BAB Trust

Annual Report
September 30, 2012

Management Report of Fund Performance

This annual management report of fund performance for BAB Trust (the "Fund") contains financial highlights but does not contain the complete annual financial statements of the Fund. **The annual financial statements and accompanying notes are attached to this report.**

You can obtain a copy of the annual financial statements at no cost by writing to the Manager to the following address: Connor, Clark & Lunn Capital Markets Inc., Suite 300, 181 University Avenue, Toronto, Ontario M5H 3M7, or calling (416) 862-2020 or visiting the Manager's website at www.cclcapitalmarkets.com or by visiting www.sedar.com.

Securityholders 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.

Note that any reference to "Net Assets" or "Net Assets per Unit" or "GAAP Net Assets" means that the value was determined in accordance with the Canadian Generally Accounting Principles "GAAP" for financial statements purposes. Also any reference to "Net Asset Value" or "Net Asset Value per Unit" or "Transactional NAV" means that the value was determined for valuation and transactional purposes. An explanation of the difference between both values can be found in note 3 to the financial statements.

Investment Objectives and Strategy

The Fund is an investment fund established under the laws of the Province of Ontario and governed by the Trust Agreement between Connor, Clark & Lunn Capital Markets Inc. (the "Manager") the manager of the Fund and RBC Dexia Investor Services Trust (the "Trustee") dated January 28, 2010. The Fund's principal office is at 181 University Avenue, Suite 300, Toronto, Ontario M5H 3M7. The fiscal year-end of the Fund is September 30. The Fund has one class of Units.

The Fund's investment objectives are to:

(i) provide the Unitholder with distributions; and

(ii) maximize total return for the Unitholder, while seeking to reduce risk.

In order to achieve the Fund's investment objectives, Nuveen Asset Management (the "Sub-Advisor"), the Fund's Sub-Advisor, actively manages its Portfolio. The Portfolio includes a minimum of 80% Build America Bonds (measured at the time of purchase), with the remainder of the Portfolio, if any, to be comprised of other Permissible Securities ("Permissible Securities" means U.S. Treasury Securities, U.S. Government Agency Securities, other Investment Grade (measured at time of purchase) municipal obligations and cash and cash equivalents). The Fund may also use derivatives for hedging purposes only.

Build America Bonds are bonds issued by U.S. state and local governments to finance capital projects that meet essential needs such as public schools, roads, water and transportation infrastructure, bridges, ports and public buildings, among others, pursuant to the American Recovery and Reinvestment Act of 2009 or other related, similar or successor legislation. Many Build America Bonds are general obligation bonds, which are backed by the full faith and taxing power of the governments issuing them. Most issuers of Build America Bonds receive a subsidy from the U.S. federal government equal to 35% of the interest paid to investors, which allows such issuers to issue bonds that pay interest rates that are competitive with the rates typically paid by private bond issuers. This form of government bond, with the credit going to the issuer, makes the bonds attractive to entities that pay no U.S. income tax, such as pension plans and non-U.S. investors, as well as to investors seeking potential high rates of interest income.

Risk

There were no changes in risk exposure of the Fund for the year ended September 30, 2012.

Recent Developments

Future accounting changes

On October 31, 2012, the IASB issued an amendment to IFRS 10 exempting investment entities from consolidating their controlled investments. The Fund qualifies as investment entity and measures all controlled investments at fair value with changes in fair value recognized through profit or loss.

On December 12, 2011, the Canadian Accounting Standards Board ("AcSB") extended the deferral of the mandatory International Financial Reporting Standards ("IFRS") changeover date for investment companies to fiscal year beginning on or after January 1, 2014.

On May 12, 2011, the International Accounting Standards Board issued IFRS 13 Fair Value Measurement, which defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosure about fair value measurements. It only applies when other IFRSs require or permit fair value measurement. If an asset or a liability measured at fair value has a bid price and an ask price, it requires valuation to be based on a price within the bid-ask spread that is most representative of fair value. It allows the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. This may result in eliminating the difference between the net asset value per unit and net assets per unit under the current Canadian GAAP. The Manager is currently assessing the Fund's Unitholder structure and investments to determine the impact of these standards. The Manager has determined that there will likely be no material impact to the net asset value per unit from the changeover to IFRS.

Results of Operations

The Sub-Advisor's Commentary (November 2012)

Portfolio Strategy and Performance

After sustaining the economy through its faltering recovery over the last few years, the manufacturing sector showed signs of wavering toward the end of the reporting period, even as the housing sector is starting to reawaken after five years of slumber. The latest sign of trouble for manufacturing was the stunning -13.2% drop in durable goods order in August, the most significant drop over the past several months and a sharp reversal from the increases we witnessed earlier in the year. While most of the decline was attributed to a collapse in the notoriously volatile aircraft orders, the modest 1.1% gain in non-defense capital goods orders (excluding aircraft) was not enough to offset the downwardly revised -5.2% drop in July. Negative trends also emerged in other areas, as industrial production fell by -1.2% in August and manufacturing production off by -0.7%, figures which both been positive earlier in the year. Manufacturers eliminated -16,000 jobs in September after cutting -22,000 positions in August. This is a sharp shift from earlier in the year when manufacturing was perceived to be a potential bright spot in the economy. The manufacturing index of the Institute for Supply Management (ISM) also ended the period lower than where it begin: after some volatility and even a contraction below 50, it ended the reporting period at just 51.5.

On the positive side, it was also encouraging to hear that light vehicle sales began to rise in September to an annualized rate of 14.94 million units, the highest since March 2008. More generally, the increase of 114,000 in the number of nonfarm payroll jobs in September – from earlier May lows of 69,000 – makes the risk of recession seem a bit less likely. Still, signs of slowing in manufacturing are especially worrisome since gross domestic product grew by just 1.3% in the second quarter, and exports are under pressure due to weak economic conditions in Europe.

Meanwhile, signs of recovery in the housing market include the fact that building permits increased from an annual rate of 536,000 in February 2011 to 801,000 in August, and the Standard & Poor's Case-Shiller index of housing prices rose by 4.0% from January to July 2012 (for 20 cities, seasonally-adjusted). Improvement in the housing sector could help the economy in at least two ways: by providing more construction jobs and by easing the credit pressure on banks from nonperforming mortgage loans (which have fallen from 5.67% of bank assets in 2010Q1 to 4.00% in 2012Q2). Stronger bank balance sheets and stable or improving home prices should encourage more mortgage lending.

While the year over year change in the consumer price index was a modest 1.7% in August, a sharp increase in gasoline prices helped boost prices in August by 0.6%. Excluding food and energy, prices rose by 0.1% in August and by 1.9% over the last year, a trend that has eased somewhat over the past six months. In September average hourly earnings were 1.8%

higher than they were a year ago. The ISM's prices paid index for manufacturers dipped in June below 50%, but otherwise remained above the crucial 50% mark, and rose to 58.1% in September. The Federal Reserve's accommodative monetary policy and the recent upturn in energy costs have temporarily pushed expectations for inflation higher as the spread between 10-year Treasury yields and 10-year inflation-protection securities fluctuated over the past six months, but ended up at about 2.4%.

