GUARDIAN HIGH YIELD BOND FUND

FINANCIAL STATEMENTS

DECEMBER 31, 2012

March 28, 2013

Independent Auditor's Report

To the Unitholders and Trustee of
Guardian High Yield Bond Fund (the Fund)

We have audited the accompanying financial statements of the Fund, which comprise the statement of investment portfolio as at December 31, 2012, the statements of net assets as at December 31, 2012 and 2011 and the statements of operations and changes in net assets for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2012 and 2011 and the results of its operations and the changes in its net assets for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Guardian High Yield Bond Fund

Statements of Net Assets

As at December 31		**2012**		**2011**
Assets				
Investments, at fair value*	$	73,804,010	$	55,736,241
Cash and short-term securities		3,616,080		6,288,080
Subscriptions receivable		35,905		556,700
Interest receivable		1,294,902		1,042,431
Unrealized appreciation on forward currency contracts, at fair value		-		248,584
		78,750,897		63,872,036
Liabilities				
Redemptions payable		-		5,000
Accrued expenses		45,055		12,474
Unrealized depreciation on forward currency contracts, at fair value		-		210,640
		45,055		228,114
Net assets representing unitholders' equity (Note 4)	$	78,705,842	$	63,643,922
Net assets per Series I unit (Note 3)	$	10.53	$	10.08
*Investments, at average cost	$	72,178,360	$	56,750,402

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

Approved on behalf of the Manager,
Guardian Capital LP:

Per: **"George Mavroudis"**

Per: **"C. Verner Christensen"**

Guardian High Yield Bond Fund

Statements of Operations

For the years ended December 31	2012	2011
Income:		
Interest	$ 5,739,399	$ 4,126,187
Securities lending income (Note 11)	311	659
Total income	5,739,710	4,126,846
Operating Expenses (Note 5):		
Administration fee	141,161	116,862
Independent review committee costs	4,988	2,300
Interest charges	1,550	129
Total expenses	147,699	119,291
Net investment income	5,592,011	4,007,555
Realized gain on sale of investments	165,798	548,146
Realized gain (loss) on foreign currency contracts	37,998	(350,094)
Realized (loss) gain on foreign currency transactions	(95,065)	198,145
Change in unrealized appreciation (depreciation) in value of investments	2,664,677	(1,090,808)
Change in unrealized depreciation in forward currency contracts	(37,944)	(505,447)
Increase in net assets from operations	$ 8,327,475	$ 2,807,497
Increase in net assets from operations per Series I unit	$ 1.26	$ 0.50

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

Guardian High Yield Bond Fund

Statements of Changes in Net Assets

For the years ended December 31	**2012**	**2011**
Net assets, beginning of year	$ 63,643,922	$ 54,968,046
Increase in net assets from operations	8,327,475	2,807,497
Distributions to unitholders from:		
Net investment income	(5,550,915)	(4,212,709)
Realized gain on sale of investments	(118,995)	(207,383)
	(5,669,910)	(4,420,092)
Capital transactions:		
Proceeds from sale of units	8,867,365	7,287,959
Reinvested distributions	5,669,910	4,420,092
Redemption of units	(2,132,920)	(1,419,580)
	12,404,355	10,288,471
Net assets, end of year	$ 78,705,842	$ 63,643,922

Change in Series I units		
Units issued and outstanding, beginning of year	6,311,020	5,319,078
Number of units issued	824,255	688,520
Number of units reinvested	536,923	436,768
	7,672,198	6,444,366
Number of units redeemed	(198,458)	(133,346)
Units issued and outstanding, end of year	7,473,740	6,311,020

