 178,900 units were purchased in the interim period ended June 30, 2010 under this program at an average price of \$9.20 per unit. Investors may also redeem their units annually, in November, in accordance with the Fund’s redemption provisions.

RELATED PARTY TRANSACTIONS

Related party transactions consist of services provided by the Manager pursuant to a management agreement. See the Management Fees section below.

MANAGEMENT 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 0.30% per annum of the Net Asset Value of the Fund, plus applicable taxes. The management fee is used by the Manager to cover its costs to obtain the Fund’s assets, the cost to administer the Fund, and for profit. In addition, Flaherty & Crumrine Incorporated, the Portfolio Manager of the Fund, and Brompton Capital Advisors Inc. (“BCAI”) are entitled to receive an additional fee equal to 0.70% per annum of the Net Asset Value, plus applicable taxes. The Fund also pays to the Manager a service fee equal to 0.40% 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 six months ended June 30, 2010, \$0.5 million was paid in management and advisory fees and \$0.2 million was paid in service fees.

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 and unaudited interim financial statements. *The information in the following tables is presented in accordance with NI 81-106 and, as a result, does not act as a continuity of opening and closing Net Assets 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 Assets per Unit⁽¹⁾

	For the Six Months Ended June 30, 2010	For the Years Ended December 31				
		2009	2008	2007	2006	2005
Net Assets, beginning of period/year ⁽²⁾⁽³⁾⁽⁴⁾	\$ 9.09	\$ 6.55	\$ 17.34	\$ 22.01	\$ 22.35	\$ 23.23
Increase (decrease) from operations ⁽⁵⁾						
Total revenue	0.57	1.23	2.30	2.24	2.30	2.14
Total expenses	(0.14)	(0.20)	(0.57)	(0.99)	(1.01)	(0.81)
Realized gain (loss) for the period/year	0.34	(0.66)	(11.59)	(0.04)	(0.34)	(0.11)
Unrealized gain (loss) for the period/year	0.27	4.68	0.14	(4.25)	0.29	(0.55)
Total increase (decrease) in Net Assets from operations	\$ 1.04	\$ 5.05	\$ (9.72)	\$ (3.04)	\$ 1.24	\$ 0.67
Distributions to unitholders: ⁽⁴⁾						
From net investment income	\$ N/A ⁽⁶⁾	\$ 0.73	\$ 1.05	\$ 0.84	\$ 1.09	\$ 0.22
From net realized gain on investments	N/A ⁽⁶⁾	—	—	—	—	0.82
Return of capital	N/A ⁽⁶⁾	0.49	0.45	0.66	0.44	0.59
Total distributions to unitholders	\$ 0.48	\$ 1.22	\$ 1.50	\$ 1.50	\$ 1.53	\$ 1.63
Net Assets, end of period/year⁽²⁾⁽³⁾⁽⁴⁾	\$ 9.44	\$ 9.09	\$ 6.55	\$ 17.34	\$ 22.08	\$ 23.35

⁽¹⁾ This information is derived from the Fund’s audited annual and unaudited interim financial statements. The Net Assets per unit presented in the financial statements differs from the Net Asset Value calculated for weekly Net Asset Value purposes. The difference is primarily a result of investments being valued at bid prices for financial statement purposes and closing prices for weekly Net Asset Value purposes.

⁽²⁾ Represents basic Net Assets per unit.

⁽³⁾ The Net Assets from the beginning of 2007 are for financial reporting purposes. The Net Assets per unit for prior periods are based on the prior period financial statements and have not been adjusted for the new accounting standards adopted in 2007.

⁽⁴⁾ Net Assets per unit and distributions per unit are based on the actual number of units outstanding at the relevant time.

⁽⁵⁾ The increase (decrease) in Net Assets from operations per unit is based on the weighted average number of units outstanding over the fiscal period.

⁽⁶⁾ Allocations for the period ended June 30, 2010, are not determinable until year end.

Ratios and Supplemental Data (Based on Net Asset Value)

As at	June 30, 2010	December 31				
		2009	2008	2007	2006	2005
Net Asset Value (in 000s)	\$ 122,100	\$ 79,408	\$ 43,414	\$ 87,061	\$ 174,138	\$ 268,420
Number of units outstanding (in 000s)	12,799	8,655	6,591	5,001	7,886	12,011
Management expense ratio ("MER") ⁽¹⁾	3.55%	2.93%	4.17%	4.75%	4.47%	3.45%
Trading expense ratio ⁽²⁾	—	—	0.01%	0.04%	0.08%	0.12%
Portfolio turnover rate ⁽³⁾	8.60%	82.46%	66.00%	82.01%	73.24%	131.75%
Net Asset Value per unit – basic	\$ 9.54	\$ 9.18	\$ 6.59	\$ 17.41	\$ 22.08	\$ 22.35
Net Asset Value per unit – diluted	\$ N/A	\$ 9.09	\$ N/A	\$ N/A	\$ N/A	\$ N/A
Closing market price – units	\$ 9.07	\$ 9.18	\$ 6.32	\$ 16.14	\$ 22.37	\$ 21.40
Closing market price – warrants ⁽⁴⁾	\$ N/A	\$ 0.11	\$ N/A	\$ N/A	\$ N/A	\$ N/A

⁽¹⁾ MER is based on the requirements of NI 81-106 and includes the total expenses (excluding commissions and other portfolio transaction costs) of the Fund for the stated period, including interest expenses and issuance costs, and is expressed as an annualized percentage of the average Net Asset Value of the period.

⁽²⁾ The trading expense ratio represents total commissions expressed as an annualized percentage of daily average Net Asset Value of the Fund during the period.

⁽³⁾ The Fund's portfolio turnover rate indicates how actively the Fund's Portfolio Manager 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. 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.

⁽⁴⁾ The closing price of the warrant is for the class of warrant then outstanding.

Expense Ratio

The MER of the Fund was 3.55% for the six months ended June 30, 2010, which included the one-time expense of warrant fees as well as higher interest expenses, compared to 2.93% in 2009. 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.

