Pinnacle Income Fund

ScotiaMcLeod™

Management Report of Fund Performance
(as at December 31, 2007)

This annual management report of fund performance contains financial highlights but does not contain the complete annual financial statements of the fund. You can get a copy of the annual financial statements at your request, and at no cost, by asking your ScotiaMcLeod advisor or by calling toll-free 1 800 530-0197 (416 506-8404 in Toronto). You can also write to us at 40 King Street West, P.O. Box 4085, Stn. 'A' Scotia Plaza, Toronto, Ontario M5Z 2X6 or by visiting www.scotiamcleod.com or SEDAR at www.sedar.com.

You may also contact us using one of these methods to request a copy of the fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure.

In this document, we, us, and ScotiaMcLeod refers to ScotiaMcLeod, a division of Scotia Capital Inc and fund refers to the Pinnacle Income Fund.

This report may contain forward-looking statements about the fund. Such statements are predictive in nature and depend upon or refer to future events or conditions and may include such words as "expects", "plans", "anticipates", "believes", "estimates" or other similar expressions. In addition, any statement regarding future performance, strategies, prospects, action or plans is also a forward-looking statement. Forward-looking statements are subject to known and unknown risks and uncertainties and other factors that may cause actual results, performance, events, activity and achievements to differ materially from those expressed or implied by such statements. Such factors include general economic, political and market conditions, interest and foreign exchange rates, regulatory or judicial proceedings, technological change, and catastrophic events. You should consider these and other factors carefully before making any investment decisions and before relying on forward-looking statements. We have no specific intention of updating any forward-looking statements whether as a result of new information, future events or otherwise.

Management Discussion of Fund Performance

Investment objectives and strategies

The fund's objective is to preserve investment capital while seeking to achieve increased income by investing primarily in a portfolio of Canadian government and corporate bonds, preferred shares of Canadian corporations and loans of supranational organizations. The fund's investments may also include mortgage-backed securities, mortgage bonds, mortgages, term loans, short-term instruments and cash equivalents. Duration may vary by no more than one year from the duration of the Universe Bond Index (formerly the Scotia Capital Universe Bond Index).

Risk

The overall risks of investing in the fund remain as discussed in its simplified prospectus. The fund remains suitable for investors who want a high level of regular interest income while tracking the performance of a major Canadian bond index, who are looking for lower risk, and who are investing for at least three years.

The risks most relevant to the fund during the year included interest rate risk and credit risk. To mitigate these risks, the portfolio advisor used a bullet yield curve strategy (making investments in the middle of the curve) to take advantage of the flat yield curve. In addition, the duration in the fund has been increased so that it is longer than the Index.

Results of operations

Over the review period, the fund returned 4.23% compared to a 3.68% return for the DEX Universe Bond Index. In contrast to the index, the fund's return is after the deduction of expenses paid by the fund.

The most important influence affecting markets in 2007 was the credit market turmoil stemming from problems in the U.S. housing market, where prices were inflated in recent years by the easy availability of financing, no-documentation loans and sub-prime mortgages with below-market 'teaser' interest rates. The U.S. financial sector's under-estimation of the risks of such profligate lending practices was also felt in Canada, where several of the major banks recorded significant write-downs, bank funding spreads quadrupled, and the $33 billion non-bank Asset-Backed Commercial Paper (ABCP) market seized up.

In response to the crisis, the U.S. Federal Reserve cut interest rates twice for a total of 50 basis points (bps) while the Bank of Canada reduced interest rates by 25 bps during the fourth quarter. Coordinated efforts by central bankers around the world and regular announcements near the end of the year regarding the injection of billions of dollars of additional liquidity into the banking system did little to stimulate or reassure the market.

The fund's duration was adjusted throughout the year in response to the volatile market conditions. For most of the first half of the year, the fund was in short duration. For the remaining half of the year, the bias of the portfolio advisor was to be in long duration. The fund was underweight the index in both duration and credit throughout the year, which was the major reason the fund outperformed relative to the index.

