



## FAIRWAY INVESTMENT GRADE INCOME FUND



### **Annual Report**

Year ended December 31, 2006

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# Annual Management Report of Fund Performance

For the Year Ended December 31, 2006

This annual management report of fund performance for Fairway Investment Grade Income Fund (the "Trust") contains financial highlights and is included with the annual audited financial statements in the annual report of the Trust. You may request a copy of the Trust's current proxy voting policies and procedures, or quarterly portfolio disclosure at no cost from Fairway Advisors Inc., by calling toll free (1-866) 299-7929, or locally (416) 507-4110, by writing to us at: BCE Place, 181 Bay Street, Suite 3740 P.O. Box 750, Toronto, ON M5J 2T3, or by visiting our website at [www.fairwaycapital.com](http://www.fairwaycapital.com) or SEDAR at [www.sedar.com](http://www.sedar.com).

The Trust's proxy voting disclosure record for the period ending June 30, 2007 will be available free of charge upon request at any time after August 31, 2007, by visiting our website at [www.fairwaycapital.com](http://www.fairwaycapital.com).

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### *Investment Objective and Strategies*

Fairway Investment Grade Income Fund is a closed-end investment trust, the units of which are listed on the Toronto Stock Exchange under the symbol FGF.UN. Fairway Advisors Inc. is the manager (the "Manager") and trustee (the "Trustee") of the Trust.

The Trust's investment objective is to:

- (i) provide unitholders with stable monthly distributions;
- (ii) mitigate the impact of significant interest rate increases on the value of the Trust; and
- (iii) preserve and enhance the net asset value per unit of the Trust.

In order to achieve the Trust's investment objective, the Trust, including the borrowings under the Trust's Loan Facility (see *Borrowings*), will be invested in a portfolio (the "Investment Grade Portfolio") consisting primarily of investment grade corporate bonds and investment grade hybrid preferred securities of principally United States and Canadian issuers. The corporate bond portion of the Investment Grade Portfolio is managed by MFC Global Investment Management (Canada) ("MFC Global"). The hybrid preferred securities portion of the Investment Grade Portfolio is managed by MFC Global Investment Management (U.S.), LLC ("MFC Global (U.S.)") (formerly Sovereign Asset Management LLC, see *Recent Developments*) (MFC Global and MFC Global (U.S.), collectively, the "Investment Advisor"). The initial allocation of the managed assets of the

Investment Grade Portfolio between MFC Global and MFC Global (U.S.) was approximately 25% and 75%, respectively.

### *Risk*

The Trust's investment activities expose it to various types of risk associated with the financial instruments in which it invests directly. In addition to the risks of investing in corporate bond, equity and preferred securities markets generally, the Trust is subject to other risks, including the following:

- Currency risk
- Interest rate risk
- Credit risk

For a detailed disclosure of risks associated with an investment in the Trust's units please refer to the Trust's most recent Annual Information Form.

### *Results of Operations*

The net asset value per unit of the Trust as at December 31, 2006 was \$8.76 compared to \$9.07 at the end of 2005. Net assets decreased to \$25.5 million during 2006 from \$48.0 million at the end of 2005. The change in net assets is attributed to the various components of the net asset value as outlined below. For a further analysis of the impact to the net asset value on a per unit basis, please see the section on *Financial Highlights*.

### *Managed Portfolio*

A discussion by the Investment Advisors to the Trust:

#### **Corporate Bonds – MFC Global Investment Management (Canada)**

##### *Market Review*

The Canadian bond market, as measured by the Scotia Capital Universe Bond Index, posted a total return of +4.1% in 2006. The yield curve for Government of Canada bonds flattened for the second consecutive year.

Economic growth, as measured by GDP, started the year strongly, but began to slow by the second quarter, and continued to slow throughout the remainder of the year. This caused interest rates to rise at first, in the beginning of the year, and to fall during the second half of the year. Canada's bank rate began 2006 at 3.25%. The Bank of Canada then made four consecutive rate increases, raising the rate to 4.25% in May. The bank then hinted that a "pause" in further increases might be in order, and went on to hold its overnight rate unchanged to year end.

# Annual Management Report of Fund Performance (continued)

For the Year Ended December 31, 2006

The U.S. Federal Reserve (the “Fed”) also made four 25-basis-point increases in early 2006, bringing its rate to 5.25% by mid-year where it remained. Expectations of slower economic growth and reduced commodity prices (particularly for oil) reduced inflationary expectations in the fourth quarter of 2006, causing the market to anticipate the Fed may lower interest rates during 2007.

## Portfolio

The Trust benefited from being entirely invested in corporate debt, as this sector provided higher returns than government bonds. The Trust participated in various new corporate issues, which were funded mainly by sales from the financial sector, in order to take advantage of attractive relative pricing.

As the interest rate curve flattened, the Investment Advisor gradually reduced the duration of the Canadian fixed-income portion of the portfolio throughout the year. This allowed the corporate bond portion of the Investment Grade Portfolio to achieve the same yield with less interest rate risk.

## Outlook & Strategy

In December 2006, the Bank of Canada reiterated that Canada's growth and economic forecasts remained essentially unchanged, and that the risks to the inflation outlook remained balanced. The bank also acknowledged that fourth-quarter growth may be weaker than expected, but it did not change the neutral tone of its overall statement.

While rate cuts appear to be the next move, recent strong employment data and a weakening dollar may indicate that any change in direction won't be evident until later in 2007. MFC Global is reviewing yield curve and duration strategies to position the bond portfolio for such an occurrence. Given the continued pace of profitability and current market valuations, MFC Global foresees no need to radically change sector exposures in the equity portfolio.

MFC Global plans to continue with a defensive strategy, so the portfolio can continue to benefit from prudent credit selection while maintaining the appropriate risk-return profile.

## **Preferred Securities – MFC Global Investment Management (U.S.), LLC**

### Market Review

The early part of 2006 saw a flattish period in treasuries and a decline in the 30-year rate that can be accredited to the new U.S. \$14 billion of treasury bonds auctioned during the period. The treasury market as a whole had reduced volatility and the expectation for mid-term yields held steady. Interest rate volatility across the treasury curve also hit historic lows. There were a number of new preferred issues adding to the supply with significant redemption activity. Nearly \$2 billion in preferreds were called away early in the year. On the political front, industry watchers saw U.S. House and Senate negotiators reach an agreement on legislation to extend the 15% tax rate on qualified dividends until 2010.

There was a consensus that the 10-year treasury yields may have peaked near the 5.25% level in May and going forward, would allow preferreds to increase their return prospects. A slowing economy, with a Federal Reserve hold on rates, impacted adjustable rate securities. As a result, most fixed-rate preferreds outperformed floating-rate preferreds.

The summer proved hotter than normal and the utility industry and preferred stocks continued their forward trend with energy, communication and water companies reaching new highs. The benchmark 10-year note yield went back under 5% and primed the sector for continued success.

The latter part of 2006 saw the biggest utility rally of the year, highlighted with many utility stocks hitting 52-week highs. Longer duration preferreds continued their upward trend fueled by a rallying treasury market. Utilities continued to see gains and momentum as the Dow Utility Index climbed to another all time high. The housing market continued its year long slump and started to bleed into the employment numbers, fueling speculation for a weaker economy.

### Portfolio

As of December 31, 2006, MFC Global (U.S.)'s sector allocation of the hybrid preferred portion of the Investment Grade Portfolio was as follows: approximately 58% was in financial companies, 27% in utilities, 7% in telecom, 4% in energy, and 4% in other industries. On a country allocation basis, roughly 90% of the assets were invested in North America and the balance in European countries.

