

PHILLIPS, HAGER & NORTH FUNDS

**2011**  
**Annual Management**  
**Report of Fund**  
**Performance**

**MONEY MARKET FUNDS**

Phillips, Hager & North Canadian Money Market Fund	2
Phillips, Hager & North \$U.S. Money Market Fund	9

**FIXED INCOME FUNDS**

Phillips, Hager & North Short Term Bond & Mortgage Fund	16
Phillips, Hager & North Bond Fund	24
Phillips, Hager & North Community Values Bond Fund	32
Phillips, Hager & North Total Return Bond Fund	40
Phillips, Hager & North Inflation-Linked Bond Fund	48
Phillips, Hager & North High Yield Bond Fund	55
Phillips, Hager & North Short Inflation-linked Bond Fund	63
Phillips, Hager & North Long Inflation-linked Bond Fund	67

**BALANCED FUNDS**

Phillips, Hager & North Monthly Income Fund	71
Phillips, Hager & North Balanced Fund	78
Phillips, Hager & North Community Values Balanced Fund	86

**CANADIAN EQUITY FUNDS**

Phillips, Hager & North Dividend Income Fund	94
Phillips, Hager & North Canadian Equity Fund	102
Phillips, Hager & North Community Values Canadian Equity Fund	110
Phillips, Hager & North Canadian Equity Value Fund	118
Phillips, Hager & North Canadian Equity Underlying Fund	125
Phillips, Hager & North Canadian Growth Fund	130
Phillips, Hager & North Canadian Income Fund	137
Phillips, Hager & North Vintage Fund	145

**U.S. EQUITY FUNDS**

Phillips, Hager & North U.S. Dividend Income Fund	152
Phillips, Hager & North U.S. Multi-Style All-Cap Equity Fund	159
Phillips, Hager & North U.S. Equity Fund	166
Phillips, Hager & North Currency-Hedged U.S. Equity Fund	174
Phillips, Hager & North U.S. Growth Fund	182

**INTERNATIONAL AND GLOBAL EQUITY FUNDS**

Phillips, Hager & North Overseas Equity Fund	189
Phillips, Hager & North Currency-Hedged Overseas Equity Fund	197
Phillips, Hager & North Global Equity Fund	205
Phillips, Hager & North Community Values Global Equity Fund	213

**TARGET DATE FUNDS**

Phillips, Hager & North LifeTime 2015 Fund	221
Phillips, Hager & North LifeTime 2020 Fund	226
Phillips, Hager & North LifeTime 2025 Fund	231
Phillips, Hager & North LifeTime 2030 Fund	236
Phillips, Hager & North LifeTime 2035 Fund	241
Phillips, Hager & North LifeTime 2040 Fund	246
Phillips, Hager & North LifeTime 2045 Fund	251

**BONAVISTA INVESTMENT FUNDS**

BonaVista Global Balanced Fund	256
BonaVista Canadian Equity Value Fund	264

**THE ROLE OF THE BOARD OF GOVERNORS**

271
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MONEY MARKET FUND

**PHILLIPS, HAGER & NORTH  
CANADIAN MONEY MARKET FUND**

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December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with a steady level of current income, capital preservation and liquidity by investing in a well-diversified portfolio of short-term Canadian money market securities with strong credit ratings. To achieve the Fund's investment objective, we invest in government or government guaranteed treasury bills, high-grade corporate notes, and asset-backed commercial paper. At the time of purchase, securities will generally have a term to maturity of less than 183 days and the portfolio's term to maturity will typically average 30 days. The Fund is conservatively managed and does not invest in foreign securities.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$1.58 billion as of December 31, 2011, from \$1.38 billion at the end of 2010. Of this change, \$179.2 million was due to net inflows and \$14.3 million to investment returns.

As of December 31, 2011, the current yields were 0.6% for Series D units, 0.7% for Series F units, 1.1% for Series O units, 0.6% for Series B units and 0.6% for Advisor Series units. During the one-year period ending December 31, 2011, the Fund's Series D units returned 0.63%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The past year was the third year of the "zero interest rate" environment that followed the financial crisis of 2008. Central banks of most of the developed world, including the Bank of Canada, have maintained extremely low target lending rates in their efforts to stimulate sluggish economies. This has led to a very challenging environment for money market investors to make significant returns.

The Fund was invested primarily in high-quality commercial paper, banker's acceptances and bank-sponsored asset-backed commercial paper for most of the year.

It is important to note that despite the challenging, low-yielding environment, the Fund did not take on additional risk by investing in lower-quality, higher-yielding instruments. Capital preservation remains the Fund's primary objective.

The Bank of Canada kept its target overnight lending rate at 1.0% for the entire year. In the early part of the year, the market was expecting the Bank to raise rates in the latter part of the year, but this did not happen. There was little difference in yields during the last half of the year, reducing our ability to add value via strategic allocations. Despite this, our primary focus was diligent security and issuer selection.

### Recent Developments

The global economy will likely experience slow growth over the next several quarters. Setting inflation targets is the primary objective of most central banks, including the Bank of Canada, and inflationary price increases have been well contained in the past year.

In Canada and the U.S., the core inflation rate is approximately 2%, which is in the middle of the target range set by the central banks. Central banks, including the Bank of Canada, appear to have little reason to implement interest rate increases in this low-growth, low-inflation environment. Furthermore, the U.S. Federal Reserve Board has indicated its intention to keep its "zero interest rate" policy in place until at least the middle of 2013.

It appears that the low-interest-rate environment will likely persist for the foreseeable future. The Fund will continue to focus on investments in high-quality commercial paper, banker's acceptances and asset-backed commercial paper, as well as continuing to maintain its goal of capital preservation.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>				Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital		Total
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.11</b>	<b>(0.05)</b>	–	–	<b>0.06</b>	<b>(0.06)</b>	–	–	–	<b>(0.06)</b>	<b>10.00</b>
Dec. 31, 2010	10.00	0.08	(0.04)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00
Dec. 31, 2009	10.00	0.11	(0.05)	–	–	0.06	(0.06)	–	–	–	(0.06)	10.00
Dec. 31, 2008 <sup>3</sup>	10.00 <sup>†</sup>	0.04	(0.01)	–	–	0.03	(0.03)	–	–	–	(0.03)	10.00
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.11</b>	<b>(0.05)</b>	–	–	<b>0.06</b>	<b>(0.06)</b>	–	–	–	<b>(0.06)</b>	<b>10.00</b>
Dec. 31, 2010 <sup>4</sup>	10.00 <sup>†</sup>	0.01	(0.01)	–	–	–	–	–	–	–	–	10.00
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.12</b>	<b>(0.05)</b>	–	–	<b>0.07</b>	<b>(0.07)</b>	–	–	–	<b>(0.07)</b>	<b>10.00</b>
Dec. 31, 2010	10.00	0.08	(0.04)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00
Dec. 31, 2009	10.00	0.12	(0.06)	–	–	0.06	(0.06)	–	–	–	(0.06)	10.00
Dec. 31, 2008	10.00	0.36	(0.05)	–	–	0.31	(0.31)	–	–	–	(0.31)	10.00
Dec. 31, 2007 <sup>5</sup>	10.00 <sup>†</sup>	0.24	(0.03)	–	–	0.21	(0.21)	–	–	–	(0.21)	10.00
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.11</b>	<b>(0.05)</b>	–	–	<b>0.06</b>	<b>(0.06)</b>	–	–	–	<b>(0.06)</b>	<b>10.00</b>
Dec. 31, 2010	10.00	0.08	(0.04)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00
Dec. 31, 2009	10.00	0.10	(0.04)	–	–	0.06	(0.06)	–	–	–	(0.06)	10.00
Dec. 31, 2008	10.00	0.37	(0.05)	–	–	0.32	(0.32)	–	–	–	(0.32)	10.00
Dec. 31, 2007	10.00	0.47	(0.05)	–	–	0.42	(0.42)	–	–	–	(0.42)	10.00
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.12</b>	<b>(0.05)</b>	–	–	<b>0.07</b>	<b>(0.07)</b>	–	–	–	<b>(0.07)</b>	<b>10.00</b>
Dec. 31, 2010	10.00	0.08	(0.04)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00
Dec. 31, 2009	10.00	0.10	(0.04)	–	–	0.06	(0.06)	–	–	–	(0.06)	10.00
Dec. 31, 2008	10.00	0.36	(0.03)	–	–	0.33	(0.33)	–	–	–	(0.33)	10.00
Dec. 31, 2007 <sup>5</sup>	10.00 <sup>†</sup>	0.26	(0.02)	–	–	0.24	(0.24)	–	–	–	(0.24)	10.00
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.11</b>	–	–	–	<b>0.11</b>	<b>(0.11)</b>	–	–	–	<b>(0.11)</b>	<b>10.00</b>
Dec. 31, 2010	10.00	0.08	–	–	–	0.08	(0.08)	–	–	–	(0.08)	10.00
Dec. 31, 2009	10.00	0.10	–	–	–	0.10	(0.10)	–	–	–	(0.10)	10.00
Dec. 31, 2008	10.00	0.36	–	–	–	0.36	(0.36)	–	–	–	(0.36)	10.00
Dec. 31, 2007	10.00	0.46	–	–	–	0.46	(0.46)	–	–	–	(0.46)	10.00

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

† Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>11 674</b>	<b>1 167</b>	<b>0.55</b>	<b>0.55</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	11 201	1 120	0.37	0.37	n/a	—
Dec. 31, 2009	10.00	8 206	821	0.51 <sup>4</sup>	0.75	n/a	—
Dec. 31, 2008 <sup>5</sup>	10.00	2 439	244	0.74	1.85	n/a	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>8 497</b>	<b>850</b>	<b>0.55</b>	<b>0.55</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010 <sup>6</sup>	10.00	690	69	0.37	0.37	n/a	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>678</b>	<b>68</b>	<b>0.53</b>	<b>0.53</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	1 002	100	0.43	0.43	n/a	—
Dec. 31, 2009	10.00	1 770	177	0.53 <sup>4</sup>	0.62	n/a	—
Dec. 31, 2008	10.00	6 461	646	0.62	0.63	n/a	—
Dec. 31, 2007 <sup>7</sup>	10.00	1 211	121	0.60	0.96	n/a	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>432 080</b>	<b>43 208</b>	<b>0.55</b>	<b>0.55</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	459 423	45 942	0.41	0.41	n/a	—
Dec. 31, 2009	10.00	563 832	56 383	0.44 <sup>4</sup>	0.51	n/a	—
Dec. 31, 2008	10.00	713 765	71 376	0.52	0.52	n/a	—
Dec. 31, 2007	10.00	641 142	64 114	0.49	0.52	n/a	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>8 664</b>	<b>866</b>	<b>0.50</b>	<b>0.50</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	7 607	761	0.37	0.37	n/a	—
Dec. 31, 2009	10.00	2 456	246	0.43 <sup>4</sup>	0.49	n/a	—
Dec. 31, 2008	10.00	3 449	345	0.49	0.49	n/a	—
Dec. 31, 2007 <sup>7</sup>	10.00	202	20	0.49	2.52	n/a	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>1 115 361</b>	<b>111 536</b>	<b>0.03</b>	<b>0.03</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	903 528	90 353	0.03	0.03	n/a	—
Dec. 31, 2009	10.00	818 885	81 888	0.02 <sup>4</sup>	0.02	n/a	—
Dec. 31, 2008	10.00	959 549	95 955	0.03	0.03	n/a	—
Dec. 31, 2007	10.00	972 238	97 224	0.02	0.02	n/a	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 0.50%, Series B – 0.53%, Series D – 0.43%, Series F – 0.42%, Series O – 0.03%.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated up to the annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	up to 0.65%	38%	62%
Advisor Series	up to 0.65%	38%	62%
Series B	up to 0.60%	17%	83%
Series D	Note 1	23%	77%
Series F	up to 0.40%	–	100%

Note 1 – up to 0.50% (decreasing to 0.40% on the net Series D asset value over \$200,000,000).

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

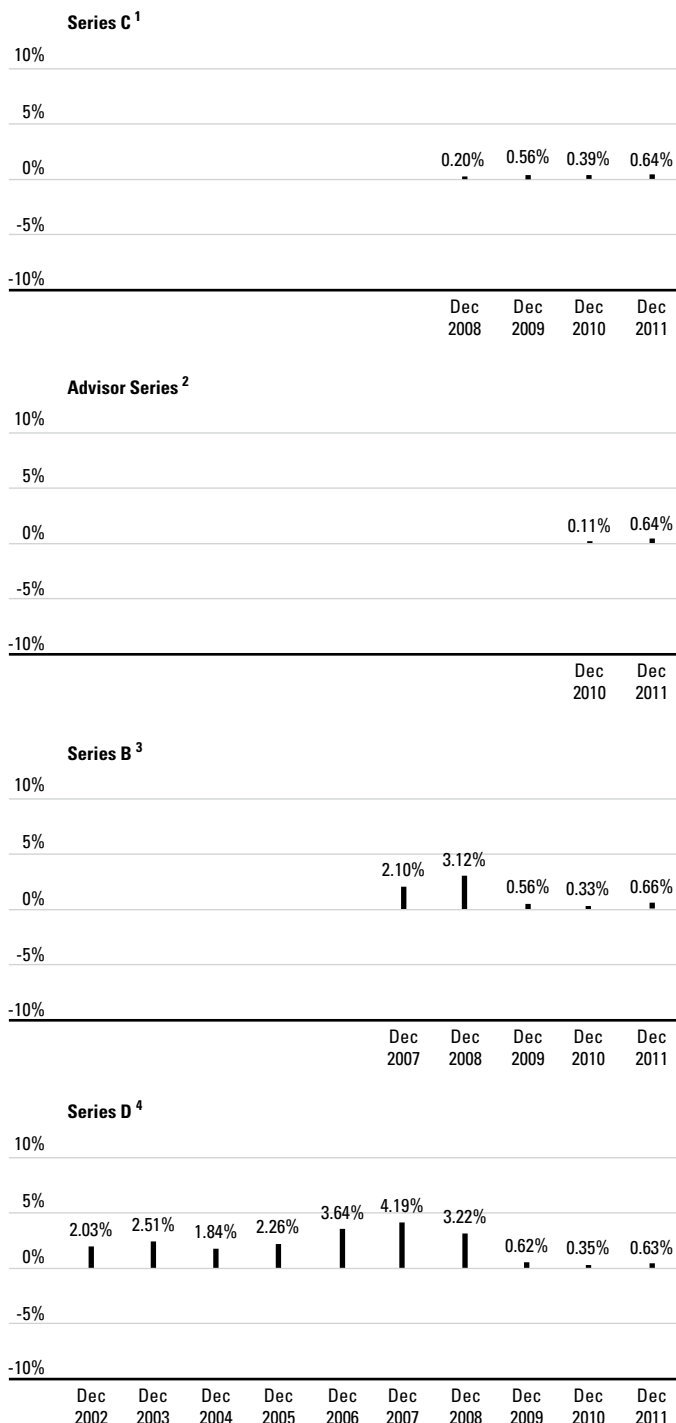
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

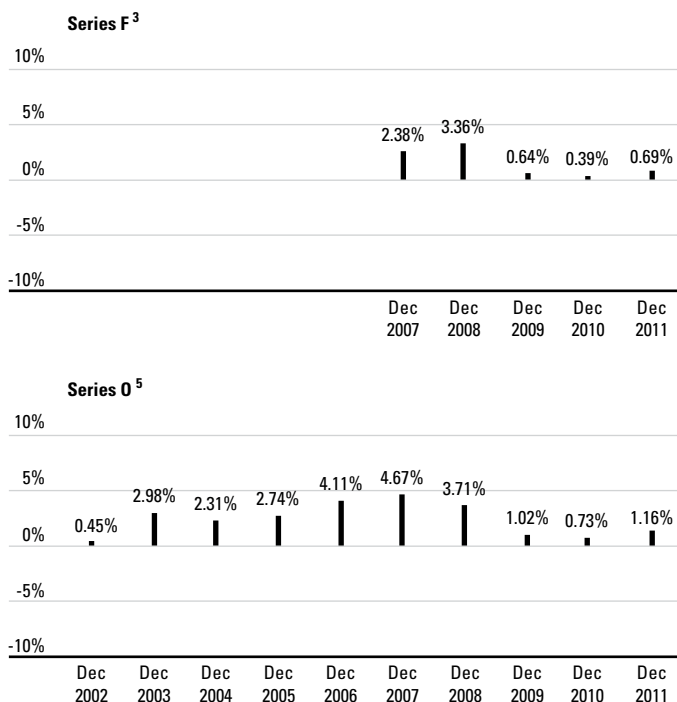
**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.





**PAST PERFORMANCE (cont.)**



<sup>1</sup> From November 2008.

<sup>2</sup> From October 2010.

<sup>3</sup> From June 2007.

<sup>4</sup> Series D was known as Series A prior to November 17, 2008.

<sup>5</sup> From October 2002.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Corporate Notes	100.0

**Top 25 Holdings**

	% of Net Asset Value
Bank of Nova Scotia 1.152% Feb 22 12	2.7
Bay Street Funding Trust - Class A 1.120% Jan 13 12	2.4
Fusion Trust 1.159% Feb 23 12	2.3
Diversified Trust 1.152% Mar 13 12	2.3
Bay Street Funding Trust - Class A 1.124% Jan 10 12	2.2
Bell Aliant Regional Communications 1.096% Jan 30 12	2.0
Bank of Nova Scotia 1.180% May 15 12	2.0
Canadian Imperial Bank of Commerce 1.240% Mar 1 12	2.0
Canadian Master Trust - Series A 1.150% Feb 22 12	1.9
Diversified Trust 1.151% Mar 19 12	1.9
SUMMIT Trust 1.138% Feb 6 12	1.8
HSBC Bank Canada 1.201% Jan 4 12	1.7
HSBC Bank Canada 1.150% Mar 22 12	1.6
SUMMIT Trust 1.151% Mar 19 12	1.4
Prime Trust - Senior Notes 1.152% Feb 6 12	1.4
Fusion Trust 1.162% Jan 27 12	1.4
Merit Trust - Senior Notes 1.151% Jan 23 12	1.4
Bank of Montreal 1.200% Jun 5 12	1.3
Bank of Nova Scotia 1.150% Jan 11 12	1.3
Bank of Nova Scotia 1.150% Feb 1 12	1.3
Prime Trust - Senior Notes 1.152% Feb 1 12	1.3
National Bank of Canada 1.085% Jan 23 12	1.2
National Bank of Canada 1.084% Jan 20 12	1.1
Enbridge Inc. 1.118% Jan 16 12	1.1
OMERS Realty Corp. 1.102% Mar 20 12	1.1
<b>Top 25 Holdings</b>	<b>42.1</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, www.phn.com, or by e-mailing us at info@phn.com.

MONEY MARKET FUND

**PHILLIPS, HAGER & NORTH  
\$U.S. MONEY MARKET FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE (in US\$)

### Investment Objective and Strategies

The Fund seeks to provide investors with a steady level of current income while preserving capital by investing primarily in Canadian short-term debt instruments denominated in U.S. dollars. To achieve the Fund's investment objective, we invest in government or government-guaranteed treasury bills, asset-backed commercial paper and high-grade corporate notes. At the time of purchase, the portfolio's term to maturity will typically average 30 days. The Fund is managed within a conservative framework.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$66.7 million as of December 31, 2011, from \$54.0 million at the end of 2010. Of this change, \$12.6 million was due to net inflows and \$0.1 million to investment returns.

As of December 31, 2011, the current yields were 0.1% for Series D units, 0.1% for Series F units, 0.2% for Series O units, 0.1% for Series B units and 0.1% for Advisor Series units. During the one-year period ending December 31, 2011, the Fund's Series D units returned 0.11% in U.S. dollar terms. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The past year was the third year of the "zero interest rate" environment that followed the financial crisis of 2008. Central banks of most of the developed world, led by the U.S. Federal Reserve Board, have maintained extremely low target lending rates in their efforts to stimulate sluggish economies. This has led to a very challenging environment for money market investors to make significant returns.

The Fund was invested mostly in U.S. dollar issues of Canadian corporations, banks and bank-sponsored asset-backed commercial paper. There was also a smaller allocation to U.S. dollar securities issued by the provinces. These instruments all yielded more than U.S. Treasury bills during the past year, which allowed the Fund to have a higher yield than its benchmark.

It is important to note that despite the challenging, low-yielding environment, the Fund did not take on additional risk by investing in lower-quality, higher-yielding instruments. Capital preservation remains the Fund's primary objective.

The U.S. Federal Reserve Board kept its federal funds rate at 0-0.25% for the entire year, as it did in 2009 and 2010. Because of this, the 0-365 day part of the yield curve remained essentially flat for the entire year, reducing our ability to add value via strategic allocations along the curve. Despite this, our primary focus was diligent security and issuer selection.

In response to an extremely low-interest-rate environment, we temporarily reduced the management fees on the Fund during 2011 to support the yield to unitholders. The decision to temporarily reduce the management fees or return management fees to their prior level is determined at our discretion.

### Recent Developments

The global economy will likely experience slow growth over the next several quarters. Setting inflation targets is one of the U.S. Federal Reserve's objectives, and inflationary price increases have been well contained in the past year, with the core inflation rate near 2% in the United States. Furthermore, the U.S. Federal Reserve has indicated its intention to keep its "zero interest rate" policy in place until at least the middle of 2013.

It appears that the low-rate environment will likely persist for the foreseeable future. The Fund will continue to focus on high-quality commercial paper, banker's acceptances, asset-backed commercial paper, and provincial bonds, as well as continuing to maintain its goal of capital preservation.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each Fund.

**FINANCIAL HIGHLIGHTS (in US\$)**

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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

**Change in Net Assets Per Unit**

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.02</b>	<b>(0.01)</b>	–	–	<b>0.01</b>	<b>(0.01)</b>	–	–	–	<b>(0.01)</b>	<b>10.00</b>	
Dec. 31, 2010	10.00	0.03	(0.02)	–	–	0.01	(0.01)	–	–	–	(0.01)	10.00	
Dec. 31, 2009	10.00	0.06	(0.04)	–	–	0.02	(0.02)	–	–	–	(0.02)	10.00	
Dec. 31, 2008 <sup>3</sup>	10.00 <sup>†</sup>	0.03	(0.01)	–	–	0.02	(0.02)	–	–	–	(0.02)	10.00	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.02</b>	<b>(0.01)</b>	–	–	<b>0.01</b>	<b>(0.01)</b>	–	–	–	<b>(0.01)</b>	<b>10.00</b>	
Dec. 31, 2010 <sup>4</sup>	10.00 <sup>†</sup>	0.01	–	–	–	0.01	(0.01)	–	–	–	(0.01)	10.00	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.02</b>	<b>(0.01)</b>	–	–	<b>0.01</b>	<b>(0.01)</b>	–	–	–	<b>(0.01)</b>	<b>10.00</b>	
Dec. 31, 2010	10.00	0.03	(0.02)	–	–	0.01	(0.01)	–	–	–	(0.01)	10.00	
Dec. 31, 2009	10.00	0.09	(0.05)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00	
Dec. 31, 2008	10.00	0.30	(0.06)	–	–	0.24	(0.24)	–	–	–	(0.24)	10.00	
Dec. 31, 2007 <sup>5</sup>	10.00 <sup>†</sup>	0.27	(0.03)	–	–	0.24	(0.24)	–	–	–	(0.24)	10.00	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.02</b>	<b>(0.01)</b>	–	–	<b>0.01</b>	<b>(0.01)</b>	–	–	–	<b>(0.01)</b>	<b>10.00</b>	
Dec. 31, 2010	10.00	0.03	(0.02)	–	–	0.01	(0.01)	–	–	–	(0.01)	10.00	
Dec. 31, 2009	10.00	0.08	(0.04)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00	
Dec. 31, 2008	10.00	0.31	(0.06)	–	–	0.25	(0.25)	–	–	–	(0.25)	10.00	
Dec. 31, 2007	10.00	0.54	(0.06)	–	–	0.48	(0.48)	–	–	–	(0.48)	10.00	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.02</b>	<b>(0.01)</b>	–	–	<b>0.01</b>	<b>(0.01)</b>	–	–	–	<b>(0.01)</b>	<b>10.00</b>	
Dec. 31, 2010	10.00	0.03	(0.02)	–	–	0.01	(0.01)	–	–	–	(0.01)	10.00	
Dec. 31, 2009	10.00	0.08	(0.04)	–	–	0.04	(0.04)	–	–	–	(0.04)	10.00	
Dec. 31, 2008	10.00	0.30	(0.05)	–	–	0.25	(0.25)	–	–	–	(0.25)	10.00	
Dec. 31, 2007 <sup>5</sup>	10.00 <sup>†</sup>	0.28	(0.02)	–	–	0.26	(0.26)	–	–	–	(0.26)	10.00	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>0.03</b>	<b>(0.01)</b>	–	–	<b>0.02</b>	<b>(0.02)</b>	–	–	–	<b>(0.02)</b>	<b>10.00</b>	
Dec. 31, 2010	10.00	0.03	(0.01)	–	–	0.02	(0.02)	–	–	–	(0.02)	10.00	
Dec. 31, 2009	10.00	0.08	–	–	–	0.08	(0.08)	–	–	–	(0.08)	10.00	
Dec. 31, 2008	10.00	0.31	(0.01)	–	–	0.30	(0.30)	–	–	–	(0.30)	10.00	
Dec. 31, 2007	10.00	0.54	(0.01)	–	–	0.53	(0.53)	–	–	–	(0.53)	10.00	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (in US\$) (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>3 389</b>	<b>339</b>	<b>0.14</b>	<b>0.14</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	2 710	272	0.20	0.20	n/a	—
Dec. 31, 2009	10.00	2 064	206	0.43 <sup>4</sup>	0.91	n/a	—
Dec. 31, 2008 <sup>5</sup>	10.00	321	32	0.86	2.22	n/a	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>156</b>	<b>16</b>	<b>0.14</b>	<b>0.14</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010 <sup>6</sup>	10.00	10	—	0.20	0.20	n/a	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>1 189</b>	<b>119</b>	<b>0.14</b>	<b>0.14</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	1 201	120	0.21	0.21	n/a	—
Dec. 31, 2009	10.00	1 666	167	0.48 <sup>4</sup>	0.74	n/a	—
Dec. 31, 2008	10.00	2 041	204	0.71	0.73	n/a	—
Dec. 31, 2007 <sup>7</sup>	10.00	837	84	0.71	1.34	n/a	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>29 924</b>	<b>2 992</b>	<b>0.14</b>	<b>0.14</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	25 671	2 567	0.21	0.21	n/a	—
Dec. 31, 2009	10.00	29 233	2 923	0.44 <sup>4</sup>	0.64	n/a	—
Dec. 31, 2008	10.00	39 095	3 909	0.60	0.64	n/a	—
Dec. 31, 2007	10.00	60 460	6 046	0.60	0.66	n/a	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>6 743</b>	<b>674</b>	<b>0.12</b>	<b>0.12</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	6 373	637	0.16	0.16	n/a	—
Dec. 31, 2009	10.00	6 093	609	0.41 <sup>4</sup>	0.63	n/a	—
Dec. 31, 2008	10.00	4 428	443	0.60	0.62	n/a	—
Dec. 31, 2007 <sup>7</sup>	10.00	1 203	120	0.60	0.93	n/a	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>10.00</b>	<b>25 294</b>	<b>2 529</b>	<b>0.06</b>	<b>0.06</b>	<b>n/a</b>	<b>—</b>
Dec. 31, 2010	10.00	18 070	1 807	0.06	0.06	n/a	—
Dec. 31, 2009	10.00	19 527	1 953	0.04 <sup>4</sup>	0.10	n/a	—
Dec. 31, 2008	10.00	21 603	2 160	0.07	0.09	n/a	—
Dec. 31, 2007	10.00	38 082	3 808	0.07	0.11	n/a	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 0.44%, Series B – 0.49%, Series D – 0.43%, Series F – 0.40%, Series O – 0.05%.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (in US\$) (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated up to the annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	up to 0.75%	33%	67%
Advisor Series	up to 0.75%	33%	67%
Series B	up to 0.60%	17%	83%
Series D	up to 0.50%	20%	80%
Series F	up to 0.50%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

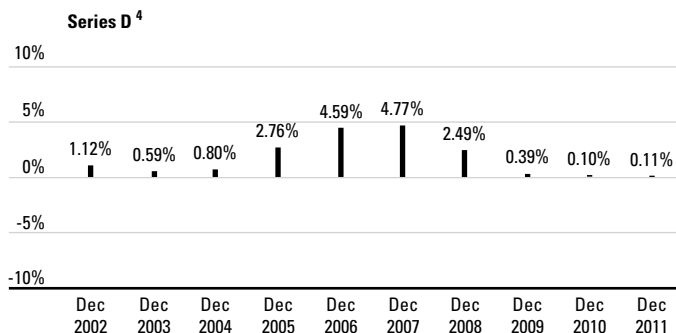
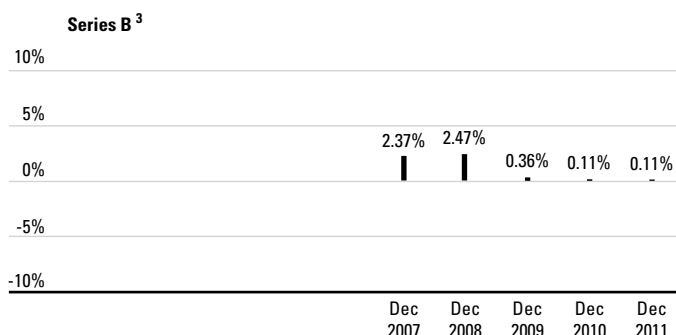
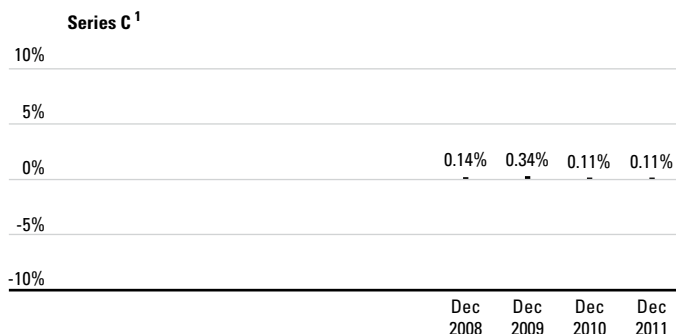
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE (in US\$)**

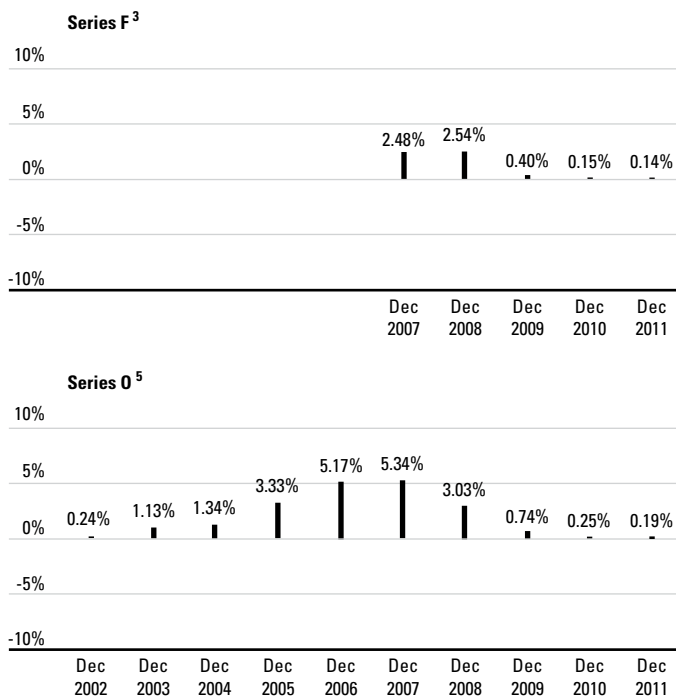
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (in US\$) (cont.)**



<sup>1</sup> From November 2008.

<sup>2</sup> From October 2010.

<sup>3</sup> From June 2007.

<sup>4</sup> Series D was known as Series A prior to November 17, 2008.

<sup>5</sup> From October 2002.

**SUMMARY OF INVESTMENT PORTFOLIO (in US\$)**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Corporate Notes	90.3
Government Notes	9.7

**Top 25 Holdings**

	% of Net Asset Value
Province of Quebec 0.109% Mar 15 12	9.7
Bank of Montreal 0.229% Feb 13 12	7.9
Bay Street Funding Trust – Class A 0.253% Jan 5 12	4.6
Toronto-Dominion Bank 0.169% Feb 2 12	4.5
Darwin Receivables Trust – Senior Notes 0.298% Jan 12 12	3.7
Caisse Centrale Desjardins 0.180% Mar 28 12	3.7
Fusion Trust 0.348% Mar 14 12	3.6
Canadian Master Trust – Series A 0.269% Jan 23 12	3.5
SUMMIT Trust 0.261% Jan 20 12	3.3
Diversified Trust 0.270% Mar 6 12	3.3
Reliant Trust 0.329% Mar 29 12	3.1
Prime Trust – Senior Notes 0.189% Feb 1 12	3.0
SAFE Trust – Series 1996-1 0.349% Feb 23 12	3.0
SOUND Trust 0.360% Mar 15 12	3.0
TransCanada PipeLines Ltd. 0.521% Feb 6 12	2.9
TransCanada PipeLines Ltd. 0.360% Jan 17 12	2.5
Gaz Metropolitan Inc. 0.420% Mar 13 12	2.5
Zeus Receivables Trust – Senior Notes 0.302% Mar 14 12	2.5
Enbridge Inc. 0.223% Jan 13 12	2.3
Finning International Inc. 0.330% Jan 4 12	2.3
Merit Trust – Senior Notes 0.300% Feb 6 12	2.2
Brookfield Asset Management Inc., Class A 0.415% Jan 20 12	2.1
Merit Trust – Senior Notes 0.329% Mar 29 12	2.1
HSBC Bank Canada 0.202% Feb 27 12	1.9
McCain Financial Canada 0.300% Jan 3 12	1.7
<b>Top 25 Holdings</b>	<b>84.9</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



FIXED-INCOME FUND

**PHILLIPS, HAGER & NORTH  
SHORT TERM BOND & MORTGAGE FUND**

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December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with relatively high yields and stability of capital by investing primarily in Canadian government and corporate bonds and multi-residential mortgages on property located in Canada in accordance with National Policy Statement No. 29. To achieve the Fund's investment objective, we invest in high-quality Canadian corporate bonds, government bonds, and up to 40% of the Fund's net assets in conventional first mortgages and mortgages guaranteed under the *National Housing Act* (Canada). We may also invest in asset-backed commercial paper. Securities purchased will generally not have a term to maturity exceeding seven years and three months, and the average term to maturity of the portfolio will generally be three years.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$2.78 billion as of December 31, 2011, from \$2.00 billion at the end of 2010. Of this change, \$690.1 million was due to net inflows and \$90.7 million to investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 3.6%. Over the same time period, the Fund's benchmark index, the DEX Short Term Bond Index, returned 4.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

While short-term bonds rose during 2011 amid falling interest rates, we positioned the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden jump in rates, detracted from performance when interest rates, especially on longer-term debt securities, remained near their historically lowest levels at the end of the year. Our interest rate strategy caused the Fund to underperform its benchmark for the year.

The Fund's credit strategies, however – that is, our positioning in corporate, provincial and government agency bonds, as well as mortgages – performed well. We maintained an overweight position in corporate bonds versus the benchmark throughout the year.

Corporate bond spreads were high by historical standards at the start of the year, and moved higher as the year progressed. Successful security selection led to a positive performance from our corporate bonds, which more than offset the effect of wider short-term corporate credit spreads.

Mortgage spreads remained wide all year, providing a yield of 1.5% to 2.0% over Government of Canada bonds. The Fund's modest allocation to mortgages, which the benchmark does not own, also added to performance.

### Recent Developments

The portfolio is positioned in expectation that current record low interest rates will eventually give way to an economic recovery, and rise. We would later reduce the extent of this duration bias if interest rates rise as expected.

Provincial, corporate and mortgage credit spreads remain at wide levels due to the ongoing uncertainty stemming from Europe, and the resulting retreat to federal bonds of "safe haven" countries. The Fund remains overweight in its exposure to corporate bonds and mortgages and we plan to hold this position as long as credit spreads remain wide. If market volatility and uncertainty begin to subside, which we feel is still a ways off, or if corporate credit spreads widen further, making them more attractive from a buyer's point of view, we would consider adding to the Fund's corporate bond position.