The duration decisions in the fund were based on the portfolio advisor's outlook that the economy was going to continue to do well and that central banks around the world were going to raise interest rates in response to mounting inflation pressures. While typically this would be a constructive environment to be

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overweight credit, the fund remained underweight, as the absolute level of spreads were very narrow and did not compensate for the potential risks and additionally, the portfolio advisor felt that the business cycle was very mature. Both of these strategies added value in the fund during the first half of the year, as interest rates rose in response to higher inflation expectations, and credit spreads widened on the back of the aforementioned credit crisis.

Conversely, in the second half of 2007, the fund's performance merely tracked the index. The portfolio advisor overweighted corporate credit in late August and September on assumptions that the credit crisis was going to be relatively short lived (similar to 1998). Unfortunately, this position caused a modest drag on performance during the fourth quarter of 2007, as credit spreads continued to widen significantly, and as the true extent of the banking system's financial losses grew much larger than initial expectations. That underperformance was largely made up for by being long in duration, as it became clear central bankers were going to have to, and did, cut interest rates significantly in seeking to stimulate the economy.

In summary, the portfolio outperformed the index by a small margin in 2007. All of this added value occurred in the first half of the year, with approximately 30% of this attributable to duration management and the balance attributable to the fund's credit positions.

During the period, the fund experienced net sales of $61,261,489.

Recent developments

The extent of the financial crisis was evidenced at the year-end by the magnitude of investments made by sovereign investment funds in some of the world's largest financial institutions in order to shore up their capital bases following massive sub-prime mortgage write-offs. The portfolio advisor believes that the biggest issue facing the market is one of confidence, as no one is sure about the extent and depth of this exposure by those financial institutions that to date have been silent on the matter.

In addition, it seems apparent that the U.S. Treasury Department is trying to impose a Japanese solution to the U.S. debt problem. This course of action did not work well when Japan experienced a banking crisis triggered by the collapse of real estate and stock values in the late 80s, and there is no reason to believe that it will work well in the U.S. As a result, the portfolio advisor is forecasting that both U.S. interest rates and economic growth will decline significantly in 2008. Consequently, going forward, the portfolio advisor intends to increase duration in the fund, concentrate maturities in the middle of the yield curve, and reduce the fund's credit positions.

Effective May 1, 2007, in accordance with National Instrument 81-107, *Independent Review Committee for Investment Funds*, we, as manager of the fund, have established an Independent Review Committee ("IRC"). The IRC became operational on November 1, 2007 and currently has three members, each of whom is independent of the manager and any party related to the manager. The current members of the IRC are Eric F. Kirzner, Robert S. Bell and D. Murray Paton. Additional information about the IRC is available in the fund's annual information form.

Implementation of accounting policy

National Instrument 81-106 requires the fund's net asset value to be calculated in accordance with Canadian generally accepted accounting principles ('GAAP'). Effective October 1, 2006, *CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement*, requires financial instruments which are actively traded to be valued based on the last bid price for the security. Prior to that date, fair value for GAAP purposes was based on the last traded price for the day, when available.

The Canadian Securities Administrators ("CSA") granted interim relief to investment funds from complying with National Instrument 81-106 for the purposes of calculating and reporting of net asset value (other than for financial reporting purposes). This relief has been extended and will expire on the earlier of September 30, 2008 and the date upon which changes to National Instrument 81-106 come into effect. Accordingly, the value used to determine the daily price of the fund's units for purchase and redemption by investors ('Pricing NAV') is not affected by this accounting policy change. In accordance with the decision of the CSA, a reconciliation between the Pricing NAV and the net asset value calculated in accordance with Section 3855 ('GAAP NAV') is required in the notes to the financial statements of the fund.

Related party transactions

We are the Manager, Trustee and Principal Distributor of the fund.

Financial Highlights

The following tables show selected key financial information about the fund and are intended to help you understand the fund's financial performance for the past five years ended December 31, as applicable. This information is derived from the fund's audited annual financial statements.