# Annual Management Report of Fund Performance (continued)

For the Year Ended December 31, 2006

## *Outlook & Strategy*

The unfavorable influences of mild weather could have utility earnings and customer usage facing difficult times in the first quarter of 2007. In general, warmer than normal temperatures adversely affect utilities' earnings, thus disappointing investors. However, it is possible that expected market moves will allow investors to find bargains later in the first quarter.

Weather issues aside, with the average utility fund up 24% in 2006, the demand for power and expected use of excess supply is a likely forecast. MFC Global (U.S.) believes investors will always be looking for utilities with strong balance sheets and dividend expansion. The increasing amount of M&A and LBOs will further prompt the sector for bullish momentum, and if the Fed makes a move to cut interest rates, it will make these companies' dividend yields that much more attractive.

## **Income, Expenses and Distributions (all comparative 2005 information relates to the period from February 25, 2005 ("Date of Inception") to December 31, 2005)**

For the year ended December 31, 2006, the Trust generated income from investments in the form of interest and dividends in the amount of \$3.7 million. As a basis of comparison, the Trust generated income from investments of \$3.6 million for the 2005 period.

The Trust paid management fees and operating expenses of \$0.8 million (2005 – \$0.7 million) and had interest carrying charges of \$1.1 million on its Loan Facility (2005 – \$0.8 million). The management expense ratio ("MER") for the Trust was 1.89% (1.95% excluding a partial reimbursement of one-time costs associated with the offering of the Trust) (2005 – 10.29%; 1.79% excluding one-time costs associated with the offering of the Trust).

The Trust distributed \$2.7 million to unitholders during the year (2005 – \$2.9 million).

The average daily net assets for the year were approximately \$9.9 million less than in the 2005 period due in large part to \$20.6 million in net redemptions for the year. Income generated from the portfolio of investments and any operating expenses calculated as a percentage of the net assets of the Trust, such as management fees and some administration fees, have decreased accordingly on a relative basis.

The 2006 calendar year was the first full year of operations for the Trust.

## **Borrowings**

The Manager, on behalf of the Trust, has entered into a revolving term credit facility (the "Loan Facility") with the Bank of Nova Scotia ("BNS"). The aggregate amount of borrowings under the credit facility and other forms of leverage may not exceed 35% of the total assets of the Trust at the time the borrowing or other transaction is entered into. The Trust has entered into a general security agreement providing BNS with a first charge on the assets of the Trust as collateral for indebtedness arising out of the credit facility.

As at December 31, 2006, the Manager, on behalf of the Trust, had drawn down loans in the aggregate principal amount of CAD \$3,550,000 (2005 – CAD \$6,250,000) and U.S. \$9,100,000 (CAD \$10,605,146 equivalent) (2005 – U.S. \$16,000,000; CAD \$18,655,194 equivalent). The combined loans when reflected in Canadian dollars represented approximately 34.2% of the total assets of the Trust (2005 – 33.6%). The highest amounts drawn down on the Loan Facility in 2006 were CAD \$6,250,000 and U.S. \$16,000,000 (2005 – CAD \$6,250,000 and U.S. \$16,000,000). The lowest amounts drawn down on the Loan Facility in 2006 were CAD \$3,550,000 and U.S. \$9,100,000 (2005 – nil). Proceeds from the draw down of the Loan Facility are used to purchase investments for the Trust.

## **Unitholder Activity**

The Trust's annual redemption feature allows unitholders to redeem out of the Trust at the end of August in any given year starting in 2006.

The Trust has a unique feature whereby 30% of the management fees paid to the Manager are in the form of units of the Trust in lieu of cash. This is done in order to keep more cash in the Trust for investment purposes. The Trust issued 14,132 units (2005 – 11,261) with a value of \$124,990 (2005 – \$106,219) as part of the management fees paid to the Manager.

The Trust also has the right (but not the obligation), exercisable in its sole discretion, at any time, to purchase (in the open market or by invitation for tenders) units for cancellation up to a maximum in any twelve month period of up to 10% of the number of units outstanding at the commencement of such period, in all cases at prices not exceeding the net asset value per unit of the Trust on the valuation date immediately prior to the date of any such purchase. During the year, the Trust repurchased 28,400 units (2005 – 32,700) for cancellation under the repurchase program, at a total cost of \$233,640 (2005 – \$276,461).

# Annual Management Report of Fund Performance (continued)

For the Year Ended December 31, 2006

On July 12, 2006, the Manager issued a notice of intention to repurchase units of the Trust through a normal course issuer bid (“NCIB”). Under the NCIB, the Trust may repurchase up to approximately 10% of the public float of units for cancellation at a price not exceeding the net asset value of the Trust. All such purchases would be accretive and enhance returns to continuing unitholders. Purchases of units commenced on July 14, 2006 and must terminate on July 13, 2007, or on such earlier date as the Trust may complete its purchase limit. For the year ended December 31, 2006, the Trust repurchased 45,100 units (2005 – nil) for cancellation under the NCIB at a total cost of \$387,522.

## **Recent Developments**

### Fairway and Jovian Partnership

In May 2006, Jovian Capital Corporation (“Jovian”) through its wholly-owned subsidiary Jovian Asset Management Inc. acquired 100% of the Class A Shares and 49% of the Class C Shares in Fairway Asset Management Corp. (formerly, Impax Capital Corp.), parent company to Fairway Capital Management Corp., the parent of the Manager.

On November 1, 2006, Jovian announced that its subsidiary, Jovian Asset Management Inc., had given notice of its intention to exercise its option to acquire the remaining 51% of the issued and outstanding Class C Shares of Fairway Asset Management Corp. As part of this pending change of control, and as part of an ongoing product re-branding strategy, Fairway Asset Management Corp. has been renamed JovFunds Management Inc. This change of control is expected to close on or about March 31, 2007.

Jovian is a publicly-traded company listed on the TSX Venture Exchange (JVN). Jovian is a management and holding company with interests in a variety of financial service firms specializing in wealth and asset management. The Jovian group of companies operates as a national financial services organization with approximately \$13.5 billion of client assets.

### Name Change of the Portfolio Manager

Effective October 1, 2006, Sovereign Asset Management LLC, one of the Investment Advisors of the Trust, changed its name to MFC Global Investment Management (U.S.), LLC.

The name change does not impact the management of the hybrid preferred securities portion of the Investment Grade Portfolio. The portfolio management professionals and support staff remain the same. The portfolio management teams will continue to use the same investment philosophy and process as before.

## **Related Party Transactions**

The Manager provides all administrative services required by the Trust, including the appointment of the Investment Advisor. The Manager receives a monthly fee at the annual rate of 1.0%, plus applicable taxes, of the net asset value of the Trust, calculated and accrued daily and payable monthly in arrears. The Manager is responsible for payment of the investment management fees of the Trust to the Investment Advisors out of its annual management fees. For additional information, see *Management Fees*.

## **Recommendations or Reports by the Advisory Board**

The Fairway Advisory Board tabled no reports and made no material recommendations to management of the Trust in the period ended December 31, 2006.

## **Independent Review Committee**

National Instrument 81-107 – Independent Review Committee for Investment Funds (“NI 81-107”), came into force on November 1, 2006. NI 81-107 will require all publicly offered investment funds, such as the Trust, to establish an independent review committee (the “IRC”). The Manager must refer all conflict of interest matters for review or approval to the IRC. NI 81-107 will also impose obligations upon the Manager to establish written policies and procedures for dealing with conflict of interest matters, to maintain records in respect of these matters and to provide the IRC with guidance and assistance in carrying out its functions and duties.