### Related-Party Transactions

#### **Manager, Portfolio Advisor and Registrar**

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### **Distributor**

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>10.45</b>	<b>0.36</b>	<b>(0.12)</b>	<b>0.03</b>	<b>0.04</b>	<b>0.31</b>	<b>(0.23)</b>	–	<b>(0.01)</b>	–	<b>(0.24)</b>	<b>10.53</b>
Dec. 31, 2010	10.47	0.41	(0.12)	0.06	(0.08)	0.27	(0.26)	–	(0.05)	–	(0.31)	10.45
Dec. 31, 2009	10.05	0.44	(0.11)	0.07	(0.07)	0.33	(0.27)	–	–	–	(0.27)	10.47
Dec. 31, 2008 <sup>3</sup>	9.95 <sup>†</sup>	0.06	(0.02)	0.01	0.09	0.14	(0.01)	–	–	–	(0.01)	10.05
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>10.45</b>	<b>0.36</b>	<b>(0.12)</b>	<b>0.03</b>	<b>0.04</b>	<b>0.31</b>	<b>(0.23)</b>	–	<b>(0.01)</b>	–	<b>(0.24)</b>	<b>10.53</b>
Dec. 31, 2010 <sup>4</sup>	10.63 <sup>†</sup>	0.07	(0.02)	0.01	(0.01)	0.05	(0.05)	–	(0.05)	–	(0.10)	10.45
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>10.53</b>	<b>0.37</b>	<b>(0.09)</b>	<b>0.03</b>	<b>0.04</b>	<b>0.35</b>	<b>(0.25)</b>	–	<b>(0.01)</b>	–	<b>(0.26)</b>	<b>10.61</b>
Dec. 31, 2010	10.52	0.42	(0.09)	0.06	(0.08)	0.31	(0.27)	–	(0.05)	–	(0.32)	10.53
Dec. 31, 2009	10.08	0.45	(0.09)	0.15	0.25	0.76	(0.28)	–	–	–	(0.28)	10.52
Dec. 31, 2008	9.91	0.46	(0.09)	0.05	(0.11)	0.31	(0.28)	–	–	–	(0.28)	10.08
Dec. 31, 2007 <sup>5</sup>	9.77 <sup>†</sup>	0.24	(0.04)	0.01	0.04	0.25	(0.11)	–	–	–	(0.11)	9.91
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>10.42</b>	<b>0.36</b>	<b>(0.06)</b>	<b>0.03</b>	<b>0.04</b>	<b>0.37</b>	<b>(0.29)</b>	–	<b>(0.01)</b>	–	<b>(0.30)</b>	<b>10.49</b>
Dec. 31, 2010	10.42	0.41	(0.06)	0.06	(0.08)	0.33	(0.31)	–	(0.05)	–	(0.36)	10.42
Dec. 31, 2009	10.00	0.45	(0.06)	0.12	0.20	0.71	(0.32)	–	–	–	(0.32)	10.42
Dec. 31, 2008	9.86	0.47	(0.07)	0.07	0.01	0.48	(0.34)	–	–	–	(0.34)	10.00
Dec. 31, 2007	9.96	0.49	(0.06)	(0.07)	(0.10)	0.26	(0.38)	–	–	–	(0.38)	9.86
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>10.40</b>	<b>0.36</b>	<b>(0.06)</b>	<b>0.03</b>	<b>0.04</b>	<b>0.37</b>	<b>(0.29)</b>	–	<b>(0.01)</b>	–	<b>(0.30)</b>	<b>10.48</b>
Dec. 31, 2010	10.41	0.40	(0.06)	0.06	(0.08)	0.32	(0.31)	–	(0.05)	–	(0.36)	10.40
Dec. 31, 2009	9.99	0.44	(0.06)	0.08	(0.07)	0.39	(0.32)	–	–	–	(0.32)	10.41
Dec. 31, 2008	9.85	0.46	(0.06)	0.06	0.12	0.58	(0.33)	–	–	–	(0.33)	9.99
Dec. 31, 2007 <sup>5</sup>	9.77 <sup>†</sup>	0.23	(0.03)	(0.01)	0.07	0.26	(0.18)	–	–	–	(0.18)	9.85
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>10.11</b>	<b>0.35</b>	<b>(0.01)</b>	<b>0.03</b>	<b>0.04</b>	<b>0.41</b>	<b>(0.33)</b>	–	<b>(0.01)</b>	–	<b>(0.34)</b>	<b>10.19</b>
Dec. 31, 2010	10.14	0.40	(0.01)	0.06	(0.07)	0.38	(0.38)	–	(0.05)	–	(0.43)	10.11
Dec. 31, 2009	9.78	0.43	–	0.12	0.20	0.75	(0.42)	–	–	–	(0.42)	10.14
Dec. 31, 2008	9.74	0.46	(0.01)	0.06	0.01	0.52	(0.48)	–	–	–	(0.48)	9.78
Dec. 31, 2007	9.89	0.47	–	(0.06)	(0.05)	0.36	(0.49)	–	–	–	(0.49)	9.74

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.54</b>	<b>334 540</b>	<b>31 740</b>	<b>1.15</b>	<b>1.15</b>	<b>316.04</b>	—
Dec. 31, 2010	10.46	293 873	28 085	1.13	1.13	321.53	—
Dec. 31, 2009	10.48	174 348	16 640	1.12 <sup>2</sup>	1.13	181.88	—
Dec. 31, 2008 <sup>5</sup>	10.06	799	79	1.17	1.59	192.71	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.54</b>	<b>27 700</b>	<b>2 628</b>	<b>1.15</b>	<b>1.15</b>	<b>316.04</b>	—
Dec. 31, 2010 <sup>6</sup>	10.46	7 659	732	1.13	1.13	321.53	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>10.62</b>	<b>359</b>	<b>34</b>	<b>0.89</b>	<b>0.89</b>	<b>316.04</b>	—
Dec. 31, 2010	10.54	412	39	0.87	0.87	321.53	—
Dec. 31, 2009	10.53	488	46	0.87 <sup>2</sup>	0.97	181.88	—
Dec. 31, 2008	10.10	896	89	0.89	1.05	192.71	—
Dec. 31, 2007 <sup>7</sup>	9.92	130	13	0.88	3.21	357.57	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.50</b>	<b>290 682</b>	<b>27 674</b>	<b>0.61</b>	<b>0.61</b>	<b>316.04</b>	—
Dec. 31, 2010	10.43	272 713	26 142	0.59	0.59	321.53	—
Dec. 31, 2009	10.43	284 489	27 264	0.60 <sup>2</sup>	0.60	181.88	—
Dec. 31, 2008	10.01	195 641	19 539	0.63	0.63	192.71	—
Dec. 31, 2007	9.87	204 605	20 735	0.61	0.61	357.57	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.49</b>	<b>121 186</b>	<b>11 557</b>	<b>0.61</b>	<b>0.61</b>	<b>316.04</b>	—
Dec. 31, 2010	10.41	103 749	9 962	0.59	0.59	321.53	—
Dec. 31, 2009	10.42	31 635	3 035	0.60 <sup>2</sup>	0.61	181.88	—
Dec. 31, 2008	10.00	471	47	0.63	1.38	192.71	—
Dec. 31, 2007 <sup>7</sup>	9.85	—	—	0.61	1 758.98	357.57	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>10.20</b>	<b>2 006 961</b>	<b>196 807</b>	<b>0.06</b>	<b>0.06</b>	<b>316.04</b>	—
Dec. 31, 2010	10.12	1 322 295	130 633	0.05	0.05	321.53	—
Dec. 31, 2009	10.15	919 031	90 533	0.05 <sup>2</sup>	0.05	181.88	—
Dec. 31, 2008	9.79	634 317	64 767	0.06	0.06	192.71	—
Dec. 31, 2007	9.74	607 977	62 410	0.05	0.05	357.57	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.10%, Series B – 0.84%, Series D – 0.58%, Series F – 0.58%, Series O – 0.05%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.00%	50%	50%
Advisor Series	1.00%	50%	50%
Series B	0.75%	33%	67%
Series D	0.50%	30%	70%
Series F	0.50%	–	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

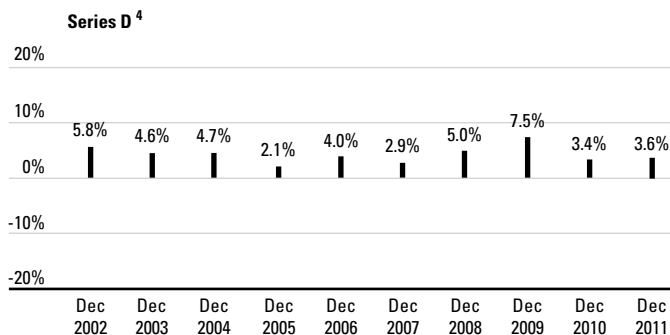
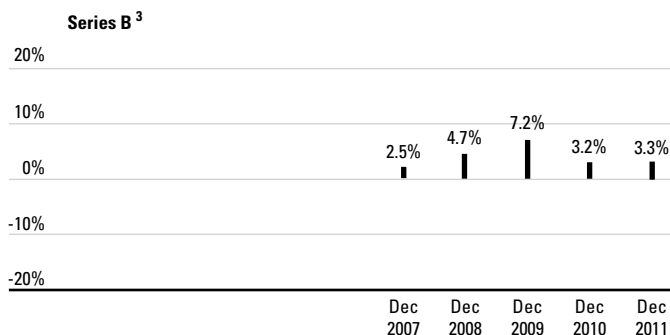
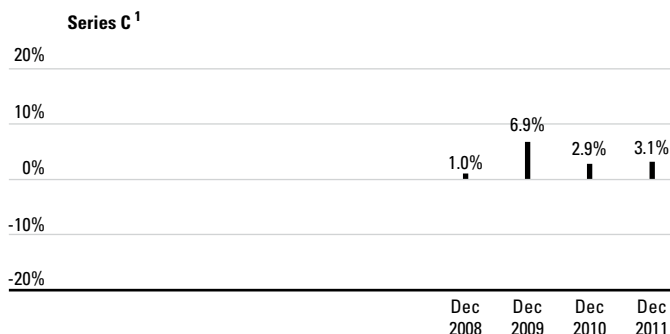
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

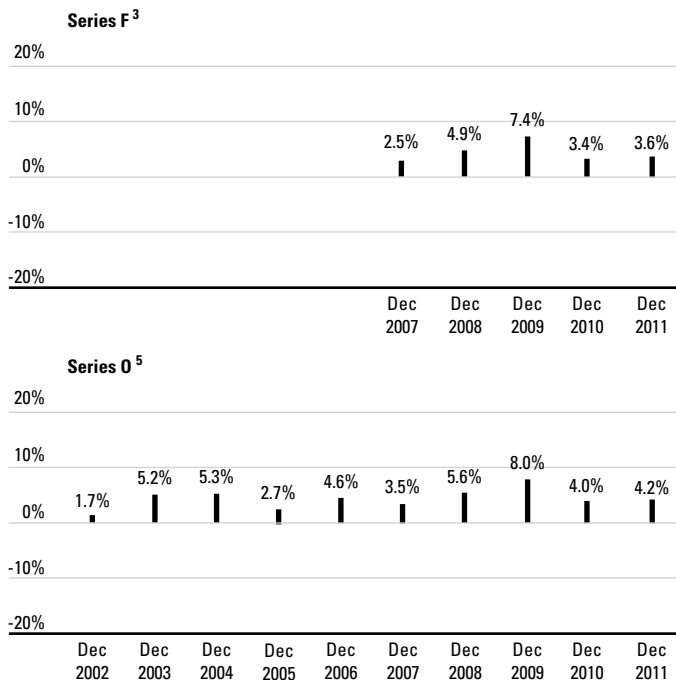
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**DEX Short Term Bond Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	3.1	4.3	—	—	4.5
Benchmark	4.7	4.3	—	—	4.7
Advisor Series <sup>2</sup>	3.1	—	—	—	2.1
Benchmark	4.7	—	—	—	3.5
Series B <sup>3</sup>	3.3	4.5	—	—	4.6
Benchmark	4.7	4.3	—	—	5.5
Series D <sup>4</sup>	3.6	4.8	4.5	4.3	—
Benchmark	4.7	4.3	5.1	4.8	—
Series F <sup>3</sup>	3.6	4.8	—	—	4.8
Benchmark	4.7	4.3	—	—	5.5
Series O <sup>5</sup>	4.2	5.4	5.0	—	4.9
Benchmark	4.7	4.3	5.1	—	4.7

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date December 1993.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**DEX Short Term Bond Index** This index is a measure of the performance of Canadian bonds with terms to maturity of one to five years and is a good proxy for a short-term fixed-income investment.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Corporate Bonds	48.1
Federal Bonds	12.3
Mortgages	11.2
Provincial Bonds	2.4
Cash/Other	26.0

**Top 25 Holdings**

	% of Net Asset Value
Cash & Cash Equivalents	25.9
Government of Canada 1.000% Feb 1 14	4.1
Canada Housing Trust No. 1 2.750% Jun 15 16	2.4
Cards II Trust 3.333% May 15 16	2.0
Canada Housing Trust No. 1 2.750% Sep 15 14	2.0
Cadillac Fairview Finance Trust 3.240% Jan 25 16	1.6
Bank of Montreal 2.960% Aug 2 16	1.5
Canadian Imperial Bank of Commerce 5.150% Jun 6 18	1.5
Toronto-Dominion Bank 5.382% Nov 1 17	1.5
Canadian Imperial Bank of Commerce 4.110% Apr 30 20	1.5
Master Credit Card Trust 5.237% May 21 13	1.4
Bear Stearns Cos. LLC CAD 4.350% Jul 20 12	1.4
Golden Credit Card Trust 5.421% Apr 15 13	1.2
Morgan Stanley CAD 4.500% Feb 23 12	1.1
Bank of Montreal 3.490% Jun 10 16	1.1
Bank of Montreal 5.200% Jun 21 17	1.0
Nova Scotia Power Inc. 5.750% Oct 1 13	0.9
Teranet Holdings LP 3.531% Dec 16 15	0.9
RBC Subordinated Notes Trust 4.580% Apr 30 17	0.9
Rogers Communications Inc. 5.800% May 26 16	0.8
Golden Credit Card Trust 3.510% May 15 16	0.8
Bank of Nova Scotia 4.940% Apr 15 19	0.8
Canadian Mortgage Pools 2.750% Jan 1 16	0.7
Royal Bank of Canada 3.360% Jan 11 16	0.7
Province of Ontario 5.000% Mar 8 14	0.7
<b>Top 25 Holdings</b>	<b>58.4</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



FIXED-INCOME FUND

## PHILLIPS, HAGER & NORTH BOND FUND

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December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

### **A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with relatively high yields and stability of capital by investing in a well-diversified portfolio of fixed income securities issued primarily by Canadian governments and corporations. Through a mix of interest income and capital appreciation, the Fund aims to provide a competitive rate of return while controlling the interest rate and credit risks to which it is exposed. To achieve the Fund's investment objective, we invest primarily in high-quality Canadian corporate and government bonds issued in either Canadian or U.S. dollars. We may also invest in asset-backed commercial paper. The average term to maturity of the portfolio is managed within strict guidelines, and typically falls between seven and 12 years.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$7.26 billion as of December 31, 2011, from \$5.66 billion at the end of 2010. Of this change, \$1.03 billion was due to net inflows and \$564.0 million to investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 8.3%. Over the same time period, the Fund's benchmark index, the DEX Universe Bond Index, returned 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Bonds enjoyed their third consecutive strong year as interest rates fell to record lows. However, we positioned the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden jump in rates, detracted from performance when interest rates, especially on longer-term debt securities, remained near their historically lowest levels at the end of the year.

The Fund's credit strategies, however – that is, our positioning in corporate, provincial and government agency bonds, as well as mortgages – performed well. We maintained an overweight position in corporate and provincial bonds versus the benchmark throughout the year.

Yields on provincial bonds were higher than Government of Canada bonds throughout the year, and as a result, we increased the Fund's exposure to provincial bonds. These shifts allowed our provincial strategies to add value. The Fund's position in corporate bonds, although larger on an absolute basis, was only modestly overweight versus the benchmark. Successful security selection led to a positive performance from our corporate bonds.

We engaged in a small, non-benchmark U.S. bond strategy for most of the year. U.S. bonds outperformed Canadian bonds, which led to a modest increase in return relative to the benchmark from this position. This position was currency hedged throughout its holding period, and was closed at a profit in the third quarter.

### Recent Developments

The portfolio is positioned in expectation that current record low interest rates will rise as a result of an economic recovery. We would adjust the Fund's investment allocations if interest rates rise as expected.

Provincial, corporate and mortgage credit spreads remain at wide levels due to the ongoing uncertainty stemming from Europe, and the resulting retreat to federal bonds of "safe-haven" countries. In this environment, we prefer provincial bonds over corporate debt securities, and will continue to hold an overweight position in provincial bonds as there is sufficient extra income from provincial bonds to justify such a position. If market volatility and uncertainty begin to subside, which we feel is not imminent, or if corporate credit spreads widen further, making them more attractive from a buyer's point of view, we would consider adding to the Fund's corporate bond position.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material

breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>				Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital		Total
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>10.31</b>	<b>0.42</b>	<b>(0.12)</b>	<b>0.16</b>	<b>0.36</b>	<b>0.82</b>	<b>(0.29)</b>	–	<b>(0.06)</b>	–	<b>(0.35)</b>	<b>10.75</b>
Dec. 31, 2010	10.14	0.46	(0.11)	0.14	0.11	0.60	(0.35)	–	(0.12)	–	(0.47)	10.31
Dec. 31, 2009	9.76	0.49	(0.12)	0.12	0.13	0.62	(0.40)	–	(0.09)	–	(0.49)	10.14
Dec. 31, 2008 <sup>3</sup>	9.56 <sup>†</sup>	0.06	(0.01)	0.01	0.26	0.32	(0.03)	–	(0.01)	–	(0.04)	9.76
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>10.31</b>	<b>0.42</b>	<b>(0.12)</b>	<b>0.16</b>	<b>0.36</b>	<b>0.82</b>	<b>(0.29)</b>	–	<b>(0.06)</b>	–	<b>(0.35)</b>	<b>10.75</b>
Dec. 31, 2010 <sup>4</sup>	10.63 <sup>†</sup>	0.08	(0.02)	0.02	0.02	0.10	(0.08)	–	(0.12)	–	(0.20)	10.31
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>10.35</b>	<b>0.42</b>	<b>(0.09)</b>	<b>0.16</b>	<b>0.36</b>	<b>0.85</b>	<b>(0.31)</b>	–	<b>(0.06)</b>	–	<b>(0.37)</b>	<b>10.79</b>
Dec. 31, 2010	10.16	0.47	(0.09)	0.14	0.11	0.63	(0.36)	–	(0.12)	–	(0.48)	10.35
Dec. 31, 2009	9.75	0.49	(0.08)	0.15	0.35	0.91	(0.41)	–	(0.09)	–	(0.50)	10.16
Dec. 31, 2008	9.85	0.49	(0.08)	0.08	(0.31)	0.18	(0.35)	–	(0.03)	–	(0.38)	9.75
Dec. 31, 2007 <sup>5</sup>	9.62 <sup>†</sup>	0.25	(0.04)	0.03	0.13	0.37	(0.13)	–	–	–	(0.13)	9.85
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>10.24</b>	<b>0.42</b>	<b>(0.06)</b>	<b>0.16</b>	<b>0.36</b>	<b>0.88</b>	<b>(0.35)</b>	–	<b>(0.06)</b>	–	<b>(0.41)</b>	<b>10.67</b>
Dec. 31, 2010	10.06	0.46	(0.06)	0.14	0.11	0.65	(0.39)	–	(0.12)	–	(0.51)	10.24
Dec. 31, 2009	9.67	0.49	(0.06)	0.15	0.33	0.91	(0.44)	–	(0.09)	–	(0.53)	10.06
Dec. 31, 2008	9.80	0.48	(0.06)	0.11	(0.22)	0.31	(0.40)	–	(0.03)	–	(0.43)	9.67
Dec. 31, 2007	9.95	0.47	(0.06)	(0.06)	(0.12)	0.23	(0.39)	–	–	–	(0.39)	9.80
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>10.28</b>	<b>0.42</b>	<b>(0.06)</b>	<b>0.16</b>	<b>0.36</b>	<b>0.88</b>	<b>(0.35)</b>	–	<b>(0.06)</b>	–	<b>(0.41)</b>	<b>10.72</b>
Dec. 31, 2010	10.10	0.46	(0.06)	0.14	0.11	0.65	(0.39)	–	(0.12)	–	(0.51)	10.28
Dec. 31, 2009	9.71	0.49	(0.06)	0.13	0.32	0.88	(0.44)	–	(0.09)	–	(0.53)	10.10
Dec. 31, 2008	9.82	0.49	(0.06)	0.07	(0.27)	0.23	(0.39)	–	(0.03)	–	(0.42)	9.71
Dec. 31, 2007 <sup>5</sup>	9.62 <sup>†</sup>	0.24	(0.03)	0.02	0.17	0.40	(0.19)	–	–	–	(0.19)	9.82
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>10.27</b>	<b>0.41</b>	–	<b>0.16</b>	<b>0.36</b>	<b>0.93</b>	<b>(0.41)</b>	–	<b>(0.06)</b>	–	<b>(0.47)</b>	<b>10.70</b>
Dec. 31, 2010	10.07	0.46	–	0.14	0.11	0.71	(0.44)	–	(0.12)	–	(0.56)	10.27
Dec. 31, 2009	9.68	0.48	–	0.15	0.33	0.96	(0.48)	–	(0.09)	–	(0.57)	10.07
Dec. 31, 2008	9.83	0.48	–	0.10	(0.23)	0.35	(0.48)	–	(0.03)	–	(0.51)	9.68
Dec. 31, 2007	10.00	0.48	–	(0.06)	(0.10)	0.32	(0.48)	–	–	–	(0.48)	9.83

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.76</b>	<b>192 971</b>	<b>17 926</b>	<b>1.17</b>	<b>1.17</b>	<b>158.96</b>	—
Dec. 31, 2010	10.33	138 241	13 386	1.14	1.14	166.39	—
Dec. 31, 2009	10.16	64 362	6 334	1.11 <sup>2</sup>	1.13	92.65	—
Dec. 31, 2008 <sup>5</sup>	9.78	9 985	1 021	1.13	1.16	117.63	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.76</b>	<b>22 764</b>	<b>2 115</b>	<b>1.17</b>	<b>1.17</b>	<b>158.96</b>	—
Dec. 31, 2010 <sup>6</sup>	10.33	1 983	192	1.14	1.14	166.39	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>10.80</b>	<b>4 512</b>	<b>418</b>	<b>0.89</b>	<b>0.89</b>	<b>158.96</b>	—
Dec. 31, 2010	10.36	5 483	529	0.86	0.86	166.39	—
Dec. 31, 2009	10.17	7 986	785	0.85 <sup>2</sup>	0.86	92.65	—
Dec. 31, 2008	9.77	10 472	1 072	0.86	0.89	117.63	—
Dec. 31, 2007 <sup>7</sup>	9.86	3 528	358	0.86	1.05	351.88	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.68</b>	<b>861 453</b>	<b>80 648</b>	<b>0.61</b>	<b>0.61</b>	<b>158.96</b>	—
Dec. 31, 2010	10.25	820 284	80 022	0.59	0.59	166.39	—
Dec. 31, 2009	10.08	804 910	79 867	0.58 <sup>2</sup>	0.58	92.65	—
Dec. 31, 2008	9.69	797 070	82 250	0.59	0.59	117.63	—
Dec. 31, 2007	9.81	868 478	88 503	0.58	0.58	351.88	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.73</b>	<b>97 683</b>	<b>9 104</b>	<b>0.61</b>	<b>0.61</b>	<b>158.96</b>	—
Dec. 31, 2010	10.30	69 654	6 766	0.60	0.60	166.39	—
Dec. 31, 2009	10.12	48 941	4 836	0.59 <sup>2</sup>	0.59	92.65	—
Dec. 31, 2008	9.72	12 189	1 254	0.59	0.62	117.63	—
Dec. 31, 2007 <sup>7</sup>	9.83	2 229	227	0.59	0.83	351.88	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>10.71</b>	<b>6 080 197</b>	<b>567 456</b>	<b>0.02</b>	<b>0.02</b>	<b>158.96</b>	—
Dec. 31, 2010	10.28	4 629 060	450 231	0.02	0.02	166.39	—
Dec. 31, 2009	10.09	3 098 575	307 000	0.02 <sup>2</sup>	0.02	92.65	—
Dec. 31, 2008	9.69	3 115 148	321 403	0.03	0.03	117.63	—
Dec. 31, 2007	9.84	2 823 236	286 950	0.02	0.02	351.88	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.10%, Series B – 0.84%, Series D – 0.58%, Series F – 0.58%, Series O – 0.02%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.00%	50%	50%
Advisor Series	1.00%	50%	50%
Series B	0.75%	33%	67%
Series D	0.50%	30%	70%
Series F	0.50%	–	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

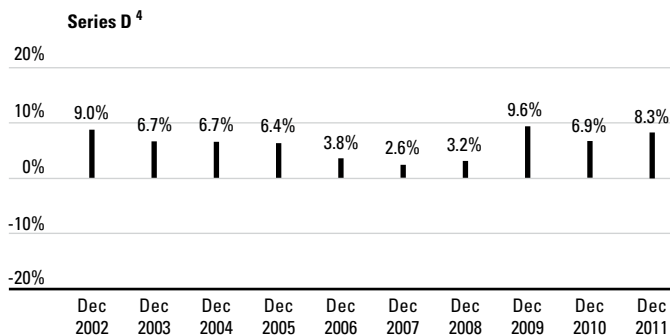
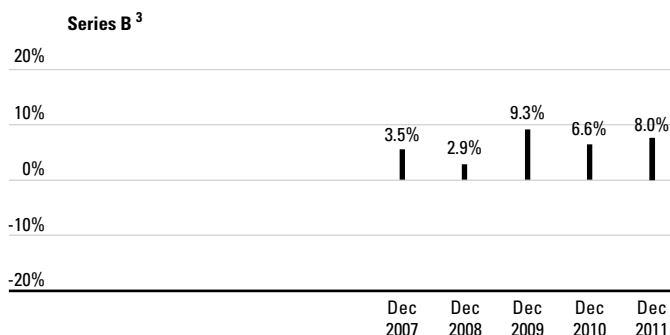
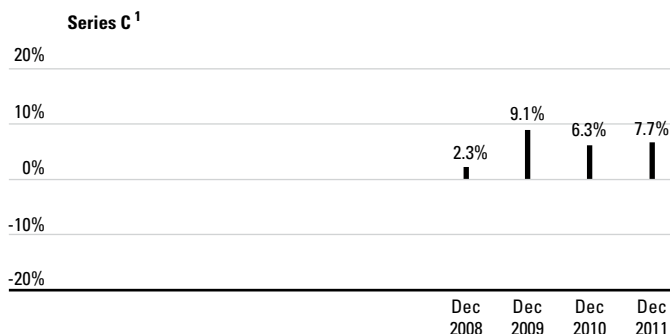
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

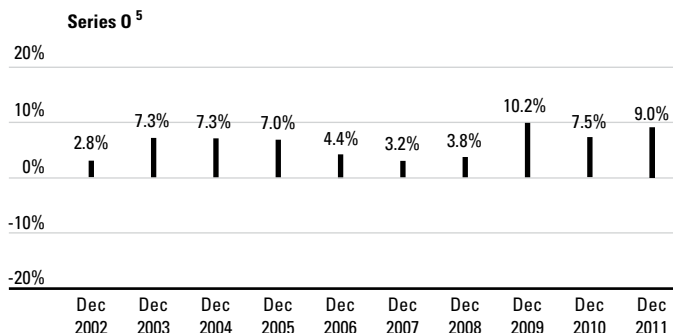
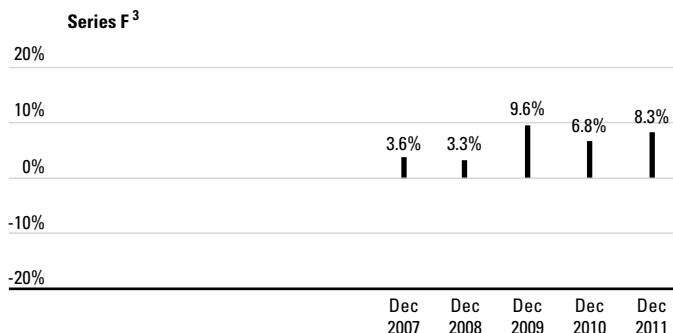
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**DEX Universe Bond Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	7.7	7.7	—	—	8.3
Benchmark	9.7	7.3	—	—	8.1
Advisor Series <sup>2</sup>	7.7	—	—	—	5.7
Benchmark	9.7	—	—	—	7.4
Series B <sup>3</sup>	8.0	8.0	—	—	6.7
Benchmark	9.7	7.3	—	—	7.3
Series D <sup>4</sup>	8.3	8.3	6.1	6.3	—
Benchmark	9.7	7.3	6.4	6.5	—
Series F <sup>3</sup>	8.3	8.3	—	—	7.0
Benchmark	9.7	7.3	—	—	7.3
Series O <sup>5</sup>	9.0	8.9	6.7	—	6.8
Benchmark	9.7	7.3	6.4	—	6.4

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date December 1970.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Corporate Bonds	42.6
Provincial Bonds	31.0
Federal Bonds	7.1
Mortgages	0.9
Cash/Other	18.4

**Top 25 Holdings**

	% of Net Asset Value
Cash & Cash Equivalents	18.4
Province of Ontario 7.600% Jun 2 27	10.6
Province of Ontario 6.500% Mar 8 29	3.8
Province of Ontario 4.650% Jun 2 41	3.6
Canada Housing Trust No. 1 3.750% Mar 15 20	2.3
Morgan Stanley CAD 4.500% Feb 23 12	1.7
Government of Canada 4.000% Jun 1 41	1.7
Toronto-Dominion Bank 5.382% Nov 1 17	1.6
Province of Ontario 8.500% Dec 2 25	1.4
Bank of Montreal 3.490% Jun 10 16	1.3
Province of Ontario 4.200% Jun 2 20	1.2
Bank of Nova Scotia 6.000% Oct 3 18	1.2
Province of Quebec 6.000% Oct 1 29	1.1
Ontario Electricity Financial Corp. 8.250% Jun 22 26	1.1
Bank of Montreal 2.960% Aug 2 16	1.1
Province of Ontario 4.600% Jun 2 39	1.1
Province of Quebec 4.500% Dec 1 19	1.1
Government of Canada 3.250% Jun 1 21	1.0
Royal Bank of Canada 3.180% Nov 2 20	1.0
Golden Credit Card Trust 3.510% May 15 16	1.0
Bank of Montreal 5.180% Jun 10 15	1.0
Government of Canada 2.750% Sep 1 16	0.9
Royal Bank of Canada 2.680% Dec 8 16	0.9
Province of Ontario 4.700% Jun 2 37	0.9
Bank of Nova Scotia 2.740% Dec 1 16	0.8
<b>Top 25 Holdings</b>	<b>61.8</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



FIXED-INCOME FUND

**PHILLIPS, HAGER & NORTH  
COMMUNITY VALUES BOND FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with relatively high yields and stability of capital by investing primarily in a well-diversified portfolio of fixed income securities issued by Canadian governments and corporations that conduct themselves in a socially responsible manner. To achieve the Fund's investment objective, we invest primarily in high-quality Canadian corporate and government bonds issued in Canadian or U.S. dollars. We may also invest in asset-backed commercial paper. The average term to maturity of the portfolio is managed within strict guidelines, typically between seven and twelve years.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$133.9 million as of December 31, 2011, from \$129.9 million at the end of 2010. Of this change, \$7.9 million was due to net outflows, offset by \$11.9 million of investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 8.2%. Over the same time period, the Fund's benchmark index, the DEX Universe Bond Index, returned 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Bonds enjoyed their third consecutive strong year as interest rates fell to record lows. However, the portfolio manager positioned the fixed-income portion of the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden jump in rates, detracted from performance when interest rates, especially on longer-term debt securities, remained near their historically lowest levels at the end of the year.

The Fund's credit strategies, however – that is, our positioning in corporate, provincial and government agency bonds, as well as mortgages – performed well. We maintained an overweight position in corporate and provincial bonds versus the benchmark throughout the year.

Yields on provincial bonds were higher than Government of Canada bonds throughout the year, and as a result, we increased the Fund's exposure to provincial bonds. These shifts allowed our provincial strategies to add value. The Fund's position in corporate bonds, although larger on an absolute basis, was only modestly overweight versus the benchmark. Successful security selection led to a positive performance from our corporate bonds.

We engaged in a small, non-benchmark U.S. bond strategy for most of the year. U.S. bonds outperformed Canadian bonds, which led to a modest increase in return relative to the benchmark from this position. This position was currency hedged throughout its holding period, and was closed at a profit in the third quarter.

### Recent Developments

The portfolio is positioned in expectation that current record low interest rates will rise as a result of an economic recovery. We would adjust the Fund's investment allocations if interest rates rise as expected.

