Management's Responsibility Statement

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

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

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

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

(Signed)

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

(Signed)

Craig T. Kikuchi
Chief Financial Officer
Brompton Funds Management Limited

Auditors' Report to Unitholders

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

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

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

(Signed)

PricewaterhouseCoopers LLP
Chartered Accountants
Toronto, Ontario
March 8, 2007

Statements of Net Assets

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

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

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

(Signed)

Peter A. Braaten
Director

(Signed)

James W. Davie
Director

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

Statements of Operations and Deficit

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

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

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

Statements of Cash Flows

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

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

Statements of Changes in Net Assets

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

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

Statement of Investments

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

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

Statement of Investments (continued)

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

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

Statement of Investments (continued)

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

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

Notes to the Financial Statements

December 31, 2006 and 2005

1. OPERATIONS

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

a) **Valuation of Investments**

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

b) **Investment Transactions and Income Recognition**

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

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

c) **Foreign Currency Forward Contracts**

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

d) **Income Taxes**

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

e) **Foreign Exchange**

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

f) **Fair Value of Financial Instruments**

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

Notes to the Financial Statements (continued)

3. UNITS OF THE FUND

Authorized

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

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

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

Issued

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

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

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

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

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

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

4. DISTRIBUTIONS TO UNITHOLDERS

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

5. MANAGEMENT, ADVISOR AND SERVICE FEES

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

6. INVESTMENT TRANSACTIONS

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

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

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

7. FOREIGN CURRENCY FORWARD CONTRACTS

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

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

At December 31, 2005

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

Notes to the Financial Statements (continued)

8. OPTION CONTRACTS

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

Option Contracts Purchased

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

As at December 31, 2005

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

Option Contracts Written

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

As at December 31, 2005

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

9. SECURITIES LENDING

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

10. LOANS PAYABLE

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

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

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

11. ADOPTION OF FUTURE ACCOUNTING STANDARDS

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