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

Guardian High Yield Bond Fund

Statement of Investment Portfolio
As at December 31, 2012

Par Value / Shares / Units		Security	Coupon Rate	Maturity Date	Average Cost	Fair Value
		Canadian Bonds - 60.8%				
		Corporate				
$ 1,500,000		Athabasca Oil Corp.	7.500%	November 19, 2017	$ 1,500,000	$ 1,502,813
1,500,000	USD	Banro Corp.	10.000%	March 1, 2017	1,497,828	1,291,919
500,000	USD	Baytex Energy Corp.	6.750%	February 17, 2021	494,623	517,847
400,000		Bell Aliant Regional Communications LP *	6.170%	February 26, 2037	401,516	407,033
1,000,000		Black Press Group Ltd.**	10.000%	February 4, 2014	1,000,000	1,000,000
850,000		Bombardier Inc.	7.350%	December 22, 2026	793,375	888,250
1,000,000		Canadian Satellite Radio Holdings Inc.	9.750%	June 21, 2018	995,000	1,118,750
500,000		Cascades Inc.	7.750%	December 15, 2016	513,750	520,625
500,000	USD	Cascades Inc.	7.750%	December 15, 2017	519,844	526,476
450,000	USD	CCS Inc.	11.000%	November 15, 2015	409,563	446,944
1,000,000		Connacher Oil & Gas Ltd.	8.750%	August 1, 2018	1,000,000	680,000
1,400,000	USD	Connacher Oil & Gas Ltd.	8.500%	August 1, 2019	1,364,017	947,905
1,250,000		Data & Audio Visual Enterprises Wireless Inc.	9.500%	April 29, 2018	1,250,000	1,162,711
865,684		Data & Audio Visual Enterprises Holdings Inc.**	15.000%	September 25, 2018	865,684	903,108
900,000	USD	Fairfax Financial Holdings Ltd.	7.375%	April 15, 2018	928,815	1,021,587
250,000		Fairfax Financial Holdings Ltd	6.400%	May 25, 2021	248,980	271,941
1,000,000	USD	Fairfax Financial Holdings Ltd.	7.750%	July 15, 2037	972,141	1,137,337
750,000		Garda World Security Corp.	9.750%	March 15, 2017	736,110	782,619
1,500,000		Golf Town Canada Inc.	10.500%	July 24, 2018	1,500,000	1,516,110
1,500,000	USD	IAMGOLD Corp.	6.750%	October 1, 2020	1,458,180	1,456,209
900,000	USD	Inmet Mining Corp.	8.750%	June 1, 2020	895,016	976,610
1,000,000		Iron Mountain Canada Corp.	7.500%	March 15, 2017	1,000,000	1,031,419
1,000,000		Kruger Products LP *	8.000%	August 9, 2018	1,000,000	1,069,167
1,500,000	USD	Lone Pine Resources Canada Ltd.	10.375%	February 15, 2017	1,492,832	1,403,935
2,625,000	USD	Millar Western Forest Products Ltd.	8.500%	April 1, 2021	2,178,110	2,365,406
1,500,000		Newalta Corp.	7.625%	November 23, 2017	1,500,000	1,611,563
1,000,000		North American Energy Partners Inc.	9.125%	April 7, 2017	1,000,000	871,667
1,000,000	USD	Nova Chemicals Corp.	8.625%	November 1, 2019	1,084,251	1,130,118
1,500,000		Paramount Resources Ltd.	8.250%	December 13, 2017	1,500,000	1,553,073
1,000,000		Paramount Resources Ltd.	7.625%	December 4, 2019	1,000,000	1,001,250
3,000,000	USD	PetroBakken Energy Ltd.	8.625%	February 1, 2020	3,020,980	3,030,349
500,000	USD	Precision Drilling Corp.	6.625%	November 15, 2020	502,427	535,188
500,000	USD	Quadra FNX Mining Ltd.	7.750%	June 15, 2019	483,471	516,519
2,000,000		Quebecor Media Inc.	6.625%	January 15, 2023	2,000,000	2,045,496
1,000,000		RTL-Westcan LP	9.500%	April 7, 2017	1,000,000	1,048,506
750,000		Savanna Energy Services Corp. *	7.000%	May 25, 2018	750,000	767,500
500,000		Sherritt International Corp.	7.750%	October 15, 2015	425,740	533,642
2,000,000		Sherritt International Corp.	8.000%	November 15, 2018	2,000,000	2,117,626
500,000		Sherritt International Corp	7.500%	September 24, 2020	500,000	512,287
500,000	USD	Taseko Mines Ltd.	7.750%	April 15, 2019	471,036	479,180
3,750,000		Trident Exploration Corp.	8.250%	April 13, 2018	3,046,428	3,565,624
1,000,000		Trilogy Energy Corp.	7.250%	December 13, 2019	1,000,000	1,019,688
500,000		Vermilion Energy Inc. *	6.500%	February 10, 2016	500,000	529,525
		Total Canadian Corporate Bonds			**46,799,717**	**47,815,522**

** Denotes all or part of securities on loan.*
*** Level 3 securities*
The accompanying notes are an integral part of these financial statements.