The fund's net assets per unit[1]

		December 31				
		2007	2006	2005	2004	2003
Net assets per unit – beginning of period	$	10.70	10.82	10.58	10.40	10.37
Increase (decrease) from operations:						
Total revenue	$	0.51	0.49	0.49	0.54	0.59
Total expenses	$	(0.01)	(0.01)	(0.01)	(0.02)	(0.03)
Realized gains (losses) for the period	$	(0.12)	0.08	0.15	0.04	0.10
Unrealized gains (losses) for the period	$	0.07	(0.13)	0.10	0.14	0.03
Total increase (decrease) from operations[2]	$	0.45	0.43	0.73	0.70	0.69
Distributions:						
From income (excluding dividends)	$	(0.48)	(0.46)	(0.45)	(0.52)	(0.58)
From dividends	$	–	–	–	–	–
From capital gains	$	–	(0.05)	(0.05)	–	(0.08)
Return of capital	$	–	–	–	–	–
Total distributions for period[3]	$	(0.48)	(0.51)	(0.50)	(0.52)	(0.66)
Net assets per unit – end of period[4]	$	10.65	10.70	10.82	10.58	10.40

(1) The adoption of the new accounting policy may result in a different valuation of securities held by the fund for financial reporting purposes than the market value used to determine the net asset value of the fund for the purchase and redemption of the fund's units. An explanation of these differences can be found in the notes to the fund's financial statements.
(2) Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial period.
(3) Distributions were paid in cash/reinvested in additional units of the fund, or both.
(4) The net assets per unit at period end is not a cumulative amount but, rather, the value of the fund's unit, in accordance with GAAP, as at the fund's period end.

Ratios and supplemental data

		December 31				
		2007	2006	2005	2004	2003
Total net asset value (000's)[1]	$	331,133	256,626	174,625	120,910	99,065
Number of units outstanding (000s)[1]		31,071	23,982	16,145	11,429	9,521
Management expense ratio[2]	%	0.08	0.09	0.14	0.17	0.27
Management expense ratio before waivers or absorptions[2]	%	0.08	0.09	0.14	0.17	0.27
Trading expense ratio[3]	%	–	–	–	–	–
Portfolio turnover rate[4]	%	258.46	170.41	170.03	106.40	230.00

(1) This information is provided as at the period end of the year shown.
(2) Management expense ratio is based on total expenses excluding commissions and other portfolio transaction costs for the stated period and is expressed as an annualized percentage of the daily average net asset value during the period.
(3) The trading expense ratio represents total commissions and other transaction costs expressed as an annualized percentage of daily the average net asset value during the period.
(4) The fund's portfolio turnover rate indicates how actively the fund's portfolio advisor manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the fund buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a fund.

Management fees

No management fees are paid to us by the fund. Each unitholder pays, on a quarterly basis, a negotiated asset based fee for all services offered as part of the Pinnacle Program. These services include general management of the fund, portfolio advisory and distribution services, and investment management consulting services.

We pay up to 72% of the fee paid by each unitholder for distribution related services provided by dealers. At least 28% of the fee paid by each unitholder is attributable to the costs of investment management, administration and profit.

Past Performance

The performance shown assumes that all distributions made by the fund in the periods shown were reinvested in additional units of the fund. If you hold units of the fund outside of a registered plan, you will be taxed on these distributions.

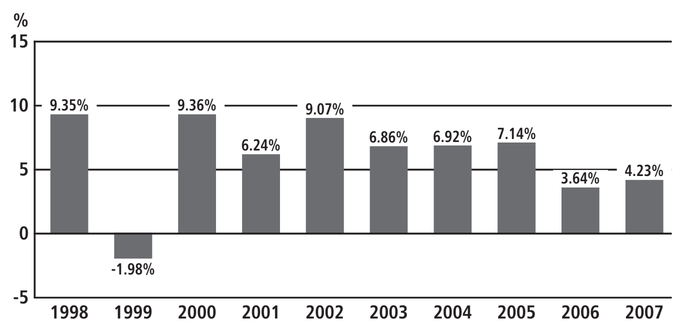
The performance information does not take into account sales, redemption, distribution or other optional charges that would have reduced returns.