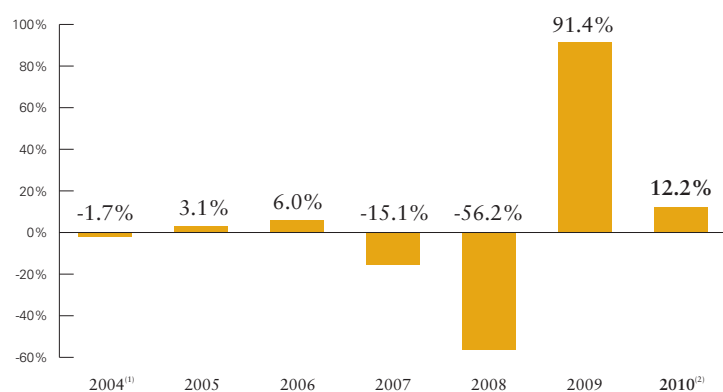
Excluding interest expenses and warrant fees, the MER was 1.64% for the six months ended June 30, 2010, compared to 1.61% for 2009. This latter MER is more representative of the ongoing efficiency of the administration of the Fund.

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 cash distributions made by the Fund and deemed distributions based on the warrants' intrinsic value at the exercise date of the warrants in the periods shown were reinvested at Net Asset Value per unit in additional units of the Fund.

The bar chart shows the Fund's return for each year/period since inception to June 30, 2010. The chart shows, in percentage terms, how an investment held on the first day of each fiscal year/period would have changed by the last day of the fiscal period.

Year-by-Year Returns



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

⁽²⁾ Period from January 1, 2010 to June 30, 2010.

The following table shows the Fund's compound return for each period indicated, compared with the return for the Merrill Lynch Hybrid Preferred Securities Index ("Merrill Lynch Index"). The Merrill Lynch Index is an unleveraged, unmanaged index of investment grade, exchange traded preferred stocks with outstanding market values of at least \$30 million and at least one year to maturity.

Annual Compound Returns

	Six Months Ended June 30, 2010	Since Inception ⁽¹⁾
Flaherty & Crumrine Investment Grade Fixed Income Fund	12.2%	(2.7%)
Merrill Lynch Hybrid Preferred Securities Index	5.7%	1.7%

⁽¹⁾ Period from December 15, 2004 (commencement of operations) to June 30, 2010.

For the six months ended June 30, 2010, the Fund provided a strong return of 12.2%, significantly outperforming the Merrill Lynch Index due to careful security selection by the Portfolio Manager and the benefits of the leverage strategy, which enhances positive returns.

Since inception, the Fund has underperformed the Merrill Lynch Index due to the negative impact of leverage as the average cost of leverage was slightly higher than the return provided by the portfolio; the cost of the safety net hedge, which has been suspended since November 2008; and the costs of Fund administration, as represented by the MER. As credit conditions continue to improve, the strategy of employing leverage should lead to further positive performance, while investors continue to be paid a high level of monthly income.

Please see the Portfolio Manager's Report for further information.

SUMMARY OF INVESTMENT PORTFOLIO

As at June 30, 2010

Total Net Asset Value	\$ 122,100,299
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Portfolio Composition	% of Portfolio	% of Net Asset Value
Preferred securities:		
Banking	34.3%	55.0%
Insurance	32.0%	51.4%
Utilities	9.6%	15.4%
Financial services	3.4%	5.4%
Energy	3.2%	5.1%
Real estate investment trust	2.3%	3.7%
	84.8%	136.0%
Corporate debt:		
Insurance	2.0%	3.2%
Miscellaneous industries	1.3%	2.1%
Financial services	0.7%	1.2%
Utilities	0.7%	1.2%
Telecommunication	0.3%	0.5%
	5.0%	8.2%
Cash and short-term investments	10.2%	16.3%
Total investment portfolio	100.0%	160.5%
Currency forward contracts		(2.0%)
Other net liabilities		(58.5%)
Total Net Asset Value		100.0%

Top 25 Holdings	% of Portfolio	% of Net Asset Value
Cash and short-term investments	10.2%	16.3%
Axis Capital Holdings Limited, 7.50% Pfd.	4.3%	6.9%
Comerica Capital Trust II, 6.576% Capital Securities	4.1%	6.7%
ACE Capital Trust II, 9.7% due April 1, 2030	3.3%	5.3%
Enbridge Energy Partners L.P., 8.05% due October 1, 2037	3.2%	5.1%
HSBC Holdings PLC, 8% Pfd Series II	3.1%	5.0%
BB&T Capital Trust VI, 9.6% Pfd.	3.0%	4.8%
FPL Group Capital Inc., variable rate due October 1, 2066	3.0%	4.8%
Everest Reinsurance Holdings Inc., 6.6% due May 15, 2067	2.9%	4.7%
PNC Preferred Funding Trust III, Pfd.	2.9%	4.6%
Delphi Financial Group, Inc., 7.376% due May 15, 2037	2.9%	4.6%
Dominion Resources Inc., 7.5% due June 30, 2066	2.7%	4.3%
Duke Realty L.P., 8.25% due August 15, 2019	2.3%	3.7%
Capital One Capital III, 7.686% August 15, 2036	2.1%	3.3%
Arch Capital Group Ltd., 8% Pfd.	2.1%	3.3%
Dominion Resources Capital Trust I, 7.83%, due December 1, 2027	2.0%	3.3%
Liberty Mutual Insurance Co., 7.697% due October 15, 2097	2.0%	3.2%
USF&G Capital I, 8.5% due December 15, 2045 Capital Security	1.9%	3.1%
Aon Capital A, 8.205% due January 1, 2027	1.9%	3.0%
PartnerRe Finance II Inc., 6.44% due December 1, 2066	1.8%	2.9%
Fifth Third Capital Trust IV, variable rate due April 1, 2037	1.8%	2.9%
MetLife Inc., variable rate due August 15, 2039	1.6%	2.6%
FPL Group Capital Inc., variable rate due September 1, 2067	1.6%	2.6%
JPMorgan Chase Capital XXIX, 6.7% Capital Security Series CC	1.5%	2.5%
MetLife Capital Trust X, variable rate due April 8, 2038	1.5%	2.5%

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.

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. The firm uses intensive credit analysis, thorough analysis of securities' terms and structures 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

While valuations in the US preferred securities market have certainly improved since the depths of the financial crisis in March 2009, preferreds struggled during the three months ending June 30, 2010, particularly in response to developments occurring in Europe during May. We expect that this pattern of generally rising preferred prices punctuated by setbacks and above-average volatility will be the hallmark of the preferred market during the second half of 2010.