Guardian High Yield Bond Fund

Statement of Investment Portfolio
As at December 31, 2012

Par Value / Shares / Units		Security	Coupon Rate	Maturity Date	Average Cost	Fair Value
		United States Bonds - 32.5%				
$1,500,000		AK Steel Corp.	7.625%	May 15, 2020	$ 1,490,326	$ 1,299,387
1,500,000	CAD	Allied Nevada Gold Corp.	8.750%	June 1, 2019	1,480,740	1,563,750
1,500,000		Armstrong Energy Inc.	11.750%	December 15, 2019	1,432,065	1,430,072
1,500,000		CHC Helicopter SA	9.250%	October 15, 2020	1,498,656	1,571,959
500,000		Clear Channel Communications Inc.	10.750%	August 1, 2016	374,360	375,876
500,000		Clondalkin Acquisition BV	2.308%	December 15, 2013	393,096	477,935
500,000		CNG Holdings Inc.	9.375%	May 15, 2020	497,127	505,317
900,000		Corrections Corp of America	7.750%	June 1, 2017	1,007,954	953,257
750,000		Cott Beverages Inc.	8.125%	September 1, 2018	796,950	825,185
500,000		DISH DBS Corp.	7.750%	May 31, 2015	528,516	556,969
1,000,000		Dole Food Co Inc.	8.000%	October 1, 2016	1,049,124	1,035,527
350,000		El Paso Corp.	7.250%	June 1, 2018	356,763	402,804
1,000,000		Huntington Ingalls Industries Inc.	7.125%	March 15, 2021	961,008	1,082,822
900,000		Iron Mountain Corp.	8.375%	August 15, 2021	961,136	994,703
1,000,000		Magnum Hunter Resources Corp.	9.750%	May 15, 2020	983,255	1,033,037
1,000,000		MetroPCS Wireless Inc.	7.875%	September 1, 2018	1,041,311	1,077,844
500,000		Milagro Oil & Gas	10.500%	May 15, 2016	457,041	368,408
1,500,000		Miramax LLC	10.000%	October 20, 2021	1,429,639	1,471,945
425,000		NES Rentals Holdings Inc.	12.250%	April 15, 2015	408,286	436,925
500,000		NRG Energy Inc	7.625%	January 15, 2018	495,463	552,613
1,000,000		NRG Energy Inc.	8.250%	September 1, 2020	979,061	1,115,182
1,500,000		Parker Drilling Co.	9.125%	April 1, 2018	1,560,986	1,594,362
1,000,000		PBF Holding Co., LLC / PBF Finance Corp.	8.250%	February 15, 2020	981,410	1,072,865
1,000,000		Pilgrims Pride Corp.	7.875%	December 15, 2018	1,014,875	1,009,389
1,000,000		Qwest Communications International Inc.	7.125%	April 1, 2018	1,018,805	1,038,912
500,000		Seminole Hard Rock Entertainment Inc.	2.808%	March 15, 2014	302,829	494,115
400,000		Smithfield Foods Inc.	6.625%	August 15, 2022	402,317	440,099
350,000		United Refining	10.500%	February 28, 2018	330,618	378,117
366,000		Windstream Corp.	7.875%	November 1, 2017	387,897	409,979
		Total United States Bonds			**24,621,614**	**25,569,355**
		Mortgage Backed - 0.4%				
350,000		Merrill Lynch Financial Assets Inc.	6.450%	June 12, 2035	322,415	352,212
		Total Mortgage Backed			**322,415**	**352,212**
		Common Stocks - 0.1%				
72,000		Banro Corp., Warrants (02Mar17)			-	66,921
13,200		Data & Audio Visual Enterprises Holdings Inc., Warrants (25Sep18)			-	-
2,400		Data & Audio Visual Enterprises Wireless Inc., Warrants (25Sep18)			-	-
13,000		Insight Health Services Holdings			434,614	-
		Total Common Stocks			**434,614**	**66,921**
		Total Investments - 93.8%			**72,178,360**	**73,804,010**
		Short-Term Securities - 4.3%				
93,026		Guardian Canadian Short-Term Investment Fund, Series I units - 1.2%			930,258	930,258
		Short-Term Notes - 3.1%				
$1,000,000		Province of Ontario	0.141%	February 4, 2013	988,472	995,532
550,000		Province of Quebec	0.144%	January 14, 2013	546,035	547,598
940,000		Province of Quebec	0.138%	February 5, 2013	929,118	935,796
		Total Short-Term Notes			**2,463,625**	**2,478,926**
		Total Short-Term Securities			**3,393,883**	**3,409,184**
		Other Net Assets - 1.9%				**1,492,648**
		Total Net Assets - 100.0%				**$ 78,705,842**

** Denotes all or part of securities on loan.*
The accompanying notes are an integral part of these financial statements.

