

# Pinnacle Canadian Mid Cap Equity Fund

(formerly Pinnacle Canadian Mid Cap Value Equity Fund)

## Management Report of Fund Performance

(as at December 31, 2008)

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 our website at [www.scotiacleod.com](http://www.scotiacleod.com) or SEDAR at [www.sedar.com](http://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 our refers to ScotiaMcLeod, a division of Scotia Capital Inc. and fund refers to the Pinnacle Canadian Mid Cap Equity 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 achieve long-term returns through capital growth by investing primarily in stocks of small and medium capitalization Canadian corporations. The fund's investments may also include up to 15% cash and cash equivalents.

To achieve its investment objectives, the fund uses a value-oriented investment style that focuses on investments in shares of companies whose share prices are low compared to their perceived potential value.

### 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 Canadian medium capitalization value holding in a diversified portfolio, who can accept moderate to high risk, and who are investing for at least three years.

### Results of Operations

Over the review period, the fund returned  $-39.76\%$  compared to a  $-38.77\%$  return for the S&P/TSX Completion Index and  $-33.00\%$  return for the S&P/TSX Composite Index (Total Return). In contrast to the indices, the fund's return is after the deduction of expenses paid by the fund.

This year was characterized by slowing global growth and the worst financial crisis in history. While the crisis has been in place for over a year, the situation changed drastically in the third quarter as the U.S. financial system nearly stalled with the bankruptcy of Lehman Brothers, a U.S. investment bank.

Recent data suggests that the current U.S. recession could be the worst since WWII. In Canada, there are many signs of slowing but the magnitude seems less severe than south of the border. Although Canada generally tends to lag behind the U.S., the Canadian economy started with a much stronger base and significantly less banking problems.

With the economic and credit woes deepening, the Canadian stock market corrected sharply in the second half of the year amid all the uncertainty. As global growth weakened, oil and commodity prices tumbled exerting additional downward pressure on the resources loaded, Canadian market.

Unlike the market decline at the beginning of the decade, which mainly impacted the Technology sector, in the current environment there was simply no place to hide. All of the index's ten economic sectors reported negative returns for the year.

Specific holdings that contributed to the fund's relative under-performance include Major Drilling and Allen-Vanguard. Major Drilling provides drilling support for oil, gas, and base metal exploration companies and has been hurt by declining commodity prices. Allen-Vanguard had disappointing financial results due to operational challenges and as a result, has been eliminated from the portfolio.

On the positive side, Metro Inc., a food distributor and retailer, was the top contributor appreciating over 50% during the year. Metro, one of our more defensive consumer names, benefited from strong earnings growth after a period of intense competition in the Ontario marketplace.

Another significant contributor was SXC Health Solutions, which provides the software interface between pharmacies and health insurance companies. Higher transaction volumes and strong financial performance were behind the company's success.

Performance was also negatively impacted by the fund's exposure to smaller capitalized companies. Smaller companies continued to bear the brunt of the liquidity crisis and dramatically underperformed larger capitalized companies this year.

During the period, the fund experienced net sales of \$6,401,112. The fund's year over year dividend income decreased 54% due to Income Trust distribution reclassification, subsequently, interest income increased 344% over the same period.

### Recent Developments

On January 2, 2008, Monrusco Bolton Investments Inc. was appointed portfolio advisor to the fund. Please see Past Performance for more details. As a result, the portfolio advisor sold most of the holdings in the fund and purchased new securities, consistent with their investment philosophy. The fund continues to be invested in Canadian equities.

The portfolio advisor believes the near term economic outlook is very bleak and likely to remain this way for some time to come. However, despite the gloom, there is some cause for optimism as central banks around the world aggressively lower interest rates and governments offer up fiscal stimulus and corporate bailout packages.

The portfolio advisor feels that while there is certainly more bad news to come, the current crisis will eventually work its way through the system. This time next year, the portfolio advisor expects to see significant improvement in the economic outlook. More importantly, markets are forward looking and will start to trend higher long before the economic news turns positive.