Provincial, corporate and mortgage credit spreads remain at wide levels due to the ongoing uncertainty stemming from Europe, and the resulting retreat to federal bonds of "safe-haven" countries. In this environment, we prefer provincial bonds over corporate debt securities, and will continue to hold an overweight position in provincial bonds as there is sufficient extra income from provincial bonds to justify such a position. If market volatility and uncertainty begin to subside, which we feel is not imminent, or if corporate credit spreads widen further, making them more attractive from a buyer's point of view, we would consider adding to the Fund's corporate bond position.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>10.95</b>	<b>0.43</b>	<b>(0.12)</b>	<b>0.26</b>	<b>0.30</b>	<b>0.87</b>	<b>(0.30)</b>	–	<b>(0.08)</b>	–	<b>(0.38)</b>	<b>11.39</b>
Dec. 31, 2010	10.81	0.46	(0.12)	0.18	0.12	0.64	(0.36)	–	(0.15)	–	(0.51)	10.95
Dec. 31, 2009	10.37	0.50	(0.12)	0.06	(0.07)	0.37	(0.37)	–	(0.01)	–	(0.38)	10.81
Dec. 31, 2008 <sup>3</sup>	10.16 <sup>†</sup>	0.07	(0.02)	(0.17)	0.45	0.33	(0.04)	–	(0.01)	–	(0.05)	10.37
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>10.95</b>	<b>0.43</b>	<b>(0.12)</b>	<b>0.26</b>	<b>0.30</b>	<b>0.87</b>	<b>(0.30)</b>	–	<b>(0.08)</b>	–	<b>(0.38)</b>	<b>11.39</b>
Dec. 31, 2010 <sup>4</sup>	11.32 <sup>†</sup>	0.08	(0.02)	0.03	0.02	0.11	(0.09)	–	(0.15)	–	(0.24)	10.95
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>10.98</b>	<b>0.43</b>	<b>(0.10)</b>	<b>0.26</b>	<b>0.30</b>	<b>0.89</b>	<b>(0.32)</b>	–	<b>(0.08)</b>	–	<b>(0.40)</b>	<b>11.42</b>
Dec. 31, 2010	10.82	0.46	(0.10)	0.18	0.12	0.66	(0.37)	–	(0.15)	–	(0.52)	10.98
Dec. 31, 2009	10.37	0.51	(0.10)	0.14	0.33	0.88	(0.39)	–	(0.02)	–	(0.41)	10.82
Dec. 31, 2008	10.41	0.52	(0.11)	–	(0.12)	0.29	(0.35)	–	(0.01)	–	(0.36)	10.37
Dec. 31, 2007 <sup>5</sup>	10.16 <sup>†</sup>	0.25	(0.05)	(0.02)	0.24	0.42	(0.13)	–	–	–	(0.13)	10.41
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>10.89</b>	<b>0.42</b>	<b>(0.06)</b>	<b>0.26</b>	<b>0.29</b>	<b>0.91</b>	<b>(0.36)</b>	–	<b>(0.08)</b>	–	<b>(0.44)</b>	<b>11.33</b>
Dec. 31, 2010	10.74	0.46	(0.06)	0.18	0.12	0.70	(0.41)	–	(0.15)	–	(0.56)	10.89
Dec. 31, 2009	10.30	0.51	(0.07)	0.14	0.31	0.89	(0.43)	–	(0.02)	–	(0.45)	10.74
Dec. 31, 2008	10.37	0.51	(0.08)	0.02	(0.12)	0.33	(0.41)	–	(0.01)	–	(0.42)	10.30
Dec. 31, 2007	10.52	0.50	(0.08)	(0.10)	(0.08)	0.24	(0.39)	–	–	–	(0.39)	10.37
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>10.92</b>	<b>0.42</b>	<b>(0.06)</b>	<b>0.26</b>	<b>0.30</b>	<b>0.92</b>	<b>(0.36)</b>	–	<b>(0.08)</b>	–	<b>(0.44)</b>	<b>11.36</b>
Dec. 31, 2010	10.77	0.46	(0.06)	0.18	0.12	0.70	(0.41)	–	(0.15)	–	(0.56)	10.92
Dec. 31, 2009	10.33	0.51	(0.07)	0.11	0.29	0.84	(0.43)	–	(0.02)	–	(0.45)	10.77
Dec. 31, 2008	10.40	0.51	(0.08)	0.01	(0.11)	0.33	(0.41)	–	(0.01)	–	(0.42)	10.33
Dec. 31, 2007 <sup>5</sup>	10.16 <sup>†</sup>	0.25	(0.04)	(0.04)	0.21	0.38	(0.19)	–	–	–	(0.19)	10.40
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>10.76</b>	<b>0.42</b>	<b>(0.01)</b>	<b>0.25</b>	<b>0.29</b>	<b>0.95</b>	<b>(0.41)</b>	–	<b>(0.08)</b>	–	<b>(0.49)</b>	<b>11.20</b>
Dec. 31, 2010	10.61	0.45	(0.01)	0.18	0.12	0.74	(0.45)	–	(0.15)	–	(0.60)	10.76
Dec. 31, 2009	10.16	0.50	(0.01)	0.13	0.26	0.88	(0.47)	–	(0.02)	–	(0.49)	10.61
Dec. 31, 2008	10.25	0.50	(0.01)	0.04	(0.12)	0.41	(0.49)	–	(0.01)	–	(0.50)	10.16
Dec. 31, 2007	10.43	0.49	(0.01)	(0.09)	(0.06)	0.33	(0.48)	–	–	–	(0.48)	10.25

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>11.41</b>	<b>7 889</b>	<b>692</b>	<b>1.16</b>	<b>1.16</b>	<b>162.93</b>	—
Dec. 31, 2010	10.97	5 272	481	1.13	1.13	149.79	—
Dec. 31, 2009	10.83	1 571	145	1.16 <sup>2</sup>	1.30	109.91	—
Dec. 31, 2008 <sup>5</sup>	10.39	19	2	1.25	28.80	130.98	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>11.41</b>	<b>2 346</b>	<b>206</b>	<b>1.16</b>	<b>1.16</b>	<b>162.93</b>	—
Dec. 31, 2010 <sup>6</sup>	10.97	—	—	1.13	1.13	149.79	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>11.43</b>	<b>332</b>	<b>29</b>	<b>0.97</b>	<b>0.97</b>	<b>162.93</b>	—
Dec. 31, 2010	10.99	362	33	0.93	0.93	149.79	—
Dec. 31, 2009	10.84	343	32	0.98 <sup>2</sup>	1.10	109.91	—
Dec. 31, 2008	10.38	385	37	1.04	1.21	130.98	—
Dec. 31, 2007 <sup>7</sup>	10.42	229	22	1.03	2.21	323.64	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>11.34</b>	<b>21 546</b>	<b>1 900</b>	<b>0.62</b>	<b>0.62</b>	<b>162.93</b>	—
Dec. 31, 2010	10.90	20 990	1 926	0.60	0.60	149.79	—
Dec. 31, 2009	10.76	18 209	1 693	0.65 <sup>2</sup>	0.65	109.91	—
Dec. 31, 2008	10.31	18 473	1 791	0.75	0.75	130.98	—
Dec. 31, 2007	10.38	13 826	1 333	0.77	0.77	323.64	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>11.38</b>	<b>3 467</b>	<b>305</b>	<b>0.61</b>	<b>0.61</b>	<b>162.93</b>	—
Dec. 31, 2010	10.94	3 215	294	0.61	0.61	149.79	—
Dec. 31, 2009	10.79	830	77	0.65 <sup>2</sup>	0.73	109.91	—
Dec. 31, 2008	10.34	165	16	0.73	1.12	130.98	—
Dec. 31, 2007 <sup>7</sup>	10.41	66	6	0.77	6.36	323.64	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>11.21</b>	<b>98 386</b>	<b>8 774</b>	<b>0.06</b>	<b>0.06</b>	<b>162.93</b>	—
Dec. 31, 2010	10.78	100 103	9 290	0.06	0.06	149.79	—
Dec. 31, 2009	10.62	93 193	8 772	0.09 <sup>2</sup>	0.09	109.91	—
Dec. 31, 2008	10.17	67 473	6 631	0.12	0.12	130.98	—
Dec. 31, 2007	10.26	67 586	6 587	0.10	0.10	323.64	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.11%, Series B – 0.90%, Series D – 0.58%, Series F – 0.58%, Series O – 0.06%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.00%	50%	50%
Advisor Series	1.00%	50%	50%
Series B	0.80%	31%	69%
Series D	0.50%	30%	70%
Series F	0.50%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

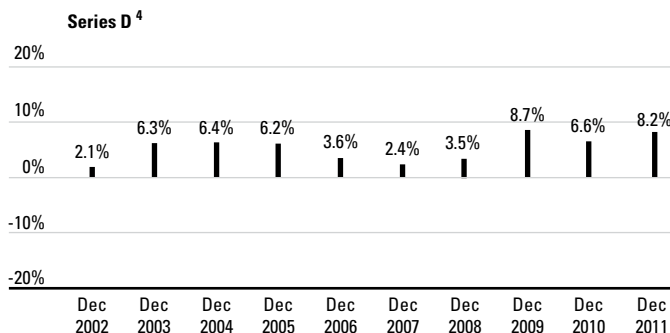
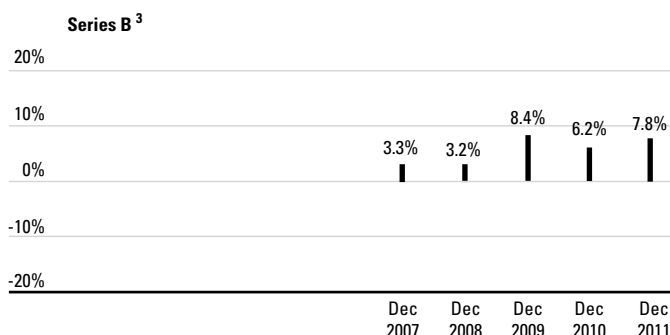
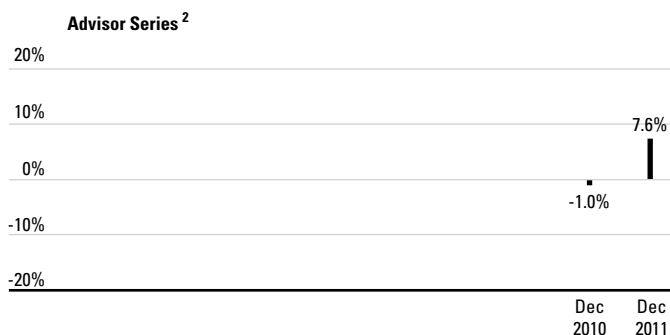
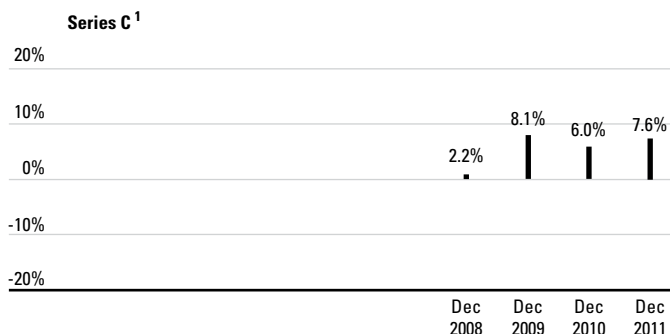
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

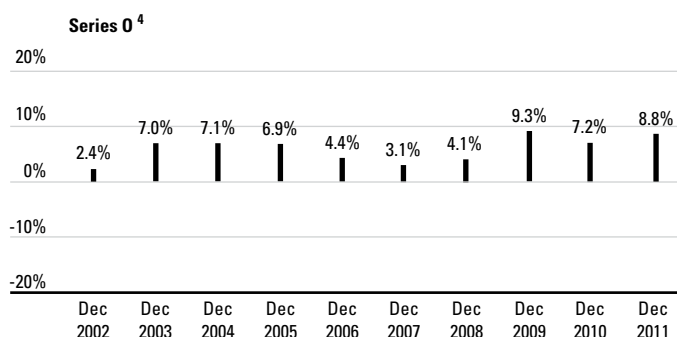
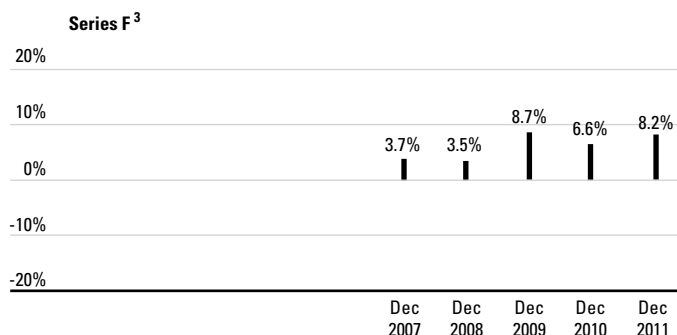
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**DEX Universe Bond Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	7.6	7.2	—	—	7.8
Benchmark	9.7	7.3	—	—	8.1
Advisor Series <sup>2</sup>	7.6	—	—	—	5.6
Benchmark	9.7	—	—	—	7.4
Series B <sup>3</sup>	7.8	7.4	—	—	6.4
Benchmark	9.7	7.3	—	—	7.3
Series D <sup>4</sup>	8.2	7.8	5.8	—	5.8
Benchmark	9.7	7.3	6.4	—	6.3
Series F <sup>3</sup>	8.2	7.8	—	—	6.8
Benchmark	9.7	7.3	—	—	7.3
Series O <sup>4</sup>	8.8	8.4	6.5	—	6.5
Benchmark	9.7	7.3	6.4	—	6.3

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date September 2002.

Series D was known as Series A prior to November 17, 2008. Although the Fund was prospectused in August 2002, Series A and Series O units were not offered for sale until September 2002. We are therefore not permitted to disclose performance data for this Fund for any period prior to September 2002.

**INDEX DESCRIPTION**

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)  
As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Corporate Bonds	38.3
Provincial Bonds	32.2
Federal Bonds	9.1
Cash/Other	20.4

### Top 25 Holdings

	% of Net Asset Value
Cash & Cash Equivalents	20.4
Province of Ontario 7.600% Jun 2 27	11.5
Province of Ontario 4.200% Jun 2 20	3.7
Province of Ontario 6.500% Mar 8 29	3.6
Toronto-Dominion Bank 5.382% Nov 1 17	2.8
Government of Canada 3.250% Jun 1 21	2.3
Province of Ontario 4.650% Jun 2 41	2.0
Canada Housing Trust No. 1 3.750% Mar 15 20	1.8
Province of Ontario 5.850% Mar 8 33	1.7
Province of Ontario 8.100% Sep 8 23	1.6
Government of Canada 2.750% Sep 1 16	1.5
Province of Quebec 6.000% Oct 1 29	1.5
Bank of Montreal 2.960% Aug 2 16	1.4
Province of Ontario 8.500% Dec 2 25	1.4
Province of Ontario 4.600% Jun 2 39	1.3
Canada Housing Trust No. 1 2.750% Jun 15 16	1.1
Royal Bank of Canada 3.180% Nov 2 20	1.1
Government of Canada 4.000% Jun 1 41	1.1
Golden Credit Card Trust 3.510% May 15 16	1.0
HSBC Bank Canada 3.558% Oct 4 17	1.0
Master Credit Card Trust 5.297% Aug 21 12	1.0
Bank of Montreal 5.200% Jun 21 17	0.9
Caisse Centrale Desjardins 3.502% Oct 5 17	0.9
Royal Bank of Canada 2.680% Dec 8 16	0.9
Bank of America Corp. CAD 4.810% Jun 1 16	0.8
Top 25 Holdings	68.3

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



FIXED-INCOME FUND

**PHILLIPS, HAGER & NORTH  
TOTAL RETURN BOND FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with stability of capital by investing primarily in a well-diversified portfolio of fixed income securities issued primarily by Canadian governments and corporations. It also invests in derivatives. Through a mix of interest income and capital appreciation, the Fund aims to provide a competitive rate of return while controlling the interest rate and credit risks to which it is exposed. To achieve the Fund's investment objective, we invest primarily in medium- to high-quality corporate bonds and government bonds of Canadian, U.S. and other foreign issuers. The Fund may also invest in asset-backed commercial paper to enhance its return (the Fund's weighting in high-yield bonds is generally restricted to a maximum of 20% of its total assets). The average term to maturity of the portfolio is managed within strict guidelines, and typically falls between seven and 12 years.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$2.54 billion as of December 31, 2011, from \$2.44 billion at the end of 2010. Of this change, \$90.2 million was due to net outflows, offset by \$191.2 million of investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 8.1%. Over the same time period, the Fund's benchmark index, the DEX Universe Bond Index, returned 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Bonds enjoyed their third consecutive strong year as interest rates fell to record lows. However, we positioned the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden jump in rates, detracted from performance when interest rates, especially on longer-term debt securities, remained near their historically lowest levels at the end of the year. Our interest rate strategy caused the Fund to underperform its benchmark for the year.

The Fund's credit strategies, however – that is, our positioning in corporate, provincial and government agency bonds, as well as mortgages – performed well. We maintained an overweight position in corporate and provincial bonds versus the benchmark throughout the year. Yields on provincial bonds were higher than Government of Canada bonds throughout the year, and as a result, we increased the Fund's exposure to provincial bonds. These shifts allowed our provincial strategies to add value. The Fund's position in corporate bonds, although larger on an absolute basis, was only modestly overweight versus the benchmark. Successful security selection led to a positive performance from our corporate bonds. The Fund's small position in high-yield bonds performed well compared with other bonds; however, they underperformed the investment grade bonds within the Fund.

We engaged in a small, non-benchmark U.S. bond strategy for most of the year. U.S. bonds outperformed Canadian bonds, which led to a modest increase in return relative to the benchmark from this position. This position was currency hedged throughout its holding period, and was closed at a profit in the third quarter.

### Recent Developments

The Fund is positioned in expectation that current record low interest rates will rise as a result of an economic recovery. We would adjust the Fund's investment allocations if interest rates rise as expected.

Provincial, corporate and mortgage credit spreads remain at wide levels due to the ongoing economic uncertainty in Europe, and the resulting retreat to federal bonds of "safe-haven" countries. In this environment, we prefer provincial bonds over corporate debt securities, and will continue to hold an overweight position in provincial bonds as there is sufficient extra income from provincial bonds to justify such a position. If market volatility and uncertainty begin to subside, which we feel is not imminent, or if corporate credit spreads widen further, making them more attractive from a buyer's point of view, we would consider adding to the Fund's corporate bond position.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a Related-Party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a Related-Party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>11.18</b>	<b>0.48</b>	<b>(0.13)</b>	<b>0.18</b>	<b>0.29</b>	<b>0.82</b>	<b>(0.35)</b>	–	<b>(0.04)</b>	–	<b>(0.39)</b>	<b>11.62</b>
Dec. 31, 2010	11.05	0.48	(0.12)	0.19	0.12	0.67	(0.35)	–	(0.17)	–	(0.52)	11.18
Dec. 31, 2009	10.50	0.57	(0.12)	0.18	0.27	0.90	(0.46)	–	(0.10)	–	(0.56)	11.05
Dec. 31, 2008 <sup>3</sup>	10.33 <sup>†</sup>	(0.04)	(0.02)	(0.08)	0.44	0.30	–	–	–	–	–	10.50
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>11.18</b>	<b>0.48</b>	<b>(0.13)</b>	<b>0.18</b>	<b>0.29</b>	<b>0.82</b>	<b>(0.35)</b>	–	<b>(0.04)</b>	–	<b>(0.39)</b>	<b>11.62</b>
Dec. 31, 2010 <sup>4</sup>	11.52 <sup>†</sup>	0.08	(0.02)	0.03	0.02	0.11	(0.05)	–	(0.17)	–	(0.22)	11.18
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>11.29</b>	<b>0.49</b>	<b>(0.10)</b>	<b>0.18</b>	<b>0.29</b>	<b>0.86</b>	<b>(0.39)</b>	–	<b>(0.04)</b>	–	<b>(0.43)</b>	<b>11.72</b>
Dec. 31, 2010	11.13	0.48	(0.10)	0.19	0.13	0.70	(0.36)	–	(0.17)	–	(0.53)	11.29
Dec. 31, 2009	10.56	0.59	(0.09)	0.20	0.46	1.16	(0.47)	–	(0.10)	–	(0.57)	11.13
Dec. 31, 2008	10.80	0.41	(0.10)	(0.04)	(0.48)	(0.21)	(0.30)	–	–	–	(0.30)	10.56
Dec. 31, 2007 <sup>5</sup>	10.54 <sup>†</sup>	0.29	(0.05)	0.03	0.16	0.43	(0.17)	–	–	–	(0.17)	10.80
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>11.18</b>	<b>0.48</b>	<b>(0.06)</b>	<b>0.18</b>	<b>0.29</b>	<b>0.89</b>	<b>(0.43)</b>	–	<b>(0.04)</b>	–	<b>(0.47)</b>	<b>11.61</b>
Dec. 31, 2010	11.03	0.48	(0.06)	0.19	0.12	0.73	(0.40)	–	(0.17)	–	(0.57)	11.18
Dec. 31, 2009	10.48	0.58	(0.06)	0.20	0.44	1.16	(0.51)	–	(0.10)	–	(0.61)	11.03
Dec. 31, 2008	10.75	0.43	(0.07)	0.02	(0.31)	0.07	(0.36)	–	–	–	(0.36)	10.48
Dec. 31, 2007	10.90	0.53	(0.06)	(0.07)	(0.13)	0.27	(0.45)	–	–	–	(0.45)	10.75
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>11.20</b>	<b>0.48</b>	<b>(0.07)</b>	<b>0.18</b>	<b>0.29</b>	<b>0.88</b>	<b>(0.43)</b>	–	<b>(0.04)</b>	–	<b>(0.47)</b>	<b>11.62</b>
Dec. 31, 2010	11.05	0.48	(0.07)	0.19	0.12	0.72	(0.40)	–	(0.17)	–	(0.57)	11.20
Dec. 31, 2009	10.50	0.56	(0.06)	0.19	0.31	1.00	(0.51)	–	(0.10)	–	(0.61)	11.05
Dec. 31, 2008	10.77	0.28	(0.06)	(0.15)	(0.07)	–	(0.35)	–	–	–	(0.35)	10.50
Dec. 31, 2007 <sup>5</sup>	10.54 <sup>†</sup>	0.29	(0.03)	0.04	0.17	0.47	(0.22)	–	–	–	(0.22)	10.77
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>11.12</b>	<b>0.48</b>	–	<b>0.18</b>	<b>0.29</b>	<b>0.95</b>	<b>(0.49)</b>	–	<b>(0.04)</b>	–	<b>(0.53)</b>	<b>11.54</b>
Dec. 31, 2010	10.99	0.47	–	0.19	0.12	0.78	(0.47)	–	(0.17)	–	(0.64)	11.12
Dec. 31, 2009	10.45	0.58	–	0.20	0.46	1.24	(0.58)	–	(0.10)	–	(0.68)	10.99
Dec. 31, 2008	10.78	0.45	–	0.05	(0.31)	0.19	(0.47)	–	–	–	(0.47)	10.45
Dec. 31, 2007	10.95	0.55	–	(0.07)	(0.07)	0.41	(0.53)	–	–	–	(0.53)	10.78

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>11.63</b>	<b>218 565</b>	<b>18 788</b>	<b>1.16</b>	<b>1.16</b>	<b>123.09</b>	—
Dec. 31, 2010	11.20	190 033	16 969	1.14	1.14	136.37	—
Dec. 31, 2009	11.07	108 239	9 778	1.11 <sup>2</sup>	1.13	84.61	—
Dec. 31, 2008 <sup>5</sup>	10.53	4 245	403	1.11	1.26	78.55	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>11.63</b>	<b>45 403</b>	<b>3 903</b>	<b>1.16</b>	<b>1.16</b>	<b>123.09</b>	—
Dec. 31, 2010 <sup>6</sup>	11.20	2 800	250	1.14	1.14	136.37	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>11.74</b>	<b>3 513</b>	<b>299</b>	<b>0.89</b>	<b>0.89</b>	<b>123.09</b>	—
Dec. 31, 2010	11.30	3 729	330	0.86	0.86	136.37	—
Dec. 31, 2009	11.15	4 319	387	0.84 <sup>2</sup>	0.88	84.61	—
Dec. 31, 2008	10.59	6 107	577	0.84	0.91	78.55	—
Dec. 31, 2007 <sup>7</sup>	10.82	1 715	159	0.85	1.26	379.08	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>11.62</b>	<b>804 147</b>	<b>69 210</b>	<b>0.60</b>	<b>0.60</b>	<b>123.09</b>	—
Dec. 31, 2010	11.20	826 458	73 803	0.58	0.58	136.37	—
Dec. 31, 2009	11.05	874 988	79 151	0.57 <sup>2</sup>	0.57	84.61	—
Dec. 31, 2008	10.51	890 669	84 765	0.58	0.58	78.55	—
Dec. 31, 2007	10.76	995 222	92 452	0.58	0.58	379.08	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>11.64</b>	<b>223 472</b>	<b>19 202</b>	<b>0.61</b>	<b>0.61</b>	<b>123.09</b>	—
Dec. 31, 2010	11.22	156 757	13 977	0.60	0.60	136.37	—
Dec. 31, 2009	11.07	79 581	7 187	0.58 <sup>2</sup>	0.59	84.61	—
Dec. 31, 2008	10.52	14 393	1 368	0.58	0.61	78.55	—
Dec. 31, 2007 <sup>7</sup>	10.78	1 378	128	0.58	1.16	379.08	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>11.56</b>	<b>1 249 599</b>	<b>108 130</b>	<b>0.02</b>	<b>0.02</b>	<b>123.09</b>	—
Dec. 31, 2010	11.14	1 263 961	113 481	0.02	0.02	136.37	—
Dec. 31, 2009	11.01	1 285 874	116 803	0.02 <sup>2</sup>	0.02	84.61	—
Dec. 31, 2008	10.48	1 160 448	110 753	0.03	0.03	78.55	—
Dec. 31, 2007	10.79	1 891 707	175 315	0.02	0.02	379.08	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.10%, Series B – 0.84%, Series D – 0.57%, Series F – 0.58%, Series O – 0.02%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.00%	50%	50%
Advisor Series	1.00%	50%	50%
Series B	0.75%	33%	67%
Series D	0.50%	30%	70%
Series F	0.50%	–	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

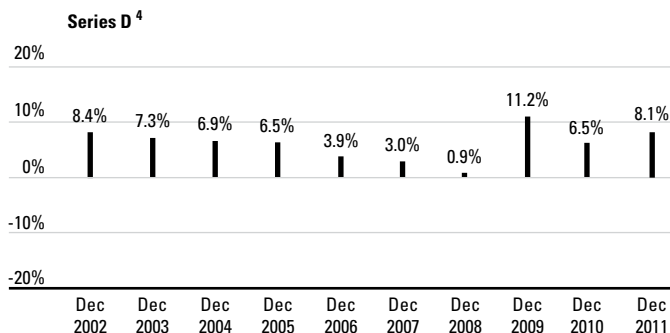
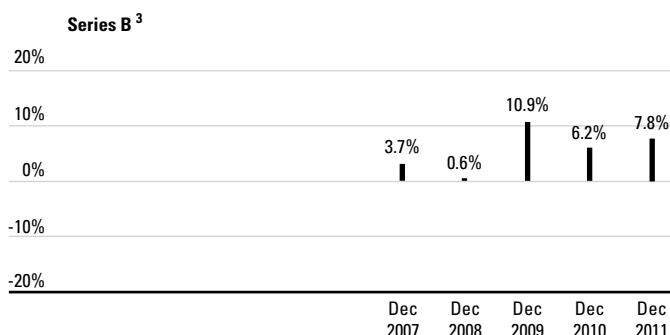
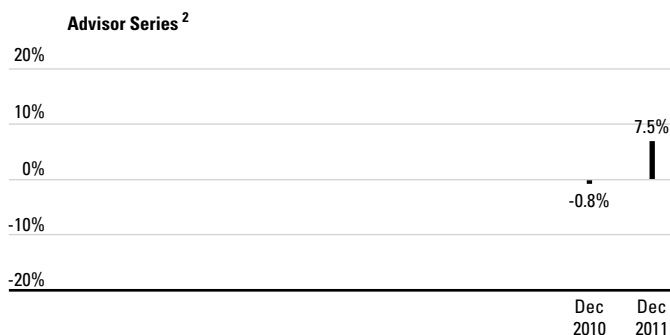
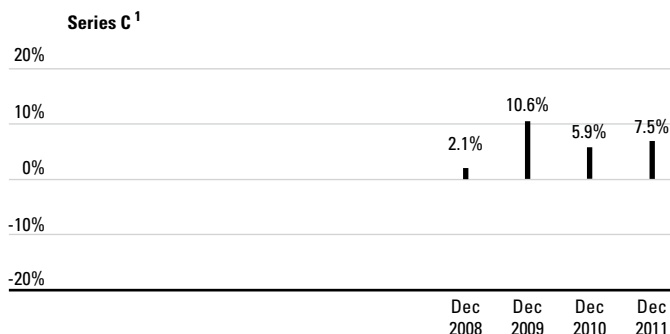
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

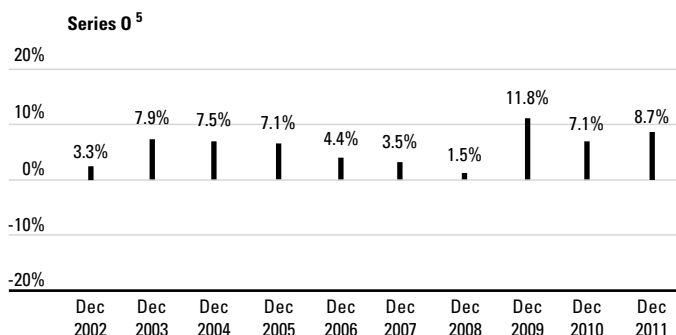
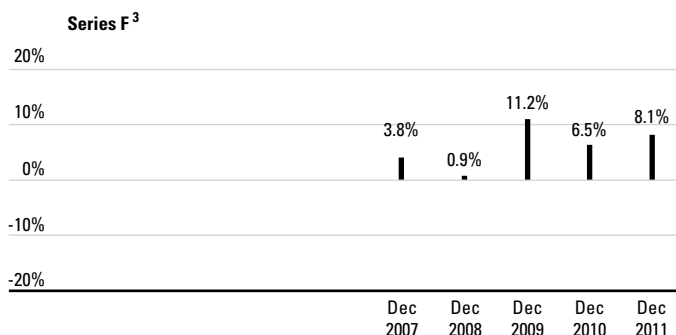
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**DEX Universe Bond Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	7.5	8.0	—	—	8.5
Benchmark	9.7	7.3	—	—	8.1
Advisor Series <sup>2</sup>	7.5	—	—	—	5.6
Benchmark	9.7	—	—	—	7.4
Series B <sup>3</sup>	7.8	8.3	—	—	6.5
Benchmark	9.7	7.3	—	—	7.3
Series D <sup>4</sup>	8.1	8.6	5.9	6.2	—
Benchmark	9.7	7.3	6.4	6.5	—
Series F <sup>3</sup>	8.1	8.6	—	—	6.7
Benchmark	9.7	7.3	—	—	7.3
Series O <sup>5</sup>	8.7	9.2	6.5	—	6.8
Benchmark	9.7	7.3	6.4	—	6.4

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date July 2000.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008. Although Series A units of the Fund were created in June 2000, units were not offered for sale under a simplified prospectus until July 2000. We are therefore not permitted to disclose performance data for this Fund for any period prior to July 2000.

**INDEX DESCRIPTION**

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Corporate Bonds	51.0
Provincial Bonds	31.5
Federal Bonds	4.4
Mortgages	0.4
Cash/Other	12.7

### Top 25 Holdings

	% of Net Asset Value
<b>Long Positions</b>	
Cash & Cash Equivalents	12.5
Province of Ontario 7.600% Jun 2 27	10.1
Province of Ontario 4.650% Jun 2 41	3.2
Phillips, Hager & North High Yield Bond Fund	2.9
Morgan Stanley CAD 4.500% Feb 23 12	2.7
Province of Ontario 8.100% Sep 8 23	2.2
Government of Canada 3.250% Jun 1 21	2.1
Province of Quebec 6.250% Jun 1 32	2.0
Province of Ontario 6.500% Mar 8 29	1.9
RBC Subordinated Notes Trust 4.580% Apr 30 17	1.8
Toronto-Dominion Bank 5.382% Nov 1 17	1.8
Bank of Nova Scotia 6.000% Oct 3 18	1.8
Province of Ontario 4.600% Jun 2 39	1.8
Province of Ontario 5.850% Mar 8 33	1.7
Bank of Montreal 2.960% Aug 2 16	1.7
Master Credit Card Trust 5.297% Aug 21 12	1.5
Wells Fargo Financial Canada Corp. 5.200% Sep 13 12	1.5
Province of Ontario 6.200% Jun 2 31	1.5
Province of Ontario 4.200% Jun 2 20	1.4
Golden Credit Card Trust 3.510% May 15 16	1.4
Province of Ontario 8.500% Dec 2 25	1.0
Ontario Electricity Financial Corp. 8.250% Jun 22 26	1.0
American Express Canada Credit Corp. 5.900% Apr 2 13	0.9
Royal Bank of Canada 2.680% Dec 8 16	0.9
Total	61.3
<b>Short Positions</b>	
Bankers Acceptance Future, September 2012	(4.4)
Total	(4.4)

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



FIXED-INCOME FUND

**PHILLIPS, HAGER & NORTH  
INFLATION-LINKED BOND FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to generate inflation-protected interest income to help investors preserve their real (or inflation-adjusted) purchasing power over the long term. To achieve the Fund's investment objective, we invest primarily in real return bonds and inflation-linked bonds issued or guaranteed by Canadian and foreign governments and corporations, including Canadian Real Return Bonds ("RRBs") and U.S. issued Treasury Inflation Protected Securities ("TIPs").

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$190.4 million as of December 31, 2011, from \$145.1 million at the end of 2010. Of this change, \$18.4 million was due to net inflows and \$26.8 million to investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 17.1%. Over the same time period, the Fund's benchmark index, the DEX Real Return Bond Overall Index, returned 18.3%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Real return bonds ("RRBs") enjoyed their third consecutive strong year as interest rates fell to record lows. Thirty-year interest rates fell to an extremely low 0.45% by year-end, and real 10-year rates fell to -0.08%, meaning investors are accepting less than inflation over the next 10 years.

However, we positioned the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden rise in interest rates, detracted from performance when interest rates remained near their historically lowest levels at the end of the year. We underestimated the extent of this rate decline, expecting the recovering Canadian and U.S. economies to lead rates higher. This rebound did not happen, and our interest rate strategy caused the Fund to underperform its benchmark for the year.

The Fund's credit strategies – that is, our positioning in provincial and corporate RRBs – were modest. There are so few corporate and provincial RRBs in Canada that they are difficult to obtain. Furthermore, the pricing of provincial RRBs makes their spreads lower, and therefore less attractive than conventional bonds. We held an underweight position in provincial RRBs throughout the year in light of this spread mismatch. Our corporate position is a 0.3% allocation to Teranet Holdings, which provided a steady 1.8% yield premium over Federal RRBs.

We engaged in a small position in U.S. TIPs (the U.S. version of an RRB) early in the year, which were yielding more than Canadian RRBs at the time. This position was currency hedged throughout its holding period, and was closed at a profit in the middle of 2011.

### Recent Developments

The portfolio is positioned in expectation that current record low interest rates will rise as a result of an economic recovery. We would adjust the Fund's investment allocations if interest rates rise as expected.

Corporate RRBs remain difficult to obtain, and we will continue to look for opportunities to purchase them when they become available. Provincial RRBs remain expensive relative to conventional bonds, and although we hold some of them, we hold an underweight position compared to the benchmark. We would consider adding to the Fund's position in provincial RRBs if they become more attractive in a manner favourable to investors.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>11.34</b>	<b>0.53</b>	<b>(0.11)</b>	<b>0.38</b>	<b>1.10</b>	<b>1.90</b>	<b>(0.44)</b>	–	–	–	<b>(0.44)</b>	<b>12.76</b>
Dec. 31, 2010	10.76	0.41	(0.10)	0.22	0.67	1.20	(0.31)	–	(0.21)	–	(0.52)	11.34
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	0.12	(0.05)	0.07	0.76	0.90	(0.04)	–	(0.01)	–	(0.05)	10.76
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>11.34</b>	<b>0.53</b>	<b>(0.11)</b>	<b>0.38</b>	<b>1.10</b>	<b>1.90</b>	<b>(0.44)</b>	–	–	–	<b>(0.44)</b>	<b>12.76</b>
Dec. 31, 2010 <sup>4</sup>	11.69 <sup>†</sup>	0.08	(0.02)	0.04	0.11	0.21	(0.16)	–	(0.21)	–	(0.37)	11.34
<b>Series D</b>												
<b>Dec. 31, 2011</b>	<b>11.37</b>	<b>0.53</b>	<b>(0.06)</b>	<b>0.38</b>	<b>1.10</b>	<b>1.95</b>	<b>(0.46)</b>	–	–	–	<b>(0.46)</b>	<b>12.84</b>
Dec. 31, 2010	10.76	0.40	(0.06)	0.22	0.70	1.26	(0.32)	–	(0.21)	–	(0.53)	11.37
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	0.14	(0.03)	0.07	0.70	0.88	(0.05)	–	(0.01)	–	(0.06)	10.76
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>11.36</b>	<b>0.53</b>	<b>(0.04)</b>	<b>0.38</b>	<b>1.10</b>	<b>1.97</b>	<b>(0.48)</b>	–	–	–	<b>(0.48)</b>	<b>12.82</b>
Dec. 31, 2010	10.77	0.44	(0.04)	0.21	0.66	1.27	(0.33)	–	(0.24)	–	(0.57)	11.36
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	0.11	(0.02)	0.07	0.72	0.88	(0.05)	–	(0.01)	–	(0.06)	10.77
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>11.44</b>	<b>0.54</b>	–	<b>0.39</b>	<b>1.11</b>	<b>2.04</b>	<b>(0.52)</b>	–	–	–	<b>(0.52)</b>	<b>12.91</b>
Dec. 31, 2010	10.78	0.45	–	0.20	0.61	1.26	(0.33)	–	(0.21)	–	(0.54)	11.44
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	0.11	–	0.07	0.71	0.89	(0.06)	–	(0.01)	–	(0.07)	10.78

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2009.

<sup>4</sup> From October 2010.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>12.77</b>	<b>81 511</b>	<b>6 383</b>	<b>0.93</b>	<b>0.93</b>	<b>93.37</b>	—
Dec. 31, 2010	11.35	52 550	4 631	0.92	0.92	91.58	—
Dec. 31, 2009 <sup>4</sup>	10.77	18 586	1 726	0.90	0.90	60.74	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>12.77</b>	<b>4 474</b>	<b>350</b>	<b>0.93</b>	<b>0.93</b>	<b>93.37</b>	—
Dec. 31, 2010 <sup>5</sup>	11.35	624	55	0.92	0.92	91.58	—
<b>Series D</b>							
<b>Dec. 31, 2011</b>	<b>12.85</b>	<b>37 723</b>	<b>2 936</b>	<b>0.56</b>	<b>0.56</b>	<b>93.37</b>	—
Dec. 31, 2010	11.38	16 317	1 433	0.55	0.55	91.58	—
Dec. 31, 2009 <sup>4</sup>	10.77	9 168	851	0.53	0.53	60.74	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>12.83</b>	<b>26 677</b>	<b>2 079</b>	<b>0.39</b>	<b>0.39</b>	<b>93.37</b>	—
Dec. 31, 2010	11.37	30 840	2 713	0.38	0.38	91.58	—
Dec. 31, 2009 <sup>4</sup>	10.78	9 536	885	0.38	0.38	60.74	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>12.93</b>	<b>40 019</b>	<b>3 096</b>	<b>0.02</b>	<b>0.02</b>	<b>93.37</b>	—
Dec. 31, 2010	11.45	44 855	3 917	0.02	0.02	91.58	—
Dec. 31, 2009 <sup>4</sup>	10.79	6 180	573	0.03	0.03	60.74	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2009.