GUARDIAN HIGH YIELD BOND FUND

NOTES TO FINANCIAL STATEMENTS

1. Formation of Fund:

Guardian High Yield Bond Fund (the “Fund”) was formed on May 1, 1999 and Guardian Capital LP (the “Manager”) is the Manager and trustee of the Fund. The primary objective of the Fund is to generate a high level of interest income by investing predominately in high-yield bonds and debentures issued primarily by Canadian corporations and other Canadian entities, as well as other securities, such as high-yield bonds offered in the non - Canadian marketplace. Pursuant to an amendment to the Fund’s Declaration of Trust, effective March 30, 2012, the Fund was authorized to issue Series A units, in addition to the Series I units previously issued. No Series A units have been issued.

2. Significant accounting policies:

a) Basis of presentation:

These financial statements, prepared in accordance with Canadian generally accepted accounting principles (“GAAP”), include estimates and assumptions made by the Manager that may affect the reported amounts of assets, liabilities, income and expenses during the reporting year. Actual results could differ from these estimates. The following is a summary of significant accounting policies followed by the Fund.

b) Valuation of investments:

In accordance with Accounting Guideline 18 – Investment Companies, investments are categorized as held for trading, and are required to be recorded at fair value as defined in Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3855, “Financial Instruments – Recognition and Measurement” (“Section 3855”). The fair values of investments as at the financial reporting date are determined as follows:

i) Securities listed upon a recognized public stock exchange are valued at their bid prices on the valuation date. Securities with no available bid prices are valued at the closing sale prices.

ii) Securities not listed upon a recognized public stock exchange are valued using valuation techniques, on such basis and in such manner as established by the Manager.

iii) Short-term notes and bonds are valued at the average bid quotations from recognized investment dealers.

iv) Investment funds are valued at the closing net asset value per unit reported by the administrator of such funds.

v) A forward currency contract is an agreement between two parties (the Fund and the counterparty) to purchase or sell a currency against another currency at a set price on a future date. The Fund may enter into forward currency contracts for hedging purposes. This can include the hedging of all or a portion of the currency exposure of an investment or group of investments, either directly or indirectly. The counterparties to all forward currency contracts have a credit rating of at least A. Forward currency contracts are valued at the realized or unrealized gain or loss that would arise as a result of closing the position at the valuation date.

c) Cash and short-term securities:

Cash includes cash on deposit with the custodian and is carried at the face amount thereof, which is its fair value. Short-term securities include highly liquid short-term investments with terms to maturity of less than 90 days, and the investment in Guardian Canadian Short-Term Investment Fund.

2. Significant accounting policies: (continued):

d) Investment transactions and income recognition:

Investment transactions are accounted for on the trade date. Interest income is accrued daily. Securities lending income is accrued daily over the period the securities are loaned. Interest on syndicated or participating loans is paid periodically, and is accrued daily. Commitment or upfront fees paid to investors for entering into the agreement are recognized as income over the term to maturity. Discounts arising on the purchase of short-term notes are recognized as interest income over the term to maturity. Realized gains (losses) from investment transactions and unrealized appreciation (depreciation) in value of investments are determined on an average cost basis. Gains or losses realized at the close of a forward contract are recorded in the Statements of Operations as "Realized appreciation or depreciation on forward currency contracts". Unrealized gains or losses on a forward contract are recorded in the Statements of Net Assets as "Unrealized appreciation or depreciation on forward currency contracts". Brokerage commissions and other transaction costs, if any, are expensed in the year incurred, and are reported as "Transaction costs" in the Statements of Operations.

e) Translation of foreign currency transactions and balances:

The market values of investments and other assets and liabilities in foreign currencies are translated into Canadian dollars, which is the Fund's functional currency, at the rates of exchange prevailing on each valuation date. Purchases and sales of investments, income and expenses are translated at the rates of exchange prevailing on the respective dates of such transactions. Foreign exchange gains (losses) on completed transactions are included in realized gain (loss) on sale of investments and unrealized gains (losses) are included in change in unrealized appreciation (depreciation) in value of forward currency contracts.