Portfolio Strategy and Performance

For the past year, portfolio activity was relatively muted. The Fund primarily pursued a strategy of shifting the portfolio from non-index eligible holdings – holdings which are less liquid in nature and holdings that management believes will underperform on a going forward basis – to only index-eligible holdings. By the end of the reporting period, the Fund had successfully pared non-index holdings to effectively zero. Over the past year, the Fund primarily sold bonds to fund the annual tender, or to raise cash to meet collateral calls when US Treasuries rose in value. When that collateral was released, however, the Fund was active as a buyer of bonds and established new positions and add odd-lot positions to existing holdings in names such as AA rated Indianapolis, AA rated Indiana general obligation bonds, AA rated North Carolina Turnpikes, and A rated State of Illinois.

Given the relatively limited amount of Fund activity over the past several quarters, the overall structure of the Fund was little changed. As of September 30, the Fund's allocation to general obligation / appropriation debt was 35% of assets; toll roads: 19%; water/sewer 16%; public power: 13%; with airport, dedicated tax and transportation each under 5%. The Fund marginally increased its exposure to general obligation bonds (with purchase of Indianapolis GO) while decreasing exposure to public power. The Fund's average credit rating ended at AA-, using the highest of Moody's, S&P and Fitch.

The Fund posted a positive return of 11.39% for the year. The Barclays Build America Bond Index slighted outperformed most other long dated broad fixed income indices, returning 11.91% for year, with only Long Corporates generating a higher return:

- Barclays Build America Bond Index: 11.91%
- Barclays U.S. Aggregate: 5.16%
- Barclays U.S. Long Corporates: 15.01%
- Barclays U.S. Gov't Long: 6.41%

The interest rate hedge and foreign currency both marginally hurt performance, and the underlying municipal bond portfolio also underperformed for the period. The Barclays BAB Index has an approximate 15% weighting to State of California general obligation bonds. During the last several months of the year in particular, the credit spread of California GOs compressed significantly more than other index bonds, leading to meaningful outperformance for the name. In order to remain diversified, the Fund's exposure to California GOs is significantly less than the Index's weight; as a result, however, the Fund has sought to make up performance in other names in the portfolio.

Credit Conditions

While many individual states, municipalities and school districts continue to deal with daunting fiscal challenges, the aggregate figures for state and local governments throughout the United States are not as dismal as the newspaper headlines might suggest. The following table summarizes data compiled by the U.S. Census Bureau regarding tax revenues of state and local governments. For the four quarters through June 2012, total state revenues were 3.5% higher than in the year earlier period, and local revenues were up 3.1% from a year ago. Compared to the revenues collected at the depths of the recession, during the year ended June 30, 2008, total state tax revenues have increased 1.2%, while local tax revenues were up by 17.1%.

Tax Revenue, 4 Qtrs through 6/30/12				
	Change from 4 Qtrs through 6/30/11			
	Total	Personal Income	Sales	Property
State	3.5%	4.5%	2.4%	
Local	3.1%			1.4%
	Change from 4 Qtrs through 6/30/08			
	Total	Personal Income	Sales	Property
State	1.2%	-3.1%	0.1%	
Local	17.1%			18.2%

A report from the U.S. Census Bureau on state-administered pension plans for the fiscal year ended 6/30/2011 revealed that contributions to the retirement plans increased by 8.1% from fiscal 2010, with government contributions rising by 10.7% and employee contributions increasing by 3.0%. Government contributions totaled $72 billion, while employees contributed $34 billion. The growth in contributions closely matched the 8.2% increase in benefit payments.

The Census Bureau's report also illustrated the demographic challenge facing pension plans. In 1991 the ratio of active employees to beneficiaries was 3.0 to 1. By 2001, the ratio had fallen to 2.5 to 1, and by 2011 it was down to 1.8 to 1. In some states the problem is more severe; in Michigan the ratio is 1.1 to 1.

In September the California legislature approved changes to the state's pension plans for new employees. The maximum salary on which pensions will be based will be limited to $110,000 for those who also qualify for Social Security and $130,000 for those who do not qualify. The retirement age for full benefits will rise from 50 to 57 for public safety employees and from 55 to 67 for other employees.

In 2010 the Center for Retirement Research at Boston College published a study of the performance of pension obligation bonds (POBs), which demonstrated the risks associated with issuing such bonds after a period of strong performance by the stock market. From the date of issuance until the stock market peaked in 2007, the cumulative returns on pension assets were less than the interest costs of POBs issued between 1997 and 2001. Through mid-2009, when the stock market was beginning its recovery, returns were less than costs for bonds issued between 1997 and 2008. These findings do not bode well for the City of Fort Lauderdale, Florida, which, in the same week when the Dow Jones Industrial average reached the highest it has been since December 2007, approved plans to sell $340 million taxable pension obligation bonds.

According to another report from the Center for Retirement Research, the ratio of pension assets to liabilities for 126 public pension plans fell to 75% in 2011 from 76% in 2010, 87% in 2007 and 103% in 2001, based on the rates of return assumed by the plan sponsors. If liabilities are discounted at a 5% rate, the ratio of assets to liabilities is estimated to drop to 50%. The annual required contribution to pension plans rose to 15.7% of payroll costs in 2011 versus 13.6% in 2010 and 6.1% in 2002. Actual contributions were only 79% of the required amounts, whereas they had equaled 86% in 2006 and 100% in 2001.

While people sometimes use the term "general obligation" to refer to various forms of tax-supported debt, the importance of finer distinctions has become clearer in the last few years. The strongest commitments have a pledge of full faith and taxing power without limitation as to rate or amount together with a statutory lien on tax revenues. Other bonds may have a full faith and credit pledge, but not a lien on tax revenues. Still other bonds may be obligations payable from the general fund but without a pledge to raise taxes if necessary. Then there are the bonds, or certificates of participation, which are backed by a municipality's promise to make rental payments under a lease. In these situations, it is important to evaluate how essential the facilities are to the operations of the government.

These distinctions have proven important in the case of Vallejo, California and its plan of reorganization. While the City had no general obligation bonds outstanding, holders of bonds backed by special revenues from incremental taxes and the water system are being paid in full; holders of certificates of participation for essential facilities agreed to restructure the debt, but they will recover all their principal; however, holders of leases on nonessential property, which in one case consisted of undeveloped land, restructured the debt at a significant loss. Likewise, the lack of essentiality was a key consideration in the decision of the Vadnais, Minnesota, in September to stop making lease payments on a sports facility.

Policies at the state level can also have a great impact on the creditworthiness of local governments. On one hand, Rhode Island in July 2011 passed legislation which grants to all general obligation debt a statutory first lien on tax revenue and state aid. This provision gave the City of Central Falls considerable leverage in its negotiations with public employee unions, retirees and other creditors. On the other hand, the State of California has transferred responsibilities to the counties, diverted revenues from redevelopment agencies to schools to reduce its obligation to fund education, and has stood by this summer while Stockton, San Bernardino and Mammoth Lakes filed for bankruptcy in rapid succession.