We judge the health of the preferred market by two primary measures – the potential for relative price performance and overall liquidity (how easy is it to buy and sell securities without impacting prices).

In our opinion, preferred securities continue to offer investors attractive levels of income and the potential for price appreciation when compared to other types of US dollar denominated fixed-income investments. During the darkest days of the market collapse (late 2008 to early 2009), preferred prices were weaker than every other US fixed income market sector, except junk bonds. While the gap has narrowed appreciably over the past year, preferred securities still offer good relative value to investors. During the second quarter, preferred spreads versus US Treasury, corporate and municipal bonds widened somewhat, moderately increasing the relative value, and therefore the attraction, of preferred securities.

Not only do preferreds look attractive versus the broader US credit markets, but the broader credit markets also appear attractive versus other types of investments. Measures of cash flows into and out of US mutual funds indicate that demand for higher yielding fixed-income products remains strong. This is no surprise. With decelerating US GDP growth, resulting high levels of volatility and uncertainty about the stock market, huge deficits faced by state and local municipalities and money market fund yields hovering around zero, many investors have turned to corporate bonds and preferred securities.

Liquidity, the other measure of market health, is also relatively strong at present, although some explanation is required. The preferred market is never highly liquid, at least by the standards of most other securities markets. A large-cap, exchange traded common stock may trade hundreds or thousands of times each day with a tiny bid/offer spread; in the preferred universe, most trades require greater effort. But relative to historical measures of liquidity, the preferred market has been reasonably active recently.

As mentioned above, during the second quarter the primary pressure on preferreds occurred during the first two weeks of May as fears over a European debt crisis intensified. Prices fell despite surprisingly supportive economic data in the US, where the bulk of preferred issuers are domiciled. The global recession had caused government budget deficits to swell almost everywhere, and the financial markets became concerned about the so-called PIIGS countries' (Portugal, Ireland, Italy, Greece, and Spain) ability to repay their debt. The resulting sharply higher sovereign debt interest rates paid by these countries (especially Greece) only intensified the problems they face in bringing their debt under control.

With Greece on the verge of a liquidity crisis, the European Monetary Union ("EMU") and International Monetary Fund ("IMF") combined to offer a £110 billion assistance package to Greece in exchange for commitments by that country to sharply reduce its deficit. This averted an immediate crisis, but the financial markets quickly turned on the other high-deficit countries, forcing European officials to follow up only days later with a more comprehensive set of proposals totaling £750 billion to address the widening crisis in other European countries.

All of these concerns about Europe weighed on the preferred securities market for two reasons. First, investors worry about the direct exposure that companies may have to these countries. On that score, we cannot identify any material exposure in the Fund's portfolio to Greece, the weakest of the EMU sovereigns. However, some of the issuers in the portfolio do have exposure to Spain and Italy – although we would characterize this exposure as modest.

The second broad concern facing investors is the possibility that sovereign debt problems could lead to a breakup of the EMU and the Euro. Given the interconnectedness of the global financial system, breakup of the EMU would be highly disruptive to say the least, and no doubt negatively affect the preferred market. While we think this is an extremely low-probability scenario, until markets have concluded it's a "no chance" scenario, we will keep our eye on it. The creation of the debt stabilization fund and renewed budget restraint in high-deficit countries gives us comfort that sovereign risks are moving in the right direction.

Preferred market participants are also evaluating the potential impact of the financial regulation legislation recently passed by the US Congress (and now rechristened "Dodd-Frank"). The legislation will make significant changes to both the operations and capitalization of US financial companies.

First, Dodd-Frank will raise effective capital requirements for most financial companies and make it more difficult to lower them in the future. For preferred investors, this is clearly good news.

Second, Dodd-Frank contains a provision that will make the trust preferred securities (“TruPS”) of larger banks ineligible as Tier 1 capital (after a phase-out period), although TruPS issued by smaller banks will retain their Tier 1 capital eligibility permanently. (While all TruPS issued on or after May 19, 2010 will not receive Tier 1 capital treatment, regardless of the size of the issuing bank, there has been no public issuance since that date.)

This is mixed news for preferred investors. Banks are more likely to call TruPS that are no longer eligible as Tier 1 capital, and most TruPS allow issuers to call them at par if they no longer qualify as Tier 1 capital. That’s potentially good news for TruPS that trade below par, but bad news for the limited number of issues that trade at a premium. However, the long timetable for implementation of the new capital rules should limit the impact on outstanding preferred securities.

Third, Dodd-Frank will restrict the activities of financial institutions in a number of ways. For preferred investors, two of the most important are (i) the “Volker Rule” limiting proprietary trading, along with investments in hedge funds and private equity, and (ii) the requirements for derivatives activities. We see these provisions as reducing both the risks that financial institutions can take and the profits they can generate. However, on balance, we think these limitations on bank activities will benefit preferred investors.

Overall, we believe Dodd-Frank will force banks to hold more capital, take less risk, or both. When we combine that with regulators’ desire for banks to hold a higher proportion of high-quality capital (i.e., common equity), we see it as decidedly good news for preferred investors. We may need to reassess that conclusion when regulators turn the legislation into final rules. However, for now we are cautiously optimistic about the impact of Dodd-Frank on preferreds.

While the US Congress has considered Dodd-Frank, regulators in the US and abroad are formulating new capital standards for banks. These new rules, Basel III, will replace current Basel II guidelines that, in retrospect, permitted banks to operate with inadequate capital as markets became stressed. While the new rules are still being negotiated, two things are clear. First, banks will need to hold higher levels of capital than under Basel II, partly because certain asset classes will carry higher “risk weights” and partly because required capital ratios have increased or will increase. Second, the “quality” of capital will improve, with a particular emphasis on the strongest form of capital – common equity. As preferred investors, we have always paid a great deal of attention to the composition of capital at the companies in which we invest, and we are happy to see regulators do the same. Over time, this should result in banks with higher common equity ratios and less reliance on preferred and hybrid securities (in percentage terms). That no doubt will prompt changes to the preferred market, with shrinkage in some areas, expansion in others, and eventually emergence of some new forms of hybrid capital.