f) Other assets and liabilities:

For the purposes of categorization in accordance with Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3862, "Financial Instruments – Disclosures", interest receivable on investments, amounts due from brokers, subscription receivable and other net assets are designated as loans and receivables, and recorded at cost or amortized cost. Similarly, amounts due to brokers, redemption payable, accrued expenses and other liabilities are designated as other financial liabilities and reported at cost or amortized cost. Cost or amortized cost approximates fair value for these assets and liabilities due to their short term nature.

g) Increase (decrease) in net assets from operations per unit:

Increase (decrease) in net assets from operations per unit is calculated as the increase (decrease) in net assets from operations divided by the average number of units of the series outstanding during the year.

3. Comparison of net asset value:

The value of the Fund's net assets of a series per unit for financial statement presentation purposes ("Net Assets per Unit") is calculated by dividing the net assets of the series, calculated in accordance with GAAP by using the bid prices for investments, by the total number of units of the series outstanding. For the net asset value per unit for the purpose of the issuance and redemption of units of a series ("Net Asset Value per Unit"), the series' net assets are valued using the closing traded prices for investments. This difference in the valuation of the series' investments account for the potential difference between Net Assets per Unit and Net Asset Value per Unit.

3. Comparison of net asset value (continued):

A comparison of the Net Asset Value per Unit and the Net Assets per Unit is as follows:

	Net Asset Value per Unit	Net Assets per Unit
As at December 31, 2012		
Series I	**$10.56**	**$10.53**
As at December 31, 2011		
Series I	**$10.12**	**$10.08**

4. Unitholders’ equity:

Unitholders' equity includes the amounts representing the net assets of the Fund, which includes any undistributed net income and realized gain (loss) on sale of investments, and unrealized appreciation (depreciation) in value of investments. The Fund is authorized to issue Series I and Series A units. An unlimited number of the Fund's units of each series may be issued, which are redeemable at Net Asset Value per Unit for the series at the unitholder’s option in accordance with the provisions of the Declaration of Trust. There are certain minimum purchase amounts for Series A units. The net asset value of the Fund attributable to Series A units are subject to a management fee charged to the Fund and payable to the Manager. There are no restrictions or special capital requirements on subscriptions and redemptions of Series I units. The changes in the number of issued units are disclosed in the Statements of Changes in Net Assets. In accordance with the Fund’s investment objectives and the risk management policies stated in Note 9, the Fund invests the subscriptions received in appropriate investments, while maintaining sufficient liquidity to meet redemptions.

5. Operating expenses:

The Manager charges to the Fund a fixed annual management fee of 1.50% of the average daily net asset value of the Fund attributable to Series A units of the Fund, which is accrued daily and paid at the end of the month. The Manager also charges to the Fund a fixed administration fee of 0.18% of the average daily net asset value of the Fund, in return for the payment by the Manager of certain variable operating expenses of the Fund, including audit, custody, transfer agency, fund accounting, filing, securityholder reporting, legal, other related expenses and HST on these expenses. The Fund’s expenses consist of the management fee, the administration fee, interest costs, fees and expenses of the Independent Review Committee, any new costs related to regulatory or legal requirements imposed upon the Fund, the HST on all of these expenses and any income taxes to which the Fund may be subject.

6. Income taxes:

The Fund qualifies as a unit trust under the provisions of the Income Tax Act (Canada) and, as such, is not subject to income taxes on its net taxable capital gains and its net income for the year if it distributes such gains and income (less any applicable losses carried forward) to unitholders. The taxable income of the Fund is allocated and distributed annually to unitholders so as to eliminate any income taxes otherwise payable by the Fund. The distributions are automatically reinvested in additional units of the Fund. As at December 31, 2012, no capital losses were available to be carried forward and applied against future capital gains. There were no non-capital losses to be carried forward as of December 31, 2012.

7. Transaction costs:

Total transaction costs (brokerage commissions) paid to dealers in connection with the portfolio transactions of the Fund for the year ended December 31, 2012 amounted to $nil (December 31, 2011 - nil). There were no soft dollar transactions for the year ended December 31, 2012 and 2011.

8. Concentration of unitholders:

Two unitholders of the Fund at December 31, 2012 held a total of 64,935 units, 47% (December 31, 2011 – 36,464 units, 62%) of the outstanding Series I units. The investment activities of these unitholders could have a material impact on the Fund.