How the fund has performed in the past does not necessarily indicate how it will perform in the future.

All rates of return are calculated based on Pricing NAV.

Year-by-year returns

This chart shows the fund's annual performance, which changes from year to year. It shows in percentage terms how much an investment held on January 1 in each year would have increased or decreased by December 31 of that year.



Annual compound returns

This table shows the fund's annual compound returns compared to the DEX Universe Bond Index (formerly the Scotia Capital Universe Bond Index), for the periods shown ending December 31, 2007.

		1 Year	3 Years	5 Years	10 Years
Pinnacle Income Fund	%	4.23	4.99	5.74	6.03
DEX Universe Bond Index	%	3.68	4.73	5.60	6.26

The DEX Universe Bond Index is a broad measure of the total return of Canadian bonds that mature in more than one year. It includes approximately 900 Canadian federal, provincial, municipal and corporate bonds rated BBB or higher.

A discussion of the fund's performance relative to the index is found under *Results of Operations*.

Summary of Investment Portfolio

(as at December 31, 2007)

This is a breakdown of the fund's investments and a list of up to 25 of its largest holdings. The holdings will change as the portfolio advisor buys and sells securities. You can obtain an up to date list of portfolio holdings on a quarterly basis by contacting your ScotiaMcLeod advisor, by calling toll-free 1 800 530-0197 (416-506-8404 in Toronto) or by visiting www.scotiamcleod.com.

Asset mix[1]

	% of net asset value[2]
Federal Government Bonds	49.0
Corporate Bonds	39.7
Provincial Government Bonds	10.6

[1] 0.7% of the fund's assets are held in cash, other assets and liabilities.
[2] Based on Pricing NAV.

Top holdings

Issuer	% of net asset value[1]
Canada Housing Trust 4.80% Jun. 15, 2012	12.4
Government of Canada 5.00% Jun. 1, 2014	10.0
Province of Quebec 5.75% Dec. 1, 2036	7.6
Government of Canada 4.25% Dec. 1, 2009	6.9
Government of Canada 4.00% Jun. 1, 2017	6.8
Government of Canada 3.75% Sep. 1, 2011	4.7
Government of Canada 5.75% Jun. 1, 2033	4.2
Government of Canada 3.75% Jun. 1, 2012	4.0
Royal Office Finance LP 5.21% Nov. 12, 2032	3.4
The Toronto-Dominion Bank 5.76% Dec. 18, 2017	2.6
The Toronto-Dominion Bank 4.78% Dec. 14, 2105	2.4
The Royal Bank of Scotland Group PLC, 6.67% Dec. 31, 2049	2.0
The Greater Toronto Airports Authority 6.45% Dec. 3, 2027	1.9
Province of Ontario 4.70% Jun. 2, 2037	1.7
Kreditanstalt fuer Wiederaufbau 5.15% Dec. 15, 2017	1.6
Ontario School Boards Financing Corp. 7.20% Jun. 9, 2025	1.5
The Toronto-Dominion Bank 5.38% Nov. 1, 2017	1.4
Glacier Credit Card Trust 4.27% Nov. 18, 2011	1.4
Province of Quebec 6.00% Oct. 1, 2012	1.4
Landwirtschaftliche Rentenbank 4.25% Nov. 16, 2012	1.2
HSBC Canada Asset Trust 7.78% Dec. 31, 2049	1.2
Merrill Lynch Financial Assets, Inc. 6.67% May 7, 2021	1.0
Royal Bank of Canada 4.97% Jun. 5, 2014	0.9
The Greater Toronto Airports Authority 6.45% Jul. 30, 2029	0.9
Nordic Investment Bank 5.15% Jul. 26, 2017	0.8
Top holdings total	83.9

[1] Based on Pricing NAV.