While the US and international regulatory changes may generate some volatility in the preferred market, we expect the changes will offer opportunities for the Fund’s portfolio as well. And, although preferreds have recovered since early last year, valuations continue to remain below long-term relationships when compared with other US fixed income securities.

FORWARD-LOOKING STATEMENTS

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlook 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 on 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.

NOTICE

The accompanying unaudited financial statements of Flaherty & Crumrine Investment Grade Fixed Income Fund for the six months ended June 30, 2010 have been prepared by management and have not been reviewed by the external auditors of the Fund.

Signed

Mark A. Caranci
Chief Executive Officer
August 12, 2010

Signed

Craig T. Kikuchi
Chief Financial Officer

STATEMENTS OF NET ASSETS (Unaudited)

As at	June 30, 2010	Dec. 31, 2009
Assets		
Investments, at fair value ⁽¹⁾	\$ 174,714,258	\$ 118,626,329
Unrealized gain on forward contracts (note 10)	—	1,223,383
Cash and short-term investments	19,927,889	4,523,046
Income receivable	2,048,409	1,505,996
Total assets	196,690,556	125,878,754
Liabilities		
Unrealized loss on forward contracts (note 10)	2,408,067	—
Accounts payable and accrued liabilities	319,459	361,063
Amounts payable for investments purchased	3,493,013	—
Distributions payable to unitholders (note 7)	1,023,912	692,376
Loans payable (note 11)	68,647,454	46,127,396
Total liabilities	75,891,905	47,180,835
Unitholders' equity		
Unitholders' capital (note 4)	134,630,955	97,461,556
Warrants (note 5)	—	520,739
Contributed surplus (note 4)	59,202,207	58,891,531
Deficit	(73,034,511)	(78,175,907)
Net Assets representing unitholders' equity	\$ 120,798,651	\$ 78,697,919
Units outstanding (note 4)	12,798,894	8,654,700
Net Assets per unit – basic (note 5)	\$ 9.44	\$ 9.09
Net Assets per unit – diluted (note 5)	\$ N/A	\$ 9.04

⁽¹⁾ Investments, at fair value, exclude the value of derivative contracts which are disclosed separately on the Statement of Net Assets.

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

STATEMENTS OF OPERATIONS AND DEFICIT (Unaudited)

For the six months ended June 30	2010	2009
Income		
Dividends	\$ 1,625,363	\$ 1,248,392
Securities lending income (note 12)	—	255
Interest income	3,847,275	3,473,544
	5,472,638	4,722,191
Expenses		
Advisory fees (note 8)	294,263	152,213
Management fees (note 8)	183,273	69,455
Service fees (note 8)	162,035	75,067
Audit fees	15,373	17,827
Independent review committee fees	14,959	14,960
Trustee fees	6,248	6,248
Custodial fees	2,065	5,764
Legal fees	5,987	3,410
Unitholder reporting costs	20,468	6,932
Other administrative expenses	57,632	41,161
Interest and bank charges (note 11)	582,178	233,754
	1,344,481	626,791
Net investment income	4,128,157	4,095,400
Net realized gain (loss) on investments and foreign currency transactions (note 9)	2,416,755	(4,107,751)
Transaction costs	(45)	(71)
Net realized gain (loss) on forward contracts (note 10)	791,696	(2,661,660)
Net change in unrealized gain/loss on investments and foreign currency transactions	6,168,915	14,590,688
Net change in unrealized gain/loss on forward contracts (note 10)	(3,631,450)	4,603,287
Increase in Net Assets from operations	9,874,028	16,519,893
Deficit, beginning of period	(78,175,907)	(110,185,270)
Distributions to unitholders (note 7)	(4,732,632)	(4,768,645)
Deficit, end of period	\$ (73,034,511)	\$ (98,434,022)
Increase in Net Assets from operations per unit – basic (note 5)⁽¹⁾	\$ 1.04	\$ 2.47
Increase in Net Assets from operations per unit – diluted (note 5)⁽¹⁾	\$ N/A	\$ 2.38

⁽¹⁾ Based on the weighted average number of units outstanding for the period (note 4).

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

STATEMENTS OF CASH FLOWS (Unaudited)

For the six months ended June 30	2010	2009
Cash flows from operating activities:		
Increase in Net Assets from operations	\$ 9,874,028	\$ 16,519,893
Adjustments to reconcile net cash provided by (used in) operations:		
Net realized (gain) loss on sale of investments, options and foreign currency transactions	(2,478,405)	3,683,737
Net change in unrealized gain/loss on investments and foreign currency transactions	(5,569,326)	(14,384,089)
Net change in unrealized gain/loss on forward contracts	3,631,450	(4,603,287)
Decrease (increase) in income receivable	(542,413)	421,994
Increase (decrease) in accounts payable and accrued liabilities	(41,604)	(13,047)
Purchase of investments (note 9)	(55,217,337)	(17,336,667)
Proceeds from sale of investments (note 9)	11,887,244	16,659,320
Cash provided by (used in) operating activities	(38,456,363)	947,854
Cash flows from financing activities:		
Increase (decrease) in loans payable	21,302,966	5,872,312
Distributions paid to unitholders (note 7)	(4,401,096)	(4,740,514)
Repurchase of units (note 4)	(1,646,170)	—
Proceeds from distribution reinvestment plan (note 7)	—	35,632
Proceeds from issuance of units upon exercise of warrants, net (note 5)	38,643,236	5,150,996
Amounts paid for redemption of units (note 4)	(37,730)	(130,878)
Cash provided by financing activities	53,861,206	6,187,548
Net increase in cash and short-term investments	15,404,843	7,135,402
Cash and short-term investments, beginning of period	4,523,046	780,330
Cash and short-term investments, end of period	\$ 19,927,889	\$ 7,915,732
Supplemental information:		
Interest paid	\$ 551,910	\$ 201,104

STATEMENTS OF CHANGES IN NET ASSETS (Unaudited)