The Stockton bankruptcy may bring some clarity to the question of the relative priority of pension obligations and obligations to bondholders. When denying a request to prevent the City from suspending health care payments for retirees, the judge noted that the U.S. Constitution forbids states from impairing contracts, whereas the U.S. Congress is not prevented from altering contracts, which is what the federal bankruptcy law is designed to do.

Capital transactions

The Fund is authorized to issue an unlimited number of redeemable, transferable one class of units (the "Units"), each of which represents an equal, undivided interest in the net assets of the Fund, subject to the terms and conditions of the Trust Agreement.

On February 18, 2010, the Fund completed an initial public offering pursuant to the prospectus dated January 28, 2010. $29,666,219 was raised through the issue of 1,270,700 Units. The Units were issued at $23.35 per unit.

During the year ended September 30, 2012, $2,598,177 was paid to redeem 107,083 Units (during the year ended September 30, 2011, $4,031,456 was paid to redeem 169,297 Units).

Distributions

The Fund pays distributions if, as and when declared by the Fund from time to time. The Fund declared $2,361,000 distributions during the year ended September 30, 2012 ($2,581,000 during the year ended September 30, 2011).

Recommendations or Reports by the Independent Review Committee

The Independent Review Committee of the Fund tabled no special reports and made no extraordinary material recommendations to management of the Fund during the year ended September 30, 2012.

Related Party Transactions

Management Fees

In consideration for management services and investment advice, the Manager receives a Management Fee from the Fund equal in the aggregate to 0.50% per annum of the applicable Net Asset Value, calculated and payable monthly in arrears, plus applicable taxes.

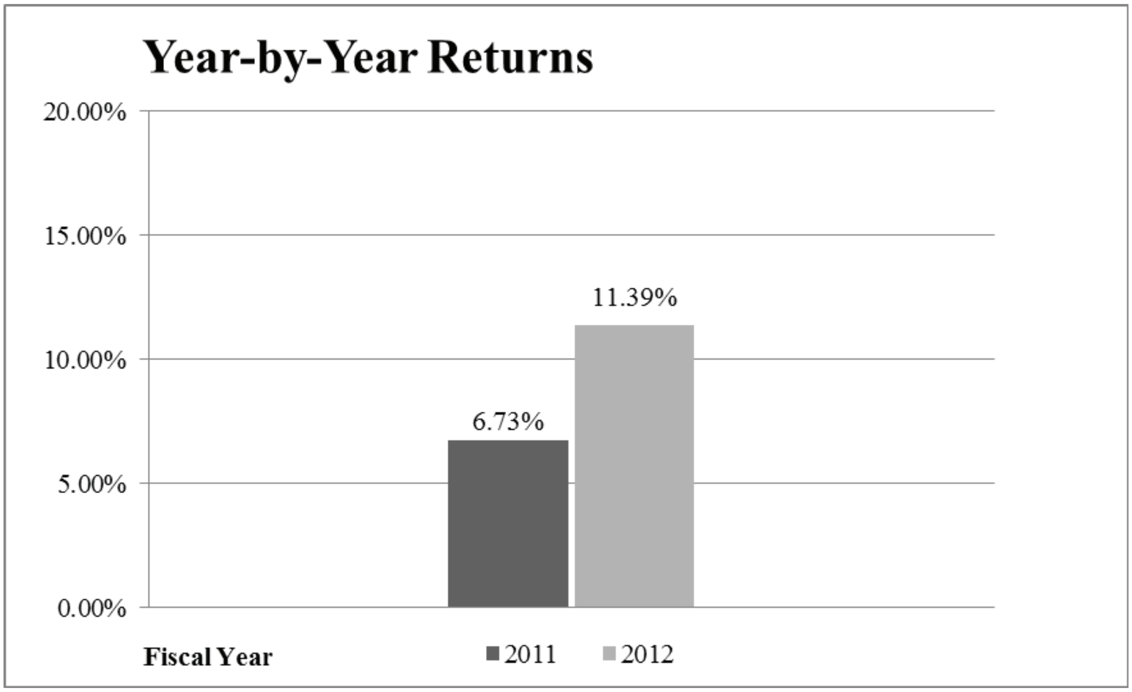
The management fees charged to the Fund during the year ended September 30, 2012 were $138,937 ($157,062 during the year ended September 30, 2011). The Manager is responsible for payment of the investment management fees out of these management fees.

Past Performance

The following bar chart and table show the Fund's annual performance by showing both annual returns by fiscal year and annualized compound returns from inception assuming all the distributions made by the Fund during the periods shown were reinvested. Past performance is not necessarily indicative of future performance.

Year-by-Year Returns

The following bar chart and table show the Fund's annual performance for the years shown. This bar chart shows, in percentage terms, how much an investment made on the first day of the period would have grown or decreased by the last day of the period.



(*) No return is available for September 30, 2010 due to the Fund commencing operations on February 18, 2010 and not existing for 12 consecutive months prior to September 30, 2010 year end.

Annual Compound Returns

	Past Year	Since Inception (1)
Based on NAV	11.39%	7.68%
Barclays Build America Bond Index	11.91%	17.37%

(1) Annualized for the period from February 18, 2010 (commencement of operations) to September 30, 2012.

The sub-advisor considers Barclays Build America Bond Index to be the most reliable/representative index for long investors in the Build America Bonds' sector. Barclays Build America Bond Index is the subset of the Barclays Capital Taxable Municipal Bond Index. The Index consists of all direct pay Build America Bonds that satisfy the rules of the Barclays Capital Taxable Municipal Index.

Financial Highlights

The following tables show selected key financial information about the Fund and are intended to aid in understanding the Fund's financial performance since inception. This information is derived from the Fund's annual financial statements:

The Fund's Net Assets per Unit:

	September 30, 2012	September 30, 2011	September 30, 2010 (1)
Net Assets, beginning of period	23.08	23.04	23.35
Increase (decrease) from operations:			
Total revenues	1.15	1.27	0.82
Total expenses	(0.10)	(0.10)	(0.07)
Realized gains (losses) for the period	2.43	0.65	0.44
Unrealized gains (losses) for the period	3.96	(0.22)	(0.85)
Total increase (decrease) from operations (2)	**2.58**	**1.60**	**0.34**
Distributions:			
From income (excluding dividends)	(1.51)	(0.47)	(0.75)
From dividends	–	–	–
From capital gains	–	–	(0.06)
Return of capital	–	(1.02)	–
Total Distributions	**(1.51)**	**(1.49)**	**(0.81)**
Net Assets, end of period (3)	**24.12**	**23.08**	**23.04**

(1) Results for the period from February 18, 2010 (commencement of operations) to September 30, 2010.

(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 of 1,561,136 over the financial period (2011 – 1,730,196).