According to NI 81-107, the IRC must be comprised of a minimum of three independent members, and will be subject to requirements to conduct regular assessments of its members and provide reports, at least annually, to the Trust and to its unitholders in respect of those functions. The report will be available on the Manager's website [www.fairwaycapital.com](http://www.fairwaycapital.com), or at the unitholder's request at no cost, by contacting the Manager at 181 Bay Street, BCE Place, Suite 3740, Toronto, Ontario M5J 2T3 or by email at [info@fairwaycapital.com](mailto:info@fairwaycapital.com).

While the initial members of the IRC will be required to be appointed by May 1, 2007, complete compliance with NI 81-107 will not be required until November 1,

# Annual Management Report of Fund Performance (continued)

For the Year Ended December 31, 2006

2007. The Manager intends to implement the requirements of, and to comply with, NI 81-107, including appointing the members of the IRC.

The Fairway Advisory Board, which was established by the Manager to provide independent advice to the Manager on matters similar in nature to those now coming within the responsibility of the IRC, will cease to operate on the establishment of the IRC by the Manager.

## Forward-Looking Statements

The matters discussed in this management report of fund performance (“MRFP”) include certain forward-looking statements. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements. Forward-looking statements may be identified, without limitation, by the use of such words as “anticipates”, “estimates”, “expects”, “intends”, “plans”, “predicts”, “projects”, “believes”, or words or phrases of similar meaning. Readers should not rely on forward-looking statements as they involve risks and uncertainties which could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements. Market fluctuations and redemption levels are unpredictable and outside the control of the Trust. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors. The Trust makes no commitment to disclose any revisions to forward-looking statements, or any facts, events or circumstances after the date of this MRFP that may bear upon forward-looking statements.

## FINANCIAL HIGHLIGHTS

The following tables show selected key financial information about the Trust and are intended to help you understand the Trust’s financial performance since its inception on February 25, 2005. This information is derived from the Trust’s audited annual financial statements.

### The Trust’s net asset value per unit for the period ended December 31,

	2006	2005
Net asset value, beginning of period <sup>(1)</sup>	\$9.07	\$10.00
<b>Increase from operations:</b>		
Total revenue	0.82	0.68
Total expenses	(0.41)	(0.28)
Realized gains (losses) for the period	(0.09)	0.27
Unrealized losses for the period	(0.04)	(0.41)
<b>Total increase from operations<sup>(2)</sup></b>	<b>0.28</b>	<b>0.26</b>
<b>Distributions:</b>		
From income (excluding dividends)	(0.38)	(0.55)
From return of capital	(0.22)	–
<b>Total annual distributions<sup>(3)</sup></b>	<b>(0.60)</b>	<b>(0.55)</b>
<b>Net asset value, end of period<sup>(4)</sup></b>	<b>\$8.76</b>	<b>\$9.07</b>

<sup>(1)</sup> Net asset value, beginning of period for 2005 represents the original investment amount as at March 16, 2005, the date of the closing of the initial offering of the Trust.

<sup>(2)</sup> Net asset value and distributions are based on the actual number of units outstanding at the relevant time. The increase from operations is based on the weighted average number of units outstanding over the financial period.

<sup>(3)</sup> Distributions were paid in cash, reinvested in additional units of the Trust, or both.

<sup>(4)</sup> The Financial Highlights are not intended to act as a continuity of the opening and closing net asset value per unit.

## Ratios and Supplemental Data

	2006	2005
Net assets (000’s) <sup>(1)</sup>	\$25,518	\$47,981
Number of units outstanding <sup>(1)</sup>	2,914,188	5,287,738
Management expense ratio <sup>(2)</sup>	1.89%	10.29%
Management expense ratio before waivers or absorptions	1.89%	10.29%
Management expense ratio excluding issue costs <sup>(2)</sup>	1.95%	1.79%
Portfolio turnover rate <sup>(3)</sup>	10.94%	31.45%
Trading expense ratio <sup>(4)</sup>	0.03%	0.16%
Closing market price	\$8.40	\$8.50

<sup>(1)</sup> This information is provided as at December 31 of the period shown.

<sup>(2)</sup> Management expense ratio is based on total expenses for the stated period and is expressed as an annualized percentage of daily average net assets during the period. For the 2005 period, the management expense ratio is annualized from the date of inception to December 31, 2005. The expenses for the 2005 and 2006 periods contain one-time costs associated with the offering of the Trust as detailed in the prospectus.

<sup>(3)</sup> The Trust’s portfolio turnover rate indicates how actively the Trust’s Investment Advisor manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Trust buying and selling all of the securities in its portfolio once in the course of the year. The higher the Trust’s portfolio turnover rate in a year, the greater the trading costs payable by the Trust 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 Trust.

<sup>(4)</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the period.

# Annual Management Report of Fund Performance (continued)

For the Year Ended December 31, 2006

## MANAGEMENT FEES

The Trust's MER consists of all of its operating expenses such as custody, valuation, transfer agent, reporting, audit and legal fees. In addition to these operational and administrative expenses, other significant components of the MER are fees that are calculated as a percentage of the net asset value of the Trust. These are the Manager and Dealer Service fees. Highlights of the key components of the Trust's MER are listed in the table below:

Description – % of Net Asset Value (NAV)	2006 (\$000's)	2005 (\$000's)
Manager – annual rate of 1.00% of NAV <sup>(1)</sup>	423	423
Dealer service – annual rate of 0.30% of NAV	130	127

<sup>(1)</sup> The Manager is responsible for the management and operational functions of the Trust. In addition, the Manager will monitor the Trust's investment strategy to ensure compliance with the investment guidelines. The Manager has retained the Investment Advisor to provide investment advisory and portfolio management services to the Trust. The Manager is responsible for the payment of the investment management fees of the Investment Advisor out of its fees.

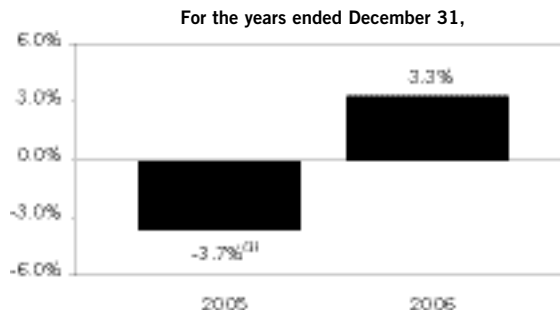
## PAST PERFORMANCE

### General

The performance information shown assumes that all distributions made by the Trust in the periods shown were reinvested in additional securities of the Trust. The performance information does not take into account sales, redemption, distribution or other optional charges that would have reduced returns on performance. The Trust's past performance is no guarantee of how it will perform in the future.

### Year-by-Year Returns

The following bar chart shows the Trust's annual performance for the years shown, and illustrates how the Trust's performance has changed from year to year. The chart shows in percentage terms how an investment made on January 1 would have increased or decreased by December 31 for each year.



<sup>(1)</sup> Return from March 16, 2005 to December 31, 2005

## Annual Compound Returns

The following table shows the Trust's annual compound returns for the periods ended December 31, 2006 as indicated. As a basis for comparison, the annual compound returns are compared to a series of indices on the same compound basis.