For the six months ended June 30	2010	2009
Net Assets, beginning of period	\$ 78,697,919	\$ 43,169,188
Operations:		
Increase in Net Assets from operations	9,874,028	16,519,893
Unitholder transactions:		
Distributions to unitholders (note 7)	(4,732,632)	(4,768,645)
Proceeds from issuance of units upon exercise of warrants, net (note 5)	38,643,236	5,150,996
Proceeds from distribution reinvestment plan (note 7)	—	35,632
Repurchase of units (note 4)	(1,646,170)	(109,633)
Redemption of units (note 4)	(37,730)	—
Total unitholder transactions	32,226,704	308,350
Net increase in Net Assets	42,100,732	16,828,243
Net Assets, end of period	\$ 120,798,651	\$ 59,997,431
Distributions per unit (note 7)	\$ 0.4800	\$ 0.7050

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

STATEMENT OF INVESTMENTS (Unaudited)

As at June 30, 2010	Cost (USD)	Cost (CAD)	Fair Value (USD)	Fair Value (CAD)	% of Portfolio
Shares/Par Value US\$					
Preferred Securities					
Banking					
\$ 1,750,000					
95,000					
\$ 34,000					
1,814,000					
\$ 203,905					
\$ 4,000,000					
\$ 1,500,000					
\$ 1,000,000					
\$ 9,000,000					
\$ 25,000					
\$ 36,100					
\$ 4,000,000					
\$ 2,500,000					
\$ 75,000					
\$ 500,000					
\$ 1,368,000					
\$ 230,000					
\$ 120,000					
\$ 113,800					
\$ 10,400					
25,000					
500,000					
\$ 5,295,000					
\$ 500,000					
\$ 3,000,000					
\$ 2,250,000					
\$ 5,150,000					
\$ 500,000					
\$ 1,900,000					
\$ 2,445,000					
	62,059,964	67,171,873	62,555,640	66,475,006	38.1%
Energy					
\$ 6,000,000					
	5,025,189	5,418,978	5,907,900	6,278,054	
	5,025,189	5,418,978	5,907,900	6,278,054	3.6%
Financial Services					
\$ 1,457,000					
29,000					
53,300					
82,450					
400,000					
\$ 1,000,000					
	1,138,665	1,224,414	1,384,150	1,470,873	
	710,500	871,501	593,050	630,207	
	1,142,890	1,331,563	1,024,426	1,088,610	
	2,081,863	2,553,618	1,739,695	1,848,694	
	410,000	412,604	390,000	414,435	
	870,000	941,345	990,980	1,053,069	
	6,353,918	7,335,045	6,122,301	6,505,888	3.7%
Insurance					
\$ 5,000,000					
\$ 3,270,000					
28,000					
150,098					
\$ 1,100,000					
\$ 600,000					
94,445					
267,500					
6,080,000					
1,000,000					
\$ 350,000					
\$ 1,500,000					
\$ 2,000,000					
\$ 2,600,000					
\$ 2,500,000					
\$ 3,910,000					
\$ 82,500					
1,250,000					
\$ 3,120,000					
\$ 1,000,000					
\$ 3,000,000					
\$ 2,000,000					
	5,153,859	5,415,617	5,987,900	6,363,066	
	3,169,150	3,376,223	3,407,112	3,620,581	
	701,400	718,721	703,080	747,131	
	3,756,737	3,960,617	3,770,462	4,006,697	
	614,758	712,113	856,625	910,296	
	243,600	294,940	470,250	499,713	
	7,958,463	9,299,795	7,906,841	8,402,238	
	5,099,888	5,692,415	5,243,000	5,571,495	
	4,379,491	4,923,148	5,289,600	5,621,015	
	1,092,500	1,124,017	1,098,910	1,167,761	
	290,500	309,279	308,000	327,297	
	1,097,500	1,275,514	1,620,000	1,721,500	
	1,670,000	1,738,479	1,665,000	1,769,319	
	2,603,583	2,710,774	2,808,000	2,983,933	
	2,497,957	2,887,325	2,971,325	3,157,491	
	2,473,127	2,619,450	3,329,756	3,538,379	
	1,269,675	1,555,098	1,616,175	1,717,435	
	1,062,500	1,074,404	1,053,637	1,119,652	
	2,969,039	3,636,478	3,550,840	3,773,315	
	1,193,560	1,296,502	1,115,030	1,184,891	
	1,923,437	2,091,514	2,070,000	2,199,694	
	1,605,000	1,716,302	1,790,000	1,902,151	
	52,825,724	58,428,725	58,631,543	62,305,050	35.8%

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

STATEMENT OF INVESTMENTS (Unaudited) (continued)

As at June 30, 2010		Cost (USD)	Cost (CAD)	Fair Value (USD)	Fair Value (CAD)	% of Portfolio
Shares/Par Value US\$	Real Estate Investment Trust					
\$ 3,652,000	Duke Realty L.P., 8.25% due August 15, 2019	\$ 4,099,370	\$ 4,246,556	\$ 4,231,208	\$ 4,496,310	
		4,099,370	4,246,556	4,231,208	4,496,310	2.6%
	Utilities					
12,000	Constellation Energy Group Inc., 8.625% due June 15, 2068	228,000	279,254	302,640	321,602	
3,519,000	Dominion Resources Capital Trust I, 7.83% due December 1, 2027	3,528,066	4,052,773	3,731,583	3,965,382	
5,000,000	Dominion Resources Inc., 7.5% due June 30, 2066	3,882,265	4,182,177	4,925,000	5,233,571	
\$ 3,000,000	FPL Group Capital Inc., variable rate due September 1, 2067	3,030,000	3,215,435	2,955,000	3,140,143	
\$ 6,075,000	FPL Group Capital Inc., variable rate due October 1, 2066	5,508,063	5,717,849	5,467,500	5,810,061	
\$ 250,000	Union Electric Co., 7.69% due December 15, 2036	257,500	282,684	257,930	274,090	
		16,433,894	17,730,172	17,639,653	18,744,849	10.7%
	Total Preferred Securities	\$146,798,059	\$160,331,349	\$155,088,245	\$164,805,157	94.5%
Shares/Par Value US\$	Corporate Debt Securities					
	Financial Services					
64,600	SATURNS Goldman Sachs Group, Inc. Debenture Backed Series 2004-2, 5.75%	\$ 956,080	\$ 1,171,007	\$ 1,337,866	\$ 1,421,689	
		956,080	1,171,007	1,337,866	1,421,689	0.8%
	Insurance					
\$ 4,249,000	Liberty Mutual Insurance Co., 7.697% due October 15, 2097	3,836,644	4,435,187	3,669,946	3,899,883	
		3,836,644	4,435,187	3,669,946	3,899,883	2.1%
	Telecommunications					
30,000	Corporate Backed Trust Certificates, 7% Sprint Capital Note-Backed Series 2003-17	474,300	547,936	607,500	645,562	
		474,300	547,936	607,500	645,562	0.4%
	Utilities					
\$ 54,000	Entergy Louisiana LLC, 6% due March 15, 2040	1,350,000	1,379,296	1,345,140	1,429,419	
		1,350,000	1,379,296	1,345,140	1,429,419	0.8%
	Miscellaneous Industries					
110,953	Pulte Homes Inc., 7.375% due June 1, 2046	2,218,972	2,531,694	2,364,408	2,512,548	
		2,218,972	2,531,694	2,364,408	2,512,548	1.4%
	Total Corporate Debt Securities	\$ 8,835,996	\$ 10,065,120	\$ 9,324,860	\$ 9,909,101	5.5%
	Embedded Broker Commission	(8,986)	(9,549)	—	—	
	Total	\$155,625,069	\$170,386,920	\$164,413,105	\$174,714,258	100.0%