(3) This is not reconciliation between the opening and the closing net assets per unit.

Ratios and Supplemental Data:

	September 30, 2012	September 30, 2011	September 30, 2010 (1)
Net asset value (000's)	35,655	36,587	40,423
Number of units outstanding	1,478,263	1,585,346	1,754,643
Management expense ratio (annualized) (2)	0.44%	0.43%	0.46%
Management expense ratio before waivers or absorptions (annualized) (2)	0.44%	0.43%	0.46%
Portfolio turnover rate (3)	41.24%	47.81%	68.37%
Trading expense ratio (4)	0.00%	0.00%	0.00%
Net asset value per unit	24.12	23.08	23.04

(1) Results for the period from February 18, 2010 (commencement of operations) to September 30, 2010.

(2) Management expense ratio is based on total expenses for the stated period and is expressed as an annualized percentage of daily average net asset value during the period.

(3) The Fund's turnover rate indicates how actively the Fund's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund's buying and selling all of the securities (including fixed income) in its portfolio once in the course of the year. There is not necessarily a relationship between turnover rate and the performance of the Fund.

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

Summary of Investment Portfolio as of September 30, 2012

The summary of investment portfolio may change due to ongoing portfolio transactions of the Fund. A quarterly update is available at www.cclcapitalmarkets.com and at www.sedar.com.

	Coupon Rate %	Maturity date	Fair value $	% of NAV
Portfolio by Category				
United States of America State and Municipal Bonds			33,594,300	94.0 %
Short-term notes			1,789,915	5.0 %
Other assets net of other liabilities			524,276	1.6 %
Foreign currency forward contracts			359,740	1.1 %
Cash			71,717	0.2 %
Interest rate swap			(684,766)	(1.9%)
Top 25 Holdings				
Los Angeles County California Public Works Financing	7.62%	08/01/2040	1,977,979	5.5 %
US Treasury Bills	0.57%	11/01/2012	1,789,915	5.0 %
New Jersey State Turnpike Authority	7.41%	01/01/2040	1,742,338	4.9 %
City of Chicago IL	6.74%	11/01/2040	1,468,615	4.1 %
County of Clark NV	6.82%	07/01/2045	1,408,677	4.0 %
Bay Area Toll Authority	6.79%	04/01/2030	1,404,047	3.9 %
South Carolina State Public Service Authority	6.45%	01/01/2050	1,336,482	3.7 %
Metropolitan Transportation Authority	6.65%	11/15/2039	1,336,353	3.7 %
Indianapolis Local Public Improvement Bond Bank	6.12%	01/15/2040	1,285,749	3.6 %
Chicago Illinois Wastewater Transmission	6.90%	01/01/2040	1,259,153	3.5 %
California State Public Works Board	8.36%	10/01/2034	1,250,386	3.5 %
Denver City & County School District No 1	5.66%	12/01/2033	1,238,244	3.5 %
Metropolitan Washington Airports Authority	8.00%	10/01/2047	1,219,175	3.4 %
Commonwealth Financing Authority	6.22%	06/01/2039	1,214,570	3.4 %
American Municipal Power - Ohio Inc.	6.05%	02/15/2043	1,203,985	3.4 %
City of New York	6.65%	12/01/2031	1,192,579	3.3 %
Municipal Electric Authority of Georgia	6.66%	04/01/2057	1,179,679	3.3 %
New York City Municipal Water Finance Authority	6.45%	06/15/2041	1,168,013	3.3 %
New Jersey Transportation Trust Fund Authority	6.10%	12/15/2028	1,133,237	3.2 %
North Texas Tollway Authority	6.72%	01/01/2049	974,396	2.7 %
Los Angeles California Department of Water & Power	5.72%	07/01/2039	924,765	2.6 %
Colorado Bridge Enterprise	6.08%	12/01/2040	829,143	2.3 %
Los Angeles California Department of Water & Power	6.60%	07/01/2050	719,131	2.0 %
Louisville & Jefferson County Metropolitan Sewer District	6.25%	05/15/2043	656,788	1.8 %
New York City Transitional Finance Authority	6.83%	07/15/2040	635,147	1.8 %
Net asset value			**35,655,182**	

Management's Responsibility for Financial Reporting

The accompanying financial statements of **BAB Trust (the "Fund")** and all the information have been prepared by Connor, Clark & Lunn Capital Markets Inc. in its capacity as Manager of the Fund and have been approved by the Board of Directors of the Manager. The Fund's Manager is responsible for all the information and representations contained in these financial statements and other sections of the Annual Report.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based on estimates and judgements. The Manager has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has ensured that the other financial information presented in this annual report is consistent with the financial statements.

The financial statements have been audited by PricewaterhouseCoopers LLP on behalf of the unitholder. They have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholder their opinion on the financial statements.

W. Neil Murdoch
President and Chief Executive Officer
Connor, Clark & Lunn Capital Markets Inc.

Darren Cabral
Vice President and Chief Financial Officer
Connor, Clark & Lunn Capital Markets Inc.

Toronto, Canada
December 19, 2012

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December 19, 2012

Independent Auditor's Report

To the Unitholder of
BAB Trust (the "Fund")

We have audited the accompanying financial statements of the Fund, which comprise the statement of investment portfolio as at September 30, 2012, the statements of net assets as at September 30, 2012 and 2011, and the statements of operations, changes in net assets and surplus and cash flow for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

PricewaterhouseCoopers LLP
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Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as at September 30, 2012 and 2011 and the results of its operations, the changes in its net assets and cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

BAB Trust

Statements of Net Assets

As at September 30, 2012 and 2011

	2012	2011
Assets	$	$
Cash	71,717	624,938
Short-term notes (cost - $1,852,997; 2011 - $7,678,165)	1,789,915	7,982,224
Investments at fair value (cost - $28,842,675; 2011 - $30,088,975)	33,594,300	35,475,200
Interest receivable	553,039	654,896
Unrealized gain on foreign currency forward contracts	359,740	-
	36,368,711	44,737,258
Liabilities		
Unrealized loss on interest rate swap contracts	684,766	5,348,387
Unrealized loss on foreign currency forward contracts	-	2,178,988
Payable on securities purchased	-	592,394
Accounts payable and accrued liabilities	14,950	14,899
Management fees payable	13,813	15,340
	713,529	8,150,008
Net assets and unitholder's equity	35,655,182	36,587,250
Units outstanding (note 5)	1,478,263	1,585,346
Net asset value per unit	24.12	23.08
Unitholder's equity		
Unit Capital (note 5)	33,085,971	35,482,666
Surplus	2,569,211	1,104,584
Total Unitholder's equity	35,655,182	36,587,250

Approved on behalf of the Manager,
Connor, Clark & Lunn Capital Markets Inc.