<sup>5</sup> From October 2010.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	0.80%	62%	38%
Advisor Series	0.80%	62%	38%
Series D	0.45%	33%	67%
Series F	0.30%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

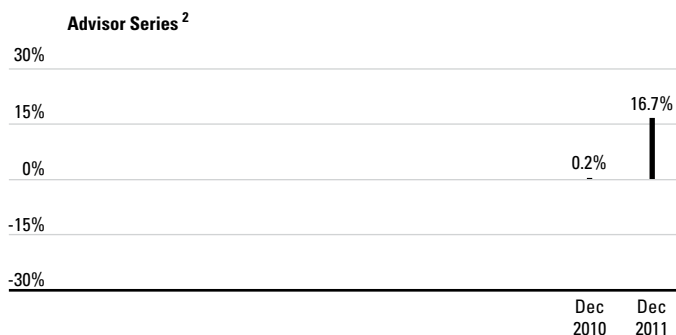
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



## PAST PERFORMANCE (cont.)



## Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

### DEX Real Return Bond Overall Index

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	16.7	—	—	—	14.0
Benchmark	18.3	—	—	—	15.0
Advisor Series <sup>2</sup>	16.7	—	—	—	14.3
Benchmark	18.3	—	—	—	15.8
Series D <sup>1</sup>	17.1	—	—	—	14.4
Benchmark	18.3	—	—	—	15.0
Series F <sup>1</sup>	17.3	—	—	—	14.5
Benchmark	18.3	—	—	—	15.0
Series O <sup>1</sup>	17.7	—	—	—	15.0
Benchmark	18.3	—	—	—	15.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date June 2009.

<sup>2</sup> Inception date October 2010.

## INDEX DESCRIPTION

**DEX Real Return Bond Overall Index** This index is a broad measure of the performance of Canadian inflation-indexed real return bonds.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Federal Bonds	73.4
Provincial Bonds	11.2
Corporate Bonds	0.3
Cash/Other	15.1

### Top 25 Holdings\*

	% of Net Asset Value
Government of Canada 4.000% Dec 1 31	18.5
Government of Canada 3.000% Dec 1 36	17.9
Cash & Cash Equivalents	15.3
Government of Canada 1.500% Dec 1 44	12.7
Government of Canada 4.250% Dec 1 21	11.8
Government of Canada 2.000% Dec 1 41	9.2
Province of Ontario 2.000% Dec 1 36	5.6
Province of Quebec 4.250% Dec 1 31	3.4
Government of Canada 4.250% Dec 1 26	3.2
Province of Quebec 4.500% Dec 1 26	1.2
Province of Quebec 3.300% Dec 1 13	0.5
Province of Quebec 4.500% Dec 1 21	0.4
Teranet Holdings LP 3.270% Dec 1 31	0.3
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

FIXED-INCOME FUND

**PHILLIPS, HAGER & NORTH  
HIGH YIELD BOND FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*



## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with a high level of income and the opportunity for capital appreciation by investing primarily in medium quality Canadian and/or foreign corporate bonds, convertible bonds, preferred shares and government bonds issued or traded in Canadian and U.S. dollars. In addition, we may also invest in asset backed commercial paper. The average term to maturity of the portfolio is managed within strict guidelines, typically between three and 10 years.

The investment objectives of the Fund set out above became effective on November 28, 2011 pursuant to receiving unitholder approval for a change in the investment objectives of the Fund.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$2.96 billion as of December 31, 2011, from \$2.58 billion at the end of 2010. Of this change, \$243.9 million was due to net inflows and \$140.5 million to investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 4.9%. Over the same time period, the Fund's benchmark index, the DEX Universe Bond Index, returned 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The past year has been extremely challenging for most risky asset classes as a host of concerns, including the potential for European sovereign debt defaults, the weakened state of the European banking industry, the prospect for a global recession, and political gridlock in the United States and Europe caused risky assets to suffer. Despite these factors, the Fund's defensive portfolio, along with the income generated from its holdings, have allowed the Fund to post a modest positive return for the period.

It is important to note that the portfolio is not managed against or expected to perform in-line with the DEX Universe Bond Index over short periods of time. It is also important to note this portfolio may lag more aggressive high-yield funds or benchmark high-yield indices as our emphasis remains on short- and intermediate-term senior paper issued by large capitalization companies with ratings ranging from BBB to B.

On the positive side, corporate health remains strong with most North American companies generating strong earnings and cash flow. In addition, corporate managers remain cautious in terms of growth initiatives, which is a positive approach from the perspective of bondholders. However, the potential for significant negative economic developments in Europe keep us in a defensive posture in terms of positioning the Fund. In light of the uncertain macroeconomic environment, we have continued to position the Fund defensively by focusing on shorter-term bonds (i.e., those with 1- to 3-year effective maturities) issued by higher-rated issuers in defensive industries.

During the reporting period, the Fund benefited from a number of corporate tender offers by companies such as HCA, Charter Cable, Cablevision Systems and Videotron who have offered to pay investors a premium in order to retire their debt early. These company buybacks have helped the portfolio generate capital appreciation which has offset the decline in overall high-yield bond prices due to macroeconomic factors.

We took advantage of the sharp declines in high-yield bond prices in August and September by using some of our cash to add to promising bond positions at what appear to be significantly discounted prices. In addition to this, when prices recovered, we took advantage of the improvement in conditions to sell some of the more expensive or more economically cyclical positions given the potential for further corrections in prices as the European situation continues to unfold.

### Recent Developments

We remain optimistic on the high-yield market although we may see further periods of volatility as European sovereign debt problems resurface. Looking ahead, if the problems in Europe do not get worse, returns in the high-yield bond market could be reasonably positive given that current yields are high in relation to the number of companies defaulting on their high-yield obligations.

We also hold a number of larger positions in the Fund that will mature or have a high likelihood of being redeemed within the next six to nine months. This is likely to create a natural source of cash in anticipation of potential opportunities arising from further fallout from the European sovereign debt crisis.

We remain steadfast to our approach of investing in less-volatile, higher-yielding bonds. Over a full investment cycle, historical returns indicate that a defensively constructed portfolio of well-researched holdings may outperform aggressive portfolios without subjecting security holders to the risks often associated with lower-rated corporate bonds.

#### **Related-Party Transactions**

##### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

##### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

##### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

##### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

##### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

##### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>11.87</b>	<b>0.81</b>	<b>(0.16)</b>	<b>(0.07)</b>	<b>(0.08)</b>	<b>0.50</b>	<b>(0.62)</b>	–	–	–	<b>(0.62)</b>	<b>11.75</b>
Dec. 31, 2010	11.63	0.74	(0.17)	0.56	(0.06)	1.07	(0.51)	–	(0.41)	–	(0.92)	11.87
Dec. 31, 2009	10.43	0.64	(0.16)	0.25	0.91	1.64	(0.44)	–	(0.05)	–	(0.49)	11.63
Dec. 31, 2008 <sup>3</sup>	10.09 <sup>†</sup>	0.10	(0.02)	–	0.65	0.73	(0.04)	–	(0.07)	–	(0.11)	10.43
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>11.87</b>	<b>0.81</b>	<b>(0.16)</b>	<b>(0.07)</b>	<b>(0.08)</b>	<b>0.50</b>	<b>(0.62)</b>	–	–	–	<b>(0.62)</b>	<b>11.75</b>
Dec. 31, 2010 <sup>4</sup>	12.45 <sup>†</sup>	0.12	(0.03)	0.09	(0.01)	0.17	(0.18)	–	(0.41)	–	(0.59)	11.87
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>11.96</b>	<b>0.82</b>	<b>(0.13)</b>	<b>(0.07)</b>	<b>(0.08)</b>	<b>0.54</b>	<b>(0.65)</b>	–	–	–	<b>(0.65)</b>	<b>11.84</b>
Dec. 31, 2010	11.68	0.78	(0.13)	0.59	(0.06)	1.18	(0.52)	–	(0.41)	–	(0.93)	11.96
Dec. 31, 2009	10.49	0.65	(0.13)	0.10	1.11	1.73	(0.49)	–	(0.05)	–	(0.54)	11.68
Dec. 31, 2008	10.96	0.70	(0.13)	0.03	(0.56)	0.04	(0.50)	–	(0.10)	–	(0.60)	10.49
Dec. 31, 2007 <sup>5</sup>	11.39 <sup>†</sup>	0.39	(0.07)	(0.07)	–	0.25	(0.25)	–	(0.33)	–	(0.58)	10.96
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>11.77</b>	<b>0.80</b>	<b>(0.10)</b>	<b>(0.07)</b>	<b>(0.08)</b>	<b>0.55</b>	<b>(0.68)</b>	–	–	–	<b>(0.68)</b>	<b>11.64</b>
Dec. 31, 2010	11.51	0.75	(0.10)	0.56	(0.06)	1.15	(0.56)	–	(0.40)	–	(0.96)	11.77
Dec. 31, 2009	10.33	0.64	(0.10)	0.13	1.06	1.73	(0.50)	–	(0.05)	–	(0.55)	11.51
Dec. 31, 2008	10.83	0.69	(0.10)	0.10	(0.55)	0.14	(0.56)	–	(0.10)	–	(0.66)	10.33
Dec. 31, 2007	11.44	0.73	(0.10)	0.38	(0.59)	0.42	(0.63)	–	(0.38)	–	(1.01)	10.83
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>11.82</b>	<b>0.81</b>	<b>(0.10)</b>	<b>(0.07)</b>	<b>(0.08)</b>	<b>0.56</b>	<b>(0.68)</b>	–	–	–	<b>(0.68)</b>	<b>11.70</b>
Dec. 31, 2010	11.57	0.74	(0.10)	0.56	(0.06)	1.14	(0.56)	–	(0.40)	–	(0.96)	11.82
Dec. 31, 2009	10.38	0.64	(0.10)	0.20	1.07	1.81	(0.50)	–	(0.05)	–	(0.55)	11.57
Dec. 31, 2008	10.84	0.70	(0.10)	0.03	(0.21)	0.42	(0.54)	–	(0.08)	–	(0.62)	10.38
Dec. 31, 2007 <sup>5</sup>	11.39 <sup>†</sup>	0.38	(0.05)	(0.06)	(0.05)	0.22	(0.32)	–	(0.36)	–	(0.68)	10.84
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>11.36</b>	<b>0.77</b>	–	<b>(0.07)</b>	<b>(0.08)</b>	<b>0.62</b>	<b>(0.75)</b>	–	–	–	<b>(0.75)</b>	<b>11.24</b>
Dec. 31, 2010	11.15	0.71	–	0.53	(0.05)	1.19	(0.66)	–	(0.40)	–	(1.06)	11.36
Dec. 31, 2009	10.04	0.62	(0.01)	0.16	1.00	1.77	(0.60)	–	(0.05)	–	(0.65)	11.15
Dec. 31, 2008	10.65	0.68	(0.01)	0.09	(0.52)	0.24	(0.75)	–	(0.10)	–	(0.85)	10.04
Dec. 31, 2007	11.31	0.72	–	0.30	(0.36)	0.66	(0.78)	–	(0.38)	–	(1.16)	10.65

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>11.79</b>	<b>453 278</b>	<b>38 439</b>	<b>1.43</b>	<b>1.43</b>	<b>68.79</b>	—
Dec. 31, 2010	11.91	463 492	38 920	1.40	1.40	103.75	—
Dec. 31, 2009	11.67	215 381	18 460	1.40 <sup>2</sup>	1.41	75.27	—
Dec. 31, 2008 <sup>5</sup>	10.44	9 579	917	1.47	1.52	23.87	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>11.79</b>	<b>10 757</b>	<b>912</b>	<b>1.43</b>	<b>1.43</b>	<b>68.79</b>	—
Dec. 31, 2010 <sup>6</sup>	11.91	6 979	586	1.40	1.40	103.75	—
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>11.88</b>	<b>7 376</b>	<b>621</b>	<b>1.15</b>	<b>1.15</b>	<b>68.79</b>	—
Dec. 31, 2010	12.00	8 204	684	1.13	1.13	103.75	—
Dec. 31, 2009	11.72	10 219	872	1.14 <sup>2</sup>	1.16	75.27	—
Dec. 31, 2008	10.51	10 797	1 028	1.19	1.24	23.87	—
Dec. 31, 2007 <sup>7</sup>	10.99	2 409	219	1.16	1.42	103.12	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>11.68</b>	<b>741 101</b>	<b>63 428</b>	<b>0.89</b>	<b>0.89</b>	<b>68.79</b>	—
Dec. 31, 2010	11.80	720 116	61 023	0.87	0.87	103.75	—
Dec. 31, 2009	11.55	526 971	45 626	0.87 <sup>2</sup>	0.87	75.27	—
Dec. 31, 2008	10.35	393 679	38 052	0.93	0.93	23.87	—
Dec. 31, 2007	10.86	458 023	42 172	0.89	0.89	103.12	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>11.74</b>	<b>354 188</b>	<b>30 164</b>	<b>0.89</b>	<b>0.89</b>	<b>68.79</b>	—
Dec. 31, 2010	11.86	354 476	29 896	0.87	0.87	103.75	—
Dec. 31, 2009	11.60	207 486	17 882	0.88 <sup>2</sup>	0.88	75.27	—
Dec. 31, 2008	10.39	26 145	2 516	0.93	0.94	23.87	—
Dec. 31, 2007 <sup>7</sup>	10.87	2 609	240	0.89	1.16	103.12	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>11.29</b>	<b>1 393 589</b>	<b>123 477</b>	<b>0.03</b>	<b>0.03</b>	<b>68.79</b>	—
Dec. 31, 2010	11.40	1 022 563	89 717	0.03	0.03	103.75	—
Dec. 31, 2009	11.19	471 953	42 175	0.05 <sup>2</sup>	0.05	75.27	—
Dec. 31, 2008	10.05	226 038	22 486	0.09	0.09	23.87	—
Dec. 31, 2007	10.68	232 875	21 815	0.04	0.04	103.12	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.36%, Series B – 1.10%, Series D – 0.84%, Series F – 0.84%, Series O – 0.03%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.25%	40%	60%
Advisor Series	1.25%	40%	60%
Series B	1.00%	25%	75%
Series D	0.75%	20%	80%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

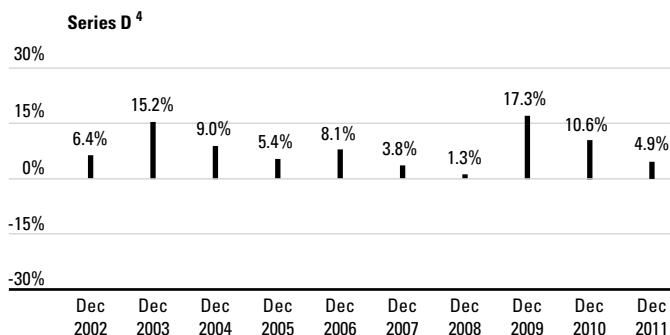
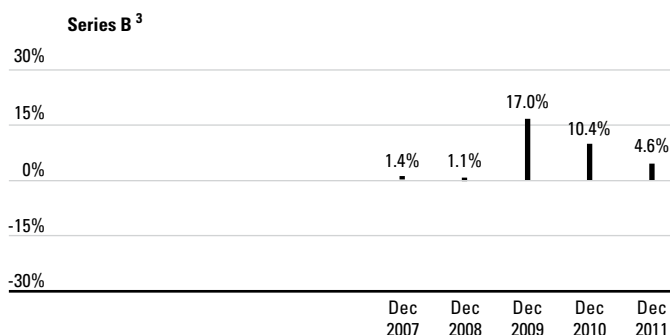
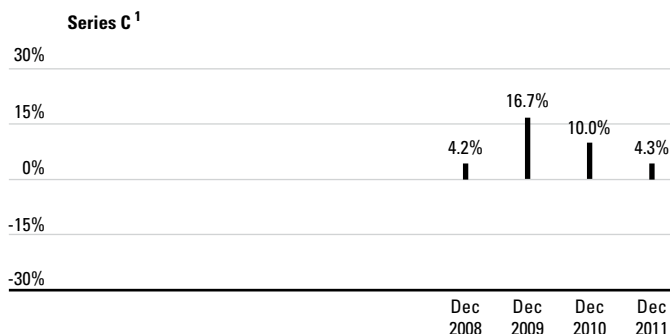
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

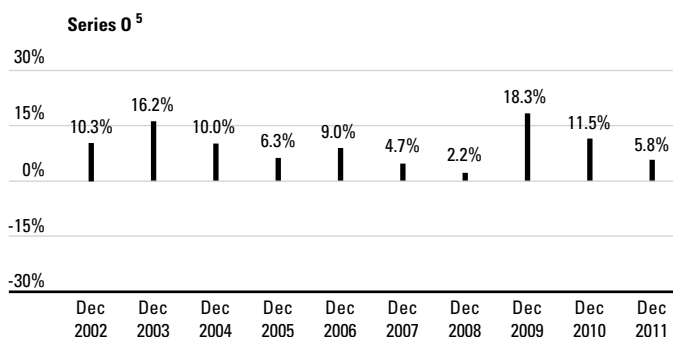
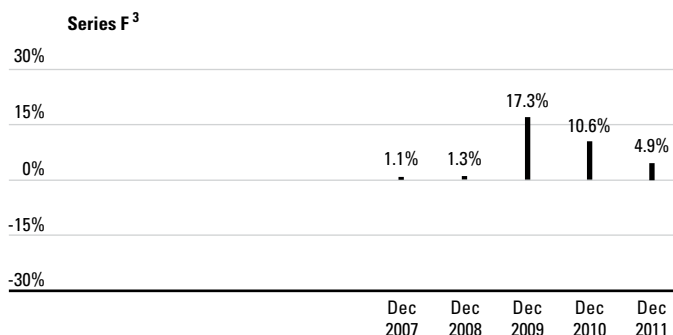
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**DEX Universe Bond Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	4.3	10.2	—	—	11.4
Benchmark	9.7	7.3	—	—	8.1
Advisor Series <sup>2</sup>	4.3	—	—	—	4.0
Benchmark	9.7	—	—	—	7.4
Series B <sup>3</sup>	4.6	10.5	—	—	7.5
Benchmark	9.7	7.3	—	—	7.3
Series D <sup>4</sup>	4.9	10.8	7.4	8.1	—
Benchmark	9.7	7.3	6.4	6.5	—
Series F <sup>3</sup>	4.9	10.8	—	—	7.6
Benchmark	9.7	7.3	—	—	7.3
Series O <sup>5</sup>	5.8	11.7	8.3	—	10.2
Benchmark	9.7	7.3	6.4	—	6.4

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date July 2000.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008. Although Series A units of the Fund were created in June 2000, units were not offered for sale under a simplified prospectus until July 2000. We are therefore not permitted to disclose performance data for this Fund for any period prior to July 2000.

**INDEX DESCRIPTION**

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Corporate Bonds	92.2
Cash/Other	7.8

### Top 25 Holdings

	% of Net Asset Value
Cash & Cash Equivalents	7.4
Qwest Communications International Inc. 7.500% Feb 15 14	4.6
Ford Credit Canada Ltd. 4.875% Mar 17 14	4.3
Quebecor Media Inc. USD 7.750% Mar 15 16	3.5
Citigroup Inc. CAD 4.650% Oct 11 22	3.1
Merrill Lynch & Co. Inc. CAD 5.290% May 30 22	3.0
Videotron Ltd. USD 9.125% Apr 15 18	3.0
Harvest Operations Corp., Convertible 7.250% Sep 30 13	2.9
QVC Inc. 7.125% Apr 15 17	2.9
Ford Credit Canada Ltd. 7.500% Aug 18 15	2.8
Harvest Operations Corp., Convertible 7.500% May 31 15	2.7
Host Hotels & Resorts LP 6.750% Jun 1 16	2.6
Host Hotels & Resorts LP 9.000% May 15 17	2.5
Wynn Las Vegas LLC Corp. 7.875% Nov 1 17	2.5
CCH II LLC 13.500% Nov 30 16	2.4
Host Marriott LP 6.375% Mar 15 15	2.4
EchoStar DBS Corp. 7.750% May 31 15	2.3
Qwest Communications International Inc. 8.000% Oct 1 15	2.2
Corus Entertainment Inc. 7.250% Feb 10 17	2.2
DISH DBS Corp. 6.625% Oct 1 14	2.1
Citigroup Inc. CAD 5.160% May 24 27	2.1
Reynolds Group Issuer Inc. 8.500% Oct 15 16	2.0
CB Richard Ellis Services Inc. 11.625% Jun 15 17	1.6
Videotron Ltd. USD 6.875% Jan 15 14	1.5
MI Developments Inc. 6.050% Dec 22 16	1.4
<b>Top 25 Holdings</b>	<b>70.0</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

FIXED INCOME FUND

**PHILLIPS, HAGER & NORTH SHORT  
INFLATION-LINKED BOND FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*



## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to generate interest income that is hedged against inflation by investing in shorter-term real return bonds and inflation-linked bonds issued by Canadian and foreign governments and corporations.

To achieve the Fund's investment objectives, we invest primarily in the above-mentioned securities. The Fund's portfolio will include various shorter-term maturities that are intended to match shorter-term liabilities and to manage the interest-rate risk of the PH&N LifeTime Funds™, which may hold the Fund in their portfolios.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 11, 2011, and its net asset value was \$0.2 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

### Recent Developments

During the reporting period, the Canadian real return bond market, as measured by the DEX Real Return Bond Index, returned 18.4%. Real return bonds ("RRBs") enjoyed their third consecutive strong year as real interest rates fell to record lows. Real 30-year interest rates fell to an extremely low 0.45% by year-end, and real 10-year rates fell to -0.08%, meaning investors are accepting less than inflation over the next 10 years.

The portfolio only has a single holding: the Government of Canada real return bond with a coupon of 4.25% and maturing in 2021. We keep the Fund fully invested in this bond. The Fund's performance will therefore depend entirely on the performance of this bond.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

#### *Trustee and Custodian*

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

#### *Other Related-Party Transactions*

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### *Related-Party Trading Activities*

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

#### *Inter-Fund Trading*

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series 0</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.52</b>	<b>–</b>	<b>–</b>	<b>0.84</b>	<b>1.36</b>	<b>(0.49)</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>(0.49)</b>	<b>10.85</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series 0</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.85</b>	<b>216</b>	<b>20</b>	<b>0.02</b>	<b>0.02</b>	<b>–</b>	<b>–</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From January 2011.

**PHILLIPS, HAGER & NORTH  
SHORT INFLATION-LINKED BOND FUND**

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. No management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Federal Bonds	98.5
Cash/Other	1.5

**Top 25 Holdings\***

	% of Net Asset Value
Government of Canada 4.250% Dec 1 21	98.3
Cash & Cash Equivalents	1.7
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

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FIXED INCOME FUND

**PHILLIPS, HAGER & NORTH LONG  
INFLATION-LINKED BOND FUND**

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December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to generate interest income that is hedged against inflation by investing primarily in longer-term real-return bonds and inflation-linked bonds issued by Canadian and foreign governments and corporations.

To achieve the Fund's investment objectives, we invest primarily in the above-mentioned securities. The Fund's portfolio will include various longer-term maturities that are intended to match longer-term liabilities and to manage the interest-rate risk of the PH&N LifeTime Funds™, which may hold the Fund in their portfolios. The Fund may also invest in asset-backed securities, including mortgage-backed securities and may invest all or a portion of the Fund's assets in one or more securities as permitted by securities legislation.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 11, 2011, and its net asset value was \$2.5 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

### Recent Developments

During the reporting period, the Canadian real return bond market, as measured by the DEX Real Return Bond Index, returned 18.4%. Real Return Bonds ("RRBs") enjoyed their third consecutive strong year as real interest rates fell to record lows. Real 30-year interest rates fell to an extremely low 0.45% by year-end, and real 10-year rates fell to -0.08%, meaning investors are accepting less than inflation over the next 10 years.

The portfolio only has a single holding: the Government of Canada real return bond with a coupon of 1.5% and maturing in 2044. We keep the Fund fully invested in this bond. The Fund's performance will therefore depend entirely on the performance of this bond.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for

its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

#### *Trustee and Custodian*

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

#### *Other Related-Party Transactions*

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### *Related-Party Trading Activities*

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

#### *Inter-Fund Trading*

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series 0</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.40</b>	<b>–</b>	<b>0.27</b>	<b>2.39</b>	<b>3.06</b>	<b>(0.28)</b>	<b>–</b>	<b>(0.20)</b>	<b>–</b>	<b>(0.48)</b>	<b>12.04</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series 0</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>12.05</b>	<b>2 495</b>	<b>207</b>	<b>0.02</b>	<b>0.02</b>	<b>23.15</b>	<b>–</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From January 2011.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. No management fees are paid by the Fund in respect of Series 0 units. Series 0 unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series 0 units of this Fund were launched January 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Federal Bonds	95.9
Cash/Other	4.1

**Top 25 Holdings\***

	% of Net Asset Value
Government of Canada 1.500% Dec 1 44	95.8
Cash & Cash Equivalents	4.2
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

BALANCED FUND

**PHILLIPS, HAGER & NORTH  
MONTHLY INCOME FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*



## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with monthly income that may consist of dividend income, interest income, realized capital gains and return of capital. Investors in the Fund will also have the potential for modest capital growth. To achieve the Fund's investment objective, we primarily invest in a well diversified balanced portfolio of income-producing equity securities, including, but not limited to, common shares of dividend-paying Canadian companies and income trusts. The Fund may also invest in fixed income securities such as preferred shares, government and corporate bonds, debentures and notes, asset backed commercial paper, mortgage backed securities and other income-generating securities.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$2.03 billion as of December 31, 2011, from \$851.3 million at the end of 2010. Most of the change was due to \$1.16 billion of net inflows.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 1.6%, which outperformed the benchmark return of -0.5%. The Fund underperformed the broad-based index return of 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Negative news about the global economy dominated the headlines and the markets in 2011. Despite the continued market volatility, the equity portion of the Fund performed well in relative terms. Major contributors to performance came from stocks such as Rogers Communications, Baytex Energy, Brookfield Renewable Energy Partners, Gibson Energy, and Mullen Group. The major detractors from performance were NAL Energy and Capstone Infrastructure. The Fund did not hold a position in BCE, and this detracted from the Fund's performance relative to the benchmark because the stock, a significant component of the benchmark, performed well.

The Canadian bond market enjoyed its third consecutive strong year as interest rates fell to record lows. However, we positioned the fixed-income portion of the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden jump in rates, detracted from performance when interest rates, especially on longer-term debt securities, remained near their historically lowest levels at the end of the year.

However, we were able to take advantage of fluctuations among federal, provincial and corporate bonds during the year. These shifts allowed the Fund to add value even though the Fund held overweight positions in provincial and corporate bonds, which underperformed relative to the benchmark.

### Recent Developments

We believe that the performance of equities since 2009 has been primarily a function of a company's perceived risk rather than its fundamental strengths. While sometimes frustrating, this lack of differentiation is creating opportunities, and we believe they will pay off when markets begin to normalize.

The extra yields required by investors to hold provincial and corporate bonds versus federal bonds remain at a high level due to the ongoing economic uncertainty in Europe, and the resulting retreat to federal bonds of "safe-haven" countries. In this environment, we prefer provincial bonds over corporate debt securities, and will continue to hold a significantly overweight position in provincial bonds as there is sufficient extra income from provincial bonds to justify such a position. The Fund is positioned to protect against a sudden jump in interest rates, in expectation that rates will rise from current record-low levels once a sustained economic recovery is underway.

### Related-Party Transactions

#### **Manager, Portfolio Advisor and Registrar**

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$646,000 (2010 – \$119,000), or 9% (2010 – 7%) of the total transaction costs paid for this Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>10.63</b>	<b>0.45</b>	<b>(0.19)</b>	<b>(0.20)</b>	<b>(0.09)</b>	<b>(0.03)</b>	<b>(0.23)</b>	<b>(0.19)</b>	<b>(0.08)</b>	<b>(0.03)</b>	<b>(0.53)</b>	<b>10.19</b>	
Dec. 31, 2010	9.99	0.61	(0.19)	0.28	1.10	1.80	(0.16)	(0.13)	(0.19)	(0.02)	(0.50)	10.63	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	—	—	—	—	—	—	—	9.99	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>10.63</b>	<b>0.45</b>	<b>(0.19)</b>	<b>(0.20)</b>	<b>(0.09)</b>	<b>(0.03)</b>	<b>(0.23)</b>	<b>(0.19)</b>	<b>(0.08)</b>	<b>(0.03)</b>	<b>(0.53)</b>	<b>10.19</b>	
Dec. 31, 2010 <sup>4</sup>	10.50 <sup>†</sup>	0.10	(0.03)	0.05	0.18	0.30	(0.03)	(0.02)	(0.03)	—	(0.08)	10.63	
<b>Series D</b>													
<b>Dec. 31, 2011</b>	<b>10.72</b>	<b>0.46</b>	<b>(0.11)</b>	<b>(0.20)</b>	<b>(0.09)</b>	<b>0.06</b>	<b>(0.23)</b>	<b>(0.19)</b>	<b>(0.08)</b>	<b>(0.03)</b>	<b>(0.53)</b>	<b>10.36</b>	
Dec. 31, 2010	9.99	0.56	(0.11)	0.26	1.00	1.71	(0.16)	(0.13)	(0.19)	(0.02)	(0.50)	10.72	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	—	—	—	—	—	—	—	9.99	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>10.75</b>	<b>0.46</b>	<b>(0.08)</b>	<b>(0.20)</b>	<b>(0.09)</b>	<b>0.09</b>	<b>(0.23)</b>	<b>(0.19)</b>	<b>(0.08)</b>	<b>(0.03)</b>	<b>(0.53)</b>	<b>10.42</b>	
Dec. 31, 2010	9.99	0.64	(0.08)	0.30	1.15	2.01	(0.16)	(0.13)	(0.19)	(0.02)	(0.50)	10.75	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	—	—	—	—	—	—	—	9.99	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>10.80</b>	<b>0.46</b>	<b>(0.01)</b>	<b>(0.20)</b>	<b>(0.09)</b>	<b>0.16</b>	<b>(0.23)</b>	<b>(0.19)</b>	<b>(0.08)</b>	<b>(0.03)</b>	<b>(0.53)</b>	<b>10.56</b>	
Dec. 31, 2010 <sup>5</sup>	10.34 <sup>†</sup>	0.24	—	0.11	0.24	0.59	(0.12)	(0.10)	(0.15)	(0.01)	(0.38)	10.80	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From December 2009.

<sup>4</sup> From October 2010.

<sup>5</sup> From April 2010.

<sup>†</sup> Initial offering net asset value per unit.

## FINANCIAL HIGHLIGHTS (cont.)

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.20</b>	<b>541 416</b>	<b>53 076</b>	<b>1.94</b>	<b>1.94</b>	<b>206.93</b>	<b>0.46</b>
Dec. 31, 2010	10.65	297 913	27 986	1.91	1.91	152.84	0.44
Dec. 31, 2009 <sup>4</sup>	10.02	4 006	400	1.84	1.84	–	0.07
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.20</b>	<b>69 861</b>	<b>6 849</b>	<b>1.94</b>	<b>1.94</b>	<b>206.93</b>	<b>0.46</b>
Dec. 31, 2010 <sup>5</sup>	10.65	10 539	990	1.91	1.91	152.84	0.44
<b>Series D</b>							
<b>Dec. 31, 2011</b>	<b>10.38</b>	<b>92 254</b>	<b>8 890</b>	<b>1.12</b>	<b>1.12</b>	<b>206.93</b>	<b>0.46</b>
Dec. 31, 2010	10.73	49 125	4 577	1.10	1.10	152.84	0.44
Dec. 31, 2009 <sup>4</sup>	10.02	1	–	0.73	0.73	–	0.07
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.44</b>	<b>61 264</b>	<b>5 869</b>	<b>0.83</b>	<b>0.83</b>	<b>206.93</b>	<b>0.46</b>
Dec. 31, 2010	10.76	34 288	3 186	0.82	0.82	152.84	0.44
Dec. 31, 2009 <sup>4</sup>	10.02	1	–	0.73	0.73	–	0.07
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>10.58</b>	<b>1 266 670</b>	<b>119 746</b>	<b>0.06</b>	<b>0.06</b>	<b>206.93</b>	<b>0.46</b>
Dec. 31, 2010 <sup>6</sup>	10.82	459 420	42 463	0.06	0.06	152.84	0.44

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From December 2009.

<sup>5</sup> From October 2010.

<sup>6</sup> From April 2010.

### Management Fees

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.65%	61%	39%
Advisor Series	1.65%	61%	39%
Series D	0.90%	28%	72%
Series F	0.65%	–	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

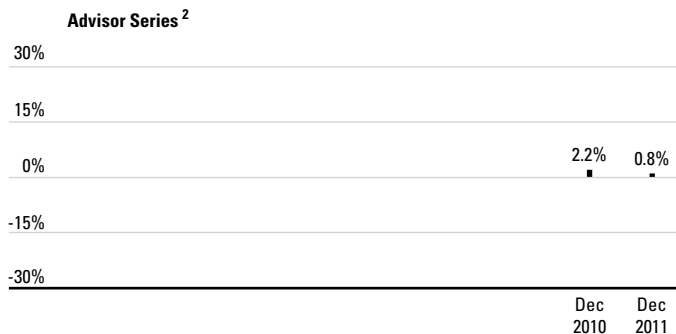
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



## PAST PERFORMANCE (cont.)

### Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmarks:

The blended benchmark (the "Benchmark") is composed of:

- 50% S&P/TSX Capped Composite Total Return Index
- 35% DEX Universe Bond Index
- 10% Merrill Lynch Canadian High Yield Index
- 5% S&P/TSX Preferred Share Total Return Index

The broad-based index is the DEX Universe Bond Index.

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	0.8	—	—	—	6.1
Benchmark	-0.5	—	—	—	6.4
Broad-based index	9.7	—	—	—	8.2
Advisor Series <sup>2</sup>	0.8	—	—	—	2.6
Benchmark	-0.5	—	—	—	2.1
Broad-based index	9.7	—	—	—	7.4
Series D <sup>1</sup>	1.6	—	—	—	6.9
Benchmark	-0.5	—	—	—	6.4
Broad-based index	9.7	—	—	—	8.2
Series F <sup>1</sup>	1.9	—	—	—	7.2
Benchmark	-0.5	—	—	—	6.4
Broad-based index	9.7	—	—	—	8.2
Series O <sup>3</sup>	2.7	—	—	—	6.7
Benchmark	-0.5	—	—	—	5.2
Broad-based index	9.7	—	—	—	9.1

The returns of each series may vary because of differences in management fees and expenses. The Benchmark and broad-based index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark and broad-based index.

<sup>1</sup> Inception date December 2009.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date April 2010.

## INDEX DESCRIPTIONS

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

**Merrill Lynch Canadian High Yield Index** This index tracks the performance of USD and CAD denominated below investment grade corporate debt publicly issued by Canadian issuers in the Canadian or US domestic markets.

**S&P/TSX Preferred Share Total Return Index** This index is comprised of preferred stocks trading on the Toronto Stock Exchange that meet criteria relating to minimum size, liquidity, issuer rating, and exchange listing.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Canadian Equities	49.1
Bonds	44.9
Preferred Equities	5.0
Cash/Other	1.0

### Top 25 Holdings

	% of Net Asset Value
Canada Housing Trust No. 1 4.800% Jun 15 12	8.1
RBC High Yield Bond Fund	5.1
Phillips, Hager & North High Yield Bond Fund	4.7
Province of Ontario 7.600% Jun 2 27	3.4
Toronto-Dominion Bank	3.0
Royal Bank of Canada	2.8
Bank of Nova Scotia	2.4
Province of Ontario 6.500% Mar 8 29	2.1
Enbridge Inc.	2.0
Canadian Imperial Bank of Commerce	1.4
Brookfield Office Properties Canada	1.4
Rogers Communications Inc., Class B	1.4
Manulife Financial Corporation	1.2
ARC Resources Ltd.	1.2
Province of Ontario 4.200% Jun 2 20	1.2
TransCanada Corp.	1.2
Magna International Inc., Class A	1.2
Genworth MI Canada Inc.	1.2
Goldcorp Inc.	1.1
Province of Ontario 4.650% Jun 2 41	1.0
Shaw Communications Inc., Class B	1.0
Barrick Gold Corp.	1.0
Brookfield Asset Management Inc., Class A	0.9
Canada Housing Trust No. 1 3.750% Mar 15 20	0.9
Canadian National Railway Co.	0.9
Top 25 Holdings	51.8

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

BALANCED FUND

**PHILLIPS, HAGER & NORTH  
BALANCED FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth and income by investing in a strategic asset mix of Canadian and foreign equities, Canadian fixed income securities and money market instruments. Its asset mix is adjusted periodically to reflect changing economic and market conditions. The magnitude and timing of all rebalancing decisions within the Fund are made by a team of investment professionals who focus on determining the best asset mix in any given economic environment, with the goal of maximizing returns while minimizing risk. To achieve the Fund's investment objective, we invest primarily in Canadian and foreign common stocks; bonds issued by the Government of Canada, provincial governments and Canadian corporations; and high-quality money market securities, including asset-backed commercial paper.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$722.9 million as of December 31, 2011, from \$825.8 million at the end of 2010. Of this change, \$73.7 million was due to net outflows and \$29.1 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -3.6%, which underperformed the benchmark return of -0.4%. The Fund underperformed the broad-based index return of 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The Fund underperformed its benchmark during the reporting period, primarily due to weakness in the overseas and Canadian equity components of the Fund. Our bottom-up process led us to hold underweight positions in a number of the defensive parts of the market, where we felt that the premium being demanded for safety was very high. It was the continued strong performance of these sectors that led primarily to our underperformance in equities.