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

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

June 30, 2010 and 2009

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 (“GAAP”) and should be read in conjunction with the most recent audited financial statements at December 31, 2009. The significant accounting policies used for preparing these unaudited interim financial statements are consistent with those used in preparing the audited annual financial statements, except as described below.

Future Accounting Changes

In June 2010, the Canadian Accounting Standards Board (“AcSB”) released an exposure draft to propose that investment companies may defer the adoption of International Financial Reporting Standards (“IFRS”), as published by the International Accounting Standards Board, until fiscal years beginning on or by January 1, 2012. The Fund will adopt IFRS by the deadline to be set out in the AcSB’s proposed amendment or such earlier time as required by the Canadian Securities Administrators.

The Fund has developed a plan to meet the timetable published by the Canadian Institute of Chartered Accountants (“CICA”) for changeover to IFRS. Key elements of the plan include the determination of the qualitative impact and the quantitative impact, if any, on the Fund’s financial statements in accordance with IFRS. The Fund has presently determined that there will be no impact to Net Assets per unit from the changeover to IFRS. The impact of IFRS on accounting policies and implementation decisions will mainly be in the area of additional note disclosures and, potentially, different presentation of unitholder interests in the financial statements of the Fund.

3. RECONCILIATION OF NET ASSETS TO NET ASSET VALUE

In accordance with National Instrument (“NI”) 81-106, a reconciliation is required between the Net Assets for financial reporting purposes (the “Net Assets”) and the Net Asset Value for reporting other than in the financial statements (the “Net Asset Value”). The reconciliation is as follows:

As at	June 30, 2010		December 31, 2009		
	Total	Per Unit	Total	Per Unit – Basic	Per Unit – Diluted
Net Asset Value	\$ 122,100,299	\$ 9.54	\$ 79,408,406	\$ 9.18	\$ 9.09
Section 3855 adjustment	(1,301,648)	(0.10)	(710,487)	(0.09)	(0.05)
Net Assets	\$ 120,798,651	\$ 9.44	\$ 78,697,919	\$ 9.09	\$ 9.04

4. 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 Asset Value 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 following the Redemption Valuation Date.

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.

The Fund received approval from the Toronto Stock Exchange for a normal course issuer bid program for the period from December 24, 2009 to December 23, 2010, which allows the Fund to purchase up to 864,100 units for cancellation. The Fund may only repurchase units when the Net Asset Value per unit exceeds its trading price.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited) (continued)

June 30, 2010 and 2009

Issued

For the period ended June 30, 2010, the Fund issued 4,327,350 units upon the exercise of warrants (note 5) and no units (2009 – 5,549) pursuant to the reinvestment plan (note 7).

For the period ended June 30, 2010, 4,256 (2009 – 1,476) units were redeemed using the monthly redemption option at an average price of \$8.87 (2009 – \$6.19) per unit and 178,900 units (2009 – 14,500) were purchased for cancellation.

As at June 30, 2010, the Fund had accumulated contributed surplus of \$59,202,207 (2009 – \$58,891,531). 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 period ended June 30, 2010 was 9,490,411 (2009 – 6,700,031 basic units and 6,937,257 diluted units).

5. WARRANTS

Unitholders received warrants on the basis of one warrant for each unit held on February 10, 2009. A warrant entitled the holder to subscribe for one unit of the Fund at a subscription price of \$6.65. Warrants not exercised prior to September 15, 2009 were void and of no value. Upon the exercise of a warrant, the Fund paid a fee equal to \$0.10 per warrant to the dealer whose client was exercising the warrant.

The Fund issued 6,583,670 warrants to unitholders of record on February 10, 2009. During the year ended December 31, 2009, 6,583,670 warrants were exercised for net proceeds of \$43,123,039. Based on the Black-Scholes model calculation, the fair value of each warrant on the date of issuance was estimated to be nil. Costs associated with the issuance of these warrants amounted to \$132,888.

Unitholders received Class A warrants on the basis of one-half of one warrant for each unit held on December 15, 2009. A Class A warrant entitled the holder to subscribe for one unit of the Fund at a subscription price of \$9.07. Class A warrants not exercised prior to June 15, 2010 were void and of no value. Upon the exercise of a Class A warrant, the Fund paid a fee equal to \$0.14 per warrant to the dealer whose client was exercising the warrant.

The Fund issued 4,327,350 Class A warrants to unitholders of record on December 15, 2009. All outstanding Class A warrants were fully exercised by June 15, 2010. Pursuant to the Class A warrant offering, the Fund issued 4,327,350 units for net proceeds of \$38,643,236. Based on the closing price of the first trading day, the fair value of each warrant on the date of issuance was \$0.16 per warrant. Costs associated with the issuance of these warrants amounted to \$150,000.

While the warrants and Class A warrants were outstanding, diluted Net Assets per unit was calculated when the closing price on the Toronto Stock Exchange of the Fund's units on a valuation date was greater than the subscription price. To calculate diluted Net Assets per unit, Net Assets were increased by the net proceeds received from the exercise of all warrants, and units were increased by the number of units issued from the exercise of all outstanding warrants.