With single digit earnings multiples, equity valuations are relatively attractive while the market capitalization of many companies is below liquidation value. Given the current valuation levels and the market uncertainty, the portfolio advisor is maintaining a slow and steady approach with no significant changes to portfolio construction anticipated. Proceeds from recent dispositions will be invested in holdings that the portfolio advisor believes are the most mispriced which could provide significant upside.

Looking ahead, the portfolio advisor will continue to emphasize quality companies which have better growth prospects, higher profit margins, and stronger balance sheets. The portfolio advisor believes this will ensure that the fund is well positioned to weather this uncertain period and benefit when markets ultimately rebound.

Additionally, smaller capitalized stocks have begun to show some signs of life recently and the portfolio advisor believes that significant bad news has already been priced into these

stocks. A reduction of credit spreads is a positive catalyst and while it is difficult to catch market bottoms, the portfolio advisor feels the upside over the next 12-18 months looks appealing.

### Future Accounting Changes

The Canadian Accounting Standards Board confirmed that effective January 1, 2011, International Financial Reporting Standards ("IFRS") will replace current Canadian standards and interpretations as Canadian generally accepted accounting principles for publicly accountable enterprises, which includes investment funds. We have commenced development of a changeover plan to meet the implementation date. The key elements of the plan will include identifying differences between the fund's current accounting policies and those it expects to apply under IFRS, as well as any accounting policy and implementation decisions and their resulting impact, if any, on the net assets or net asset value of the fund.

### Related Party Transactions

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

In 2008, the fund paid brokerage fees to Scotia Capital Inc. in the amount of \$25,979.35. The fund has standing instructions from its Independent Review Committee for the payment of the brokerage fees to Scotia Capital Inc. as set out in the Outsourcing to Related Parties Policy.

### 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.

#### The Fund's Net Assets per Unit<sup>(1)</sup>

	2008	2007	2006	2005	2004
Net Assets, beginning of year	\$ 14.63	16.33	14.62	13.63	12.41
<b>Increase (decrease) from operations</b>					
Total revenue	\$ 0.24	0.42	0.31	0.34	0.24
Total expenses	\$ (0.05)	(0.07)	(0.06)	(0.07)	(0.07)
Realized gains (losses) for the period	\$ (0.45)	2.34	0.13	1.98	0.32
Unrealized gains (losses) for the period	\$ (5.66)	(1.95)	1.63	0.36	0.88
<b>Total increase (decrease) from operations<sup>(2)</sup></b>	\$ (5.92)	0.74	2.01	2.61	1.37
<b>Distributions</b>					
From income (excluding dividends)	\$ -	-	-	-	-
From dividends	\$ (0.18)	(0.30)	(0.22)	(0.24)	(0.13)
From capital gains	\$ -	(2.11)	-	(1.38)	-
Return of capital	\$ -	-	-	-	-
<b>Total Annual Distributions<sup>(3)</sup></b>	\$ (0.18)	(2.41)	(0.22)	(1.62)	(0.13)
<b>Net assets at December 31st of year shown</b>	\$ 8.59	14.63	16.37	14.62	13.63

<sup>(1)</sup> This information is derived from the fund's audited financial statements. The net assets per security presented in the financial statements differs from the net asset value calculated for fund pricing purposes. This difference is due to the

requirements of generally accepted accounting principles ("GAAP"), including CICA Handbook Section 3855, and may result in a different valuation of securities held by the fund in accordance with GAAP than the market value used to determine net asset value of the fund for the purchase, switch and redemption of the fund's units ("Pricing NAV"). The pricing NAV per unit at the end of the period is disclosed in Ratios and Supplemental Data.

- (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.

**Ratios and Supplemental Data**

	2008	2007	2006	2005	2004
Total net asset value (000's) <sup>(1)</sup>	\$ 36,527	52,110	47,567	40,849	31,366
Number of units outstanding (000's) <sup>(1)</sup>	4,223	3,553	2,905	2,794	2,301
Management expense ratio <sup>(2)</sup>	% 0.41	0.38	0.38	0.50	0.54
Management expense ratio before waivers or absorptions <sup>(2)</sup>	% 0.41	0.38	0.38	0.50	0.61
Trading expense ratio <sup>(3)</sup>	% 0.49	0.14	0.11	0.20	-
Portfolio turnover rate <sup>(4)</sup>	% 161.00	52.80	37.74	59.79	30.50
Net asset value per unit	\$ 8.65	14.66	16.37	14.62	13.63

- (1) This information is provided December 31st 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 portfolio transaction costs expressed as an annualized percentage of the daily 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, or performance.