Percentage Return:	1 Year	Since Inception <sup>(1)</sup>
Fairway Investment Grade Income Fund	3.3%	-0.3%
Blended Index	6.8%	N/A
Scotia Capital Universe Bond Index <sup>(2)</sup>	4.1%	N/A
Merrill Lynch Preferred Stock Hybrid Securities Index <sup>(3)</sup>	7.7%	N/A

<sup>(1)</sup> Return from March 16, 2005.

<sup>(2)</sup> Source: Scotia Capital

<sup>(3)</sup> Source: Merrill Lynch

The Blended Index is comprised of 25% Scotia Capital Universe Bond Index and 75% Merrill Lynch Preferred Stock Hybrid Securities Index, which approximates the respective portions of the Investment Grade Portfolio managed by MFC Global and MFC Global (U.S.).

The Scotia Capital Universe Bond Index consists of a broadly diversified selection of investment-grade Government of Canada, provincial, corporate and municipal bonds issued domestically in Canada and denominated in Canadian dollars.

The Merrill Lynch Preferred Stock Hybrid Securities Index is an unmanaged index of investment-grade, exchange-traded preferred stocks with outstanding market values of at least U.S. \$30 million and at least one year to maturity.

# Annual Management Report of Fund Performance (continued)

For the Year Ended December 31, 2006

## SUMMARY OF INVESTMENT PORTFOLIO

As at December 31, 2006

Top 25 Investments	% of Net Assets
Lehman Brothers Holdings Capital Trust	5.91
Georgia Power Capital Trust	5.23
ING Groep NV	5.21
Telephone & Data Systems, Inc.	5.13
SLM Corporation <i>6.00% Dec 15/43</i>	5.02
Virginia Power Capital Trust <i>7.38% Jul 30/42</i>	4.91
Great Plains Energy Incorporated <i>8.00% Feb 16/07</i>	4.87
Provident Financial Group, Inc. <i>7.75%</i>	4.79
Nexen Inc. <i>7.35% Nov 01/43</i>	4.68
BNY Capital V <i>5.95% May 01/33 Series F</i>	4.33
Corporate-Backed Trust Certificates	3.76
Aegon NV <i>6.38%</i>	3.59
Household Finance Corporation <i>6.88%</i>	3.52
The Phoenix Companies, Inc. <i>7.45% Jan 15/32</i>	3.50
CU Inc.	3.50
Duke Realty Corporation	3.46
Verizon New England Inc. <i>7.00% May 15/42 Series B</i>	3.43
Heco Capital Trust III <i>6.50% Mar 18/34</i>	3.37
Bell Canada <i>5.00% Feb 15/17</i>	3.36
Entergy Mississippi Inc. <i>7.25% Dec 01/32</i>	3.36
Structured Repackaged Asset-Backed Trust Securities for Dominion Resources, Inc. <i>5.90% Dec 15/32 Series D</i>	3.29
USB Capital	3.17
The Thomson Corporation <i>5.20% Dec 01/14</i>	3.05
Westcoast Energy Inc. <i>8.30% Dec 20/13</i>	3.04
Morgan Stanley Capital Trust	2.96
<b>Top 25 Investments</b>	<b>100.44</b>
Other Investments	56.96
Cash and Cash Equivalents	3.94
Liabilities less other assets	(61.34)
<b>Total Net Assets</b>	<b>100.00</b>

Portfolio Composition	% of Net Assets
<b>Preferred Securities</b>	
United States	101.57
Netherlands	8.81
Canada	4.68
United Kingdom	2.47
<b>Total Preferred Securities</b>	<b>117.53</b>
<b>Bonds</b>	
Canada	39.57
United States	0.23
<b>Total Bonds</b>	<b>39.80</b>
<b>Future Contracts</b>	<b>0.07</b>
Cash and Cash Equivalents	3.94
Liabilities less other assets	(61.34)
<b>Total Net Assets</b>	<b>100.00</b>
<b>Total Net Asset Value</b>	<b>\$25,518,275</b>

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 at [www.fairwaycapital.com](http://www.fairwaycapital.com).

# Management's Responsibility for Financial Reporting

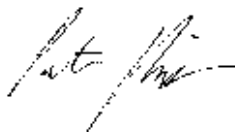
The accompanying financial statements of Fairway Investment Grade Income Fund (the "Trust") are the responsibility of the manager and trustee to the Trust, Fairway Advisors Inc. (the "Manager"). They have been prepared in accordance with Canadian generally accepted accounting principles using information available and include certain amounts that are based on the Manager's best estimates and judgments.

The Manager has developed and maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to produce relevant, reliable and timely financial information, including the accompanying financial statements.

These financial statements have been approved by the Board of Directors of the Manager and have been audited by Ernst & Young LLP, Chartered Accountants, on behalf of the unitholders. The auditors' report outlines the scope of their audit and their opinion on the financial statements.



Steven J. Hawkins  
*Chief Executive Officer*  
Fairway Advisors Inc.



Peter Rizakos  
*Managing Partner*  
Fairway Advisors Inc.

March 12, 2007

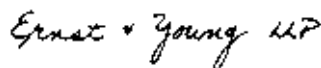
## Auditors' Report

### **TO THE UNITHOLDERS OF FAIRWAY INVESTMENT GRADE INCOME FUND**

We have audited the statements of investments of Fairway Investment Grade Income Fund [the "Trust"] as at December 31, 2006, the statements of net assets as at December 31, 2006 and 2005 and the statements of operations, changes in net assets and cash flows for the year ended December 31, 2006 and the period from February 25, 2005 to December 31, 2005. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 Trust as at December 31, 2006, its net assets as at December 31, 2006 and 2005 and the results of its operations, the changes in its net assets and its cash flows for the year ended December 31, 2006 and the period February 25, 2005 to December 31, 2005 in accordance with Canadian generally accepted accounting principles.



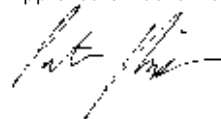
**Chartered Accountants**

Toronto, Canada,  
**March 12, 2007.**

## Statement of Net Assets

As at December 31,	2006	2005
<b>Assets</b>		
Investments, at market value (cost – \$41,028,064; 2005 – \$73,110,635)	\$ 40,147,030	\$ 71,134,151
Cash and cash equivalents	1,005,689	2,691,561
Receivable for open future contracts	18,191	–
Accrued interest, dividends and distributions from trusts	165,772	330,640
Prepaid interest on loan	14,375	10,636
	41,351,057	74,166,988
<b>Liabilities</b>		
Unit repurchases payable	17,280	–
Loan facility payable (Note 7)	14,155,146	24,905,194
Due to brokers	20,978	67,213
Payable for open forward contracts (Note 8)	1,415,189	289,238
Management fees payable	27,457	52,184
Accounts payable and accrued liabilities	50,923	62,542
Distributions payable	145,809	810,039
	15,832,782	26,186,410
<b>Net assets, at market value</b>	<b>\$ 25,518,275</b>	<b>\$ 47,980,578</b>
<b>Number of units outstanding (Note 6)</b>	<b>2,914,188</b>	<b>5,287,738</b>
<b>Net asset value per unit</b>	<b>\$ 8.76</b>	<b>\$ 9.07</b>

Approved on behalf of the Board of Directors of the Manager:



Peter Rizakos  
Director



Steven J. Hawkins  
Director

## Statement of Operations

	Year ended December 31, 2006	Period from February 25, 2005 (Date of Inception) to December 31, 2005
<b>Investment income</b>		
Interest	\$ 958,118	\$ 984,251
Dividends	2,733,872	2,618,151
	3,691,990	3,602,402
<b>Expenses</b>		
Management fees (Note 4)	553,384	550,272
Administration fees	79,995	46,300
Audit fees	36,435	19,862
Custodian fees	27,565	24,726
Legal fees	31,093	13,424
Securityholder reporting costs	21,013	30,860
Transfer agency fees	23,943	13,557
Other	1,904	9,501
Interest (Note 7)	1,072,965	759,835
	1,848,297	1,468,337
<b>Net investment income</b>	<b>1,843,693</b>	<b>2,134,065</b>
<b>Realized and unrealized loss on investments</b>		
Net realized loss on sale of investments	(2,580,226)	(798,265)
Change in unrealized appreciation (depreciation) on investments	1,113,641	(1,976,484)
Realized foreign exchange gain	2,175,570	2,166,975
Change in unrealized depreciation on foreign currency	(1,312,288)	(177,602)
<b>Net loss on investments</b>	<b>(603,303)</b>	<b>(785,376)</b>
<b>Increase in net assets from operations</b>	<b>\$ 1,240,390</b>	<b>\$ 1,348,689</b>
<b>Increase in net assets from operations per unit</b>	<b>\$ 0.2755</b>	<b>\$ 0.2553</b>

The accompanying notes are an integral part of these financial statements

## Statement of Changes in Net Assets

	Year ended December 31, 2006	Period from February 25, 2005 (Date of Inception) to December 31, 2005
<b>Increase in net assets from operations</b>	\$ 1,240,390	\$ 1,348,689
<b>Distributions to unitholders</b>		
Income	(1,701,602)	(2,935,648)
Return of capital	(994,365)	–
	(2,695,967)	(2,935,648)
<b>Capital unit transactions (Note 6)</b>		
Proceeds from issuance of trust units	–	53,100,000
Trust units issued under the Annual Management Fee (Note 4)	124,990	106,219
Issue costs	23,119	(3,355,000)
Reinvested trust units	23,648	5,379
Redeemed trust units	(20,557,321)	(12,600)
Repurchase and cancellation of trust units (Notes 12, 13)	(621,162)	(276,461)
	(21,006,726)	49,567,537
<b>Increase (decrease) in net assets during the period</b>	(22,462,303)	47,980,578
<b>Net assets, beginning of period</b>	47,980,578	–
<b>Net assets, end of period</b>	<b>\$ 25,518,275</b>	<b>\$ 47,980,578</b>

## Statement of Cash Flows

	Year ended December 31, 2006	Period from February 25, 2005 (Date of Inception) to December 31, 2005
<b>OPERATING ACTIVITIES</b>		
Increase in net assets from operations	\$ 1,240,390	\$ 1,348,689
Add (deduct) items not affecting cash:		
Loss on sale of investments	2,508,145	790,234
Change in unrealized (appreciation) depreciation on investments	(1,113,641)	1,976,484
Issuance of units for management fees	124,990	106,219
	2,759,884	4,221,626
Net change in non-cash assets and liabilities	148,431	(221,171)
<b>Cash provided by operating activities</b>	<b>2,908,315</b>	<b>4,000,455</b>
<b>FINANCING ACTIVITIES</b>		
Borrowing of loan facility	–	24,905,194
Repayment of loan facility	(10,750,048)	–
Distributions paid to unitholders	(3,360,197)	(2,125,609)
Net proceeds from issuance of trust units	23,119	49,745,000
Payments for redemption and/or repurchase of trust units	(21,161,203)	(289,061)
<b>Cash provided by (used in) financing activities</b>	<b>(35,248,329)</b>	<b>72,235,524</b>
<b>INVESTING ACTIVITIES</b>		
Proceeds from sale of investments	35,881,400	15,821,974
Purchases of investments	(5,227,258)	(89,366,392)
<b>Cash provided by (used in) investing activities</b>	<b>30,654,142</b>	<b>(73,544,418)</b>
<b>Net increase (decrease) in cash during the period</b>	<b>(1,685,872)</b>	<b>2,691,561</b>
Cash and cash equivalents, beginning of period	2,691,561	–
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,005,689</b>	<b>\$ 2,691,561</b>

The accompanying notes are an integral part of these financial statements

# Statement of Investments

As at December 31, 2006

Number of Shares	Description	Average Cost (\$)	Market Value (\$)	% of Net Assets
<b>PREFERRED SECURITIES</b>				
<b>Canada</b>				
39,700	Nexen Inc. 7.35% Nov 01/43	1,250,839	1,193,673	4.68
		<b>1,250,839</b>	<b>1,193,673</b>	<b>4.68</b>
<b>Netherlands</b>				
30,300	Aegon NV 6.38%	887,553	917,044	3.59
13,900	ING Groep NV 6.20%	408,564	412,590	1.62
31,000	ING Groep NV 7.05%	964,389	917,275	3.60
		<b>2,260,506</b>	<b>2,246,909</b>	<b>8.81</b>
<b>United Kingdom</b>				
10,000	Prudential PLC 6.75%	309,432	298,809	1.17
11,200	The Royal Bank of Scotland Group PLC 6.40% Series M	344,488	332,838	1.30
		<b>653,920</b>	<b>631,647</b>	<b>2.47</b>
<b>United States</b>				
6,000	BAC Capital Trust I 7.00% Dec 15/31	184,654	175,369	0.69
20,000	BAC Capital Trust IV 5.88% May 03/33	563,483	569,648	2.23
25,800	BGE Capital Trust III 6.20% Oct 15/43	722,284	744,167	2.92
38,300	BNY Capital V 5.95% May 01/33 Series F	1,133,370	1,103,820	4.32
3,600	Citigroup Capital X 6.10% Sep 30/33	108,448	104,131	0.41
18,000	Corporate-Backed Trust Certificates 6.00% Feb 15/34 Series GS	531,313	513,942	2.01
15,000	Corporate-Backed Trust Certificates 6.25% Jul 15/97	449,186	446,290	1.75
7,400	DTE Energy Trust II 7.50% Jun 01/44	239,078	225,129	0.88
7,600	Duke Realty Corporation 6.50% Series K	222,029	221,780	0.87
22,500	Duke Realty Corporation 6.60% Series L	657,163	661,044	2.59
28,800	Entergy Mississippi Inc. 7.25% Dec 01/32	920,546	856,877	3.36
14,500	FPC Capital I 7.10% May 13/39 Series A	436,065	426,175	1.67
17,000	FPL Group Capital Trust I 5.88% Mar 15/44	459,076	481,229	1.89
12,500	General Electric Capital Corporation 6.10% Nov 15/32	365,967	365,499	1.43
10,600	Georgia Power Capital Trust V 7.13% Mar 31/42	336,556	310,561	1.22
36,200	Georgia Power Capital Trust VII 5.88% Jan 15/44	1,087,401	1,023,469	4.01
42,500	Great Plains Energy Incorporated 8.00% Feb 16/07	1,352,122	1,243,191	4.87
29,000	Heco Capital Trust III 6.50% Mar 18/34	888,765	859,617	3.37
30,000	Household Finance Corporation 6.88%	943,572	898,524	3.52
14,800	HSBC Finance Corporation 6.00% Nov 30/33	433,576	429,128	1.68
11,600	KeyCorp Capital VI 6.13% Dec 15/33	337,758	330,666	1.30
20,000	Kimco Realty Corp. 6.65% Series F	612,794	587,595	2.30
21,900	Lehman Brothers Holdings Capital Trust III 6.38% Mar 15/52 Series K	651,729	640,354	2.51
30,000	Lehman Brothers Holdings Capital Trust V 6.00% Apr 22/53	865,561	867,058	3.40
4,400	Lincoln National Capital VI 6.75% Sept 11/52 Series F	138,005	130,758	0.51
9,500	Metlife, Inc. 5.88% Nov 21/33	272,384	272,797	1.07
1,700	Morgan Stanley Capital Trust III 6.25% Mar 01/33	50,573	49,747	0.19
10,000	Morgan Stanley Capital Trust IV 6.25% Apr 01/33	301,087	291,933	1.14
14,900	Morgan Stanley Capital Trust V 5.75% Jul 15/33	417,610	413,622	1.62
4,800	PLC Capital Trust IV 7.25% Sep 25/32	143,394	141,806	0.56
7,500	PNM Resources Inc. 6.75% May 16/08	421,260	461,848	1.81
40,000	Provident Financial Group, Inc. 7.75%	1,340,293	1,222,216	4.79
45,000	SLM Corporation 6.00% Dec 15/43	1,241,036	1,280,134	5.02
4,400	Southern Company Capital Trust VI 7.13% Jun 30/42	139,656	129,373	0.51
19,500	Southwest Gas Capital II 7.70% Sep 15/43	639,668	593,131	2.32
30,500	Structured Repackaged Asset-Backed Trust Securities for Dominion Resources, Inc. 5.90% Dec 15/32 Series D	887,562	838,500	3.29