Diluted increase (decrease) in Net Assets from operations per unit was calculated using the treasury stock method.

6. CAPITAL MANAGEMENT

The Fund's objectives in managing its capital 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, and to preserve the Net Asset Value per unit. The Fund's capital includes unitholders' equity and loans payable. The Fund manages its capital taking into consideration the risk characteristics of its holdings. In order to manage its capital structure, the Fund may adjust the amount of distributions paid to unitholders, return capital to unitholders, increase or decrease its level of borrowing, or purchase units for cancellation.

7. 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 period ended June 30, 2010, the Fund declared total distributions of \$0.48 (2009 – \$0.7050) per unit, which amounted to \$4,732,632 (2009 – \$4,768,645). 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 period ended June 30, 2010, no units (2009 – 5,549) were issued by the Fund pursuant to the reinvestment plan.

8. 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 0.30% 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. 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. Fees are calculated and payable monthly. For the periods ended June 30, 2010 and 2009, no units were issued for the payment of management or 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.

9. INVESTMENT TRANSACTIONS

Investment transactions for the periods ended June 30 were as follows:

	2010	2009
Proceeds from sale of investments	\$ 11,887,244	\$ 17,389,991
Less cost of investments sold:		
Investments at cost, beginning of period	122,608,018	115,957,480
Investments purchased during the period	58,710,350	20,820,042
Investments at cost, end of period	(170,386,920)	(113,053,592)
Cost of investments sold during the period	10,931,448	23,723,930
Net realized gain (loss) on sale of investments	\$ 955,796	\$ (6,333,939)

For the periods ended June 30, 2010 and 2009, there were no soft dollar amounts paid.

10. FOREIGN CURRENCY FORWARD CONTRACTS

The Fund uses foreign currency forward contracts to hedge foreign exchange risks associated with its US dollar investment portfolio. During the period ended June 30, 2010, the Fund realized gains in the amount of \$791,696 (2009 – losses of \$2,661,660) on the close-out of certain contracts.

At June 30, 2010, the Fund had entered into the following foreign currency forward contracts with a Canadian chartered bank with an AA rating:

Canadian Dollars Purchased	US Dollars Sold	Delivery Date	Forward Rate (USD/CAD)	Unrealized Loss
\$ 40,826,115	\$ (39,290,000)	Aug. 19, 2010	0.96968	\$ (937,438)
41,249,044	(39,290,000)	Nov. 19, 2010	0.95906	(548,375)
40,919,811	(39,290,000)	Feb. 17, 2011	0.97365	(922,254)
\$ 122,994,970	\$ (117,870,000)			\$ (2,408,067)

As at December 31, 2009:

Canadian Dollars Purchased	US Dollars Sold	Delivery Date	Forward Rate (USD/CAD)	Unrealized Gain
\$ 25,968,003	\$ (24,400,000)	Feb. 19, 2010	0.93959	\$ 415,314
25,968,003	(24,400,000)	May 19, 2010	0.93959	411,821
25,968,003	(24,400,000)	Nov. 19, 2010	0.93959	396,248
\$ 77,904,009	\$ (73,200,000)			\$ 1,223,383

11. 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 \$3.3 million for working capital purposes under one tranche and US\$75.0 million under the second tranche for investment purposes. Both tranches may be availed at the prime rate of interest plus a fixed percentage, the bankers' acceptance rate plus a fixed percentage, the LIBOR rate plus a fixed percentage or by US base rate borrowings plus a fixed percentage. At June 30, 2010, the Fund had a US dollar loan equivalent to \$68.7 million (US\$64.6 million) outstanding under this facility. During the period ended June 30, 2010, the Fund realized a foreign exchange gain in the amount of \$1,522,609 (2009 – gain of \$2,650,202) on the repayment of borrowings in US dollars, and borrowings in US dollars had an unrealized foreign exchange loss of \$2,210,364 (2009 – loss of \$1,398,737). The credit facility is secured by a first-ranking and exclusive charge on all of the Fund's assets. For the period ended June 30, 2010, the minimum and maximum amounts of borrowings were \$45.8 million (2009 – \$23.2 million) and \$68.7 million (2009 – \$39.8 million), respectively.

12. SECURITIES LENDING

The Fund has entered into a securities lending program with its custodian, RBC Dexia Investor Services Trust. The aggregate market value of all 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 the United States Government or its agencies, or a permitted supranational agency as defined in NI 81-102. The market values of the securities on loan and the related collateral at June 30, 2010, were \$28,000 (2009 – nil) and \$29,000 (2009 – nil), respectively.

13. FINANCIAL RISK MANAGEMENT

The Fund's investment activities expose it to a variety of financial risks. The Statement of Investments presents the securities held by the Fund as at June 30, 2010, and groups the securities by asset type and market segment. Significant risks that are relevant to the Fund are discussed below. The Manager attempts to minimize potential adverse effects of these risks on the Fund's performance by employing a professional, experienced portfolio manager, by diversifying the investment portfolio within the constraints of the investment objectives, and by using financial instruments to hedge certain risk exposures. All securities purchased by the Fund are rated investment grade at the time of investment. To assist in managing risks, the Manager also maintains a governance structure that oversees the Fund's investment activities and monitors compliance with the Fund's stated investment strategy and restrictions, internal guidelines, and securities regulations.

The investment portfolio is primarily comprised of US dollar denominated corporate debt and preferred securities. It is the Manager's intention to hedge substantially all of the US dollar foreign exchange exposure at all times.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited) (continued)

June 30, 2010 and 2009

a) Interest Rate Risk

Interest rate risk arises on interest-bearing financial instruments such as corporate debt and preferred securities. The Fund is exposed to the risk that the value of interest-bearing financial instruments will fluctuate due to changes in the prevailing levels of market interest rates. Due to the negative effect that rising long-term interest rates can have on the value of a long-term duration portfolio, the Fund may employ a safety net hedge strategy to help mitigate this impact. The Fund purchases out-of-the-money put options on US Treasury futures under this strategy. The Fund is also exposed to interest rate risk on its variable interest rate loans. Fluctuations in interest rates have a direct impact on the interest payments the Fund makes on its loans.