Bonds enjoyed their third consecutive strong year as interest rates fell to record lows. However, we positioned the fixed-income portion of the Fund to benefit from an overall rise in interest rates. This stance, which was meant to protect against a sudden jump in rates, detracted from performance when interest rates, especially on longer-term debt securities, remained near their historically lowest levels at the end of the year. Our interest rate strategy detracted from performance relative to the benchmark.

The Fund's credit strategies, however – that is, our positioning in corporate, provincial and government agency bonds, as well as mortgages – were positive. We maintained an overweight position in provincial and corporate bonds versus the benchmark throughout the year. Yields on provincial bonds were higher than Government of Canada bonds throughout the year, and as a result, we increased the Fund's exposure to provincial bonds. These shifts allowed our provincial strategies to add value. The Fund's position in corporate bonds, although larger on an absolute basis, was only modestly overweight versus the benchmark. Successful security selection led to a positive performance from our corporate bonds.

The Fund moved from an overweight position to an underweight position in equities through the second half of 2011. At the end of the reporting period, the Fund carried an underweight position in Canadian and overseas equities, an overweight position in U.S. equities, a neutral position in bonds, and an overweight position in cash.

### Recent Developments

The Fund remains positioned for gradual economic recovery, as we believe the global economic issues hindering investor confidence will eventually be resolved. Corporate fundamentals remain strong, and the negative sentiment being driven by headlines is creating significant investment opportunities in equities with exposure to the market cycle. We are taking advantage of these opportunities while continuing to focus on high-quality, well-managed companies with above-average growth prospects and conservative valuations.

The portfolio is positioned in expectation that current record low interest rates will rise as a result of an economic recovery. We would adjust the Fund's investment allocations if interest rates rise as expected.



Provincial, corporate and mortgage credit spreads remain at wide levels due to the ongoing uncertainty stemming from Europe, and the resulting retreat to federal bonds of “safe-haven” countries. The Fund remains overweight in its exposure to corporate bonds and mortgages, and plans to hold this position as long as credit spreads remain wide. If market volatility and uncertainty begin to subside, which we feel is not imminent, or if corporate credit spreads widen further, making them more attractive from a buyer’s point of view, we would consider adding to the Fund’s corporate bond position.

#### **Related-Party Transactions**

##### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

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##### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients’ Series C, Advisor Series, Series B or Series D units.

##### ***Trustee and Custodian***

RBC Dexia Investor Services Trust (“RBC Dexia”) is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund’s property on behalf of unitholders and holds the assets of the Fund.

##### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$16,000 (2010 – \$6,000), or 6% (2010 – 2%) of the total transaction costs paid for this Fund.

##### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors (“BoG”) in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

##### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

##### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>17.50</b>	<b>0.58</b>	<b>(0.33)</b>	<b>0.21</b>	<b>(1.26)</b>	<b>(0.80)</b>	<b>(0.14)</b>	<b>(0.08)</b>	<b>(0.24)</b>	–	<b>(0.46)</b>	<b>16.23</b>
Dec. 31, 2010	16.58	0.54	(0.33)	0.35	0.63	1.19	(0.22)	(0.02)	(0.06)	–	(0.30)	17.50
Dec. 31, 2009	14.30	0.64	(0.30)	(0.02)	2.68	3.00	(0.19)	(0.09)	–	–	(0.28)	16.58
Dec. 31, 2008 <sup>3</sup>	13.90 <sup>†</sup>	0.40	(0.04)	(0.12)	0.82	1.06	(0.01)	(0.01)	–	–	(0.02)	14.30
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>17.50</b>	<b>0.58</b>	<b>(0.33)</b>	<b>0.21</b>	<b>(1.26)</b>	<b>(0.80)</b>	<b>(0.14)</b>	<b>(0.08)</b>	<b>(0.24)</b>	–	<b>(0.46)</b>	<b>16.23</b>
Dec. 31, 2010 <sup>4</sup>	17.28 <sup>†</sup>	0.09	(0.05)	0.06	0.11	0.21	(0.10)	(0.01)	(0.06)	–	(0.17)	17.50
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>17.47</b>	<b>0.58</b>	<b>(0.24)</b>	<b>0.21</b>	<b>(1.25)</b>	<b>(0.70)</b>	<b>(0.20)</b>	<b>(0.12)</b>	<b>(0.24)</b>	–	<b>(0.56)</b>	<b>16.20</b>
Dec. 31, 2010	16.55	0.54	(0.24)	0.35	0.63	1.28	(0.29)	(0.03)	(0.06)	–	(0.38)	17.47
Dec. 31, 2009	14.27	0.55	(0.21)	(0.06)	2.32	2.60	(0.24)	(0.12)	–	–	(0.36)	16.55
Dec. 31, 2008	17.95	0.68	(0.23)	(0.32)	(4.43)	(4.30)	(0.26)	(0.09)	–	–	(0.35)	14.27
Dec. 31, 2007 <sup>5</sup>	19.34 <sup>†</sup>	0.53	(0.13)	1.05	(1.69)	(0.24)	(0.11)	(0.04)	(0.69)	–	(0.84)	17.95
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>17.28</b>	<b>0.57</b>	<b>(0.14)</b>	<b>0.21</b>	<b>(1.24)</b>	<b>(0.60)</b>	<b>(0.26)</b>	<b>(0.16)</b>	<b>(0.24)</b>	–	<b>(0.66)</b>	<b>16.01</b>
Dec. 31, 2010	16.36	0.53	(0.14)	0.34	0.62	1.35	(0.36)	(0.04)	(0.06)	–	(0.46)	17.28
Dec. 31, 2009	14.11	0.57	(0.13)	(0.04)	2.26	2.66	(0.29)	(0.15)	–	–	(0.44)	16.36
Dec. 31, 2008	17.81	0.63	(0.14)	(0.22)	(3.48)	(3.21)	(0.35)	(0.13)	–	–	(0.48)	14.11
Dec. 31, 2007	19.09	0.62	(0.16)	1.17	(1.73)	(0.10)	(0.33)	(0.11)	(0.73)	–	(1.17)	17.81
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>17.30</b>	<b>0.57</b>	<b>(0.15)</b>	<b>0.21</b>	<b>(1.24)</b>	<b>(0.61)</b>	<b>(0.26)</b>	<b>(0.16)</b>	<b>(0.24)</b>	–	<b>(0.66)</b>	<b>16.03</b>
Dec. 31, 2010	16.37	0.53	(0.15)	0.34	0.62	1.34	(0.36)	(0.04)	(0.06)	–	(0.46)	17.30
Dec. 31, 2009	14.13	0.61	(0.13)	(0.04)	2.23	2.67	(0.29)	(0.15)	–	–	(0.44)	16.37
Dec. 31, 2008	17.83	0.70	(0.14)	(0.34)	(3.63)	(3.41)	(0.34)	(0.13)	–	–	(0.47)	14.13
Dec. 31, 2007 <sup>7</sup>	17.82 <sup>†</sup>	0.01	–	–	–	0.01	–	–	–	–	–	17.83
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>17.11</b>	<b>0.57</b>	–	<b>0.20</b>	<b>(1.23)</b>	<b>(0.46)</b>	<b>(0.35)</b>	<b>(0.21)</b>	<b>(0.24)</b>	–	<b>(0.80)</b>	<b>15.86</b>
Dec. 31, 2010	16.15	0.52	–	0.34	0.61	1.47	(0.45)	(0.05)	(0.06)	–	(0.56)	17.11
Dec. 31, 2009	14.02	0.57	–	(0.05)	2.26	2.78	(0.44)	(0.22)	–	–	(0.66)	16.15
Dec. 31, 2008	17.88	0.63	–	(0.23)	(3.53)	(3.13)	(0.56)	(0.21)	–	–	(0.77)	14.02
Dec. 31, 2007	19.25	0.65	–	1.25	(2.03)	(0.13)	(0.52)	(0.17)	(0.73)	–	(1.42)	17.88

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>7</sup> From December 2007.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>16.24</b>	<b>21 655</b>	<b>1 333</b>	<b>2.03</b>	<b>2.03</b>	<b>108.76</b>	<b>0.03</b>
Dec. 31, 2010	17.52	18 669	1 065	1.99	1.99	64.26	0.11
Dec. 31, 2009	16.60	10 475	631	1.92 <sup>2</sup>	1.93	52.86	0.10
Dec. 31, 2008 <sup>5</sup>	14.32	1 492	104	1.96	2.24	67.40	0.14
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>16.24</b>	<b>1 106</b>	<b>68</b>	<b>2.03</b>	<b>2.03</b>	<b>108.76</b>	<b>0.03</b>
Dec. 31, 2010 <sup>6</sup>	17.52	18	1	1.99	1.99	64.26	0.11
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>16.20</b>	<b>1 098</b>	<b>68</b>	<b>1.50</b>	<b>1.50</b>	<b>108.76</b>	<b>0.03</b>
Dec. 31, 2010	17.49	1 328	76	1.45	1.45	64.26	0.11
Dec. 31, 2009	16.57	1 465	88	1.39 <sup>2</sup>	1.41	52.86	0.10
Dec. 31, 2008	14.30	1 826	128	1.40	1.43	67.40	0.14
Dec. 31, 2007 <sup>7</sup>	17.96	946	53	1.42	1.80	129.74	0.01
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>16.02</b>	<b>652 471</b>	<b>40 725</b>	<b>0.91</b>	<b>0.91</b>	<b>108.76</b>	<b>0.03</b>
Dec. 31, 2010	17.30	751 233	43 422	0.89	0.89	64.26	0.11
Dec. 31, 2009	16.38	771 482	47 104	0.86 <sup>2</sup>	0.86	52.86	0.10
Dec. 31, 2008	14.13	690 577	48 863	0.87	0.87	67.40	0.14
Dec. 31, 2007	17.82	925 643	51 930	0.86	0.86	129.74	0.01
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>16.03</b>	<b>7 078</b>	<b>441</b>	<b>0.92</b>	<b>0.92</b>	<b>108.76</b>	<b>0.03</b>
Dec. 31, 2010	17.32	7 541	435	0.91	0.91	64.26	0.11
Dec. 31, 2009	16.40	6 036	368	0.87 <sup>2</sup>	0.88	52.86	0.10
Dec. 31, 2008	14.15	3 097	219	0.88	0.88	67.40	0.14
Dec. 31, 2007 <sup>9</sup>	17.83	—	—	—	—	129.74	0.01
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>15.86</b>	<b>39 513</b>	<b>2 491</b>	<b>0.04</b>	<b>0.04</b>	<b>108.76</b>	<b>0.03</b>
Dec. 31, 2010	17.13	47 023	2 745	0.04	0.04	64.26	0.11
Dec. 31, 2009	16.17	58 186	3 597	0.03 <sup>2</sup>	0.03	52.86	0.10
Dec. 31, 2008	14.04	49 678	3 538	0.04	0.04	67.40	0.14
Dec. 31, 2007	17.89	54 760	3 061	0.04	0.04	129.74	0.01

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.95%, Series B – 1.43%, Series D – 0.87%, Series F – 0.90%, Series O – 0.03%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

<sup>9</sup> From December 2007.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.25%	40%	60%
Series D	0.75%	33%	67%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

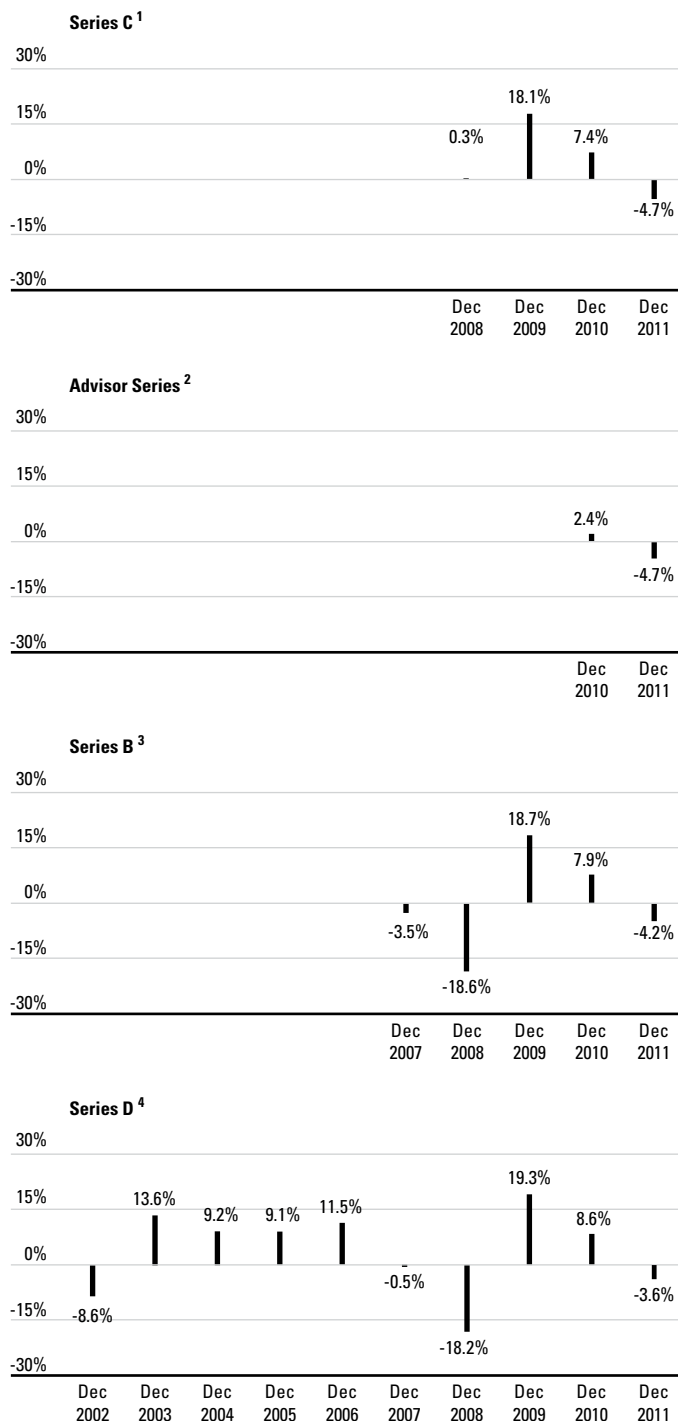
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

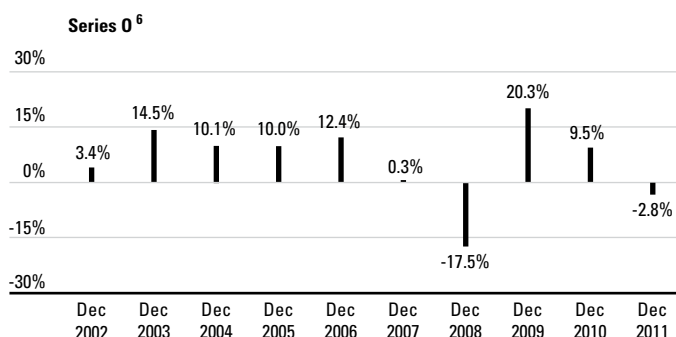
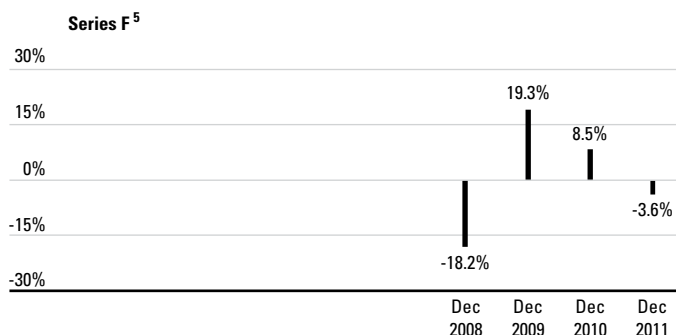
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmarks:

The blended benchmark (the "Benchmark") is composed of:

- 35% DEX Universe Bond Index
- 35% S&P/TSX Capped Composite Total Return Index
- 25% MSCI World ex Canada Total Return Index (CDN\$)
- 5% DEX 30-Day T-Bill Index

The broad-based index is the DEX Universe Bond Index.

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
<b>Series C<sup>1</sup></b>	-4.7	6.5	-	-	6.4
Benchmark	-0.4	8.5	-	-	8.5
Broad-based index	9.7	7.3	-	-	8.1
<b>Advisor Series<sup>2</sup></b>	-4.7	-	-	-	-2.1
Benchmark	-0.4	-	-	-	1.8
Broad-based index	9.7	-	-	-	7.4
<b>Series B<sup>3</sup></b>	-4.2	7.1	-	-	-0.8
Benchmark	-0.4	8.5	-	-	1.4
Broad-based index	9.7	7.3	-	-	7.3
<b>Series D<sup>4</sup></b>	-3.6	7.7	0.3	3.4	-
Benchmark	-0.4	8.5	1.8	4.8	-
Broad-based index	9.7	7.3	6.4	6.5	-
<b>Series F<sup>5</sup></b>	-3.6	7.6	-	-	0.5
Benchmark	-0.4	8.5	-	-	1.5
Broad-based index	9.7	7.3	-	-	7.1
<b>Series O<sup>6</sup></b>	-2.8	8.6	1.2	-	6.0
Benchmark	-0.4	8.5	1.8	-	6.5
Broad-based index	9.7	7.3	6.4	-	6.4

The returns of each series may vary because of differences in management fees and expenses. The Benchmark and broad-based index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark and broad-based index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date September 1991.

<sup>5</sup> Inception date December 2007.

<sup>6</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTIONS**

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**MSCI World ex Canada Total Return Index (CDN\$)** This index is the capitalization weighted index measuring the Canadian dollar performance of selected companies listed on stock exchanges in countries around the world (ex Canada).

**DEX 30-Day T-Bill Index** This index is a measure of the performance of short-term Canadian cash investments.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Bonds	34.7
Canadian Equities	31.8
U.S. Equities	14.3
Overseas Equities	11.0
Cash/Other	8.2

**Top 25 Holdings**

	% of Net Asset Value
Phillips, Hager & North Canadian Equity Underlying Fund	32.0
Phillips, Hager & North U.S. Equity Fund	14.4
Phillips, Hager & North Overseas Equity Pension Trust	11.5
Cash & Cash Equivalents	7.1
Province of Ontario 7.600% Jun 2 27	3.3
Canada Housing Trust No. 1 4.800% Jun 15 12	3.2
Ontario Electricity Financial Corp. 8.500% May 26 25	1.1
Canada Housing Trust No. 1 3.750% Mar 15 20	1.0
Province of Ontario 6.500% Mar 8 29	1.0
Province of Ontario 8.100% Sep 8 23	1.0
Province of Ontario 8.000% Jun 2 26	1.0
Morgan Stanley CAD 4.500% Feb 23 12	0.9
Province of Quebec 6.000% Oct 1 29	0.9
RBC Subordinated Notes Trust 4.580% Apr 30 17	0.8
Toronto-Dominion Bank 5.382% Nov 1 17	0.8
Province of Ontario 4.600% Jun 2 39	0.8
Bank of Nova Scotia 6.000% Oct 3 18	0.6
Bank of Montreal 2.960% Aug 2 16	0.6
Master Credit Card Trust 5.297% Aug 21 12	0.6
Merrill Lynch & Co. Inc. CAD 4.500% Jan 30 12	0.6
Bear Stearns Cos. LLC CAD 4.350% Jul 20 12	0.5
Government of Canada 4.000% Jun 1 41	0.5
Bank of Nova Scotia 4.990% Mar 27 18	0.4
Province of Ontario 4.650% Jun 2 41	0.4
Merrill Lynch & Co. Inc. CAD 5.290% May 30 22	0.4
<b>Top 25 Holdings</b>	<b>85.4</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

BALANCED FUND

**PHILLIPS, HAGER & NORTH  
COMMUNITY VALUES BALANCED FUND**

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December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth and income by investing in a strategic asset mix of Canadian and foreign equities, Canadian fixed income securities and money market instruments of companies that conduct themselves in a socially responsible manner. The Fund's asset mix is adjusted periodically to reflect changing economic and market conditions. The magnitude and timing of all rebalancing decisions within the Fund are made by a team of investment professionals who focus on determining the best asset mix in any given economic environment. To achieve the Fund's investment objective, we may fully invest in other funds managed by RBC GAM where the investment is consistent with the investment objectives and strategies of the Fund.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$13.3 million as of December 31, 2011, from \$15.9 million at the end of 2010. Of this change, \$2.1 million was attributable to net outflows and \$0.5 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -3.2%, which underperformed the benchmark return of -0.4% and the broad-based index return of 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe's crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank ("ECB") would rescue the Eurozone's financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that these steps would only temporarily alleviate the stress.

The Fund's allocation to Canadian and global equities had a negative impact on performance, with the Phillips, Hager & North Community Values Canadian Equity Fund and the Phillips, Hager & North Community Values Global Equity Fund both recording losses. The equity funds together accounted for almost two-thirds of the Fund's assets. The Fund's fixed-income investment, the Phillips, Hager & North Community Values Bond Fund, had a positive impact on returns. The bond fund accounted for about one-third of the Fund's assets.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager's view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for its economy to significantly decouple from the U.S.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.



***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

**Change in Net Assets Per Unit (\$)**

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>12.77</b>	<b>0.35</b>	<b>(0.25)</b>	<b>0.25</b>	<b>(0.88)</b>	<b>(0.53)</b>	<b>(0.05)</b>	<b>(0.04)</b>	<b>(0.33)</b>	–	<b>(0.42)</b>	<b>11.81</b>	
Dec. 31, 2010	12.12	0.36	(0.24)	0.10	0.59	0.81	(0.06)	(0.05)	(0.03)	–	(0.14)	12.77	
Dec. 31, 2009	10.37	0.49	(0.22)	(0.20)	1.99	2.06	(0.06)	(0.06)	–	–	(0.12)	12.12	
Dec. 31, 2008 <sup>3</sup>	10.36 <sup>†</sup>	0.42	(0.03)	(0.31)	0.45	0.53	(0.13)	(0.04)	–	–	(0.17)	10.37	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>12.77</b>	<b>0.35</b>	<b>(0.25)</b>	<b>0.25</b>	<b>(0.88)</b>	<b>(0.53)</b>	<b>(0.05)</b>	<b>(0.04)</b>	<b>(0.33)</b>	–	<b>(0.42)</b>	<b>11.81</b>	
Dec. 31, 2010 <sup>4</sup>	12.68	0.06	(0.04)	0.02	0.10	0.14	(0.06)	(0.05)	(0.03)	–	(0.14)	12.77	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>12.60</b>	<b>0.34</b>	<b>(0.19)</b>	<b>0.25</b>	<b>(0.87)</b>	<b>(0.47)</b>	<b>(0.07)</b>	<b>(0.06)</b>	<b>(0.33)</b>	–	<b>(0.46)</b>	<b>11.65</b>	
Dec. 31, 2010	11.94	0.36	(0.19)	0.10	0.59	0.86	(0.09)	(0.07)	(0.03)	–	(0.19)	12.60	
Dec. 31, 2009	10.22	0.36	(0.17)	(0.30)	2.00	1.89	(0.09)	(0.08)	–	–	(0.17)	11.94	
Dec. 31, 2008	12.84	0.66	(0.17)	(0.65)	(3.95)	(4.11)	(0.20)	(0.07)	–	–	(0.27)	10.22	
Dec. 31, 2007 <sup>5</sup>	12.84 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	12.84	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>12.62</b>	<b>0.34</b>	<b>(0.12)</b>	<b>0.25</b>	<b>(0.88)</b>	<b>(0.41)</b>	<b>(0.12)</b>	<b>(0.10)</b>	<b>(0.33)</b>	–	<b>(0.55)</b>	<b>11.66</b>	
Dec. 31, 2010	11.97	0.36	(0.11)	0.10	0.59	0.94	(0.14)	(0.11)	(0.03)	–	(0.28)	12.62	
Dec. 31, 2009	10.25	0.37	(0.10)	(0.30)	1.98	1.95	(0.13)	(0.12)	–	–	(0.25)	11.97	
Dec. 31, 2008	12.84	0.43	(0.11)	(0.31)	(2.34)	(2.33)	(0.22)	(0.08)	–	–	(0.30)	10.25	
Dec. 31, 2007	14.06	0.38	(0.14)	0.89	(1.33)	(0.20)	(0.18)	(0.06)	(0.77)	–	(1.01)	12.84	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>12.78</b>	<b>0.35</b>	<b>(0.12)</b>	<b>0.25</b>	<b>(0.89)</b>	<b>(0.41)</b>	<b>(0.13)</b>	<b>(0.10)</b>	<b>(0.33)</b>	–	<b>(0.56)</b>	<b>11.81</b>	
Dec. 31, 2010	12.12	0.36	(0.11)	0.10	0.60	0.95	(0.14)	(0.12)	(0.03)	–	(0.29)	12.78	
Dec. 31, 2009	10.38	0.56	(0.10)	(0.18)	2.24	2.52	(0.13)	(0.12)	–	–	(0.25)	12.12	
Dec. 31, 2008	12.84	3.07	(0.09)	(2.13)	1.84	2.69	(0.15)	(0.06)	–	–	(0.21)	10.38	
Dec. 31, 2007 <sup>5</sup>	12.84 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	12.84	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>12.66</b>	<b>0.35</b>	<b>(0.02)</b>	<b>0.25</b>	<b>(0.88)</b>	<b>(0.30)</b>	<b>(0.19)</b>	<b>(0.14)</b>	<b>(0.33)</b>	–	<b>(0.66)</b>	<b>11.69</b>	
Dec. 31, 2010	12.01	0.36	(0.02)	0.10	0.59	1.03	(0.20)	(0.16)	(0.03)	–	(0.39)	12.66	
Dec. 31, 2009	10.30	0.83	(0.02)	(0.09)	0.41	1.13	(0.18)	(0.17)	–	–	(0.35)	12.01	
Dec. 31, 2008	12.88	0.44	(0.02)	(0.31)	(2.30)	(2.19)	(0.28)	(0.10)	–	–	(0.38)	10.30	
Dec. 31, 2007	14.11	0.49	(0.03)	1.09	(1.80)	(0.25)	(0.28)	(0.09)	(0.78)	–	(1.15)	12.88	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From December 31, 2010

<sup>5</sup> From December 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>11.81</b>	<b>1 990</b>	<b>168</b>	<b>2.19</b>	<b>2.19</b>	<b>24.52</b>	<b>0.12</b>
Dec. 31, 2010	12.77	1 603	125	2.14	2.14	19.82	0.09
Dec. 31, 2009	12.12	685	57	2.11 <sup>2</sup>	2.51	20.22	0.14
Dec. 31, 2008 <sup>5</sup>	10.37	190	18	2.09	4.63	32.28	—
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>11.81</b>	<b>204</b>	<b>17</b>	<b>2.19</b>	<b>2.19</b>	<b>24.52</b>	<b>0.12</b>
Dec. 31, 2010 <sup>6</sup>	12.77	51	4	2.14	2.14	19.82	0.09
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>11.65</b>	<b>151</b>	<b>13</b>	<b>1.77</b>	<b>1.77</b>	<b>24.52</b>	<b>0.12</b>
Dec. 31, 2010	12.60	157	12	1.60	1.60	19.82	0.09
Dec. 31, 2009	11.94	147	12	1.70 <sup>2</sup>	2.33	20.22	0.14
Dec. 31, 2008	10.22	124	12	1.67	2.23	32.28	0.17
Dec. 31, 2007 <sup>7</sup>	12.84	—	—	—	—	35.48	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>11.66</b>	<b>10 141</b>	<b>870</b>	<b>1.08</b>	<b>1.08</b>	<b>24.52</b>	<b>0.12</b>
Dec. 31, 2010	12.62	10 892	863	0.95	0.95	19.82	0.09
Dec. 31, 2009	11.97	11 117	929	1.07 <sup>2</sup>	1.38	20.22	0.14
Dec. 31, 2008	10.25	9 545	931	1.09	1.55	32.28	0.17
Dec. 31, 2007	12.84	10 538	821	1.15	1.54	35.48	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>11.81</b>	<b>508</b>	<b>43</b>	<b>1.05</b>	<b>1.05</b>	<b>24.52</b>	<b>0.12</b>
Dec. 31, 2010	12.78	234	18	0.92	0.92	19.82	0.09
Dec. 31, 2009	12.12	160	13	1.06 <sup>2</sup>	1.43	20.22	0.14
Dec. 31, 2008	10.38	29	3	1.04	6.47	32.28	0.17
Dec. 31, 2007 <sup>7</sup>	12.84	—	—	—	—	35.48	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>11.69</b>	<b>319</b>	<b>27</b>	<b>0.25</b>	<b>0.25</b>	<b>24.52</b>	<b>0.12</b>
Dec. 31, 2010	12.66	2 947	233	0.23	0.23	19.82	0.09
Dec. 31, 2009	12.01	2 693	224	0.25 <sup>2</sup>	0.66	20.22	0.14
Dec. 31, 2008	10.30	218	21	0.31	1.03	32.28	0.17
Dec. 31, 2007	12.88	153	12	0.32	1.44	35.48	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 2.03%, Series B – 1.62%, Series D – 1.00%, Series F – 0.99%, Series O – 0.19%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From December 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.35%	37%	63%
Series D	0.75%	33%	67%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

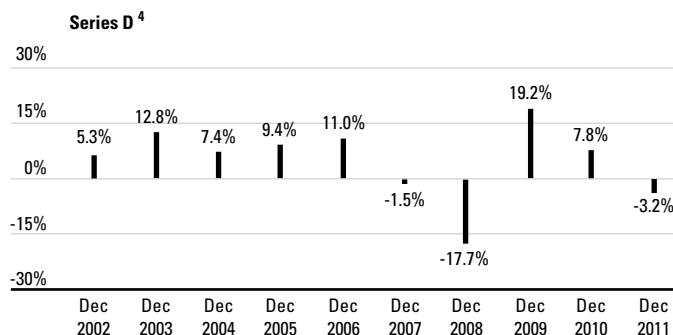
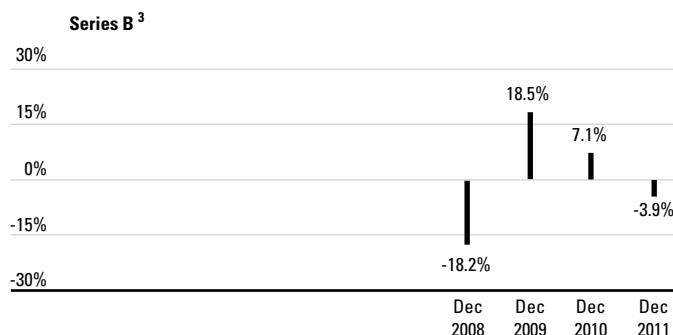
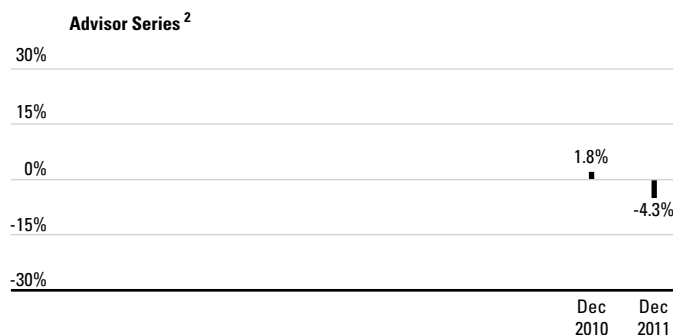
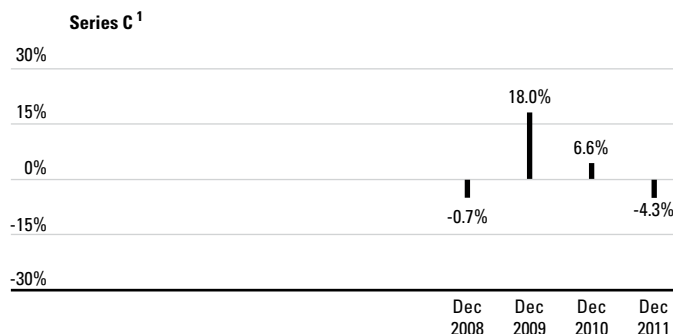
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

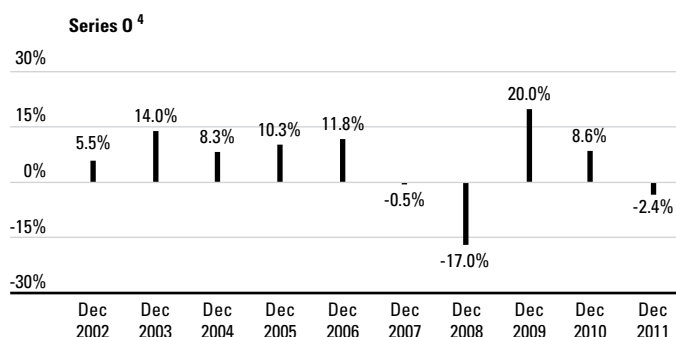
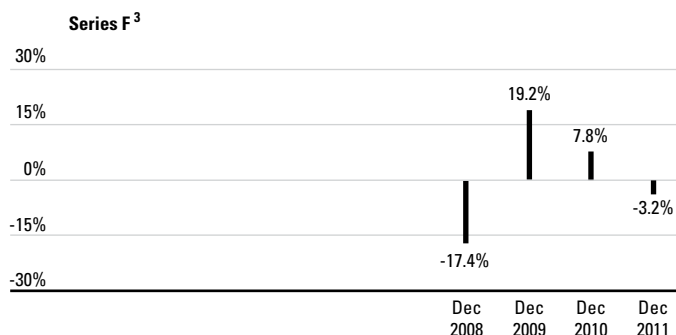
**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



PHILLIPS, HAGER & NORTH COMMUNITY  
VALUES BALANCED FUND

PAST PERFORMANCE (cont.)



Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmarks:

The blended benchmark (the "Benchmark") is composed of:

- 35% DEX Universe Bond Index
- 35% S&P/TSX Capped Composite Total Return Index
- 25% MSCI World ex Canada Total Return Index (CDN\$)
- 5% DEX 30-Day T-Bill Index

The broad-based index is the DEX Universe Bond Index.

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-4.3	6.4	—	—	6.0
Benchmark	-0.4	8.5	—	—	8.5
Broad-based index	9.7	7.3	—	—	8.1
Advisor Series <sup>2</sup>	-4.3	—	—	—	-2.2
Benchmark	-0.4	—	—	—	1.8
Broad-based index	9.7	—	—	—	7.4
Series B <sup>3</sup>	-3.9	6.8	—	—	0.0
Benchmark	-0.4	8.5	—	—	1.5
Broad-based index	9.7	7.3	—	—	7.1
Series D <sup>4</sup>	-3.2	7.5	0.2	—	4.9
Benchmark	-0.4	8.5	1.8	—	6.6
Broad-based index	9.7	7.3	6.4	—	6.3
Series F <sup>3</sup>	-3.2	7.5	—	—	0.7
Benchmark	-0.4	8.5	—	—	1.5
Broad-based index	9.7	7.3	—	—	7.1
Series O <sup>4</sup>	-2.4	8.4	1.0	—	5.8
Benchmark	-0.4	8.5	1.8	—	6.6
Broad-based index	9.7	7.3	6.4	—	6.3

The returns of each series may vary because of differences in management fees and expenses. The Benchmark and broad-based index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark and broad-based index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date December 2007.

<sup>4</sup> Inception date September 2002.