# Statement of Investments (continued)

As at December 31, 2006

Number of Shares	Description	Average Cost (\$)	Market Value (\$)	% of Net Assets
<b>PREFERRED SECURITIES</b>				
<b>United States (continued)</b>				
16,000	Telephone & Data Systems, Inc. 7.60% Dec 01/41	472,869	467,466	1.83
29,200	Telephone & Data Systems, Inc. 6.63% Mar 31/45	881,170	842,235	3.30
30,600	The Phoenix Companies, Inc. 7.45% Jan 15/32	958,529	892,601	3.50
10,000	USB Capital VI 5.75% Mar 09/35	289,959	277,832	1.09
19,000	USB Captial VII 5.88% Aug 15/35	523,774	531,201	2.08
29,700	Verizon New England Inc. 7.00% May 15/42 Series B	923,046	876,040	3.43
42,000	Virginia Power Capital Trust 7.38% Jul 30/42	1,345,323	1,252,060	4.91
17,000	Wachovia Funding Corp. 7.25% Series A	577,824	556,514	2.18
10,700	Wells Fargo Capital Trust VI 6.95% Apr 15/32	335,708	312,368	1.22
		<b>26,803,226</b>	<b>25,919,445</b>	<b>101.57</b>
<b>Total Preferred Securities</b>		<b>30,968,491</b>	<b>29,991,674</b>	<b>117.53</b>

# Statement of Investments (continued)

As at December 31, 2006

Par Value (\$)	Description	Average Cost (\$)	Market Value (\$)	% of Net Assets
<b>BONDS</b>				
<b>Canada</b>				
116,000	Bell Aliant Regional Communications LP 4.72% Sep 26/11	115,994	116,330	0.46
861,000	Bell Canada 5.00% Feb 15/17	836,392	857,740	3.36
568,000	BMO Capital Trust 5.47% Dec 31/14	579,548	594,282	2.33
827,000	CU Inc. 5.10% Nov 18/14	836,266	856,516	3.36
15,000	CU Inc. 4.80% Nov 22/21	15,000	14,956	0.06
21,000	CU Inc. 5.03% Nov 20/36	21,000	20,916	0.08
474,000	Enbridge Gas Distribution Inc. 5.16% Sep 24/14	481,553	492,591	1.93
42,000	Enbridge Pipelines Inc. 5.08% Dec 19/36	41,968	41,898	0.16
70,000	Ford Floorplan Auto Securitization Trust 4.61% Nov 15/09	70,000	70,180	0.28
21,000	FortisAlberta Inc. 4.99% Jan 03/47	20,978	20,510	0.08
306,000	Great-West Life Capital Trust 6.00% Dec 31/12	326,311	328,961	1.29
484,000	Hydro One Inc. 5.77% Nov 15/12	516,681	520,043	2.04
54,000	ING Bank of Canada 4.30% Dec 05/16	53,945	53,771	0.21
31,000	Key Nova Scotia Funding Co. 4.21% Dec 14/09	30,999	30,852	0.12
357,000	Loblaw Companies Limited 7.10% Jun 01/16	416,343	418,808	1.64
570,000	Manitoba Telecom Services Inc. 5.20% Sep 27/11	583,770	580,909	2.28
137,000	Molson Coors Capital Finance ULC 5.00% Sep 22/15	136,659	135,217	0.53
51,000	RONA Inc. 5.40% Oct 20/16	50,894	51,162	0.20
296,000	Royal Bank of Canada 3.70% Jun 24/15	287,602	290,527	1.14
271,000	Scotiabank Capital Trust 6.28% Dec 29/49	292,972	296,003	1.16
651,000	Sun Life Assurance of Canada 6.15% Jun 30/22	702,699	705,199	2.76
82,000	Telus Corporation 5.00% Jun 03/13	81,902	83,017	0.32
301,000	The Greater Toronto Airports Authority 6.25% Dec 13/12	325,166	328,020	1.29
750,000	The Thomson Corporation 5.20% Dec 01/14	775,771	779,485	3.05
49,000	The Toronto-Dominion Bank 4.78% Dec 14/16	49,000	48,523	0.19
220,000	The Toronto-Dominion Bank 5.69% Jun 03/18	231,192	234,716	0.92
556,000	Trans Canada Pipelines 5.65% Jan 15/14	581,395	592,003	2.32
27,000	Vancouver International Airport Authority 4.42% Dec 07/18	27,000	26,546	0.10
637,000	Westcoast Energy Inc. 8.30% Dec 20/13	779,879	774,863	3.04
716,000	YPG Holdings Inc. 5.71% Apr 21/14	732,775	731,962	2.87
		<b>10,001,654</b>	<b>10,096,506</b>	<b>39.57</b>
<b>United States</b>				
58,000	Aon Finance NS1 ULC 5.05% Apr 12/11	57,919	58,850	0.23
		<b>57,919</b>	<b>58,850</b>	<b>0.23</b>
<b>Total Bonds</b>		<b>10,059,573</b>	<b>10,155,356</b>	<b>39.80</b>
<b>TOTAL INVESTMENTS</b>		<b>41,028,064</b>	<b>40,147,030</b>	<b>157.33</b>
<b>Number of Contracts</b>	<b>Description</b>	<b>Average Cost (\$)</b>	<b>Market Value (\$)</b>	<b>% of Net Assets</b>
<b>SHORT FUTURES</b>				
<b>United States</b>				
18	U.S. 10 Year Treasury Note Future expiry date Mar 21/07	–	18,191	0.07
<b>Liabilities less other assets</b>			<b>(14,646,946)</b>	<b>(57.40)</b>
<b>NET ASSETS, AT MARKET VALUE</b>			<b>25,518,275</b>	<b>100.00</b>

The accompanying notes are an integral part of these financial statements

# Notes to Financial Statements

December 31, 2006

## 1. THE TRUST

Fairway Investment Grade Income Fund (the "Trust") is a closed-end investment trust established under the laws of the Province of Ontario by a Declaration of Trust dated February 25, 2005 ("Date of Inception").

The Manager and Trustee of the Trust is Fairway Advisors Inc. (the "Manager").