9. Financial risk management:

The Fund's financial instruments consist principally of short-term securities and investments. As a result, the Fund is exposed to various types of risks that are associated with its investment strategies, financial instruments and the markets in which it invests. The most significant risks include market risk which includes currency risk, interest rate risk, other price risk and concentration risk, liquidity risk and credit risk. These risks and related risk management practices employed by the Fund are discussed below:

a) Market risk

(i) Currency risk

The Fund holds assets that are valued in currencies other than the Canadian dollar, which is the Fund's functional currency. It is therefore exposed to currency risk, as the value of the assets valued in other currencies will fluctuate due to changes in exchange rates. The following table summarizes the Fund's exposure to currency risks:

	Currency exposure (in Canadian $)	
	USD	**Total**
As at December 31, 2012		
Assets		
Cash	$ 21,719	$ 21,719
Fixed-income securities held for trading	44,334,982	44,334,982
Other net assets	839,788	839,788
Total net assets	**45,196,489**	**45,196,489**
Less: hedged by forward contracts	-	-
Net currency exposure	**$ 45,196,489**	**$ 45,196,489**

	Currency exposure (in Canadian $)	
	USD	**Total**
As at December 31, 2011		
Assets		
Cash	$ 10,159	$ 10,159
Fixed-income securities held for trading	33,977,990	33,977,990
Other net assets	596,056	596,056
Total net assets	**34,584,205**	**34,584,205**
Less: hedged by forward contracts	(27,582,274)	(27,582,274)
Net currency exposure	**$ 7,001,931**	**$ 7,001,931**

At December 31, 2012, if the value of the foreign currencies increased or decreased by 5% in relation to the Canadian dollar, with all other variables held constant, this would have increased or decreased the net assets of the Fund by approximately $2,260,000, or 2.9% of the Fund's net assets (December 31, 2011 - $350,000, 0.5%).

9. Financial risk management (continued):

(ii) Interest rate risk

The Fund, which holds mainly interest-bearing financial assets, including an interest in a short-term investment fund, is subject to interest rate risk. This is due to the fact that fluctuations in the prevailing level of market interest rates could impact the value of the Fund's net assets.

The table below summarizes the Fund's exposure to interest rate risk associated with its investments in fixed income securities and indirectly through its investment in the investment fund, by remaining term to maturity.

	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	More than 5 years	Total
As at December 31, 2012						
Assets						
Fixed income investments	$ -	$ -	$ 477,935	$ 19,285,781	$ 53,973,373	$ 73,737,089
Short-term securities	966,652	2,105,730	336,802	-	-	3,409,184
Total interest sensitivity value	**$ 966,652**	**$ 2,105,730**	**$ 814,737**	**$ 19,285,781**	**$ 53,973,373**	**$ 77,146,273**

	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	More than 5 years	Total
As at December 31, 2011						
Assets						
Fixed income investments	$ -	$ -	$ 170,203	$ 11,021,573	$ 44,544,465	$ 55,736,241
Short-term securities	1,943,949	3,522,572	798,034	-	-	6,264,555
Total interest sensitivity value	**$ 1,943,949**	**$ 3,522,572**	**$ 968,237**	**$ 11,021,573**	**$ 44,544,465**	**$ 62,000,796**

At December 31, 2012, if effective interest rates increased or decreased by 0.25%, assuming a parallel shift in the yield curve and with all other variables held constant, the decrease or increase in the Fund's net assets would amount to approximately $871,000, or 1.1% of the Fund's net assets (December 31, 2011 - $674,000, 1.1%). The Fund's sensitivity to interest rate changes was estimated using the weighted average duration of the fixed-income securities, including the short-term securities held by the investment fund. The actual trading results may differ, and the difference could be material.

(iii) Other price risk

Other price risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices. The investments of the Fund are subject to normal market fluctuations and the risks inherent in investment in financial markets. The Manager moderates this risk through a careful selection of securities within specified limits, and through diversification of the investment portfolio. The Manager monitors the Fund's overall market positions on a daily basis, and positions are maintained within established ranges. As at December 31, 2012 and 2011, other price risk was negligible as the Fund has no significant exposure to investments subject to market fluctuations.