Series D was known as Series A prior to November 17, 2008. Although the Fund was prospectused in August 2002, Series A and Series O units were not offered for sale until September 2002. We are therefore not permitted to disclose performance data for this Fund for any period prior to September 2002.

INDEX DESCRIPTIONS

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**MSCI World ex Canada Total Return Index (CDN\$)** This index is the capitalization weighted index measuring the Canadian dollar performance of selected companies listed on stock exchanges in countries around the world (ex Canada).

**DEX 30-Day T-Bill Index** This index is a measure of the performance of short-term Canadian cash investments.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Canadian Equities	31.7
Bonds	27.8
U.S. Equities	13.8
Overseas Equities	10.9
Cash/Other	15.8

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North Community Values Bond Fund	35.0
Phillips, Hager & North Community Values Canadian Equity Fund	31.9
Phillips, Hager & North Community Values Global Equity Fund	25.9
Cash & Cash Equivalents	7.2
Total	100.0

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
DIVIDEND INCOME FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth and income by investing primarily in a well-diversified portfolio of dividend income-producing Canadian securities that have a relatively high yield. The securities are selected based on their long-term earnings potential and their ability to sustain an attractive yield over the long term. To achieve the Fund's investment objective, we invest primarily in large-capitalization, dividend-paying Canadian common shares and, to a lesser extent, preferred shares and bonds. U.S. stocks may be held in the Fund to complement its Canadian holdings, and will typically be concentrated in industries that are not well represented in the Canadian market.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$2.3 billion as of December 31, 2011, from \$2.6 billion at the end of 2010. Of this change, \$187.3 million was due to net outflows and \$58.5 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -2.7%. Over the same period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Following two years of strong gains, the Fund posted a negative return in 2011. Equities rallied to new highs during the first third of the year and subsequently trended lower before significantly correcting into August. A failed rally ensued, with new lows made in early October. Markets once again regrouped and worked higher into year-end. The Canadian equity markets underperformed U.S. equity markets by a wide margin, as fears of recession negatively impacted commodity stocks. Investors were concerned about the sovereign debt crisis in Europe and the risk of a slowdown in Chinese economic activity. The U.S. economy performed relatively well and its equity market also benefited from a more defensive composition.

The Fund's performance during 2011 was driven primarily by its holdings in the Energy and Financials sectors. In general, energy stocks benefited from the rise in the price of oil throughout the year despite its significant fluctuation. More specifically, the Fund benefited from its investments in such energy producers as ARC Resources, Baytex Energy, Cenovus Energy and midstream services provider Gibson Energy, as well as pipeline owner Enbridge.

The Fund also benefited from strong stock selection within the Financials sector. In general, the Canadian banks continued to report solid earnings through 2011, despite a challenging macroeconomic environment and weaker capital markets. The Fund's overweight positions in Toronto-Dominion Bank, National Bank, Brookfield Infrastructure Partners, First Capital Realty, Intact Financial, a property and casualty insurer, and MI Developments, a global industrial real estate operator, all contributed to the Fund's performance.

Additionally, the Fund's relative performance during the year was helped by not holding several poor performing stocks. These include Blackberry maker, Research In Motion, Talisman Energy, uranium producer Cameco, China-based Sino-Forest and gold producers Agnico-Eagle Mines and Kinross Gold.

The Fund's performance was hurt by certain holdings in life insurance companies and the Industrials sector. Shares of life insurance companies have been under pressure this past year as low interest rates and declining equity markets have continued to impair earnings and returns. The Fund's holdings in Manulife Financial and Sun Life Financial, mortgage insurer Genworth MI Canada and Magna International all detracted from the Fund's performance.

We remained active in the Fund during the year, adding several new names, trimming several existing holdings and eliminating others. We initiated new positions in Canexus, Brookfield Infrastructure Partners, Dundee International, Fortis, Gibson Energy, IESI-BFC, Intact Financial, MI Developments, Pengrowth Energy, Shoppers Drug Mart and Vermilion Energy. We reduced our positions in First Capital Realty, Sun Life Financial and Manulife Financial and eliminated the Fund's holdings in Canadian Oil Sands, Enerflex, GMP Capital, Groupe Aeroplan and Saputo Group.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in our view is that Europe is likely to continue to experience challenges in its sovereign debt markets. We expect North America to avoid recession and any recession in Europe to be relatively mild. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk



assets and further declines in bond yields. Our models indicate that the U.S. is not in recession, but is at risk of tumbling into one in the next year. The threat comes less from domestic conditions, and more from a possible European misstep. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. We forecast a downshift in economic growth in Canada in 2012.

Our outlook for equities remains positive. Although we expect that growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn't clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

#### **Related-Party Transactions**

##### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

##### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

##### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

##### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$97,000 (2010 – \$117,000), or 11% (2010 – 4%) of the total transaction costs paid for this Fund.

##### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

##### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

##### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>78.50</b>	<b>2.44</b>	<b>(1.52)</b>	<b>3.22</b>	<b>(6.72)</b>	<b>(2.58)</b>	–	<b>(0.33)</b>	<b>(1.44)</b>	–	<b>(1.77)</b>	<b>73.98</b>
Dec. 31, 2010	71.37	2.32	(1.42)	0.90	5.92	7.72	–	(0.70)	–	–	(0.70)	78.50
Dec. 31, 2009	54.92	2.37	(1.25)	1.36	17.91	20.39	–	(1.05)	–	–	(1.05)	71.37
Dec. 31, 2008 <sup>3</sup>	58.73 <sup>†</sup>	0.40	(0.14)	(1.27)	3.40	2.39	–	(0.56)	–	–	(0.56)	54.92
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>78.50</b>	<b>2.44</b>	<b>(1.52)</b>	<b>3.22</b>	<b>(6.72)</b>	<b>(2.58)</b>	–	<b>(0.33)</b>	<b>(1.44)</b>	–	<b>(1.77)</b>	<b>73.98</b>
Dec. 31, 2010 <sup>4</sup>	75.18 <sup>†</sup>	0.39	(0.24)	0.15	0.99	1.29	–	(0.36)	–	–	(0.36)	78.50
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>78.52</b>	<b>2.43</b>	<b>(1.32)</b>	<b>3.21</b>	<b>(6.70)</b>	<b>(2.38)</b>	–	<b>(0.56)</b>	<b>(1.44)</b>	–	<b>(2.00)</b>	<b>73.99</b>
Dec. 31, 2010	71.40	2.31	(1.23)	0.90	5.90	7.88	–	(0.90)	–	–	(0.90)	78.52
Dec. 31, 2009	54.93	2.36	(1.02)	1.19	14.44	16.97	–	(1.20)	–	–	(1.20)	71.40
Dec. 31, 2008	83.29	2.45	(1.20)	(1.55)	(29.16)	(29.46)	–	(0.91)	–	–	(0.91)	54.93
Dec. 31, 2007 <sup>5</sup>	92.38 <sup>†</sup>	1.29	(0.73)	(1.81)	(5.82)	(7.07)	(0.73)	(1.23)	(1.16)	–	(3.12)	83.29
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>77.79</b>	<b>2.41</b>	<b>(0.86)</b>	<b>3.19</b>	<b>(6.65)</b>	<b>(1.91)</b>	–	<b>(1.02)</b>	<b>(1.43)</b>	–	<b>(2.45)</b>	<b>73.30</b>
Dec. 31, 2010	70.71	2.29	(0.81)	0.89	5.85	8.22	–	(1.29)	–	–	(1.29)	77.79
Dec. 31, 2009	54.37	2.34	(0.68)	1.17	14.84	17.67	–	(1.50)	–	–	(1.50)	70.71
Dec. 31, 2008	82.73	2.43	(0.82)	(1.08)	(27.07)	(26.54)	–	(1.46)	–	–	(1.46)	54.37
Dec. 31, 2007	90.38	3.83	(1.01)	5.23	(11.33)	(3.28)	(1.02)	(1.72)	(1.19)	–	(3.93)	82.73
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>78.36</b>	<b>2.43</b>	<b>(0.70)</b>	<b>3.22</b>	<b>(6.70)</b>	<b>(1.75)</b>	–	<b>(1.21)</b>	<b>(1.46)</b>	–	<b>(2.67)</b>	<b>73.81</b>
Dec. 31, 2010	71.26	2.31	(0.65)	0.90	5.91	8.47	–	(1.48)	–	–	(1.48)	78.36
Dec. 31, 2009	54.79	2.36	(0.55)	1.13	15.25	18.19	–	(1.67)	–	–	(1.67)	71.26
Dec. 31, 2008	82.93	2.50	(0.62)	(1.80)	(26.50)	(26.42)	–	(1.32)	–	–	(1.32)	54.79
Dec. 31, 2007 <sup>5</sup>	92.38 <sup>†</sup>	1.25	(0.49)	(1.18)	(7.62)	(8.04)	(0.93)	(1.56)	(1.19)	–	(3.68)	82.93
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>76.37</b>	<b>2.37</b>	<b>(0.02)</b>	<b>3.14</b>	<b>(6.54)</b>	<b>(1.05)</b>	–	<b>(1.81)</b>	<b>(1.41)</b>	–	<b>(3.22)</b>	<b>72.01</b>
Dec. 31, 2010	69.42	2.25	(0.02)	0.88	5.75	8.86	–	(2.10)	–	–	(2.10)	76.37
Dec. 31, 2009	53.51	2.30	(0.01)	1.19	14.92	18.40	–	(2.27)	–	–	(2.27)	69.42
Dec. 31, 2008	82.14	2.41	(0.02)	(1.33)	(27.07)	(26.01)	–	(2.68)	–	–	(2.68)	53.51
Dec. 31, 2007	90.38	3.43	(0.02)	3.83	(12.87)	(5.63)	(1.61)	(2.70)	(1.19)	–	(5.50)	82.14

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>74.09</b>	<b>58 549</b>	<b>790</b>	<b>2.05</b>	<b>2.05</b>	<b>25.12</b>	<b>0.04</b>
Dec. 31, 2010	78.62	50 892	647	2.00	2.00	44.91	0.11
Dec. 31, 2009	71.51	29 917	418	1.92 <sup>2</sup>	1.92	43.01	0.07
Dec. 31, 2008 <sup>5</sup>	55.05	2 431	44	1.93	2.06	53.75	0.13
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>74.09</b>	<b>2 553</b>	<b>34</b>	<b>2.05</b>	<b>2.05</b>	<b>25.12</b>	<b>0.04</b>
Dec. 31, 2010 <sup>6</sup>	78.62	236	3	2.00	2.00	44.91	0.11
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>74.11</b>	<b>4 105</b>	<b>55</b>	<b>1.77</b>	<b>1.77</b>	<b>25.12</b>	<b>0.04</b>
Dec. 31, 2010	78.65	5 854	74	1.72	1.72	44.91	0.11
Dec. 31, 2009	71.54	7 641	107	1.65 <sup>2</sup>	1.66	43.01	0.07
Dec. 31, 2008	55.06	8 035	146	1.65	1.66	53.75	0.13
Dec. 31, 2007 <sup>7</sup>	83.49	8 633	103	1.64	1.70	36.40	0.06
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>73.41</b>	<b>1 805 881</b>	<b>24 600</b>	<b>1.18</b>	<b>1.18</b>	<b>25.12</b>	<b>0.04</b>
Dec. 31, 2010	77.92	2 059 340	26 430	1.14	1.14	44.91	0.11
Dec. 31, 2009	70.85	2 056 122	29 021	1.11 <sup>2</sup>	1.11	43.01	0.07
Dec. 31, 2008	54.50	1 712 933	31 428	1.11	1.11	53.75	0.13
Dec. 31, 2007	82.94	2 956 212	35 644	1.11	1.11	36.40	0.06
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>73.92</b>	<b>26 270</b>	<b>355</b>	<b>0.94</b>	<b>0.94</b>	<b>25.12</b>	<b>0.04</b>
Dec. 31, 2010	78.48	23 634	301	0.92	0.92	44.91	0.11
Dec. 31, 2009	71.40	17 579	246	0.87 <sup>2</sup>	0.87	43.01	0.07
Dec. 31, 2008	54.93	9 274	169	0.85	0.98	53.75	0.13
Dec. 31, 2007 <sup>7</sup>	83.14	3 943	47	1.11	1.18	36.40	0.06
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>72.12</b>	<b>416 612</b>	<b>5 777</b>	<b>0.02</b>	<b>0.02</b>	<b>25.12</b>	<b>0.04</b>
Dec. 31, 2010	76.49	419 867	5 489	0.02	0.02	44.91	0.11
Dec. 31, 2009	69.56	393 220	5 653	0.02 <sup>2</sup>	0.02	43.01	0.07
Dec. 31, 2008	53.64	304 468	5 676	0.03	0.03	53.75	0.13
Dec. 31, 2007	82.34	395 531	4 804	0.02	0.02	36.40	0.06

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.93%, Series B – 1.68%, Series D – 1.12%, Series F – 0.89%, Series O – 0.02%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.50%	33%	67%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

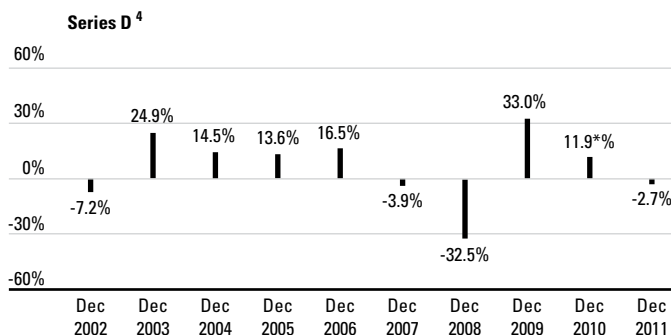
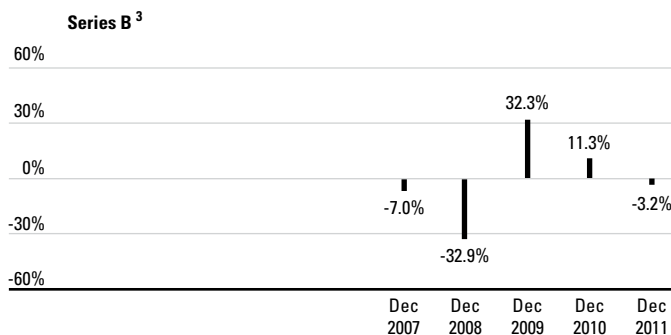
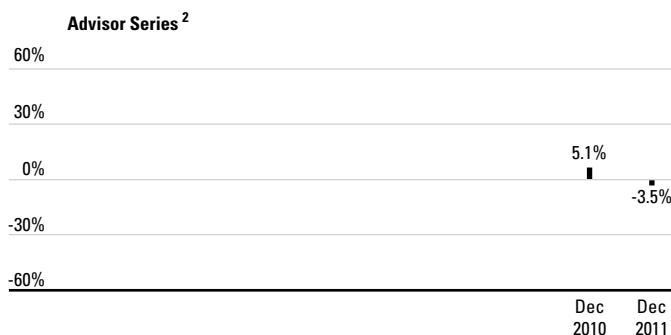
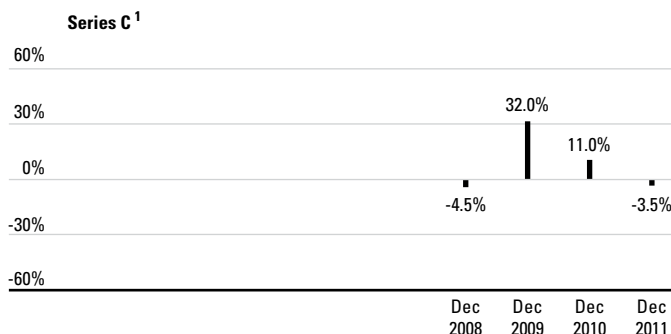
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

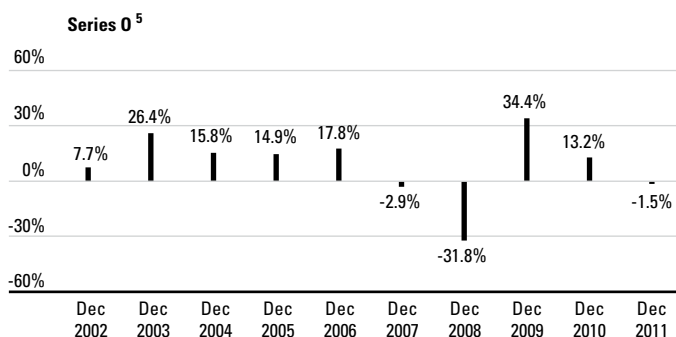
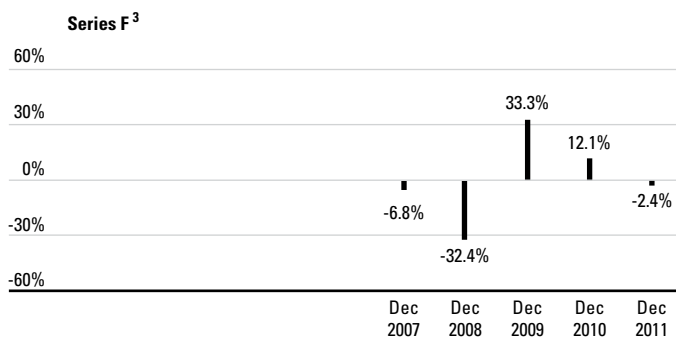
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P/TSX Capped Composite Total Return Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-3.5	12.2	—	—	10.2
Benchmark	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-3.5	—	—	—	1.2
Benchmark	-8.7	—	—	—	-2.3
Series B <sup>3</sup>	-3.2	12.5	—	—	-2.6
Benchmark	-8.7	13.2	—	—	-0.5
Series D <sup>4</sup>	-2.7	13.1	-1.2	5.1	—
Benchmark	-8.7	13.2	1.3	7.0	—
Series F <sup>3</sup>	-2.4	13.4	—	—	-1.8
Benchmark	-8.7	13.2	—	—	-0.5
Series O <sup>5</sup>	-1.5	14.4	-0.1	—	8.5
Benchmark	-8.7	13.2	1.3	—	10.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date June 1977.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Financials	40.5
Energy	23.3
Materials	9.5
Industrials	6.1
Utilities	5.1
Consumer Discretionary	5.0
Telecommunications	4.5
Consumer Staples	2.2
Index Funds	0.7
Cash/Other	3.1

**Top 25 Holdings**

	% of Net Asset Value
Toronto-Dominion Bank	7.7
Royal Bank of Canada	7.2
Bank of Nova Scotia	5.0
Cenovus Energy Inc.	3.7
Atco Ltd., Class I, Non-Voting	3.7
Enbridge Inc.	3.6
Suncor Energy Inc.	3.4
Canadian Imperial Bank of Commerce	3.3
Bank of Montreal	2.9
Canadian National Railway Co.	2.9
Barrick Gold Corp.	2.9
Cash & Cash Equivalents	2.9
Canadian Natural Resources Ltd.	2.7
Goldcorp Inc.	2.4
Brookfield Asset Management Inc., Class A	2.3
Power Corporation of Canada	2.0
TransCanada Corp.	2.0
CI Financial Corp.	1.8
Potash Corporation of Saskatchewan Inc.	1.8
Manulife Financial Corporation	1.7
TELUS Corp., Class A	1.7
Rogers Communications Inc., Class B	1.6
Baytex Energy Corp.	1.4
BCE Inc.	1.2
First Capital Realty Inc.	1.2
Top 25 Holdings	73.0

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CANADIAN EQUITY FUND**

*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in a well-diversified portfolio of common shares of Canadian companies. To achieve the Fund's investment objective, we invest in companies that we believe have a superior management team, a leadership position in their industry, a high level of profitability compared to their peers, and strong earnings potential and a reasonable valuation.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$1.36 billion as of December 31, 2011, from \$1.81 billion at the end of 2010. Of this change, \$277.2 million was due to net outflows and \$173.7 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -11.2%. Over the same period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index, returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Negative news about the global economy dominated the headlines and the markets over this past year. We continue to believe that the quality, growth and value characteristics that we identify in companies will contribute to positive long-term returns and that these market conditions create exceptional opportunities for those that continue to focus on such long-term characteristics.

Our process of stock selection helped us to avoid or minimize exposure to some of the highest profile stocks in the index (such as Research In Motion, Yellow Media and Sino-Forest), and added value in key areas including the Canadian banks and the Materials sector. However, our bottom-up process led us to hold an underweight position in a number of the more defensive parts of the market, where we felt that the premium being demanded for safety was very high, and it was the continued strong performance of these sectors that led primarily to the Fund's underperformance relative to the benchmark.

The most significant contributor to our performance relative to the benchmark was the Materials sector, through a roughly equal combination of good stock selection and our underweight of the sector. It is noteworthy that we added value through stock selection in the gold, precious metals and base metals sub-sectors. We also added value relative to the benchmark in the Information Technology sector, through our overweight position in Open Text and our underweight position in Research In Motion.

The biggest detractor from our performance relative to the benchmark was the Energy sector, primarily as a result of our underweight in pipeline and storage businesses such as TransCanada and Enbridge, as investors sought the income and stability offered by this sector. We also lost ground in the Financials sector. Canadian bank stocks performed well, but this was offset by macroeconomic forces as investors reduced their holdings of life insurers and sought refuge in real estate investment trusts.

We continue to believe that the North American and global economies will exhibit slow growth in 2012. We continue to focus on quality companies that are trading at reasonable valuations and that are able to grow and create shareholder value in any economic environment.

### Recent Developments

We believe that the recent performance of stocks has been primarily a function of a stock's perceived riskiness rather than its fundamental strength. Correlations of individual stock-price movements to the market have risen to more than 80% of late, reflecting a lack of differentiation between issuers on the part of investors. However, we believe that this lack of differentiation is creating opportunities which may pay off when investors once again focus on the fundamentals of individual companies.

The most recent set of quarterly earnings reports of Canadian companies was once again very strong, exceeding analyst expectations in Canada and the U.S. This has not been a normal economic recovery, and neither economic activity nor optimism have returned to prior levels. We believe that a continued slow recovery is most probable.

As more than 50% of the value of the S&P/TSX Capped Composite Total Return Index is represented by natural resource companies, and as China is the most important source of demand for these natural resource companies, a more severe economic slowdown in China is an obvious risk. However, as we look out a year or two, we believe that earnings for Canadian companies will continue to increase as trading volumes for many industries are still well below historical levels.



## **Related-Party Transactions**

### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$156,000 (2010 – \$44,000), or 7% (2010 – 2%) of the total transaction costs paid for this Fund.

### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>85.81</b>	<b>2.17</b>	<b>(1.60)</b>	<b>2.27</b>	<b>(12.74)</b>	<b>(9.90)</b>	–	<b>(0.07)</b>	<b>(2.80)</b>	–	<b>(2.87)</b>	<b>72.72</b>
Dec. 31, 2010	77.53	1.98	(1.53)	5.50	2.63	8.58	–	(0.70)	–	–	(0.70)	85.81
Dec. 31, 2009	58.10	1.84	(1.22)	0.01	5.91	6.54	–	(0.62)	–	–	(0.62)	77.53
Dec. 31, 2008 <sup>3</sup>	59.74 <sup>†</sup>	0.89	(0.14)	0.02	4.93	5.70	–	(0.59)	–	–	(0.59)	58.10
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>85.81</b>	<b>2.17</b>	<b>(1.60)</b>	<b>2.27</b>	<b>(12.74)</b>	<b>(9.90)</b>	–	<b>(0.07)</b>	<b>(2.80)</b>	–	<b>(2.87)</b>	<b>72.72</b>
Dec. 31, 2010 <sup>4</sup>	81.44 <sup>†</sup>	0.33	(0.26)	0.92	0.44	1.43	–	(0.70)	–	–	(0.70)	85.81
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>84.61</b>	<b>2.14</b>	<b>(1.38)</b>	<b>2.23</b>	<b>(12.52)</b>	<b>(9.53)</b>	–	<b>(0.88)</b>	<b>(2.80)</b>	–	<b>(3.68)</b>	<b>71.05</b>
Dec. 31, 2010	76.43	1.93	(1.30)	5.35	2.56	8.54	–	(0.92)	–	–	(0.92)	84.61
Dec. 31, 2009	57.57	2.04	(1.10)	0.90	17.80	19.64	–	(0.81)	–	–	(0.81)	76.43
Dec. 31, 2008	91.61	2.35	(1.32)	(1.86)	(34.18)	(35.01)	–	(1.09)	–	–	(1.09)	57.57
Dec. 31, 2007 <sup>5</sup>	99.36 <sup>†</sup>	1.54	(0.79)	7.44	(12.59)	(4.40)	–	(0.28)	(3.91)	–	(4.19)	91.61
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>84.22</b>	<b>2.13</b>	<b>(0.91)</b>	<b>2.23</b>	<b>(12.50)</b>	<b>(9.05)</b>	–	<b>(1.29)</b>	<b>(2.82)</b>	–	<b>(4.11)</b>	<b>70.70</b>
Dec. 31, 2010	76.09	1.94	(0.86)	5.38	2.58	9.04	–	(1.41)	–	–	(1.41)	84.22
Dec. 31, 2009	57.30	2.05	(0.74)	0.90	17.80	20.01	–	(1.20)	–	–	(1.20)	76.09
Dec. 31, 2008	91.27	2.28	(0.91)	(1.52)	(31.64)	(31.79)	–	(1.38)	–	–	(1.38)	57.30
Dec. 31, 2007	91.26	2.15	(1.08)	12.57	(7.73)	5.91	–	(0.77)	(3.90)	–	(4.67)	91.27
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>85.79</b>	<b>2.18</b>	<b>(0.74)</b>	<b>2.27</b>	<b>(12.75)</b>	<b>(9.04)</b>	–	<b>(1.49)</b>	<b>(2.83)</b>	–	<b>(4.32)</b>	<b>72.07</b>
Dec. 31, 2010	77.44	1.99	(0.71)	5.52	2.64	9.44	–	(1.55)	–	–	(1.55)	85.79
Dec. 31, 2009	58.32	2.17	(0.61)	0.54	18.88	20.98	–	(1.39)	–	–	(1.39)	77.44
Dec. 31, 2008	91.50	2.76	(0.67)	(2.32)	(34.69)	(34.92)	–	(0.84)	–	–	(0.84)	58.32
Dec. 31, 2007 <sup>5</sup>	99.36 <sup>†</sup>	1.47	(0.54)	7.32	(11.93)	(3.68)	–	(0.75)	(3.80)	–	(4.55)	91.50
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>83.87</b>	<b>2.13</b>	<b>(0.02)</b>	<b>2.23</b>	<b>(12.49)</b>	<b>(8.15)</b>	–	<b>(2.16)</b>	<b>(2.83)</b>	–	<b>(4.99)</b>	<b>70.36</b>
Dec. 31, 2010	75.81	1.93	(0.02)	5.38	2.57	9.86	–	(2.40)	–	–	(2.40)	83.87
Dec. 31, 2009	57.16	2.04	(0.01)	0.90	17.83	20.76	–	(2.03)	–	–	(2.03)	75.81
Dec. 31, 2008	90.70	2.28	(0.02)	(1.57)	(31.28)	(30.59)	–	(2.00)	–	–	(2.00)	57.16
Dec. 31, 2007	90.77	2.16	(0.02)	12.71	(10.13)	4.72	–	(1.80)	(4.00)	–	(5.80)	90.70

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>72.83</b>	<b>11 586</b>	<b>159</b>	<b>2.03</b>	<b>2.03</b>	<b>58.64</b>	<b>0.14</b>
Dec. 31, 2010	85.95	11 389	133	1.99	1.99	36.06	0.14
Dec. 31, 2009	77.67	6 935	89	1.92 <sup>2</sup>	1.97	43.01	0.12
Dec. 31, 2008 <sup>5</sup>	58.22	42 703	733	1.93	0.00	51.40	0.17
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>72.83</b>	<b>379</b>	<b>5</b>	<b>2.03</b>	<b>2.03</b>	<b>58.64</b>	<b>0.14</b>
Dec. 31, 2010 <sup>6</sup>	85.95	—	—	1.99	1.99	36.06	0.14
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>71.16</b>	<b>1 035</b>	<b>15</b>	<b>1.74</b>	<b>1.74</b>	<b>58.64</b>	<b>0.14</b>
Dec. 31, 2010	84.75	1 508	18	1.71	1.71	36.06	0.14
Dec. 31, 2009	76.57	2 653	35	1.65 <sup>2</sup>	1.70	43.01	0.12
Dec. 31, 2008	57.69	2 381	41	1.65	1.71	51.40	0.17
Dec. 31, 2007 <sup>7</sup>	91.72	2 217	24	1.64	1.91	31.90	0.05
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>70.81</b>	<b>679 886</b>	<b>9 602</b>	<b>1.18</b>	<b>1.18</b>	<b>58.64</b>	<b>0.14</b>
Dec. 31, 2010	84.36	893 993	10 597	1.14	1.14	36.06	0.14
Dec. 31, 2009	76.23	881 686	11 566	1.11 <sup>2</sup>	1.11	43.01	0.12
Dec. 31, 2008	57.42	694 085	12 089	1.12	1.12	51.40	0.17
Dec. 31, 2007	91.39	1 143 877	12 517	1.12	1.12	31.90	0.05
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>72.18</b>	<b>5 480</b>	<b>76</b>	<b>0.94</b>	<b>0.94</b>	<b>58.64</b>	<b>0.14</b>
Dec. 31, 2010	85.93	5 864	68	0.91	0.91	36.06	0.14
Dec. 31, 2009	77.58	3 016	39	0.87 <sup>2</sup>	0.91	43.01	0.12
Dec. 31, 2008	58.44	927	16	0.85	1.25	51.40	0.17
Dec. 31, 2007 <sup>7</sup>	91.61	236	3	1.11	3.02	31.90	0.05
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>70.47</b>	<b>666 585</b>	<b>9 459</b>	<b>0.02</b>	<b>0.02</b>	<b>58.64</b>	<b>0.14</b>
Dec. 31, 2010	84.01	903 087	10 750	0.02	0.02	36.06	0.14
Dec. 31, 2009	75.95	1 162 086	15 301	0.02 <sup>2</sup>	0.02	43.01	0.12
Dec. 31, 2008	57.28	937 558	16 369	0.02	0.02	51.40	0.17
Dec. 31, 2007	90.81	1 379 520	15 191	0.02	0.02	31.90	0.05

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 2.00%, Series B – 1.68%, Series D – 1.11%, Series F – 0.89%, Series O – 0.02%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.50%	33%	67%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

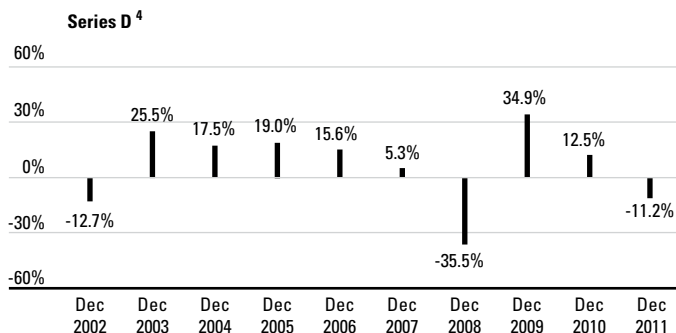
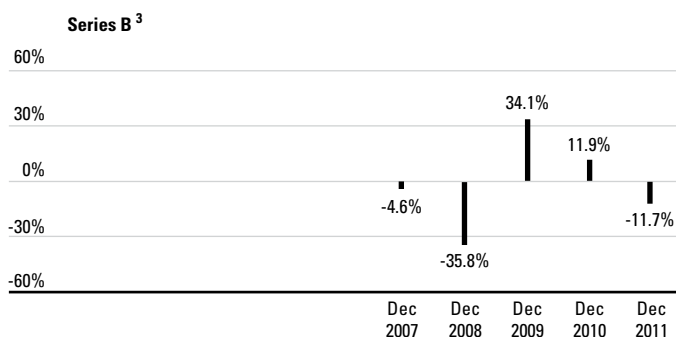
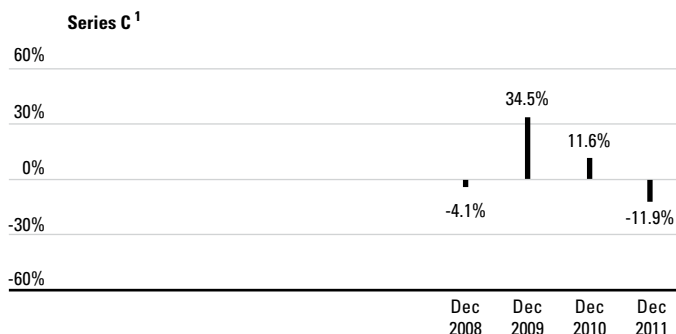
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

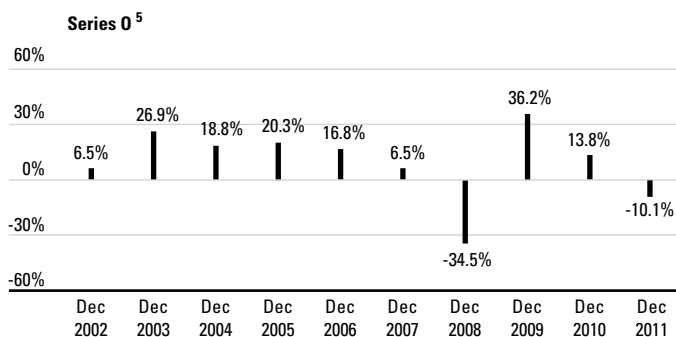
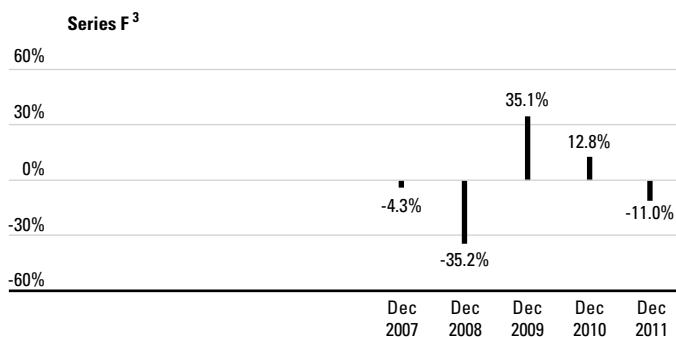
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P/TSX Capped Composite Total Return Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-11.9	9.7	—	—	8.0
Benchmark	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-11.9	—	—	—	-5.4
Benchmark	-8.7	—	—	—	-2.3
Series B <sup>3</sup>	-11.7	9.9	—	—	-4.5
Benchmark	-8.7	13.2	—	—	-0.5
Series D <sup>4</sup>	-11.2	10.5	-1.8	4.9	—
Benchmark	-8.7	13.2	1.3	7.0	—
Series F <sup>3</sup>	-11.0	10.7	—	—	-3.8
Benchmark	-8.7	13.2	—	—	-0.5
Series O <sup>5</sup>	-10.1	11.7	-0.6	—	8.9
Benchmark	-8.7	13.2	1.3	—	10.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date June 1971.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

## SUMMARY OF INVESTMENT PORTFOLIO

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

### Investment Mix

	% of Net Asset Value
Financials	31.7
Energy	25.5
Materials	16.6
Industrials	10.9
Consumer Discretionary	6.0
Telecommunications	4.4
Consumer Staples	1.9
Health Care	1.0
Information Technology	0.9
Index Funds	0.7
Cash/Other	0.4

### Top 25 Holdings

	% of Net Asset Value
Phillips, Hager & North Small Float Fund	14.8
Toronto-Dominion Bank	7.2
Royal Bank of Canada	7.0
Canadian Imperial Bank of Commerce	4.0
Canadian Natural Resources Ltd.	4.0
Suncor Energy Inc.	3.9
Bank of Nova Scotia	3.5
Rogers Communications Inc., Class B	3.3
Cenovus Energy Inc.	2.9
Potash Corporation of Saskatchewan Inc.	2.7
Canadian National Railway Co.	2.6
Barrick Gold Corp.	2.3
SNC-Lavalin Group Inc.	2.3
Manulife Financial Corporation	2.2
Enbridge Inc.	2.1
Goldcorp Inc.	2.1
Magna International Inc., Class A	1.7
Teck Resources Ltd., Class B	1.6
Power Corporation of Canada	1.6
Loblaw Companies Ltd.	1.5
ARC Resources Ltd.	1.5
EnCana Corp.	1.4
Talisman Energy Inc.	1.4
Bombardier Inc., Class B	1.2
Brookfield Asset Management Inc., Class A	1.2
Top 25 Holdings	80.0

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
COMMUNITY VALUES CANADIAN  
EQUITY FUND**

*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in common shares of high-quality Canadian companies. Our intention is that only the securities of companies that conduct themselves in a socially responsible manner will be included in the portfolio. To achieve the Fund's investment objective, we invest in companies that we believe have a superior management team, a leadership position in their industry, a high level of profitability compared to their peers, and strong earnings potential.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$62.4 million as of December 31, 2011, from \$60.7 million at the end of 2010. Of this change, \$7.5 million was due to net inflows, offset by \$5.7 million of investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -9.1%. Over the same period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index, returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Negative macro-economic events dominated the news and the markets over this past year. We continue to believe that the quality, growth and value characteristics that we identify in companies will contribute to positive long-term returns and that these market conditions create exceptional opportunities for those that continue to focus on such long-term characteristics.