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The following is a summary of significant accounting policies followed by the Trust in the preparation of its financial statements:

### *(a) Cash and cash equivalents*

Cash and cash equivalents consist of cash on deposit and short-term, interest bearing notes with a term to maturity of less than three months from the date of purchase.

### *(b) Valuation of Investments*

Investments in publicly traded securities are valued at the closing market price from the relevant exchange. Investments in securities for which closing market prices are not readily available are valued at the last reported sales price. If no sales price can be ascertained or if the securities are not quoted on an exchange, the value is based on the average of the last bid and ask prices quoted by a major dealer in such securities. Securities for which no such information is readily available are valued at fair value as determined by the Manager. The difference between market value and average cost, as recorded in the accounts, is shown as change in unrealized appreciation (depreciation) on investments.

Short-term investments, including notes and money market instruments, will be valued at cost plus accrued interest which approximates market value.

The value of any bonds, debentures and other debt obligations will be valued by taking the average of the bid and ask prices on the valuation date.

### *(c) Investment transactions and income recognition*

All investment transactions are accounted for on the trade date. Realized gains and losses from investment transactions and unrealized appreciation or depreciation in the value of investments are calculated on an average cost basis.

Interest income and expenses are recognized daily on an accrual basis.

Dividend income is recognized on the ex-dividend date.

Distributions from income trusts which are treated as dividend income, interest income or capital gains for tax purposes are included as dividend income, interest income or capital gains distributed from income trusts, as appropriate, in the statement of operations.

Distributions from income trusts which are treated as return of capital for income tax purposes reduce the average cost of the investment in the Trust on the statement of investments.

### *(d) Foreign currency translation*

Investments at market value and other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange applicable on the valuation date. Investment transactions and income and expenses are translated at the rate of exchange on the date of such transactions.

### *(e) Forward foreign currency contracts*

Forward foreign currency contracts (see Note 8) are valued at current market value on each valuation day. Gains or losses incurred when forward foreign currency contracts entered into by the Trust, which are of the nature of a general hedge of the currency exposure of the underlying portfolio of investments, mature or are closed out are included in "realized foreign exchange gain (loss)" in the Statement of Operations.

# Notes to Financial Statements (continued)

December 31, 2006

## **(f) Futures contracts**

The value of a futures contract is the gain or loss that would be realized if, on the valuation date, the position in the futures contract was closed out. Margin paid or deposited in connection with futures contracts is reflected on the statement of investments. The unrealized gains or losses on futures contracts are reported as part of the change in unrealized appreciation or depreciation on investments until the contracts are closed out. Realized gains and losses from futures contracts that are specific hedges are accounted for in the same manner as the underlying instrument being hedged. All other realized gains and losses on futures contracts are accounted for as gains or losses and are included in net realized gain (loss) on investments in the Statement of Operations.

## **(g) Accounting estimates**

Allocations of distributions received from income trusts among dividends, interest and other income, capital gains, or return of capital are based on estimates of the categorization of distribution provided by those income trusts. These allocations may change once final categorizations of the distributions are received from the respective income trusts.

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Manager to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

## **(h) Net asset value per unit**

The net asset value per unit is computed by dividing the net assets of the Trust by the total number of units outstanding on the valuation date.

### **3. TAXATION**

The Trust qualifies as a “mutual fund trust” within the meaning of the Income Tax Act (Canada). The Trust is subject to applicable federal and provincial taxes on the amount of its net income for tax purposes for the year, including net realized taxable capital gains, to the extent such net income for tax purposes has not been paid or made payable to unitholders in the year.

No provision for income taxes has been recorded in the accompanying financial statements as all income and net realized capital gains are distributed to the unitholders.

Capital losses realized over and above realized capital gains in the current taxation year can be carried forward indefinitely and may be applied against future years' capital gains. Non-capital losses arising in tax years ending after 2005 may be carried forward for a period of twenty years and applied against future years' taxable income. Previously the carryforward period was ten years. If the non-capital losses are not applied within the relevant time frame from the taxation year in which the non-capital loss arose, the non-capital loss will expire.

As at December 31, 2006, the Trust's capital and non-capital losses, with the year of expiry, are as follows:

Capital Losses	Non-Capital Losses	Year of Expiry
\$443,249	–	–

### **4. EXPENSES OF THE TRUST**

#### **(a) Management fees**

Pursuant to the Declaration of Trust, the Manager provides all administrative services required by the Trust, including the appointment of investment advisors to the Trust.

In return, the Manager receives a monthly fee at the annual rate of 1.00%, plus applicable taxes, of the net asset value of the Trust (the “Annual Management Fee”), calculated and payable monthly in arrears. For the first three years of the term of the Trust, 30% of the Annual Management Fee, excluding applicable taxes, will be paid in units and 70% of the Annual Management Fee will be paid in cash. After the first three years, the Annual Management Fee may be paid in cash and/or units at the option of the Manager. The Trust has reserved 105,000 units to be issued from treasury to the Manager as payment for the Annual Management Fee for a period of 10 years.

The Manager is responsible for payment of the investment management fees of the Trust's investment advisors out of its annual management fees.

# Notes to Financial Statements (continued)

December 31, 2006

## **(b) Other expenses**

The Trust is responsible for all other expenses incurred in connection with its operation and administration, such as custody, valuation, transfer agent, reporting, audit and legal fees. Brokerage commissions paid on securities transactions are not considered to be part of total expenses. These commissions are included in the cost of purchasing, or netted out of the proceeds from selling securities. For the year ended December 31, 2006 brokerage commissions were \$12,918 (2005 – \$62,227). The Trust will pay to registered dealers an annual service fee equal to 0.30% annually of the net asset value of units held by clients of the sales representatives of such dealers, calculated and payable semi-annually in arrears. Dealer service fees for the year were \$129,857 (2005 – \$127,353) and are included in management fees in the Statement of Operations.

## **5. UNITHOLDERS' EQUITY**

The Trust is authorized to issue an unlimited number of voting, transferable, redeemable trust units of one class, each of which represents an equal, undivided interest in the net assets of the Trust. On termination of the Trust unitholders will be entitled to receive their pro rata share of all of the assets of the Trust remaining after payment of all debts, liabilities and liquidation expenses.

The Trust is expected to terminate operations on August 31, 2015 (the "Termination Date") and the net assets will be distributed pro rata to unitholders unless an alternative later termination date is approved by the unitholders.

Units may be surrendered for redemption not more than 45 days, and at least 20 business days, prior to the second last business day of August in any year. Unitholders will receive a redemption price per unit equal to the net asset value per unit of the Trust determined as of the valuation date.

Additionally, and in accordance with the Declaration of Trust, unitholders are entitled to a monthly redemption at a redemption price equal to the lesser of: (a) 95% of the average of the daily weighted unit trading price for the 10 business days prior to the second last business day of the month and (b)

the closing unit market price on the second last business day of the month. Such redemption right must be exercised at least seven business days before month-end.