Director **Director**

(See accompanying notes to financial statements)

BAB Trust

Statements of Operations

For the years ended September 30, 2012 and 2011

	2012	2011
	$	$
Income		
Interest income	1,787,902	2,201,071
Expenses		
Management fees (note 7)	138,937	157,062
Audit fees	11,948	7,438
Custodial and other unitholder fees	7,143	5,090
Interest	2,256	589
Other fees	1,478	2,904
	161,762	173,083
Investment income	1,626,140	2,027,988
Unrealized gain (loss)		
Change in unrealized gain (loss) on investments	(634,600)	3,120,773
Change in unrealized gain (loss) on foreign exchange	(371,404)	401,673
Change in unrealized gain (loss) on foreign currency forward contracts	2,538,728	(2,672,149)
Change in unrealized gain (loss) on interest rate swap contracts	4,663,621	(1,220,806)
	6,196,345	(370,509)
Realized gain (loss)		
Net realized gain (loss) on investments	1,481,484	518,742
Net realized gain (loss) on foreign exchange	(39,581)	25,048
Net realized gain (loss) on foreign currency forward contracts	-	2,470,502
Net realized gain (loss) on interest rate swap contracts	(5,237,279)	(1,895,452)
	(3,795,376)	1,118,840
Net gain on investments	2,400,969	748,331
Increase in net assets from operations	4,027,109	2,776,319
Increase in net assets from operations per unit *	2.58	1.60

* (based on average number of 1,561,136 (2011 - 1,730,196) units outstanding during the period)

(See accompanying notes to financial statements)

BAB Trust

Statements of Changes in Net Assets and Surplus

For the years ended September 30, 2012 and 2011

	2012	2011
	$	$
Increase in net assets from operations	4,027,109	2,776,319
Distributions to unitholder from: (note 6)		
Net investment income	(2,361,000)	(819,641)
Return on capital	-	(1,761,359)
	(2,361,000)	(2,581,000)
Unitholder's transactions (note 5)		
Payments on redemption of units	(2,598,177)	(4,031,456)
Change in net assets during the year	(932,068)	(3,836,137)
Net assets - Beginning of year	36,587,250	40,423,387
Net assets - End of year	35,655,182	36,587,250
Surplus, beginning of year	1,104,584	(811,443)
Increase in net assets from operations	4,027,109	2,776,319
Cost of shares redeemed in excess of original issue price (note 5)	(201,482)	(40,651)
Distributions to unitholder	(2,361,000)	(819,641)
Surplus, end of year	2,569,211	1,104,584
Contributed surplus, beginning of year	-	13,580
Cost of shares redeemed at less than (in excess of) the original issue price	-	(13,580)
Contributed surplus, end of year	-	-

(See accompanying notes to financial statements)

BAB Trust

Statements of Cash Flow

For the years ended September 30, 2012 and 2011

	2012	2011
	$	$
Operating Activities		
Increase (decrease) in net assets from operations	4,027,109	2,776,319
Items not affecting cash:		
Unrealized (gain) loss on investments	634,600	(3,120,773)
Unrealized (gain) loss on short-term notes foreign exchange	367,141	(387,999)
Unrealized (gain) loss on foreign currency forward contracts	(2,538,728)	2,672,149
Unrealized (gain) loss on interest rate swap contracts	(4,663,621)	1,220,806
Net realized (gain) loss on investments	(1,481,484)	(518,742)
Changes in non-cash working capital:		
(Increase) decrease in interest receivable	101,857	110,627
Increase (decrease) in accounts payable and accrued liabilities	51	2,240
Increase (decrease) in management fees payable	(1,527)	1,093
Purchase of investments	(15,011,615)	(29,209,827)
Proceeds on disposition of investments	22,972,173	33,536,524
Net cash flow provided by (used in) operating activities	4,405,956	7,082,417
Financing Activities		
Distributions to unitholder	(2,361,000)	(2,581,000)
Payments on redemption of units	(2,598,177)	(4,031,456)
Net cash flow provided by (used in) financing activities	(4,959,177)	(6,612,456)
Net increase (decrease) in cash	(553,221)	469,961
Cash - beginning of year	624,938	154,977
Cash - end of year	71,717	624,938

Supplementary Information

Interest paid	2,256	589

(See accompanying notes to financial statements)

BAB Trust

Statement of Investment Portfolio

As at September 30, 2012

Investments	Coupon Rate %	Maturity date	Number of shares / par value US $	Average cost $	Fair value $	% of Net Assets
Foreign short-term notes						
U.S. Treasury Bills*	0.57%	11/01/2012	1,820,000	1,852,997	1,789,915	5.0 %
				1,852,997	1,789,915	5.0 %
Fixed Income						
United States of America State and Municipal Bonds (USD)						
Denver City & County School District No 1	5.66%	12/01/2033	1,000,000	1,166,146	1,238,244	3.5 %
State of Illinois	7.35%	07/01/2035	180,000	208,152	208,660	0.6 %
County of Clark NV	6.88%	07/01/2042	200,000	192,729	225,293	0.6 %
County of Cook IL	6.23%	11/15/2034	500,000	524,024	552,627	1.5 %
State of Illinois	6.90%	03/01/2035	500,000	553,040	565,389	1.6 %
Metropolitan Washington Airports Authority	7.46%	10/01/2046	500,000	531,150	585,210	1.6 %
Dallas Texas Convention Center	7.09%	01/01/2042	500,000	582,546	597,367	1.7 %
Metropolitan Government of Nashville & Davidson County	7.43%	07/01/2043	500,000	498,773	614,586	1.7 %
Illinois State Toll Highway Authority	6.18%	01/01/2034	500,000	521,969	624,116	1.8 %
New York City Transitional Finance Authority	6.83%	07/15/2040	485,000	518,511	635,147	1.8 %
Los Angeles California Department of Water & Power	6.60%	07/01/2050	500,000	509,798	719,131	2.0 %
Colorado Bridge Enterprise	6.08%	12/01/2040	650,000	668,438	829,143	2.3 %
Los Angeles California Department of Water & Power	5.72%	07/01/2039	750,000	822,378	924,765	2.6 %
North Texas Tollway Authority	6.72%	01/01/2049	730,000	865,636	974,396	2.7 %
New Jersey Transportation Trust Fund Authority	6.10%	12/15/2028	1,000,000	1,032,412	1,133,237	3.2 %
New York City Municipal Water Finance Authority	6.45%	06/15/2041	1,010,000	1,046,773	1,168,013	3.3 %
Municipal Electric Authority of Georgia	6.66%	04/01/2057	1,030,000	1,070,274	1,179,679	3.3 %
City of New York	6.65%	12/01/2031	1,000,000	1,003,351	1,192,579	3.3 %
American Municipal Power - Ohio Inc.	6.05%	02/15/2043	1,040,000	1,021,706	1,203,985	3.4 %
Metropolitan Washington Airports Authority	8.00%	10/01/2047	1,000,000	1,031,151	1,219,175	3.4 %
California State Public Works Board	8.36%	10/01/2034	1,000,000	1,070,008	1,250,386	3.5 %
Chicago Illinois Wastewater Transmission	6.90%	01/01/2040	1,000,000	1,016,807	1,259,153	3.5 %
Indianapolis Local Public Improvement Bond Bank	6.12%	01/15/2040	1,000,000	1,314,017	1,285,749	3.6 %
Metropolitan Transportation Authority	6.65%	11/15/2039	1,085,000	1,111,557	1,336,353	3.7 %
South Carolina State Public Service Authority	6.45%	01/01/2050	1,000,000	1,012,438	1,336,482	3.7 %
County of Clark NV	6.82%	07/01/2045	1,005,000	1,041,495	1,408,677	4.0 %
City of Chicago IL	6.74%	11/01/2040	1,100,000	1,104,395	1,468,615	4.1 %
New Jersey State Turnpike Authority	7.41%	01/01/2040	1,200,000	1,410,516	1,742,338	4.9 %
Los Angeles County California Public Works Financing	7.62%	08/01/2040	1,500,000	1,507,280	1,977,979	5.5 %
East Baton Rouge	6.09%	02/01/2045	250,000	266,332	275,738	0.9 %
Metropolitan Government of Nashville & Davidson County	6.73%	07/01/2043	500,000	553,539	586,681	1.6 %
Louisville & Jefferson County Metropolitan Sewer District	6.25%	05/15/2043	500,000	657,109	656,788	1.8 %
Commonwealth Financing Authority	6.22%	06/01/2039	1,000,000	1,180,037	1,214,570	3.4 %
Bay Area Toll Authority	6.79%	04/01/2030	1,120,000	1,228,188	1,404,047	3.9 %
				28,842,675	33,594,300	94.0 %
Total investments				30,695,672	35,384,215	99.0 %