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.

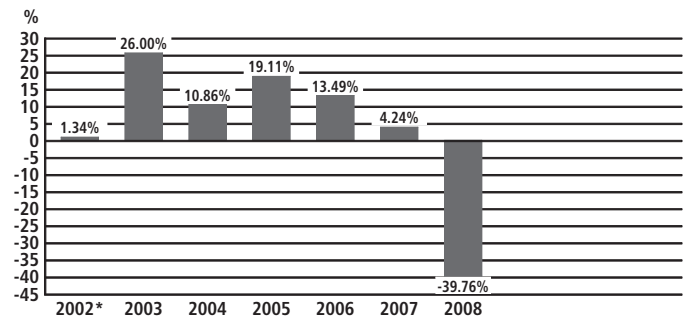
On January 2, 2008, the portfolio advisor to the fund changed from Foyston, Gordon and Payne Inc. to Montrusco Bolton

Investments Inc. This change in portfolio advisor may have materially affected the performance of the fund during the performance measurement period.

All rates of return are calculated based on Pricing NAV and are in Canadian dollars unless stated otherwise.

**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.



\* Feb. 14 – Dec. 31

**Annual Compound Returns**

This table shows the fund's annual compound returns compared to the S&P/TSX Completion Index and the S&P/TSX Composite Index (Total Return) for the periods shown ending December 31, 2008.

	1 Year	3 Years	5 Years	Since Inception <sup>(1)</sup>
Pinnacle Canadian Mid Cap Value Equity Fund	% -39.76	-10.68	-1.21	2.72
S&P/TSX Completion Index	% -38.77	-9.69	1.72	4.22
S&P/TSX Composite Index (Total Return)	% -33.00	-4.80	4.16	9.27

(1) Feb. 14, 2002

The S&P/TSX Completion Index is a market capitalization weighted, total return index comprising all stocks within the S&P/TSX Composite Index, excluding the members of the S&P/TSX 60 Index.

The S&P/TSX Composite Index (Total Return) tracks the performance of some of the largest and most widely held stocks listed on the Toronto Stock Exchange. Prior to May 1, 2002, this index was called the TSE 300 Composite Index and it tracked the 300 largest companies listed on the Toronto Stock Exchange.

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, 2008)

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.

### Sector Mix<sup>(1)</sup>

	% of net asset value <sup>(2)</sup>
Energy	24.6
Financials	19.0
Industrials	13.9
Materials	12.1
Information Technology	11.3
Consumer Discretionary	8.2
Consumer Staples	5.2
Health Care	3.2

<sup>(1)</sup> 2.5% of the fund's assets are held in cash, other assets and liabilities.

<sup>(2)</sup> Based on Pricing NAV.

### Top Holdings

Issuer	% of net asset value <sup>(1)</sup>
CGI Group Inc. Sub. Voting	6.7
Tristar Oil & Gas Ltd.	5.9
Metro Inc. Sub-Voting	5.2
Talisman Energy Inc.	4.6
SXC Health Solutions Corporation	4.6
TMX Group Inc.	4.4
Canadian Western Bank	4.3
Agnico-Eagle Mines Limited	4.0
Home Capital Group Inc. Class B Sub. Voting	4.0
Highpine Oil & Gas Ltd.	4.0
Yamana Gold Inc.	3.6
CML Healthcare Income Fund	3.2
North West Company Fund Trust	2.8
Cash and Cash Equivalents	2.6
Stantec Inc.	2.6
Vermilion Energy Trust	2.5
Addax Petroleum Corporation	2.5
Transat A.T. Inc. Class B	2.4
Petro-Canada	2.4
Power Corporation of Canada	2.3
Jaguar Mining Inc.	2.3
WestJet Airlines Ltd.	2.2
Major Drilling Group International Inc.	2.2
RONA Inc.	2.1
CAE Inc.	2.1
<b>Top holdings total</b>	<b>85.5</b>

<sup>(1)</sup> Based on Pricing NAV.



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