9. Financial risk management (continued):

(iv) Concentration risk

The Fund is exposed to the possible risk inherent in the concentration of the investment portfolio in a small number of industries or investment sectors. The Manager moderates this risk through a careful selection of securities in several investment sectors. At December 31, 2012, the percentages of the Fund's total net assets invested in each investment sector were as follows:

Sector	2012	2011
Canadian bonds	60.8%	55.0%
United States bonds	32.5%	32.0%
Mortgage backed	0.4%	0.6%
Common stocks	0.1%	-
Short-term securities	4.3%	9.9%
Other net assets	1.9%	2.5%
Total net assets	100.0%	100.0%

b) Liquidity risk

The Fund is exposed to daily cash needs related to the redemption of units, and to the discharge of financial obligations related to the daily operations of the Fund. The ability to meet these needs is managed by retaining sufficient cash and short-term securities within the Fund, and by investing in securities which are considered readily realizable and highly liquid. All liabilities of the Fund are short-term in nature and are due within 60 days.

c) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge its obligations and cause the other party to incur a financial loss. The exposure of the Fund is the credit risk associated with the ability of the issuers of the securities in which the Fund and the investment fund invest, and the counterparties to the over-the-counter derivative instruments held by the Fund, to discharge their obligations. The Manager limits the Fund's exposure to credit loss through ongoing credit evaluation of these issuers and counterparties.

The credit ratings for the securities held by the Fund directly and through the investment fund, as rated primarily by Standard & Poor's and DBRS as at December 31, 2012 and 2011 are as follows:

As at December 31, 2012 Rating category (or equivalent)	% of fixed-income securities by rating category
Bonds	
BBB	4.1%
BB	21.8%
B	52.0%
CCC	9.2%
NR	8.5%
Short-term securities	
R-1 (High)	1.0%
R-1 (Mid)	3.4%
Total	**100.0%**

9. **Financial risk management (continued):**

As at December 31, 2011 Rating category (or equivalent)	% of fixed-income securities by rating category
Bonds	
BBB	9.8%
BB	33.1%
B	36.3%
CCC	1.9%
NR	8.8%
Short-term securities	
R-1 (High)	7.1%
R-1 (Mid)	3.0%
Total	**100.0%**

All investment transactions carried out by the Fund and the investment fund are settled upon delivery, using approved brokers. The risk of default is considered minimal, as delivery of securities sold is made by the custodian coincident with the receipt of payment. On a purchase, payment is made by the custodian coincident with the receipt of the securities.

10. **Fair value disclosure:**

Classification for fair value measurements

The Fund’s financial instruments recorded at fair value have been categorized based upon a fair value hierarchy. Fair values based on quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information as inputs (Level 3), are provided in the following table, as at December 31, 2012 and 2011.

	Financial Assets at fair value as at December 31, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Canadian bonds	$ -	$ 45,912,414	$ 1,903,108	$ 47,815,522
United States bonds	-	25,569,355	-	25,569,355
Mortgage backed	-	352,212	-	352,212
Common stocks	-	66,921	-	66,921
Short-term securities	930,258	2,478,926	-	3,409,184
Total investments and short-term securities	$ 930,258	$ 74,379,828	$ 1,903,108	$ 77,213,194

	Financial Assets (Liabilities) at fair value as at December 31, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Canadian bonds	$ -	$ 33,082,233	$ 1,951,530	$ 35,033,763
United States bonds	-	20,347,779	-	20,347,779
Mortgage backed	-	354,699	-	354,699
Short-term securities	3,169,133	3,095,422	-	6,264,555
Total Investments and short-term securities	$ 3,169,133	$ 56,880,133	$ 1,951,530	$ 62,000,796
Unrealized appreciation on forward contracts	$ -	$ 248,584	$ -	$ 248,584
Unrealized depreciation on forward contracts	$ -	$ (210,640)	$ -	$ (210,640)

Significant transfers between Levels 1 and 2

There were no significant transfers between Levels 1 and 2 for the years ended December 31, 2012 and 2011.

10. Fair value disclosure (continued):

Reconciliation of the opening balance to the closing balance for instruments on Level 3

The following is a reconciliation of Level 3 fair value measurements for each of the past two years:

	Fair value measurements using Level 3 inputs	
	Fixed Income Securities	Equities
Balance at December 31, 2011	$ 1,951,530	$ -
Purchases	116,734	-
Sales	(177,315)	-
Net transfers in (out)	-	-
Gains (Losses)		
- Realized	(62)	-
- Unrealized	12,221	-
Balance at December 31, 2012	**$ 1,903,108**	**$ -**
Total change in unrealized depreciation during the year for assets held at December 31, 2012	$ (20,615)	$ -