The table below summarizes the Fund's exposure to interest rate risk as at June 30, 2010 by remaining term to maturity.

	Less Than 1 Year	1-3 Years	3-5 Years	>5 Years	Total
Preferred securities and corporate debt	\$ —	\$ —	\$ —	\$ 174,714,258	\$ 174,714,258
Loans payable	68,647,454	—	—	—	68,647,454

As at December 31, 2009:

	Less Than 1 Year	1-3 Years	3-5 Years	>5 Years	Total
Preferred securities and corporate debt	\$ —	\$ —	\$ —	\$ 118,626,329	\$ 118,626,329
Loans payable	46,127,396	—	—	—	46,127,396

As at June 30, 2010, had prevailing interest rates increased by 1%, assuming a parallel shift in the yield curve, with all other variables held constant, Net Assets would have decreased by approximately \$10.2 million or 8.4% (December 31, 2009 – \$6.4 million or 8.1%) of Net Asset Value. Similarly, had prevailing interest rates decreased by 1%, assuming a parallel shift in the yield curve, with all other variables held constant, Net Assets would have increased by \$9.4 million or 7.8% (December 31, 2009 – \$7.7 million or 9.8%) of Net Asset Value. The Fund's sensitivity to interest rate changes was estimated using the weighted average duration of the portfolio and the impact on annual interest expense for the loans payable. In practice, the actual trading results may differ, and the difference could be material.

b) Currency Risk

Currency risk is the risk that financial instruments that are denominated in a currency other than the Canadian dollar, which is the Fund's reporting currency, will fluctuate due to changes in exchange rates. The investment portfolio is comprised primarily of US dollar denominated corporate debt and preferred securities. As at June 30, 2010, the Fund's exposure to US currency of US\$183.1 million (2009 – US\$117.6 million) was substantially hedged through its US dollar denominated foreign currency forward contracts of US\$117.9 million (2009 – US\$73.3 million) notional and loans of US\$64.6 million (2009 – US\$44.0 million).

c) Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Fund. The Fund's greatest concentration of credit risk is in debt securities such as corporate debt, preferred securities and derivatives. The fair value of corporate debt, preferred securities and derivatives includes consideration of the creditworthiness of the issuer. The carrying amount of investments, as presented in the Statement of Investments, represents the maximum credit risk exposure as at June 30, 2010. The carrying amount of the Fund's other assets also represents the maximum credit risk exposure, as they will be settled in the short term.

All transactions in listed securities are settled/paid for upon delivery using approved brokers. The risk of default is considered minimal as delivery of securities sold is only made once the Fund has received payment. The trade will fail if either party fails to meet its obligation.

Credit risk arising on debt and preferred securities is mitigated by investing in investment grade securities at the time of purchase. The Portfolio Manager evaluates the credit quality of the securities prior to purchase and performs ongoing monitoring of the credit quality of the securities. The Fund would not invest more than 10% of its total assets in the securities of any one issuer at the time of purchase in accordance with investment restrictions.

The Fund has entered into a securities lending program with its custodian; see note 12. Credit risk associated with these transactions is considered minimal as all counterparties have a sufficient, approved credit rating and the value of cash or securities held as collateral must be at least 102% of the fair value of the securities loaned.

As at June 30, 2010, the Fund had invested in debt and preferred securities with the following credit ratings. Credit ratings are obtained from Standard & Poor's.

Portfolio by Rating Category

	% of Portfolio
AA	1%
A	15%
BBB	65%
Below BBB-	19%
Total	100%

As at December 31, 2009:

	% of Portfolio
AA	1%
A	9%
BBB	53%
BBB-	19%
Below BBB-	18%
Total	100%

d) Liquidity Risk

Liquidity risk is the risk that the Fund may not be able to settle or meet its obligations on time or at a reasonable price. The Fund is exposed to liquidity risk through its monthly and annual redemptions and loans payable. For the annual redemption, the Fund receives notice at least 20 business days prior to the date of redemption and has up to 10 business days following the redemption date in December to settle the redemption, which gives the Portfolio Manager time to sell securities, although there may not be sufficient time to sell the securities at a reasonable price.

The Fund also has a 364-day revolving credit facility which can be used to fund redemptions or finance investments; see note 11. The credit facility contains several financial covenants that require the Fund to meet certain financial ratios and financial condition tests. The Fund is within its financial covenants with respect to the credit facility. The Manager monitors the use of the credit facility on a regular basis.

All of the Fund's financial liabilities at June 30, 2010 and December 31, 2009 matured in less than three months.

14. FAIR VALUE DISCLOSURES

The Fund's assets and liabilities recorded at fair value have been categorized in accordance with CICA Handbook Section 3862, "Financial Instruments – Disclosure."

Section 3862 requires the Fund to classify its investments and derivative assets/liabilities into three categories based on the nature of the inputs used to determine their fair value. The categories and the nature of the inputs used in each category are as follows:

Level 1: Inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs, other than quoted prices, that are observable for the asset or liability, either directly or indirectly, including inputs in markets that are not considered to be active.

Level 3: Inputs that are unobservable. There is little if any market activity. Inputs into the determination of fair value require significant management judgement or estimation.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Assets at fair value as at June 30, 2010	Level 1	Level 2	Level 3	Total
Preferred securities and corporate debt	\$ 45,314,106	\$ 129,400,152	\$ —	\$ 174,714,258
Total	\$ 45,314,106	\$ 129,400,152	\$ —	\$ 174,714,258

Liabilities at fair value as at June 30, 2010	Level 1	Level 2	Level 3	Total
Foreign currency forward contracts	\$ —	\$ (2,408,067)	\$ —	\$ (2,408,067)
Total	\$ —	\$ (2,408,067)	\$ —	\$ (2,408,067)

Assets at fair value as at December 31, 2009	Level 1	Level 2	Level 3	Total
Preferred securities and corporate debt	\$ 25,340,413	\$ 93,285,916	\$ —	\$ 118,626,329
Foreign currency forward contracts	—	1,223,383	—	1,223,383
Total	\$ 25,340,413	\$ 94,509,299	\$ —	\$ 119,849,712

There were no transfers of financial assets between the levels during the period ended June 30, 2010 and the year ended December 31, 2009.

CORPORATE INFORMATION

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