Foreign currency forward contracts	Number of contracts	Maturity date	Contract price / rate $	Unrealized gain (loss) $	% of Net Assets
Counterparty: Bank of Montreal (S&P credit rating: A+)					
Bought CAD 35,418,796 sold USD 35,600,000	1	11/23/2012	0.9949	359,740	1.1%
				359,740	1.1%

Interest rate swap Counterparty	Notional amount US $	Fund receives floating rate index	Fund pays Fixed rate (Annualized)	Termination Date	Unrealized gain (loss) $	% of Net Assets
Bank of Montreal (S&P credit rating: A+)	(14,500,000)	3-Month USD-LIBOR	3.025%	05/30/2041	(684,766)	(1.9%)
					(684,766)	(1.9%)

Other assets net of other liabilities	595,993	1.8 %
Net assets	35,655,182	100.0 %

(*) Includes $383,741 of pledged securities as collateral for foreign currency forward contracts.

1 Corporate activities

BAB Trust (the "Fund") is an investment fund established under the laws of the Province of Ontario and governed by the Trust Agreement between Connor, Clark & Lunn Capital Markets Inc. (the "Manager") the Manager of the Fund and RBC Investor Services Trust (formerly "RBC Dexia Investor Services Trust") (the "Trustee") dated January 28, 2010. The Fund's principal office is at 181 University Avenue, Suite 300, Toronto, Ontario M5H 3M7. The fiscal year-end of the Fund is September 30th. The Fund commenced operation on February 18, 2010. The Fund has one class of units.

2 Investment objectives

The Fund's investment objectives are to:

i. provide the Unitholder with distributions; and
ii. maximize total return for the Unitholder, while seeking to reduce risk.

In order to achieve the Fund's investment objectives, Nuveen Asset Management (the "Sub-Advisor"), the Fund's Sub-Advisor, actively manages its Portfolio. The Portfolio includes a minimum of 80% Build America Bonds (measured at the time of purchase), with the remainder of the Portfolio, if any, to be comprised of other Permissible Securities ("Permissible Securities" means U.S. Treasury Securities, U.S. Government Agency Securities, other Investment Grade (measured at time of purchase) municipal obligations and cash and cash equivalents). The Fund may also use derivatives for hedging purposes only.

Build America Bonds are bonds issued by U.S. state and local governments to finance capital projects that meet essential needs such as public schools, roads, water and transportation infrastructure, bridges, ports and public buildings, among others, pursuant to the American Recovery and Reinvestment Act of 2009 or other related, similar or successor legislation. Many Build America Bonds are general obligation bonds, which are backed by the full faith and taxing power of the governments issuing them. Most issuers of Build America Bonds receive a subsidy from the U.S. federal government equal to 35% of the interest paid to investors, which allows such issuers to issue bonds that pay interest rates that are competitive with the rates typically paid by private bond issuers. This form of government bond, with the credit going to the issuer, makes the bonds attractive to entities that pay no U.S. income tax, such as pension plans and non-U.S. investors, as well as to investors seeking potential high rates of interest income.

3 Summary of significant accounting policies

Basis of presentation

These financial statements, prepared in accordance with Canadian generally accepted accounting principles, include estimates and assumptions by management that affect the reported amounts of assets, liabilities, income and expenses during the reporting period. Actual results could differ from these estimates. The following is a summary of the significant accounting policies of the Fund.

Valuation of investments

Investments are deemed to be categorized as "held for trading" in accordance with CICA 3855, Financial Instruments – Recognition and Measurement ("Section 3855") and therefore are recorded at fair value, established by the closing bid price for a security held long on the recognized exchange on which it is principally traded ("GAAP Net Assets"). Should the quoted value for a security, in the opinion of the Manager, be inaccurate, unreliable or not readily available, the fair value of the security is estimated based on valuation techniques. Fair value is determined by the Manager on the basis of the most recently reported information for the security, similar securities and the markets in which the security is active. Investment purchase and sale transactions are recorded as of the trade date and realized and unrealized gains and losses on investments are determined using average cost. Brokers' commissions and other transaction charges are immediately charged to net income in the period incurred. The fund calculates its daily Net Asset Value for the purchase and redemption of units ("Transactional NAV" or "NAV") based on the fair value of the investment fund's assets and liabilities (being the last traded price for the day).

As at September 30, 2012 and September 30, 2011, there is no difference between the Transactional NAV and the GAAP Net Assets.

Cash and short term notes

Cash and short term notes include cash and cash equivalents with maturities of less than 90 days from the date of acquisition.

Income recognition

Income from investments is recognized on an accrual basis. Interest income is based on the number of days the investment is held during the period. All income, realized and unrealized net gains (losses) and transaction costs (apart from an insignificant amount of income arising from cash) are attributable to investments and derivatives which are deemed held for trading.

Expense recognition

Expenses that are directly attributable to the Fund are recorded on an accrual basis as incurred.

Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the end of the year. Purchases and sales of investments and income and expenses are translated into Canadian dollars at the exchange rate prevailing on the transaction dates.

Realized foreign currency gains and losses on monetary assets and liabilities other than investment denominated in foreign currencies are included in the Statement of Operations in "Net realized gain (loss) on foreign exchange". Unrealized on foreign currency gains and losses on monetary assets and liabilities other than investment denominated in foreign currencies are included in the Statement of Operations in "Change in unrealized gain (loss) on foreign exchange".