	Fair value measurements using Level 3 inputs	
	Fixed Income Securities	Equities
Balance at December 31, 2010	$ 829,170	$ -
Purchases	1,100,862	434,614
Sales	(11,333)	-
Net transfers in (out)	-	-
Gains (Losses)		
- Realized	(5)	-
- Unrealized	32,836	(434,614)
Balance at December 31, 2011	**$ 1,951,530**	**$ -**
Total change in unrealized depreciation during the year for assets held at December 31, 2011	$ 32,836	$ -

Sensitivity of Level 3 fair values

The fixed income securities classified as level 3 were valued using either a valuation technique based on yield on fixed income securities with similar credit risks or based on quotations provided by dealers active in trading these securities. These securities can vary in price depending on the changes in interest rates, the changes in the credit ratings of the issuers and the supply versus demand for the bonds. If the interest rate assumption (the significant input) was increased or decreased by 0.25%, assuming a parallel shift in the yield curve and with all other variables held constant, the decrease or increase in the fair value of these fixed income securities would amount to approximately $4,000 (December 31, 2011 - $4,800). The actual trading results may differ and the difference could be material.

11. Securities lending:

The Fund has entered into a securities lending agreement with its custodian, RBC Investor Services (credit rating: AA-). The Fund will receive collateral of at least 105% of the value of the securities on loan. Collateral will generally comprise obligations guaranteed by the Government of Canada or a province thereof, or other governments with appropriate credit ratings. In the event that any of the loaned securities are not returned to RBC Investor Services, RBC Investor Services may, at its option, either restore to the Fund securities identical to the loaned securities or pay to the Fund the value of the collateral up to but not exceeding the market value of the loaned securities on the date on which the loaned securities were to have been returned (“Valuation Date”). If the collateral is not sufficient to allow RBC Investor Services to pay such market value to the Fund, RBC Investor Services shall indemnify the Fund for the difference between the fair value of the securities and the value of such collateral on the Valuation Date.

At December 31, 2012, the Fund has loaned approximately $1,828,184 (December 31, 2011 – $528,254) in securities and received approximately $1,919,594 (December 31, 2011 – $554,667) in collateral. The Fund recognized $311 in securities lending income for the year end December 31, 2012 (December 31, 2011 – $659). Securities loaned in the program earn securities lending income at market rates. The securities lending arrangements are revolving, and can be terminated at any time by the borrowers, RBC Investor Services or the Fund.

12. Future changes in accounting standards:

International Financial Reporting Standards (IFRS) have replaced Canadian GAAP for publicly accountable enterprises in Canada, which include investment funds. However, because of decisions made by the Canadian Accounting Standards Board, the adoption of IFRS by investment funds has been deferred, the latest deferral being to January 1, 2014.

The Manager has carried out an assessment of the impact on the Fund of the conversion to IFRS. Based on the Manager’s current evaluation of the differences between Canadian GAAP and IFRS, and the standards that are in effect at December 31, 2012, the Manager does not anticipate that there will be any changes to the calculation of the Fund’s Net Asset Value or Net Asset Value per Unit, which is used for the issuance and redemption of Fund units. The Manager has, however, identified the following areas in which there may be changes in the presentation of the Fund’s financial statements:

a) International Accounting Standards 32, “Financial Instruments: Presentation”, allows puttable (redeemable) instruments to be classified as equity, only if certain conditions are met. The manager is currently assessing whether the Fund's units, which are redeemable, meet the definition to be classified as equity, or will be required to be classified as a liability on the Fund’s Statement of Net Assets.

b) IFRS 13, "Fair Value Measurements", provides guidance on the measurement of fair value and allows for the use of closing traded prices to value investments. Under Canadian GAAP, the fair value of investments for financial statement purposes is currently required to be measured at closing bid prices for long positions and closing asked prices for short positions. The Manager has assessed the guidance that will apply under IFRS and has determined that the use of closing traded prices is appropriate in valuing the Fund’s investments. This change will result in the elimination of the difference between the Fund’s Net Assets per Unit and Net Asset Value per Unit, as disclosed in note 3 above.

c) A Statement of Cash Flow will be required for IFRS reporting purposes.

12. Future changes in accounting standards (continued):

d) There will also likely be requirements for additional note disclosures and modifications to existing financial statement presentation.

The Manager's current assessment of the effect of IFRS may change if new standards are issued or if the interpretations of current standards are revised.