## **6. NET CAPITAL TRANSACTIONS**

Net capital transactions for the Trust for the year from January 1, 2006 to December 31, 2006 consisted of the following:

	<b>Units</b>	<b>\$</b>
Number of units outstanding, beginning of year	5,287,738	49,567,537
Trust units issued under the Annual Management Fee (Note 4)	14,132	124,990
Distribution Reinvestment Plan	2,658	23,648
Redemptions	(2,316,840)	(20,557,321)
Repurchase and cancellation of units (Notes 12, 13)	(73,500)	(621,162)
Issue costs (including agents' fees)	–	23,119
<b>Number of units outstanding, end of year</b>	<b>2,914,188</b>	<b>28,560,811</b>

Net capital transactions for the Trust for the period from Date of Inception to December 31, 2005 consisted of the following:

	<b>Units</b>	<b>\$</b>
Number of units outstanding, beginning of period	–	–
Subscriptions	5,310,000	53,100,000
Trust units issued under the Annual Management Fee (Note 4)	11,261	106,219
Distribution Reinvestment Plan	577	5,379
Redemptions	(1,400)	(12,600)
Repurchase and cancellation of units (Note 12)	(32,700)	(276,461)
Issue costs (including agents' fees)	–	(3,355,000)
<b>Number of units outstanding, end of period</b>	<b>5,287,738</b>	<b>49,567,537</b>

# Notes to Financial Statements (continued)

December 31, 2006

## 7. LOAN FACILITY

The Manager, on behalf of the Trust, has entered into a revolving term credit facility with The Bank of Nova Scotia ("BNS"). The aggregate amount of borrowings under the credit facility and other forms of leverage may not exceed 35% of the total assets of the Trust at the time the borrowing or other transaction is entered into. The Trust has entered into a general security agreement providing BNS with a first charge on the assets of the Trust as collateral for indebtedness arising out of the credit facility.

The following tables summarize the loans drawn down by the Manager on behalf of the Trust as at December 31, 2006 and December 31, 2005.

As at December 31, 2006:

<b>Canadian Dollar Loan</b>		
<b>Interest Rate and Maturity Date</b>	<b>Canadian Dollar Principal (\$)</b>	
4.35%, January 17, 2007	3,550,000	
<b>U.S. Dollar Loan</b>		
<b>Interest Rate and Maturity Date</b>	<b>U.S. Dollar Principal (\$)</b>	<b>Canadian Dollar Equivalent Principal (\$)</b>
5.75%, January 17, 2007	9,100,000	10,605,146
<b>Aggregate Loan</b>		
<b>Principal Drawn Down</b>	<b>14,155,146</b>	

As at December 31, 2005:

<b>Canadian Dollar Loan</b>		
<b>Interest Rate and Maturity Date</b>	<b>Canadian Dollar Principal (\$)</b>	
3.26%, January 17, 2006	2,125,000	
3.38%, January 18, 2006	4,125,000	
<b>U.S. Dollar Loan</b>		
<b>Interest Rate and Maturity Date</b>	<b>U.S. Dollar Principal (\$)</b>	<b>Canadian Dollar Equivalent Principal (\$)</b>
4.69%, January 18, 2006	5,500,000	6,412,723
4.78%, January 19, 2006	10,000,000	11,659,496
4.79%, January 30, 2006	500,000	582,975
<b>Aggregate Loan</b>		
<b>Principal Drawn Down</b>	<b>24,905,194</b>	

The highest amounts drawn down on the loan facility in 2006 were CAD \$6,250,000 and U.S. \$16,000,000 (2005 – CAD \$6,250,000 and U.S. \$16,000,000). The lowest amounts drawn down on the loan facility in 2006 were CAD \$3,550,000 and U.S. \$9,100,000 (2005 – nil).

## 8. FORWARD CONTRACTS

As at December 31, 2006, the Trust had entered into forward currency contracts to deliver currencies at specified future dates as follows:

<b>Sale</b>	USD
<b>Amount (\$)</b>	26,466,934
<b>Purchase</b>	CAD
<b>Amount (\$)</b>	29,400,000
<b>Settlement Date</b>	January 31, 2007
<b>Unrealized foreign exchange loss (\$)</b>	(1,415,189)

## 9. SECURITIES LENDING

In order to generate additional returns, the Trust may enter into securities lending agreements with borrowers deemed acceptable to the Trust. Under a securities lending agreement, the borrower must pay the Trust a negotiated securities lending fee, provide compensation to the Trust equal to any distributions received by the borrower on the securities borrowed and the Trust must receive collateral security of 102% for the loaned security.

There were no securities lending transactions during the year.

## 10. DISTRIBUTIONS

The Trust endeavours to make monthly cash distributions to unitholders consisting primarily of distributions received on securities in the investment portfolio and, in certain circumstances, of net realized capital gains from the investment portfolio. These monthly distributions will be paid to unitholders on or about the last business day of each month. The monthly distribution declared to unitholders of record, at the end of each month in the year, was \$0.05 per unit.

# Notes to Financial Statements (continued)

December 31, 2006

## 11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Trust's investment activities expose it to various types of risk associated with the financial instruments in which it invests directly. In addition to the risks of investing in bond and preferred securities markets generally, the Trust is subject to other risks, including the following:

### **Currency risk**

The Trust invests in securities denominated in currencies other than its reporting currency, the Canadian dollar. Consequently, the Trust is exposed to risks that the exchange rate of the Canadian dollar relative to the other currencies may change in a manner which has an adverse effect on the reported value of that portion of the Trust's assets. The Trust manages its currency risk through foreign currency hedging strategies.

### **Interest rate risk**

The Trust invests in interest-bearing securities. The income of the Trust may be affected by changes in interest rates relevant to particular securities or as a result of the investment advisors being unable to secure similar returns on the expiry or sale of securities.

### **Credit risk**

Credit risk on financial instruments is the risk of a financial loss occurring as a result of the default of a counterparty on its obligation to the Trust. Credit risk is managed by dealing with counterparties the Trust believes to be creditworthy and by regular monitoring of credit exposures.

## 12. MANDATORY REPURCHASE PROGRAM

The Trust has the right (but not the obligation), exercisable in its sole discretion, at any time, to purchase (in the open market or by invitation for tenders) units for cancellation up to a maximum in any twelve-month period of up to 10% of the number of units outstanding at the commencement of such period, in all cases at prices not exceeding the net asset value per unit of the Trust on the valuation date immediately prior to the date of any such purchase. During the year, the Trust repurchased 28,400 units (2005 – 32,700) for cancellation under its mandatory repurchase program at a total cost of \$233,640 (2005 – \$276,461).

The units repurchased for cancellation under the mandatory repurchase program are included in repurchase and cancellation of trust units in the Statement of Changes in Net Assets.

## 13. NORMAL COURSE ISSUER BID

On July 12, 2006 the Manager issued a notice of intention (the "Notice") to repurchase units of the Trust through a normal course issuer bid (the "NCIB"). Under the NCIB, the Trust may purchase up to approximately 10% of the public float of units. Purchases of units commenced on July 14, 2006 and must terminate on July 13, 2007, or on such earlier date as the Trust may complete its purchases pursuant to the Notice. Purchases will be made in the open market through the facilities of the TSX in accordance with its rules and policies. The price that the Trust will pay for any such units may not exceed the net asset value per unit. Any units purchased by the Trust will be cancelled. All such purchases would be accretive and enhance returns to continuing unitholders. During the year, the Trust repurchased 45,100 units (2005 – nil) for cancellation via the NCIB at a cost of \$387,522. The units repurchased for cancellation under the NCIB are included in repurchase and cancellation of trust units in the Statement of Changes in Net Assets.

## 14. COMPARATIVE FINANCIAL STATEMENTS

The comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the 2006 financial statements.

# Corporate Information

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Listed

**The Toronto Stock Exchange**

Ticker Symbol

**FGF.UN**

## About Fairway

Fairway is a specialized financial services firm focused on the creation, marketing, distribution and management of investment products in both traditional and alternative asset classes. Fairway's products are structured to provide yield enhancement, tax advantages and other benefits that complement the needs of Canadian investors. Fairway's principals are experienced investment professionals who share a strong track record as innovators in the Canadian securities industry.

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