Foreign currency forward contracts

The Fund may enter into foreign currency forward contracts to hedge against exposure to foreign currency fluctuations. The carrying value of these contracts is the gain or loss that would be realized if the position were closed out on the valuation date, and is recorded as an unrealized gain or loss. Upon closing of a contract, the gain or loss is recorded as a net realized gain of loss on foreign currency forward contracts.

Interest rate swap contracts

The Fund may enter into interest rate swap contracts to hedge against interest rate fluctuations. The carrying value of these contracts is the gain or loss that would be realized if the position were closed out on the valuation date, and is recorded as an unrealized gain or loss on interest rate swap contracts. Upon closing of a contract, the gain or loss is recorded as a net realized gain or loss on interest rate swap contracts.

Increase (decrease) in net assets from operation per unit

This calculation is based on the increase (decrease) in net assets from operations divided by the weighted average number of units of that class outstanding during the period.

Designation of financial assets and liabilities

For the purpose of measuring and recognizing assets and liabilities, the following designations have been made: All investments, including derivatives, if any, are initially recognized at fair value and are designated as held for trading. Accrued interest and dividends receivable, amounts receivable for capital shares sold and securities sold, and other assets are designated as loans and receivables and reported at cost or amortized cost. Amounts payable for securities purchased and capital shares redeemed, other liabilities and accrued expenses, are designated as other financials liabilities and reported at amortized cost.

Related party transactions

All related party transactions occur in the normal course of operations and are recorded at an amount of consideration agreed to by the parties.

Future accounting changes

On October 31, 2012, the International Accounting Standards Board (the "IASB") issued an amendment to IFRS 10 exempting investment entities from consolidating their controlled investments. The Fund qualifies as investment entity and measures all controlled investments at fair value with changes in fair value recognized through profit or loss.

On December 12, 2011, the Canadian Accounting Standards Board (the "AcSB") extended the deferral of the mandatory International Financial Reporting Standards ("IFRS") changeover date for investment companies to fiscal year beginning on or after January 1, 2014.

On May 12, 2011, the IASB issued IFRS 13 Fair Value Measurement, which defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosure about fair value measurements. It only applies when other IFRSs require or permit fair value measurements. If an asset or a liability measured at fair value has a bid price and an ask price, it requires valuation to be based on a price within the bid-ask spread that is most representative of fair value. It allows the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. This may result in eliminating the difference between the NAV per unit and net assets per unit under the current Canadian GAAP. The Manager is currently assessing the Fund's Unitholder structure and investments to determine the impact of these standards. The Manager has determined that there will likely be no material impact to the NAV versus net assets per unit from the changeover to IFRS.

4 Custodian

Pursuant to the Trust Agreement RBC Investor Services Trust (formerly "RBC Dexia Investor Services Trust") ("the Custodian") (whose credit rating is AA- by S&P as of September 30, 2012 and 2011) acts as custodian of the assets of the Fund. The Custodian is also responsible for certain aspects of the Fund's day-to-day operations, including calculating the Net Asset Value, net income and net realized capital gains of the Fund and maintaining the books and records of the Fund. In consideration for these services, the Fund pays a fee to the Custodian.

5 Unitholder's equity

The Fund is authorized to issue an unlimited number of redeemable, transferable one class of units (the "Units"), each of which represents an equal, undivided interest in the Net Assets of the Fund, subject to the terms and conditions of the Trust Agreement. All the Fund's units are held by its sole unitholder (Bank of Montreal).

On February 18, 2010, the Fund raised $29,666,219 through the issue of 1,270,700 Units. The Units were issued at $23.35 per unit. During the year ended September 30, 2012, $2,598,177 was paid to redeem 107,083 Units (during the year ended September 30, 2011, $4,031,456 was paid to redeem 169,297 Units).

Changes in outstanding units during the years ended September 30, 2012 and 2011 are summarized as follows:

	Number of Units	
	September 30, 2012	September 30, 2011
Opening balance	1,585,346	1,754,643
Units issued	–	–
Units redeemed	(107,083)	(169,297)
Ending balance	1,478,263	1,585,346

The Unit Capital dollar amount represents the face value of the fund's Units minus any return on capital distributions. If the redemption price is lower than the average cost per unit, the difference is included in contributed Surplus on the Statements of net Assets. If the redemption price is greater than the average cost per unit, the difference is first charged to Contributed Surplus until the balance in Contributed Surplus is eliminated and the remaining amount is charged to Surplus (Deficit).

The Fund considers capital to include surplus and all units issued and outstanding. The Fund manages its capital in accordance with the objectives outlined in note (2).

6 Distributions

The Fund pays distributions if, as and when declared by the Fund from time to time. The Fund declared $2,361,000 distributions during the year ended September 30, 2012 ($2,581,000 during the year ended September 30, 2011).

7 Management fees

The Manager receives a Management Fee from the Fund equal in the aggregate to 0.50% per annum of the applicable Net Asset Value of the Build America Investment Grade Bond Fund, calculated and payable monthly in arrears, plus applicable taxes.

The management fees charged to the Fund during the year ended September 30, 2012 were $138,937 ($157,062 during the year ended September 30, 2011). The Manager is responsible for payment of the investment management fees out of these management fees.

8 Income taxes

The Fund is a financial institution for purposes of the "specified debt obligation" and "mark-to-market" rules contained in the Income Tax Act (Canada) since if more than 50% of the fair market value of all interests in the Fund are held by a financial institution. The Fund will be subject to tax in each taxation year under Part I of the Income Tax Act (Canada) on the amount of its income for the year, including net realized gains, if any, less the portion thereof that it deducts in respect of the amount paid or payable to unitholders in the year. The Fund may also be subject to "minimum tax" under the Tax Act. It is the intention of the Manager that all annual net taxable income will be distributed to unitholder on a calendar year basis such that Canadian income taxes payable by the Fund under present legislation will be eliminated. As a result thereof, and of the deduction of expenses in computing its taxable income, no provisions for income taxes are made in the financial statement.

As at December 31, 2011, the Fund had capital losses of $783,136 ($nil – 2010), and $nil non-capital losses as at December 31, 2011 and 2010.

9 Broker commission charges and soft dollar services

There were $nil broker commissions paid during the years ended September 30, 2012 and 2011in connection with portfolio transactions. No contractual arrangements for soft dollar services exist in the broker commission charges.

10 Financial instruments

	September 30, 2012	September 30, 2011
Assets	**$**	**$**
Cash	71,717	624,938
Held for trading	35,743,955	43,457,424
Loans and receivables	553,039	654,896
Total assets	**36,368,711**	**44,737,258**
Liabilities		
Held for trading	684,766	7,527,375
Financial liabilities at amortized cost	28,763	622,633
Total liabilities	**713,529**	**8,150,008**

For the purposes of categorization in accordance with CICA Section 3862, Financial Instruments - Disclosures, interest and dividends receivable is deemed to be loans and receivables and recorded at cost or amortized cost. Similarly, payable on securities purchased, management fees payable and accounts payable and accrued liabilities are deemed to be financial liabilities and reported at amortized cost.

The following table illustrates the classification of the Fund's financial instruments within the fair value hierarchy as at September 30, 2012 and 2011:

Assets at fair value as at September 30, 2012	Level 1	Level 2	Level 3	Total
Short-term investments	–	1,789,915	–	1,789,915
Bonds	–	33,594,300	–	33,594,300
Foreign currency forward contracts	–	359,740	–	359,740
Total	**–**	**35,743,955**	–	**35,743,955**

Liabilities at fair value as at September 30, 2012	Level 1	Level 2	Level 3	Total
Interest rate swaps	–	(684,766)	–	(684,766)
Total	**–**	**(684,766)**	–	**(684,766)**

Assets at fair value as at September 30, 2011	Level 1	Level 2	Level 3	Total
Short-term investments	–	7,982,224	–	7,982,224
Bonds	–	35,475,200	–	35,475,200
Total	**–**	**43,457,424**	–	**43,457,424**

Liabilities at fair value as at September 30, 2011	Level 1	Level 2	Level 3	Total
Interest rate swaps	–	(5,348,387)	–	(5,348,387)
Foreign currency forward contracts	–	(2,178,988)	–	(2,178,988)
Total	**–**	**(7,527,375)**	–	**(7,527,375)**

Financial instruments are classified as Level 1 when the related security or derivative is actively traded and a quoted price is available. If an instrument classified as Level 1 subsequently ceases to be actively traded, it is transferred out of Level 1. In such cases, instruments are reclassified into Level 2, unless the measurement of its fair value requires the use of significant unobservable inputs, in which case it is classified as Level 3.

Bonds and Short-term investments: Bonds and Short-term investments are classified as Level 2 as they are valued using observable inputs, including interest rate curves, credit spreads and volatilities.

Interest rate swaps and foreign currency forward contracts: contracts for which inputs, including interest rates, forward market rates and credit spreads are observable and reliable, or for which unobservable inputs are determined not to be significant to fair value, are classified as Level 2.

There were no transfers among the three levels during the years ended September 30, 2012 and 2011.

11 Financial instrument risk

The Fund's activities expose it to a variety of financial risks – Interest rate, Currency, Credit and Liquidity risk. The Investment Manager may invest in derivatives for the purpose of hedging interest rate exposure. The Investment Manger also invests in foreign currency forward contracts to hedge the Fund's foreign exchange risk exposure.

Interest rate risk

Interest rate risk arises on interest-bearing financial instruments held in the investment portfolio such as bonds and short term notes. The Fund is exposed to the risk that the value of interest-sensitive financial instruments will fluctuate due to changes in the prevailing levels of market interest rates. The table below summarizes the Fund's exposure to interest rate risks. It includes the Fund's assets and trading liabilities at fair values, categorized by the earlier of contractual re-pricing or maturity dates.

September 30, 2012:

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
Investments	1,789,915	–	–	33,594,300	359,740	**35,743,955**
Cash	–	–	–	–	71,717	**71,717**
Other assets	–	–	–	–	553,039	**553,039**
Liabilities	–	–	–	(684,766)	(28,763)	**(713,529)**
Net assets	1,789,915	–	–	32,909,534	(955,733)	**35,655,182**

September 30, 2011:

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
Investments	7,982,224	–	–	35,475,200	–	**43,457,424**
Cash	–	–	–	–	624,938	**624,938**
Other assets	–	–	–	–	654,896	**654,896**
Liabilities	–	–	–	(5,348,387)	(2,801,621)	**(8,150,008)**
Net assets	7,982,224	–	–	30,126,813	(1,521,787)	**36,587,250**

As at September 30, 2012, had prevailing interest rates raised or lowered by 1.0%, with all other variables held constant, net assets would have decreased or increased, respectively, by approximately $1,369,000 or $2,369,000 (September 30, 2011 - $340,000 or $675,000). In practise, actual results may differ from this sensitivity analysis and the difference could be material.

Currency risk

Currency risk arises from financial instruments that are denominated in a currency other than the Canadian dollar, which is the Fund's functional currency. The Fund is exposed to the risk that the value of securities denominated in other currencies will fluctuate due to changes in exchange rates. The Statement of Investments identifies all securities denominated in foreign currencies.

The tables below summarize the Fund's exposure to foreign currencies as at September 30, 2012 and 2011. Amounts shown are based on the carrying values of monetary and non-monetary assets as well as the underlying principal amounts of foreign currency derivatives such as forward contracts. Other financial assets and liabilities that are denominated in foreign currencies do not expose the Fund to significant currency risk. The table below summarizes the Fund's significant exposure to foreign currencies and the approximate impact on net assets had the Canadian Dollar ("CAD") weakened by 5% in relation to these currencies. If the Canadian dollar were to strengthen relative to these currencies, the opposite would occur. In practice, actual results may differ from this sensitivity analysis and the difference could be material.

September 30, 2012:

	Monetary instruments $	Non-monetary instruments $	Derivative instruments $	Net Exposure $	% of Net Assets	Sensitivity (based on devaluation of CAD) $
US Dollar	35,455,377	–	(35,028,682)	426,694	1.2%	21,000

September 30, 2011:

	Monetary instruments $	Non-monetary instruments $	Derivative instruments $	Net Exposure $	% of Net Assets	Sensitivity (based on devaluation of CAD) $
US Dollar	44,081,484	–	(41,160,840)	2,920,644	8.0%	146,000

Credit risk

The Fund is exposed to the risk that a security issuer or counterparty will be unable to pay amounts in full when due. The fair value of debt securities includes consideration of the credit worthiness of the debt issuer. The carrying amount of debt investments and unrealized gain on derivative instruments outstanding with counterparties represents the maximum credit risk exposure as at September 30, 2012 and 2011.

The tables below summarize the Fund's exposure to credit risk as of September 30, 2012 and September 30, 2011. Amounts shown are based on the carrying value of short term notes and bonds and the unrealized gain on derivative instruments outstanding with counterparties.

Rating [(1)]	September 30, 2012 (% of NAV)
AA+	11.9%
AA	10.9%
AA-	31.8%
A+	19.6%
A	12.6%
A-	2.7%
BBB+	5.1%
BBB	3.4%
Total	98.0%

Rating [1]	September 30, 2011 (% of NAV)
AA+	25.0%
AA	15.6%
AA-	21.6%
A+	7.2%
A	10.3%
A-	5.4%
BBB+	6.6%
BBB	3.2%
Not rated	3.2%
Total	98.1%

As at September 30, 2012 and 2011, no debt securities were contractually past due and no longer meeting interest payment obligations.

All transactions in listed securities are settled or paid for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation.

Liquidity risk

The Fund is exposed to unlimited annual redemptions in any given year. Therefore, the Fund invests the majority of its assets in investments that are traded in an active market and can be readily disposed. In addition, the Fund retains sufficient cash positions to maintain liquidity. All liabilities excluding interest rate swap due May 30, 2041, are due within three months.