Our process of stock selection helped us to avoid or minimize exposure to some of the highest profile stocks in the index (such as Research In Motion, Yellow Media and Sino-Forest), and added value in key areas including the Canadian banks and the Materials sector. However, our bottom-up process led us to hold an underweight position in a number of the more defensive parts of the market, where we felt that the premium being demanded for safety was very high, and it was the continued strong performance of these sectors that led primarily to the Fund's underperformance relative to the benchmark.

The biggest detractor from our performance relative to the benchmark was the Energy sector, primarily as a result of our underweight in pipeline and storage businesses such as TransCanada and Enbridge, as investors sought the income and stability offered by this sector. We also lost ground in the Health Care and Financials sectors.

The most significant contributor to our performance relative to the benchmark was the Materials sector, through good stock selection. We added value relative to the benchmark in the Information Technology sector, through our overweight position in Open Text and our underweight position in Research In Motion.

We continue to believe that the North American and global economies will exhibit slow growth in 2012. We continue to focus on quality companies that are trading at reasonable valuations and that are able to grow and create shareholder value in any economic environment.

### Recent Developments

Correlations of individual stock-price movements to the market have risen significantly, reflecting a lack of differentiation between issuers on the part of investors. We believe that this lack of differentiation is creating opportunities which will pay off when investors once again focus on issuer-specific characteristics.

The most recent set of corporate quarterly earnings reports was once again strong, exceeding analyst expectations in Canada and the U.S. This has not been a normal economic recovery, and neither economic activity nor optimism have returned to prior levels. Going forward, we believe that a continued slow recovery is the most probable outcome, although there is a wide range of potentially more positive or negative scenarios. Resolution of the European debt situation, U.S. economic recovery and degree of growth in China are three important factors that will drive short-term financial markets performance.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.



***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Brokerage***

The Fund has established standard brokerage arrangements at market rates with related-party dealers. These related-party commissions were \$7,000 (2010 – \$3,000), or 5% (2010 – 6%) of the total transaction costs paid for this Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>20.46</b>	<b>0.54</b>	<b>(0.39)</b>	<b>0.79</b>	<b>(3.06)</b>	<b>(2.12)</b>	–	<b>(0.07)</b>	<b>(0.17)</b>	–	<b>(0.24)</b>	<b>18.20</b>
Dec. 31, 2010	18.73	0.55	(0.37)	0.37	1.34	1.89	–	(0.13)	–	–	(0.13)	20.46
Dec. 31, 2009	14.18	0.59	(0.37)	0.43	3.77	4.42	–	(0.16)	–	–	(0.16)	18.73
Dec. 31, 2008 <sup>3</sup>	15.05 <sup>†</sup>	0.09	(0.04)	(0.13)	(0.66)	(0.74)	–	(0.11)	–	–	(0.11)	14.18
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>20.46</b>	<b>0.54</b>	<b>(0.39)</b>	<b>0.79</b>	<b>(3.06)</b>	<b>(2.12)</b>	–	<b>(0.07)</b>	<b>(0.17)</b>	–	<b>(0.24)</b>	<b>18.20</b>
Dec. 31, 2010 <sup>4</sup>	19.60 <sup>†</sup>	0.09	(0.06)	0.06	0.22	0.31	–	(0.13)	–	–	(0.13)	20.46
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>20.42</b>	<b>0.54</b>	<b>(0.36)</b>	<b>0.79</b>	<b>(3.06)</b>	<b>(2.09)</b>	–	<b>(0.09)</b>	<b>(0.17)</b>	–	<b>(0.26)</b>	<b>18.16</b>
Dec. 31, 2010	18.69	0.55	(0.34)	0.37	1.34	1.92	–	(0.15)	–	–	(0.15)	20.42
Dec. 31, 2009	14.13	0.56	(0.32)	(0.10)	4.49	4.63	–	(0.20)	–	–	(0.20)	18.69
Dec. 31, 2008	21.55	0.59	(0.37)	(0.76)	(6.78)	(7.32)	–	(0.13)	–	–	(0.13)	14.13
Dec. 31, 2007 <sup>5</sup>	23.87 <sup>†</sup>	0.31	(0.22)	1.39	(1.81)	(0.33)	–	–	(1.36)	–	(1.36)	21.55
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>20.33</b>	<b>0.54</b>	<b>(0.23)</b>	<b>0.79</b>	<b>(3.06)</b>	<b>(1.96)</b>	–	<b>(0.21)</b>	<b>(0.17)</b>	–	<b>(0.38)</b>	<b>18.08</b>
Dec. 31, 2010	18.60	0.55	(0.22)	0.37	1.34	2.04	–	(0.29)	–	–	(0.29)	20.33
Dec. 31, 2009	14.08	0.56	(0.22)	(0.14)	4.63	4.83	–	(0.31)	–	–	(0.31)	18.60
Dec. 31, 2008	21.46	0.58	(0.26)	(0.64)	(6.54)	(6.86)	–	(0.22)	–	–	(0.22)	14.08
Dec. 31, 2007	22.08	0.55	(0.33)	2.04	(1.47)	0.79	–	(0.12)	(1.36)	–	(1.48)	21.46
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>20.58</b>	<b>0.54</b>	<b>(0.18)</b>	<b>0.80</b>	<b>(3.08)</b>	<b>(1.92)</b>	–	<b>(0.26)</b>	<b>(0.17)</b>	–	<b>(0.43)</b>	<b>18.31</b>
Dec. 31, 2010	18.84	0.55	(0.17)	0.37	1.36	2.11	–	(0.35)	–	–	(0.35)	20.58
Dec. 31, 2009	14.29	0.57	(0.18)	(0.22)	4.97	5.14	–	(0.39)	–	–	(0.39)	18.84
Dec. 31, 2008	21.48	0.61	(0.20)	(0.63)	(5.10)	(5.32)	–	(0.10)	–	–	(0.10)	14.29
Dec. 31, 2007 <sup>5</sup>	23.87 <sup>†</sup>	0.30	(0.16)	1.80	(4.35)	(2.41)	–	(0.12)	(1.36)	–	(1.48)	21.48
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>20.44</b>	<b>0.54</b>	<b>(0.02)</b>	<b>0.79</b>	<b>(3.07)</b>	<b>(1.76)</b>	–	<b>(0.41)</b>	<b>(0.17)</b>	–	<b>(0.58)</b>	<b>18.18</b>
Dec. 31, 2010	18.72	0.55	(0.02)	0.37	1.35	2.25	–	(0.53)	–	–	(0.53)	20.44
Dec. 31, 2009	14.17	0.57	(0.02)	(0.25)	4.79	5.09	–	(0.52)	–	–	(0.52)	18.72
Dec. 31, 2008	21.48	0.58	(0.03)	(0.66)	(6.52)	(6.63)	–	(0.36)	–	–	(0.36)	14.17
Dec. 31, 2007	22.00	0.54	(0.03)	2.08	(1.53)	1.06	–	(0.32)	(1.37)	–	(1.69)	21.48

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>18.23</b>	<b>911</b>	<b>50</b>	<b>2.02</b>	<b>2.02</b>	<b>73.06</b>	<b>0.22</b>
Dec. 31, 2010	20.49	910	44	1.99	1.99	41.74	0.09
Dec. 31, 2009	18.77	476	25	2.05 <sup>2</sup>	2.42	56.05	0.11
Dec. 31, 2008 <sup>5</sup>	14.22	1	–	2.08	248.69	54.22	0.11
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>18.23</b>	<b>62</b>	<b>3</b>	<b>2.02</b>	<b>2.02</b>	<b>73.06</b>	<b>0.22</b>
Dec. 31, 2010 <sup>6</sup>	20.49	–	–	1.99	1.99	41.74	0.09
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>18.20</b>	<b>184</b>	<b>10</b>	<b>1.90</b>	<b>1.90</b>	<b>73.06</b>	<b>0.22</b>
Dec. 31, 2010	20.46	216	11	1.84	1.84	41.74	0.09
Dec. 31, 2009	18.72	292	16	1.95 <sup>2</sup>	2.00	56.05	0.11
Dec. 31, 2008	14.17	305	22	1.92	2.02	54.22	0.11
Dec. 31, 2007 <sup>7</sup>	21.58	255	12	1.93	3.30	34.61	0.06
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>18.12</b>	<b>18 880</b>	<b>1 042</b>	<b>1.22</b>	<b>1.22</b>	<b>73.06</b>	<b>0.22</b>
Dec. 31, 2010	20.36	22 028	1 082	1.20	1.20	41.74	0.09
Dec. 31, 2009	18.64	22 776	1 222	1.32 <sup>2</sup>	1.32	56.05	0.11
Dec. 31, 2008	14.12	22 069	1 563	1.35	1.41	54.22	0.11
Dec. 31, 2007	21.49	27 548	1 282	1.40	1.41	34.61	0.06
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>18.35</b>	<b>327</b>	<b>18</b>	<b>0.93</b>	<b>0.93</b>	<b>73.06</b>	<b>0.22</b>
Dec. 31, 2010	20.62	273	13	0.91	0.91	41.74	0.09
Dec. 31, 2009	18.88	201	11	1.05 <sup>2</sup>	1.23	56.05	0.11
Dec. 31, 2008	14.32	153	11	1.05	1.89	54.22	0.11
Dec. 31, 2007 <sup>7</sup>	21.51	85	4	1.40	6.04	34.61	0.06
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>18.22</b>	<b>42 105</b>	<b>2 311</b>	<b>0.12</b>	<b>0.12</b>	<b>73.06</b>	<b>0.22</b>
Dec. 31, 2010	20.47	37 289	1 822	0.11	0.11	41.74	0.09
Dec. 31, 2009	18.76	33 148	1 767	0.14 <sup>2</sup>	0.14	56.05	0.11
Dec. 31, 2008	14.21	31 589	2 223	0.14	0.14	54.22	0.11
Dec. 31, 2007	21.51	33 127	1 540	0.09	0.09	34.61	0.06

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.92%, Series B – 1.79%, Series D – 1.16%, Series F – 0.89%, Series O – 0.11%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.60%	31%	69%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

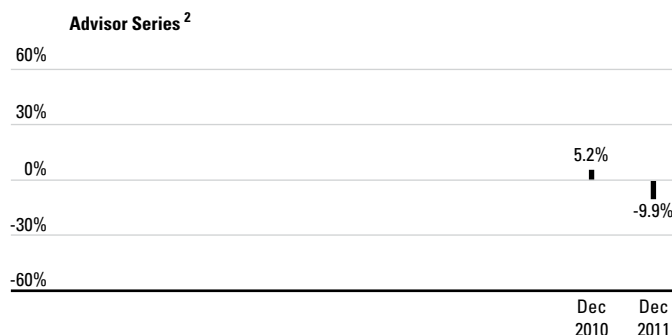
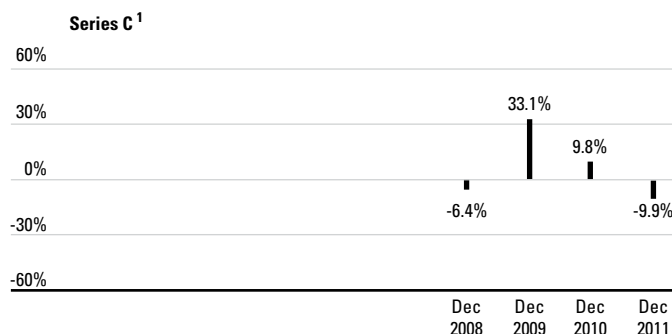
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

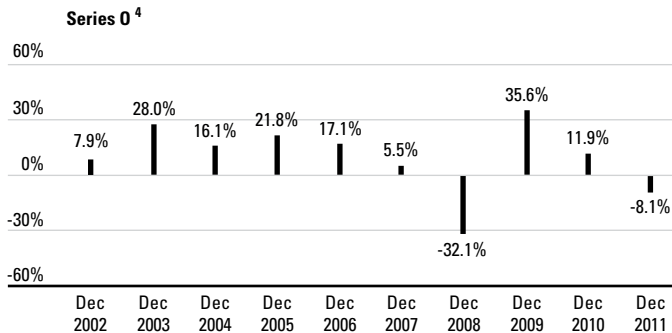
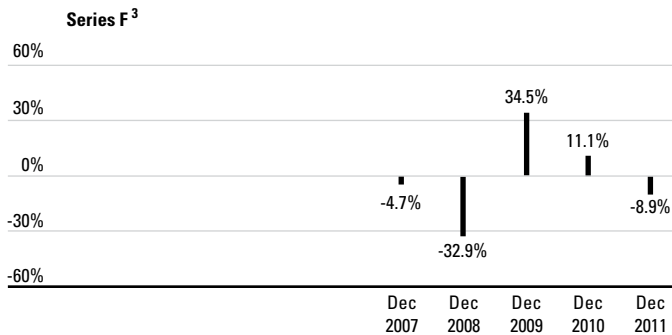
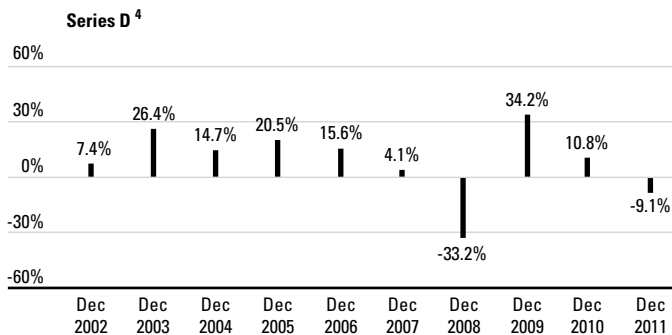
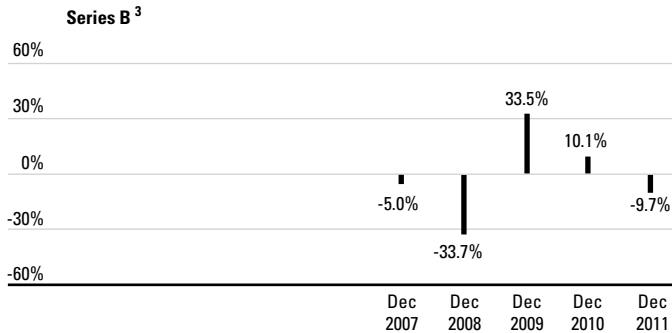
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**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P/TSX Capped Composite Total Return Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-9.9	9.6	—	—	7.1
Benchmark	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-9.9	—	—	—	-4.5
Benchmark	-8.7	—	—	—	-2.3
Series B <sup>3</sup>	-9.7	9.9	—	—	-3.9
Benchmark	-8.7	13.2	—	—	-0.5
Series D <sup>4</sup>	-9.1	10.5	-1.2	—	8.0
Benchmark	-8.7	13.2	1.3	—	10.0
Series F <sup>3</sup>	-8.9	10.8	—	—	-3.0
Benchmark	-8.7	13.2	—	—	-0.5
Series O <sup>4</sup>	-8.1	11.7	0.0	—	9.3
Benchmark	-8.7	13.2	1.3	—	10.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date September 2002.

Series D was known as Series A prior to November 17, 2008. Although the Fund was prospectused in August 2002, Series A and Series O units were not offered for sale until September 2002. We are therefore not permitted to disclose performance data for this Fund for any period prior to September 2002.

**INDEX DESCRIPTION**

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

## SUMMARY OF INVESTMENT PORTFOLIO

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

### Investment Mix

	% of Net Asset Value
Financials	34.3
Energy	25.5
Materials	13.0
Industrials	9.8
Telecommunications	6.5
Consumer Discretionary	6.0
Consumer Staples	2.2
Health Care	1.1
Information Technology	0.7
Index Funds	0.2
Cash/Other	0.7

### Top 25 Holdings

	% of Net Asset Value
Toronto-Dominion Bank	7.8
Royal Bank of Canada	7.6
Canadian Imperial Bank of Commerce	4.6
Canadian Natural Resources Ltd.	4.1
Suncor Energy Inc.	4.0
Rogers Communications Inc., Class B	3.7
Bank of Nova Scotia	3.4
Canadian National Railway Co.	3.0
Cenovus Energy Inc.	3.0
Great-West Lifeco Inc.	2.8
TELUS Corp., Class A	2.8
Potash Corporation of Saskatchewan Inc.	2.7
SNC-Lavalin Group Inc.	2.4
Enbridge Inc.	2.1
Magna International Inc., Class A	1.8
Teck Resources Ltd., Class B	1.6
Loblaw Companies Ltd.	1.6
ARC Resources Ltd.	1.5
EnCana Corp.	1.5
Manulife Financial Corporation	1.4
Talisman Energy Inc.	1.4
Power Corporation of Canada	1.3
Brookfield Asset Management Inc., Class A	1.3
Bombardier Inc., Class B	1.3
Tim Hortons Inc.	1.2
Top 25 Holdings	69.9

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CANADIAN EQUITY VALUE FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide long-term capital growth. To achieve the Fund's investment objective, we invest primarily in equities of Canadian companies priced below the manager's assessment of their true value and offering long-term opportunities for growth.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$144.1 million as of December 31, 2011, from \$41.7 million at the end of 2010. Of this change, \$5.7 million was due to investment losses, offset by \$108.1 million in net inflows.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -5.4%. Over the same period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index, returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Volatility remained quite high during 2011 as heightened macroeconomic uncertainties kept most investors focused on the short-term rather than considering a medium- to long-term investment horizon as they do in most investment environments. Macroeconomic considerations have recently trumped company and industry fundamentals. After running out of steam in the spring, recent economic data shows that the U.S. economy proved more resilient than many had anticipated. Emerging economies succumbed to the slowdown, but markets took note of a potential silver lining as policymakers in China finally began to ease monetary policy.

Looking at the year as a whole, the theme behind our performance relative to the benchmark was solid stock selection and sector allocation. The most significant contributor to our performance relative to the benchmark was the Materials sector. Part of this year's success in the Materials sector benefited by our timely decision to take profits in the sector in the second half of 2011, when we noted that the stocks reflected long-term prices. Although that kept us underweight in the Materials sector, stock picking was the dominant

factor in our performance in the sector, as our holdings fell by less than half the sector's decline. Notable contributors included positions in Yamana and Goldcorp, while we avoided Agnico-Eagle. We had a few disappointments in the Energy sector this year, such as Talisman and NuVista.

The Telecommunication Services sector was the biggest detractor from our performance, primarily because of the continued strong performance of BCE, in which we did not have any holdings. We remain of the view that BCE's valuation does not reflect the challenges and risks of their business. Falling interest rates, and management's success in identifying more cost savings than we expected, have helped BCE rally.

Although we would rather see a more optimistic employment picture and a much shorter list of structural economic challenges, we also recognize that negative headlines generally provide fertile ground for pragmatic investors with a value-based approach to investing. Regardless of the economic backdrop, our approach is to consider a range of possible bottom-up outcomes – both bullish and bearish – with a view to identifying stocks that have incorporated all of the bad economic news into their prices but do not accurately reflect potential positive developments that have a decent chance of unfolding.

### Recent Developments

We believe that the recent performance of stocks has been primarily a function of a stock's perceived riskiness rather than its fundamental strength. Correlations of individual stock price movements to the market have risen to more than 80% of late, reflecting a lack of differentiation between issuers on the part of investors. However, we believe that this lack of differentiation is creating opportunities which may pay off when investors once again focus on the fundamentals of individual companies.

The most recent set of quarterly earnings reports of Canadian companies was once again very strong, exceeding analyst expectations in Canada and the U.S. This has not been a normal economic recovery, and neither economic activity nor optimism have returned to prior levels. We believe that a continued slow recovery is most probable.

As more than 50% of the value of the S&P/TSX Capped Composite Total Return Index is represented by natural resource companies, and as China is the most important source of demand for these natural resource companies, a more severe economic slowdown in China is an obvious risk. However, as we look out a year or two, we believe that earnings for Canadian companies will continue to increase as trading volumes for many industries are still well below historical levels.



### **Related-Party Transactions**

#### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series and Series D units.

#### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

#### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$32,000 (2010 – \$5,000), or 7% (2010 – 5%) of the total transaction costs paid for this Fund.

### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

#### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>0.34</b>	<b>(0.22)</b>	<b>(0.24)</b>	<b>(0.82)</b>	<b>(0.94)</b>	—	—	<b>(0.14)</b>	—	<b>(0.14)</b>	<b>10.45</b>	
Dec. 31, 2010	10.04	0.31	(0.21)	0.74	1.57	2.41	—	—	(0.33)	—	(0.33)	11.28	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	0.04	—	—	—	—	—	—	10.04	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>0.34</b>	<b>(0.22)</b>	<b>(0.24)</b>	<b>(0.82)</b>	<b>(0.94)</b>	—	—	<b>(0.14)</b>	—	<b>(0.14)</b>	<b>10.45</b>	
Dec. 31, 2010 <sup>4</sup>	10.99 <sup>†</sup>	0.05	(0.03)	0.12	0.26	0.40	—	—	(0.33)	—	(0.33)	11.28	
<b>Series D</b>													
<b>Dec. 31, 2011</b>	<b>11.32</b>	<b>0.30</b>	<b>(0.13)</b>	<b>(0.21)</b>	<b>(0.72)</b>	<b>(0.76)</b>	—	<b>(0.03)</b>	<b>(0.14)</b>	—	<b>(0.17)</b>	<b>10.54</b>	
Dec. 31, 2010	10.04	0.31	(0.13)	0.74	1.57	2.49	—	(0.03)	(0.35)	—	(0.38)	11.32	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	0.04	—	—	—	—	—	—	10.04	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>11.35</b>	<b>0.32</b>	<b>(0.10)</b>	<b>(0.23)</b>	<b>(0.78)</b>	<b>(0.79)</b>	—	<b>(0.06)</b>	<b>(0.14)</b>	—	<b>(0.20)</b>	<b>10.57</b>	
Dec. 31, 2010	10.04	0.24	(0.10)	0.58	1.24	1.96	—	(0.06)	(0.33)	—	(0.39)	11.35	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	0.04	—	—	—	—	—	—	10.04	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>11.32</b>	<b>0.28</b>	<b>(0.01)</b>	<b>(0.20)</b>	<b>(0.69)</b>	<b>(0.62)</b>	—	<b>(0.15)</b>	<b>(0.14)</b>	—	<b>(0.29)</b>	<b>10.54</b>	
Dec. 31, 2010	10.04	0.27	(0.01)	0.63	1.35	2.24	—	(0.15)	(0.37)	—	(0.52)	11.32	
Dec. 31, 2009 <sup>3</sup>	10.00 <sup>†</sup>	—	—	—	0.04	—	—	—	—	—	—	10.04	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From December 2009.

<sup>4</sup> From October 2010.

<sup>†</sup> Initial offering net asset value per unit.

## FINANCIAL HIGHLIGHTS (cont.)

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series C</b>							
Dec. 31, 2011	10.46	8 990	859	2.02	2.02	168.85	0.48
Dec. 31, 2010	11.30	7 203	637	2.02	2.02	163.23	0.46
Dec. 31, 2009 <sup>4</sup>	10.04	248	25	1.94	1.94	—	0.03
<b>Advisor Series</b>							
Dec. 31, 2011	10.46	967	92	2.02	2.02	168.85	0.48
Dec. 31, 2010 <sup>5</sup>	11.30	1 006	89	2.02	2.02	163.23	0.46
<b>Series D</b>							
Dec. 31, 2011	10.56	27 641	2 618	1.23	1.23	168.85	0.48
Dec. 31, 2010	11.34	4 792	423	1.22	1.22	163.23	0.46
Dec. 31, 2009 <sup>4</sup>	10.04	1	—	1.09	1.09	—	0.03
<b>Series F</b>							
Dec. 31, 2011	10.59	19 262	1 820	0.94	0.94	168.85	0.48
Dec. 31, 2010	11.37	9 254	814	0.96	0.96	163.23	0.46
Dec. 31, 2009 <sup>4</sup>	10.04	1	—	0.73	0.73	—	0.03
<b>Series O</b>							
Dec. 31, 2011	10.56	87 282	8 267	0.06	0.06	168.85	0.48
Dec. 31, 2010	11.34	19 461	1 717	0.07	0.07	163.23	0.46
Dec. 31, 2009 <sup>4</sup>	10.04	1	—	—	—	—	0.03

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

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<sup>3</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From December 2009.

<sup>5</sup> From October 2010.

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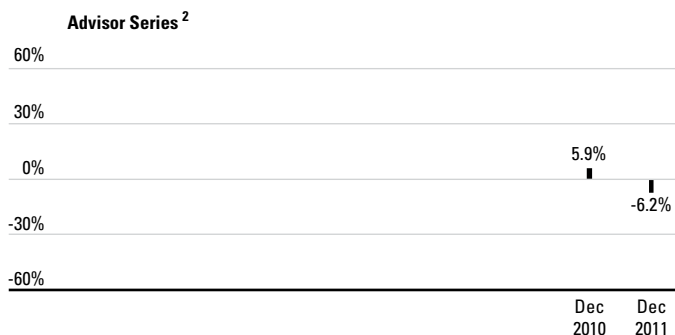
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

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**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



## PAST PERFORMANCE (cont.)

### Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

#### S&P/TSX Capped Composite Total Return Index

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-6.2	—	—	—	4.3
Benchmark	-8.7	—	—	—	3.6
Advisor Series <sup>2</sup>	-6.2	—	—	—	-0.6
Benchmark	-8.7	—	—	—	-2.3
Series D <sup>1</sup>	-5.4	—	—	—	5.1
Benchmark	-8.7	—	—	—	3.6
Series F <sup>1</sup>	-5.1	—	—	—	5.4
Benchmark	-8.7	—	—	—	3.6
Series O <sup>1</sup>	-4.3	—	—	—	6.3
Benchmark	-8.7	—	—	—	3.6

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date December 2009.

<sup>2</sup> Inception date October 2010.

### INDEX DESCRIPTION

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Financials	31.7
Energy	24.9
Materials	15.8
Industrials	5.3
Consumer Staples	4.2
Telecommunications	4.0
Consumer Discretionary	3.8
Utilities	1.5
Information Technology	1.0
Health Care	0.3
Cash/Other	7.5

### Top 25 Holdings

	% of Net Asset Value
Cash & Cash Equivalents	7.9
Royal Bank of Canada	5.7
Toronto-Dominion Bank	5.3
Canadian Natural Resources Ltd.	3.8
Barrick Gold Corp.	3.7
Bank of Nova Scotia	3.3
Potash Corporation of Saskatchewan Inc.	3.0
Canadian National Railway Co.	2.8
Cenovus Energy Inc.	2.8
Brookfield Asset Management Inc., Class A	2.5
TransCanada Corp.	2.2
Power Corporation of Canada	2.1
Goldcorp Inc.	2.1
Rogers Communications Inc., Class B	2.0
Suncor Energy Inc.	2.0
Imperial Oil Ltd.	2.0
Canadian Imperial Bank of Commerce	2.0
Bank of Montreal	2.0
TELUS Corp., Class A	2.0
Enbridge Inc.	1.9
Manulife Financial Corporation	1.6
Magna International Inc., Class A	1.5
Teck Resources Ltd., Class B	1.5
Husky Energy Inc.	1.5
Atco Ltd., Class I, Non-Voting	1.4
Top 25 Holdings	68.6

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CANADIAN EQUITY UNDERLYING FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide significant long-term capital growth by investing primarily in a well-diversified portfolio of Canadian common stocks. The Fund is expected to be used primarily as an underlying fund for other mutual funds but may also be sold directly to other investors.

To achieve the Fund's investment objectives we will focus primarily on larger-capitalization stocks. We generally invest in growth companies that have superior management, industry leadership, a high level of profitability compared with competitors, a sound financial position, strong earnings growth and a reasonable valuation.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 11, 2011, and its net asset value was \$671.7 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

### Recent Developments

Correlations of individual stock price movements to the market have risen significantly, reflecting a lack of differentiation between issuers on the part of investors. We believe that this lack of differentiation is creating opportunities which will pay off when investors once again focus on issuer-specific characteristics.

The most recent set of corporate quarterly earnings reports was once again strong, exceeding analyst expectations on both sides of the border. This has not been a normal economic recovery, and neither economic activity nor optimism has returned to prior levels. Going forward, we believe that a continued slow recovery is the most probable outcome, although there is a wide range of potentially more positive or negative scenarios. Resolution of the European debt situation, U.S. economic recovery and degree of growth in China are three important factors that will drive short-term financial markets performance.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

#### *Trustee and Custodian*

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

#### *Brokerage*

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$59,000 or 8% of the total transaction costs paid for this Fund.

#### *Other Related-Party Transactions*

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### *Related-Party Trading Activities*

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

*Inter-Fund Trading*

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series 0</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.27</b>	<b>–</b>	<b>(0.55)</b>	<b>(1.10)</b>	<b>(1.38)</b>	<b>(0.02)</b>	<b>(0.12)</b>	<b>–</b>	<b>–</b>	<b>(0.14)</b>	<b>8.85</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series 0</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>8.87</b>	<b>671 650</b>	<b>75 696</b>	<b>0.02</b>	<b>0.02</b>	<b>70.24</b>	<b>0.21</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From January 2011.

### Management Fees

RBC GAM is the manager, portfolio advisor and registrar of the Fund. No management fees are paid by the Fund in respect of Series 0 units. Series 0 unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*  
As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Financials	31.3
Energy	25.4
Materials	16.7
Industrials	10.7
Consumer Discretionary	6.2
Telecommunications	4.4
Consumer Staples	1.9
Health Care	1.0
Information Technology	0.9
Index Funds	0.8
Cash/Other	0.7

**Top 25 Holdings**

	% of Net Asset Value
Toronto-Dominion Bank	7.3
Royal Bank of Canada	7.1
Canadian Natural Resources Ltd.	4.0
Suncor Energy Inc.	4.0
Canadian Imperial Bank of Commerce	4.0
Bank of Nova Scotia	3.5
Rogers Communications Inc., Class B	3.3
Cenovus Energy Inc.	3.0
Potash Corporation of Saskatchewan Inc.	2.7
Canadian National Railway Co.	2.6
Barrick Gold Corp.	2.4
SNC-Lavalin Group Inc.	2.4
Manulife Financial Corporation	2.3
Goldcorp Inc.	2.1
Enbridge Inc.	2.1
Magna International Inc., Class A	1.8
Power Corporation of Canada	1.6
Teck Resources Ltd., Class B	1.6
Loblaw Companies Ltd.	1.5
ARC Resources Ltd.	1.5
EnCana Corp.	1.5
Talisman Energy Inc.	1.4
Bombardier Inc., Class B	1.2
Brookfield Asset Management Inc., Class A	1.2
Great-West Lifeco Inc.	1.2
<b>Top 25 Holdings</b>	<b>67.3</b>

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CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CANADIAN GROWTH FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in a well-diversified portfolio of Canadian common stocks. The Fund also may invest a portion of its assets in U.S. and international securities in order to achieve greater exposure to industries that are not well represented in Canada. To achieve the Fund's investment objective, we invest primarily in companies that we believe, among other things, have a superior management team, a leadership position in their industry, a high level of profitability compared to their peers, and strong earnings potential.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$354.1 million as of December 31, 2011, from \$403.0 million at the end of 2010. Of this change, \$42.6 million was due to investment losses and \$6.4 million to net outflows.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -11.3%. Over the same time period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index, returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Following two years of strong gains, the Fund posted a negative return in 2011. Equities rallied to new highs during the first third of the year and subsequently trended lower before significantly correcting into August. A failed rally ensued, with new lows made in early October. Markets once again regrouped and worked higher into year-end. The Canadian equity markets underperformed U.S. equity markets by a wide margin, as fears of recession negatively impacted commodity stocks. Investors were concerned about the sovereign debt crisis in Europe and the risk of a slowdown in Chinese economic activity. The U.S. economy performed relatively well and its equity market also benefited from a more defensive composition.

The Fund's performance during 2011 was driven primarily by its holdings in the Materials and Energy sectors. In the Materials sector, the Fund benefited from its overweight positions in Tahoe Resources, a silver

miner; Goldcorp; and Quadra FX, a copper producer. Quadra's shares rose significantly in mid-December after a \$15-a-share, all cash bid was made by Polish copper producer KGHM Poliska Miedz SA.

The Fund's performance was hurt by certain investments including Zungui Haixi, a China-based sportswear manufacturer; GLG Life Tech, a China-based manufacturer of zero-calorie sweetener; and Azure Dynamics, a world leader in development and production of hybrid powertrain systems for commercial vehicles.

The Fund also benefited from strong stock selection within the Energy sector. In general, energy stocks benefited from the rise in the price of oil throughout the year despite its significant fluctuations. More specifically, the Fund benefited from its investments in Tourmaline Oil as well as Trinidad Drilling and midstream energy services provider Provident Energy.

Additionally, the Fund benefited from several select investments including Canadian Real Estate Investment Trust, Valeant Pharmaceuticals, Aecon Group and Element Financial. The Fund's relative performance was also helped by not being invested in such poor-performing stocks as Sino-Forest, energy producers Nexen and Pacific Rubiales Energy or digital advertiser Yellow Media.

We remained active in the Fund during the year, adding several new holdings and reducing or exiting several existing holdings. We initiated new positions in Athabasca Oil Sands, AuRico Gold, Celestica, CI Financial, Crew Energy, Inmet Mining, Longview Oil, Osisko Mining, Painted Pony Petroleum, Vermilion Energy, Western Energy Services and Yamana Gold. We sold our positions in CGI Group, Daylight Energy, Equinox Minerals, Gildan Activewear, Lundin Mining, Petrobank Energy, Tourmaline Oil and Just Energy Group.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in our view is that Europe is likely to continue to experience challenges in its sovereign debt markets. We expect North America to avoid recession and any recession in Europe to be relatively mild. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Our models indicate that the U.S. is not in recession, but is at risk of tumbling into one in the next year. The threat comes less from domestic conditions, and more from a possible European misstep. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. We forecast a downshift in economic growth in Canada in 2012.

Our outlook for equities remains positive. Although we expect that growth next year will remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn't clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

#### **Related-Party Transactions**

##### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

##### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

##### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

##### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$18,000 (2010 – \$30,000), or 6% (2010 – 8%) of the total transaction costs paid for this Fund during this period.

##### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

##### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

##### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>29.65</b>	<b>0.51</b>	<b>(0.56)</b>	<b>0.67</b>	<b>(4.11)</b>	<b>(3.49)</b>	–	–	–	–	–	<b>26.10</b>
Dec. 31, 2010	25.34	0.78	(0.52)	1.16	4.09	5.51	–	–	–	–	–	29.65
Dec. 31, 2009	18.70	0.59	(0.45)	(1.87)	10.54	8.81	–	(0.03)	–	–	(0.03)	25.34
Dec. 31, 2008 <sup>3</sup>	19.69 <sup>†</sup>	0.14	(0.05)	(0.20)	5.40	5.29	(0.14)	–	–	–	(0.14)	18.70
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>29.65</b>	<b>0.51</b>	<b>(0.56)</b>	<b>0.67</b>	<b>(4.11)</b>	<b>(3.49)</b>	–	–	–	–	–	<b>26.10</b>
Dec. 31, 2010 <sup>4</sup>	27.89 <sup>†</sup>	0.13	(0.09)	0.19	0.68	0.91	–	–	–	–	–	29.65
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>29.20</b>	<b>0.51</b>	<b>(0.33)</b>	<b>0.66</b>	<b>(4.06)</b>	<b>(3.22)</b>	–	<b>(0.14)</b>	–	–	<b>(0.14)</b>	<b>25.77</b>
Dec. 31, 2010	24.77	0.79	(0.30)	1.17	4.14	5.80	–	–	–	–	–	29.20
Dec. 31, 2009	18.56	0.58	(0.25)	(2.83)	8.85	6.35	–	(0.22)	–	–	(0.22)	24.77
Dec. 31, 2008	30.58	0.65	(0.32)	(0.64)	(11.11)	(11.42)	(0.28)	–	–	–	(0.28)	18.56
Dec. 31, 2007	33.86	1.02	(0.39)	1.11	(3.11)	(1.37)	(0.21)	(0.46)	(0.78)	–	(1.45)	30.58
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>29.38</b>	<b>0.51</b>	<b>(0.25)</b>	<b>0.66</b>	<b>(4.10)</b>	<b>(3.18)</b>	–	<b>(0.22)</b>	–	–	<b>(0.22)</b>	<b>25.93</b>
Dec. 31, 2010	24.88	0.79	(0.23)	1.18	4.18	5.92	–	(0.02)	–	–	(0.02)	29.38
Dec. 31, 2009	18.55	0.56	(0.21)	(0.45)	7.88	7.78	–	(0.18)	–	–	(0.18)	24.88
Dec. 31, 2008 <sup>6</sup>	21.13 <sup>†</sup>	0.08	(0.02)	(1.23)	(1.91)	(3.08)	(0.32)	–	–	–	(0.32)	18.55
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>29.98</b>	<b>0.52</b>	<b>(0.01)</b>	<b>0.68</b>	<b>(4.19)</b>	<b>(3.00)</b>	–	<b>(0.46)</b>	–	–	<b>(0.46)</b>	<b>26.46</b>
Dec. 31, 2010	25.33	0.57	(0.01)	0.84	2.98	4.38	–	(0.23)	–	–	(0.23)	29.98
Dec. 31, 2009	19.00	0.59	(0.01)	(2.86)	8.73	6.45	–	(0.50)	–	–	(0.50)	25.33
Dec. 31, 2008	31.14	0.65	(0.01)	(0.12)	(12.35)	(11.83)	(0.48)	–	–	–	(0.48)	19.00
Dec. 31, 2007	34.47	0.96	(0.01)	(2.78)	(4.76)	(6.59)	(0.33)	(0.71)	(0.80)	–	(1.84)	31.14

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From October 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>26.15</b>	<b>2 448</b>	<b>94</b>	<b>2.04</b>	<b>2.04</b>	<b>41.27</b>	<b>0.07</b>
Dec. 31, 2010	29.71	2 157	73	1.99	1.99	56.14	0.16
Dec. 31, 2009	25.40	848	33	1.99 <sup>2</sup>	2.10	133.70	0.32
Dec. 31, 2008 <sup>5</sup>	18.78	54	3	1.92	32.45	102.93	0.31
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>26.15</b>	<b>56</b>	<b>2</b>	<b>2.04</b>	<b>2.04</b>	<b>41.27</b>	<b>0.07</b>
Dec. 31, 2010 <sup>6</sup>	29.71	–	–	1.99	1.99	56.14	0.16
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>25.82</b>	<b>164 779</b>	<b>6 381</b>	<b>1.22</b>	<b>1.22</b>	<b>41.27</b>	<b>0.07</b>
Dec. 31, 2010	29.26	207 213	7 082	1.19	1.19	56.14	0.16
Dec. 31, 2009	24.83	195 293	7 864	1.19 <sup>2</sup>	1.19	133.70	0.32
Dec. 31, 2008	18.64	170 784	9 163	1.18	1.18	102.93	0.31
Dec. 31, 2007	30.70	310 145	10 103	1.15	1.15	68.57	0.29
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>25.98</b>	<b>467</b>	<b>18</b>	<b>0.93</b>	<b>0.93</b>	<b>41.27</b>	<b>0.07</b>
Dec. 31, 2010	29.44	222	8	0.92	0.92	56.14	0.16
Dec. 31, 2009	24.94	198	8	0.94 <sup>2</sup>	1.51	133.70	0.32
Dec. 31, 2008 <sup>7</sup>	18.63	1	–	0.74	58.64	102.93	0.31
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>26.51</b>	<b>186 366</b>	<b>7 030</b>	<b>0.04</b>	<b>0.04</b>	<b>41.27</b>	<b>0.07</b>
Dec. 31, 2010	30.04	193 425	6 440	0.05	0.05	56.14	0.16
Dec. 31, 2009	25.39	6 002	236	0.05 <sup>2</sup>	0.05	133.70	0.32
Dec. 31, 2008	19.07	5 355	281	0.05	0.05	102.93	0.31
Dec. 31, 2007	31.25	20 957	671	0.04	0.04	68.57	0.29

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.93%, Series D – 1.16%, Series F – 0.89%, Series O – 0.04%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From October 2008.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

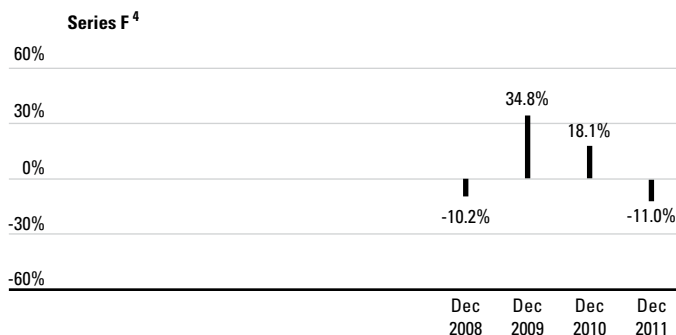
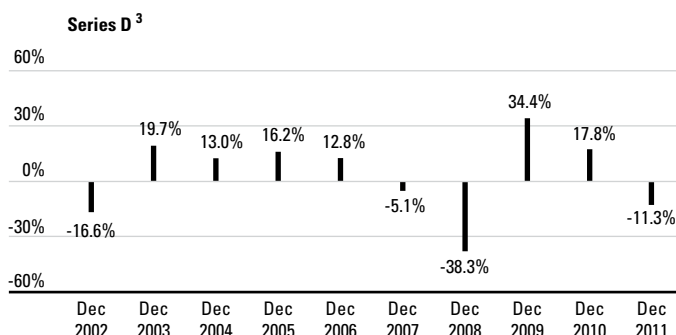
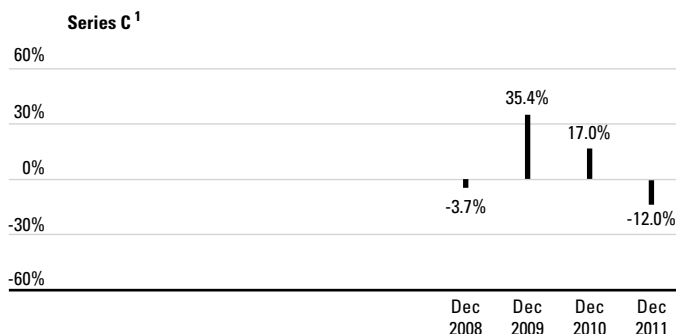
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

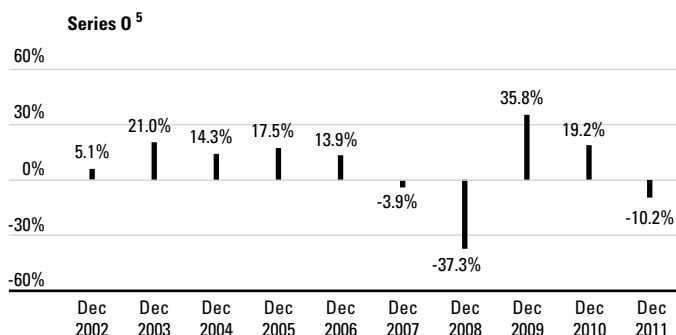
**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.





## PAST PERFORMANCE (cont.)



## Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

### S&P/TSX Capped Composite Total Return Index

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-12.0	11.7	—	—	10.0
Benchmark	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-12.0	—	—	—	-5.4
Benchmark	-8.7	—	—	—	-2.3
Series D <sup>3</sup>	-11.3	12.0	-3.8	2.0	—
Benchmark	-8.7	13.2	1.3	7.0	—
Series F <sup>4</sup>	-11.0	12.3	—	—	7.9
Benchmark	-8.7	13.2	—	—	9.8
Series O <sup>5</sup>	-10.2	13.3	-2.6	—	6.0
Benchmark	-8.7	13.2	1.3	—	10.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date February 1987.

<sup>4</sup> Inception date October 2008.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

## INDEX DESCRIPTION

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Financials	30.0
Energy	26.4
Materials	20.3
Industrials	6.0
Consumer Discretionary	4.0
Telecommunications	3.5
Consumer Staples	2.6
Index Funds	2.3
Information Technology	1.5
Health Care	1.2
Cash/Other	2.2

### Top 25 Holdings

	% of Net Asset Value
Toronto-Dominion Bank	5.1
Royal Bank of Canada	5.1
Bank of Nova Scotia	4.1
Suncor Energy Inc.	3.5
Barrick Gold Corp.	3.5
Canadian Natural Resources Ltd.	3.3
Goldcorp Inc.	2.9
Potash Corporation of Saskatchewan Inc.	2.7
Canadian National Railway Co.	2.4
TransCanada Corp.	2.3
Canadian Imperial Bank of Commerce	2.1
Bank of Montreal	2.1
Cash & Cash Equivalents	2.0
Cenovus Energy Inc.	1.9
Enbridge Inc.	1.8
Power Corporation of Canada	1.8
BCE Inc.	1.8
Rogers Communications Inc., Class B	1.7
Teck Resources Ltd., Class B	1.6
Manulife Financial Corporation	1.4
Valeant Pharmaceuticals International Inc.	1.2
Brookfield Asset Management Inc., Class A	1.2
Talisman Energy Inc.	1.1
National Bank of Canada	1.1
Wild Stream Exploration Inc.	1.0
Top 25 Holdings	58.7

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CANADIAN INCOME FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with capital preservation and a reasonably consistent level of income. To achieve the Fund's investment objective, we invest primarily in a well-diversified portfolio of dividend-paying Canadian common shares, high-quality units of Canadian income trusts or real estate investment trusts ("REITs"), and other income-producing securities including bonds of the Canadian government, provincial governments and quality Canadian corporations and high quality money market securities including asset backed commercial paper. The Fund's assets are concentrated in mid- and large-capitalization securities and it does not invest in businesses with excessive financial leverage.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$124.6 million as of December 31, 2011, from \$116.9 million at the end of 2010. Of this change, \$3.8 million was due to investment losses, offset by \$11.4 million in net inflows.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -2.9%, in line with the benchmark return of -2.9%. The Fund outperformed the broad-based index return of -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Negative macroeconomic events dominated the news and the markets over this past year. We continue to believe that the quality, growth and value characteristics that we identify in companies will contribute to positive long-term returns and that these market conditions create exceptional opportunities for those that continue to focus on such long-term characteristics.

During the reporting period, the Fund performed in line with its benchmark. During the year, we increased the Fund's exposure to cyclical stocks in order to benefit from broad market rallies, and later reduced this exposure to build a cash position during the corrective phases of the year.

Significant contributors to Fund performance came from holdings that included Rogers Communications, Baytex Energy, Brookfield Renewable Energy Partners, Gibson Energy, and Mullen Group. The major detractors to Fund performance included NAL Energy and Capstone Infrastructure, and as a result of not holding a position in BCE.

### Recent Developments

We believe that the recent performance of stocks has been primarily a function of a stock's perceived riskiness rather than its fundamental strength. Correlations of individual stock price movements to the market have risen to more than 80% of late, reflecting a lack of differentiation between issuers on the part of investors. However, we believe that this lack of differentiation is creating opportunities which may pay off when investors once again focus on issuer specific characteristics.

The most recent set of quarterly earnings reports of Canadian companies was once again very strong, exceeding analyst expectations in Canada and the U.S. This has not been a normal economic recovery, and neither economic activity nor optimism has returned to prior levels. We believe that a continued slow recovery is most probable.

As more than 50% of the value of the S&P/TSX Capped Composite Total Return Index is represented by natural resource companies, and as China is the most important source of demand for these natural resource companies, a more severe economic slowdown in China is an obvious risk. However, as we look out a year or two, we believe that earnings for Canadian companies will continue to increase as trading volumes for many industries are still well below historical levels.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

**Distributor**

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

**Trustee and Custodian**

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

**Brokerage**

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$96,000 (2010 – \$62,000), or 9% (2010 – 6%) of the total transaction costs paid for this Fund.

**Other Related-Party Transactions**

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

**Related-Party Trading Activities**

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;

- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

**Inter-Fund Trading**

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>0.41</b>	<b>(0.22)</b>	<b>0.41</b>	<b>(1.04)</b>	<b>(0.44)</b>	–	<b>(0.17)</b>	–	–	<b>(0.17)</b>	<b>10.71</b>	
Dec. 31, 2010	9.77	0.42	(0.20)	1.28	0.27	1.77	(0.07)	(0.17)	–	–	(0.24)	11.28	
Dec. 31, 2009	7.10	0.50	(0.17)	(1.82)	5.55	4.06	(0.15)	(0.12)	–	–	(0.27)	9.77	
Dec. 31, 2008 <sup>3</sup>	7.53 <sup>†</sup>	0.10	(0.01)	(3.07)	2.72	(0.26)	(0.01)	–	–	–	(0.01)	7.10	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>0.41</b>	<b>(0.22)</b>	<b>0.41</b>	<b>(1.04)</b>	<b>(0.44)</b>	–	<b>(0.17)</b>	–	–	<b>(0.17)</b>	<b>10.71</b>	
Dec. 31, 2010 <sup>4</sup>	10.81 <sup>†</sup>	0.07	(0.03)	0.21	0.04	0.29	(0.03)	(0.06)	–	–	(0.09)	11.28	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>11.37</b>	<b>0.42</b>	<b>(0.19)</b>	<b>0.41</b>	<b>(1.06)</b>	<b>(0.42)</b>	–	<b>(0.17)</b>	–	–	<b>(0.17)</b>	<b>10.82</b>	
Dec. 31, 2010	9.82	0.43	(0.17)	1.29	0.27	1.82	(0.07)	(0.17)	–	–	(0.24)	11.37	
Dec. 31, 2009	7.15	0.47	(0.14)	(2.70)	5.31	2.94	(0.17)	(0.14)	–	–	(0.31)	9.82	
Dec. 31, 2008	12.35	0.71	(0.19)	(3.79)	(2.24)	(5.51)	(0.34)	(0.16)	–	–	(0.50)	7.15	
Dec. 31, 2007 <sup>5</sup>	14.70 <sup>†</sup>	0.52	(0.12)	(0.15)	(0.65)	(0.40)	(0.21)	(0.07)	(1.71)	–	(1.99)	12.35	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>11.23</b>	<b>0.41</b>	<b>(0.13)</b>	<b>0.41</b>	<b>(1.04)</b>	<b>(0.35)</b>	–	<b>(0.22)</b>	–	–	<b>(0.22)</b>	<b>10.70</b>	
Dec. 31, 2010	9.71	0.42	(0.12)	1.27	0.27	1.84	(0.09)	(0.21)	–	–	(0.30)	11.23	
Dec. 31, 2009	7.08	0.46	(0.09)	(2.69)	5.18	2.86	(0.21)	(0.16)	–	–	(0.37)	9.71	
Dec. 31, 2008	12.26	0.70	(0.13)	(3.14)	(2.06)	(4.63)	(0.38)	(0.18)	–	–	(0.56)	7.08	
Dec. 31, 2007	13.59	0.85	(0.17)	1.69	(1.30)	1.07	(0.51)	(0.16)	(1.71)	–	(2.38)	12.26	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>11.34</b>	<b>0.42</b>	<b>(0.10)</b>	<b>0.41</b>	<b>(1.05)</b>	<b>(0.32)</b>	–	<b>(0.28)</b>	–	–	<b>(0.28)</b>	<b>10.78</b>	
Dec. 31, 2010	9.78	0.43	(0.09)	1.28	0.27	1.89	(0.09)	(0.21)	–	–	(0.30)	11.34	
Dec. 31, 2009	7.12	0.47	(0.08)	(1.10)	3.95	3.24	(0.20)	(0.17)	–	–	(0.37)	9.78	
Dec. 31, 2008	12.34	1.27	(0.06)	(16.15)	29.31	14.37	(0.39)	(0.19)	–	–	(0.58)	7.12	
Dec. 31, 2007 <sup>5</sup>	14.70 <sup>†</sup>	0.44	(0.08)	0.17	(0.89)	(0.36)	(0.22)	(0.07)	(1.72)	–	(2.01)	12.34	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>11.21</b>	<b>0.41</b>	<b>(0.01)</b>	<b>0.40</b>	<b>(1.04)</b>	<b>(0.24)</b>	–	<b>(0.39)</b>	–	–	<b>(0.39)</b>	<b>10.64</b>	
Dec. 31, 2010	9.65	0.42	(0.01)	1.26	0.27	1.94	(0.12)	(0.25)	–	–	(0.37)	11.21	
Dec. 31, 2009	7.01	0.45	(0.01)	(2.88)	5.12	2.68	(0.23)	(0.19)	–	–	(0.42)	9.65	
Dec. 31, 2008	12.22	0.70	(0.01)	(3.06)	(2.23)	(4.60)	(0.49)	(0.24)	–	–	(0.73)	7.01	
Dec. 31, 2007	13.67	0.89	(0.01)	1.22	(1.72)	0.38	(0.71)	(0.22)	(1.72)	–	(2.65)	12.22	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.72</b>	<b>4 989</b>	<b>465</b>	<b>2.06</b>	<b>2.06</b>	<b>267.31</b>	<b>0.84</b>
Dec. 31, 2010	11.30	3 538	313	2.02	2.02	283.62	1.01
Dec. 31, 2009	9.81	537	55	2.02 <sup>2</sup>	2.10	297.91	1.08
Dec. 31, 2008 <sup>5</sup>	7.14	35	5	2.00	11.16	169.54	0.52
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.72</b>	<b>507</b>	<b>47</b>	<b>2.06</b>	<b>2.06</b>	<b>267.31</b>	<b>0.84</b>
Dec. 31, 2010 <sup>6</sup>	11.30	45	4	2.02	2.02	283.62	1.01
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>10.84</b>	<b>118</b>	<b>11</b>	<b>1.79</b>	<b>1.79</b>	<b>267.31</b>	<b>0.84</b>
Dec. 31, 2010	11.39	158	14	1.73	1.73	283.62	1.01
Dec. 31, 2009	9.86	228	23	1.77 <sup>2</sup>	1.94	297.91	1.08
Dec. 31, 2008	7.19	209	29	1.71	1.92	169.54	0.52
Dec. 31, 2007 <sup>7</sup>	12.41	267	22	1.68	2.66	141.19	0.53
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.72</b>	<b>88 068</b>	<b>8 218</b>	<b>1.23</b>	<b>1.23</b>	<b>267.31</b>	<b>0.84</b>
Dec. 31, 2010	11.25	92 697	8 239	1.19	1.19	283.62	1.01
Dec. 31, 2009	9.75	78 472	8 049	1.19 <sup>2</sup>	1.19	297.91	1.08
Dec. 31, 2008	7.13	74 014	10 385	1.18	1.18	169.54	0.52
Dec. 31, 2007	12.32	160 543	13 034	1.15	1.15	141.19	0.53
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.80</b>	<b>939</b>	<b>87</b>	<b>0.96</b>	<b>0.96</b>	<b>267.31</b>	<b>0.84</b>
Dec. 31, 2010	11.36	567	50	0.93	0.93	283.62	1.01
Dec. 31, 2009	9.82	262	27	0.96 <sup>2</sup>	1.13	297.91	1.08
Dec. 31, 2008	7.16	115	16	0.90	16.53	169.54	0.52
Dec. 31, 2007 <sup>7</sup>	12.39	–	–	1.17	1 798.78	141.19	0.53
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>10.66</b>	<b>29 938</b>	<b>2 808</b>	<b>0.07</b>	<b>0.07</b>	<b>267.31</b>	<b>0.84</b>
Dec. 31, 2010	11.23	19 969	1 779	0.07	0.07	283.62	1.01
Dec. 31, 2009	9.68	17 662	1 824	0.07 <sup>2</sup>	0.07	297.91	1.08
Dec. 31, 2008	7.05	20 041	2 842	0.07	0.07	169.54	0.52
Dec. 31, 2007	12.28	35 285	2 874	0.06	0.06	141.19	0.53

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.94%, Series B – 1.69%, Series D – 1.16%, Series F – 0.89%, Series O – 0.07%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.50%	33%	67%
Series D	1.00%	25%	75%
Series F	0.75%	–	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

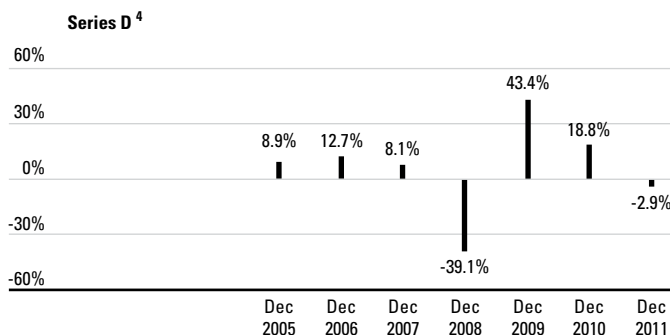
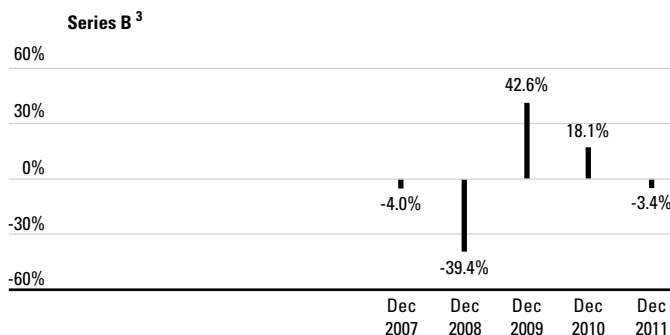
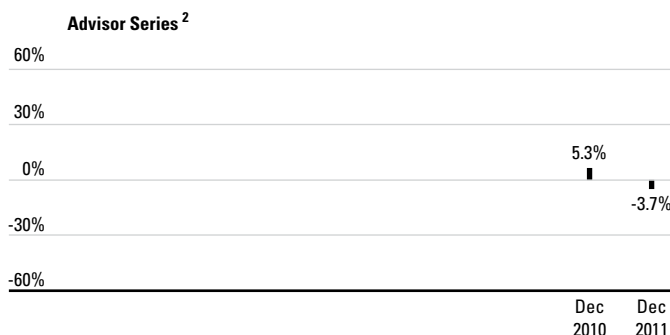
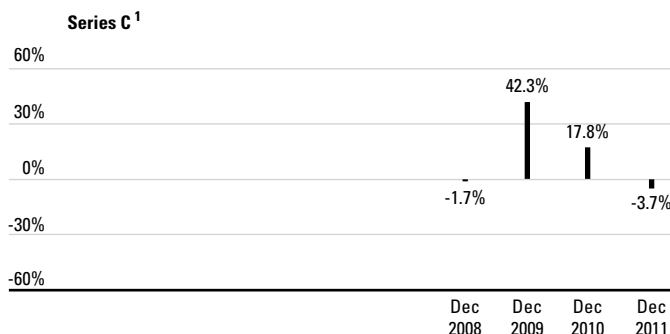
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

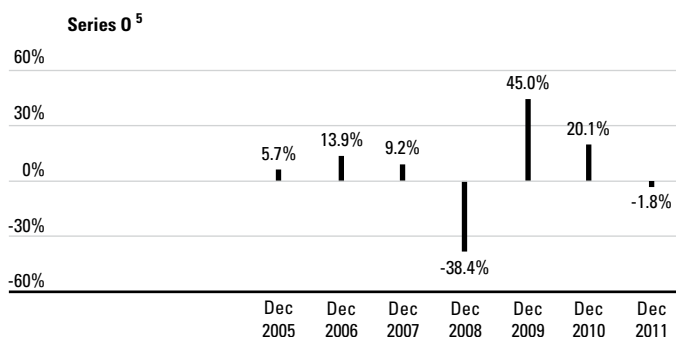
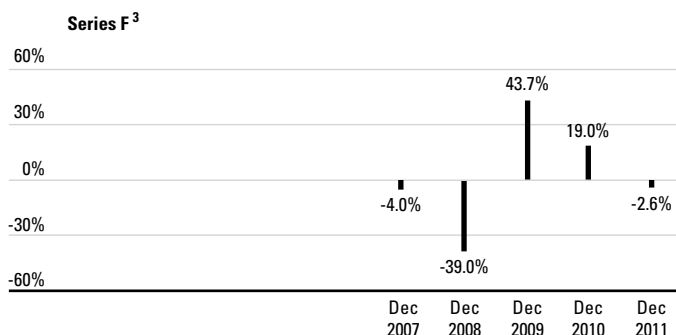
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmarks:

The blended benchmark (the "Benchmark") is composed of:

- 80% S&P/TSX Capped Composite Total Return Index
- 20% S&P/TSX Capped Income Trust Total Return Index

The broad-based index is the S&P/TSX Capped Composite Total Return Index.

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-3.7	17.3	—	—	16.1
Benchmark	-2.9	16.6	—	—	14.6
Broad-based index	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-3.7	—	—	—	1.3
Benchmark	-2.9	—	—	—	2.7
Broad-based index	-8.7	—	—	—	-2.3
Series B <sup>3</sup>	-3.4	17.6	—	—	-1.2
Benchmark	-2.9	16.6	—	—	1.8
Broad-based index	-8.7	13.2	—	—	-0.5
Series D <sup>4</sup>	-2.9	18.3	1.7	—	4.5
Benchmark	-2.9	16.6	3.4	—	6.9
Broad-based index	-8.7	13.2	1.3	—	5.7
Series F <sup>3</sup>	-2.6	18.6	—	—	-0.6
Benchmark	-2.9	16.6	—	—	1.8
Broad-based index	-8.7	13.2	—	—	-0.5
Series O <sup>5</sup>	-1.8	19.6	2.9	—	5.4
Benchmark	-2.9	16.6	3.4	—	5.2
Broad-based index	-8.7	13.2	1.3	—	4.1

The returns of each series may vary because of differences in management fees and expenses. The Benchmark and broad-based index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark and broad-based index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date June 2005.

<sup>5</sup> Inception date September 2005.

Series D was known as Series A prior to November 17, 2008. Although Series A units of the Fund were created in July 2003, units were not offered for sale under a simplified prospectus until June 2005. We are therefore not permitted to disclose performance data for this Fund for any period prior to June 2005.

**INDEX DESCRIPTIONS**

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**S&P/TSX Capped Income Trust Total Return Index** This index contains all of the income trust constituents from the S&P/TSX Composite Index, with no individual stock exceeding 10% of the overall weight.



**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Financials	37.2
Energy	24.2
Industrials	9.6
Consumer Discretionary	7.7
Materials	7.5
Utilities	4.5
Telecommunications	4.0
Consumer Staples	0.7
Health Care	0.3
Cash/Other	4.3

**Top 25 Holdings**

	% of Net Asset Value
Toronto-Dominion Bank	5.9
Royal Bank of Canada	5.7
Bank of Nova Scotia	4.7
Cash & Cash Equivalents	3.9
Enbridge Inc.	3.8
Canadian Imperial Bank of Commerce	2.9
Rogers Communications Inc., Class B	2.8
Brookfield Office Properties Canada	2.8
Manulife Financial Corporation	2.4
TransCanada Corp.	2.4
ARC Resources Ltd.	2.4
Magna International Inc., Class A	2.3
Genworth MI Canada Inc.	2.2
Goldcorp Inc.	2.1
Canadian National Railway Co.	2.1
Shaw Communications Inc., Class B	1.9
Barrick Gold Corp.	1.9
Brookfield Asset Management Inc., Class A	1.8
IGM Financial Inc.	1.8
Gibson Energy Inc.	1.8
Canadian Natural Resources Ltd.	1.8
Husky Energy Inc.	1.6
SNC-Lavalin Group Inc.	1.5
CI Financial Corp.	1.5
Canexus Corp.	1.5
<b>Top 25 Holdings</b>	<b>65.5</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

CANADIAN EQUITY FUND

**PHILLIPS, HAGER & NORTH  
VINTAGE FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth and dividend income by investing primarily in a well-diversified portfolio of Canadian common stocks listed on the TSX. To achieve the Fund's investment objective, we focus on companies that earned a return on shareholders equity that is above average within their industry over the previous five to 10 years and maintained financial strength. The Fund's investments may also emphasize small-capitalization securities when valuation levels are attractive.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$36.8 million as of December 31, 2011, from \$53.1 million at the end of 2010. Of this change, \$11.3 million was due to net outflows and \$4.9 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -11.5%. Over the same time period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index, returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Negative macroeconomic events dominated the news and the markets over this past year. We continue to believe that the quality, growth and value characteristics that we identify in companies will contribute to positive long-term returns and that these market conditions create exceptional opportunities for those that continue to focus on such long-term characteristics.

During the reporting period, the largest contributor to our performance relative to the benchmark came from the Industrials sector, driven by the Fund's overweight position. The top contributors to positive Fund performance during the reporting period were Toromont Industries, Ritchie Brothers Auctioneers and TransForce. We also added value relative to the benchmark in the Information Technology sector through our overweight position in Open Text and our underweight position in Research In Motion.

The biggest detractors from the Fund's performance were in the Financials sector, primarily as a result of our underweight position in real estate investment trusts and an overweight position in Canaccord Financial, where volatile equity markets over the past year have negatively affected the high-margin investment banking segment, as underwriting opportunities were scarcer and more competitive. The Consumer Discretionary sector was also a drag on Fund performance as we held overweight positions in Magna International and Linamar. Magna's poor performance was due to pressure on the company's profit margin because of underperforming plants in Europe. Linamar's struggles were caused by heavy capital spending to provide for rapid growth due to new orders won over the year.

The Fund remains focused on high-quality, well-managed, growth-oriented companies. These industry leaders tend to perform well in most stock market environments. During the second half of the year, we increased our holdings in several of these high-quality businesses that appear to offer particularly attractive investment returns from current share prices, including Magna International, Tourmaline Oil, Cenovus Energy, Progress Energy, Gildan Activewear, Home Capital, Enbridge and Brookfield Asset Management. To fund these purchases, we eliminated our positions in Talisman Energy, NAL Energy, Suncor Energy and Major Drilling Group.

### Recent Developments

Correlations of individual stock price movements to the market have risen significantly, reflecting a lack of differentiation between issuers on the part of investors. We believe that this lack of differentiation is creating opportunities which will pay off when investors once again focus on issuer-specific characteristics.

The most recent set of corporate quarterly earnings reports was once again strong, exceeding analyst expectations in Canada and the U.S. This has not been a normal economic recovery, and neither economic activity nor optimism has returned to prior levels. Going forward, we believe that a continued slow recovery is the most probable outcome, although there is a wide range of potentially more positive or negative scenarios. Resolution of the European debt situation, U.S. economic recovery and degree of growth in China are three important factors that will drive short-term financial-markets performance.

### **Related-Party Transactions**

#### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series and Series D units.

#### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

#### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$15,000 (2010 – \$7,000), or 7% (2010 – 3%) of the total transaction costs paid for this Fund.

#### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

#### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>19.48</b>	<b>0.46</b>	<b>(0.42)</b>	<b>0.47</b>	<b>(2.73)</b>	<b>(2.22)</b>	—	—	—	—	—	<b>17.11</b>
Dec. 31, 2010	17.76	0.35	(0.40)	1.75	(0.13)	1.57	—	—	—	—	—	19.48
Dec. 31, 2009	11.98	0.52	(0.36)	(3.00)	8.24	5.40	—	(0.07)	—	—	(0.07)	17.76
Dec. 31, 2008 <sup>3</sup>	13.06 <sup>†</sup>	0.12	(0.03)	(8.81)	9.68	0.96	—	—	—	—	—	11.98
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>19.48</b>	<b>0.46</b>	<b>(0.42)</b>	<b>0.47</b>	<b>(2.73)</b>	<b>(2.22)</b>	—	—	—	—	—	<b>17.11</b>
Dec. 31, 2010 <sup>4</sup>	18.32 <sup>†</sup>	0.06	(0.07)	0.29	(0.02)	0.26	—	—	—	—	—	19.48
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>19.62</b>	<b>0.47</b>	<b>(0.27)</b>	<b>0.48</b>	<b>(2.76)</b>	<b>(2.08)</b>	—	—	—	—	—	<b>17.36</b>
Dec. 31, 2010	17.73	0.35	(0.26)	1.75	(0.13)	1.71	—	—	—	—	—	19.62
Dec. 31, 2009	11.93	0.51	(0.22)	(7.79)	13.50	6.00	—	(0.21)	—	—	(0.21)	17.73
Dec. 31, 2008	27.27	0.34	(0.44)	(6.39)	(11.01)	(17.50)	—	—	—	—	—	11.93
Dec. 31, 2007	34.14	1.37	(0.69)	11.41	(7.24)	4.85	(0.35)	(0.30)	(10.03)	—	(10.68)	27.27
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>20.25</b>	<b>0.48</b>	<b>(0.23)</b>	<b>0.49</b>	<b>(2.81)</b>	<b>(2.07)</b>	—	—	—	—	—	<b>17.98</b>
Dec. 31, 2010	18.24	0.37	(0.22)	1.81	(0.13)	1.83	—	—	—	—	—	20.25
Dec. 31, 2009	12.10	0.53	(0.20)	(2.63)	7.50	5.20	—	(0.25)	—	—	(0.25)	18.24
Dec. 31, 2008 <sup>6</sup>	32.22 <sup>†</sup>	0.14	(0.11)	(12.55)	(14.38)	(26.90)	—	—	—	—	—	12.10
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>20.68</b>	<b>0.50</b>	<b>(0.01)</b>	<b>0.51</b>	<b>(2.93)</b>	<b>(1.93)</b>	—	—	—	—	—	<b>18.57</b>
Dec. 31, 2010	18.43	0.37	(0.01)	1.84	(0.14)	2.06	—	—	—	—	—	20.68
Dec. 31, 2009	12.43	0.54	(0.02)	(7.40)	13.28	6.40	—	(0.47)	—	—	(0.47)	18.43
Dec. 31, 2008	27.48	0.34	—	(2.65)	(13.13)	(15.44)	—	—	—	—	—	12.43
Dec. 31, 2007	34.57	1.26	—	6.17	(6.58)	0.85	(0.73)	(0.63)	(10.27)	—	(11.63)	27.48

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From June 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>17.14</b>	<b>415</b>	<b>24</b>	<b>2.27</b>	<b>2.27</b>	<b>138.78</b>	<b>0.45</b>
Dec. 31, 2010	19.51	758	39	2.24	2.24	124.85	0.40
Dec. 31, 2009	17.82	681	38	2.27 <sup>2</sup>	2.43	143.52	0.64
Dec. 31, 2008 <sup>5</sup>	12.12	59	5	2.13	2.13	437.07	2.78
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>17.14</b>	<b>35</b>	<b>2</b>	<b>2.27</b>	<b>2.27</b>	<b>138.78</b>	<b>0.45</b>
Dec. 31, 2010 <sup>6</sup>	19.51	—	—	2.24	2.24	124.85	0.40
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>17.40</b>	<b>31 231</b>	<b>1 795</b>	<b>1.51</b>	<b>1.51</b>	<b>138.78</b>	<b>0.45</b>
Dec. 31, 2010	19.65	44 867	2 283	1.46	1.46	124.85	0.40
Dec. 31, 2009	17.78	49 810	2 801	1.50 <sup>2</sup>	1.50	143.52	0.64
Dec. 31, 2008	12.11	37 041	3 060	1.79	1.79	437.07	2.78
Dec. 31, 2007	27.48	71 042	2 586	1.85	1.85	191.16	1.16
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>18.01</b>	<b>118</b>	<b>7</b>	<b>1.17</b>	<b>1.17</b>	<b>138.78</b>	<b>0.45</b>
Dec. 31, 2010	20.28	240	12	1.17	1.17	124.85	0.40
Dec. 31, 2009	18.30	202	11	1.22 <sup>2</sup>	1.64	143.52	0.64
Dec. 31, 2008 <sup>7</sup>	12.28	—	—	1.08	1.08	437.07	2.78
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>18.61</b>	<b>5 012</b>	<b>269</b>	<b>0.08</b>	<b>0.08</b>	<b>138.78</b>	<b>0.45</b>
Dec. 31, 2010	20.72	7 250	350	0.07	0.07	124.85	0.40
Dec. 31, 2009	18.49	6 465	350	0.12 <sup>2</sup>	0.12	143.52	0.64
Dec. 31, 2008	12.61	3 555	282	0.02	0.02	437.07	2.78
Dec. 31, 2007	27.68	15 152	547	—	—	191.16	1.16

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 2.21%, Series D – 1.43%, Series F – 1.16%, Series O – 0.07%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2008.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	2.00%	50%	50%
Advisor Series	2.00%	50%	50%
Series D	1.25%	20%	80%
Series F	1.00%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

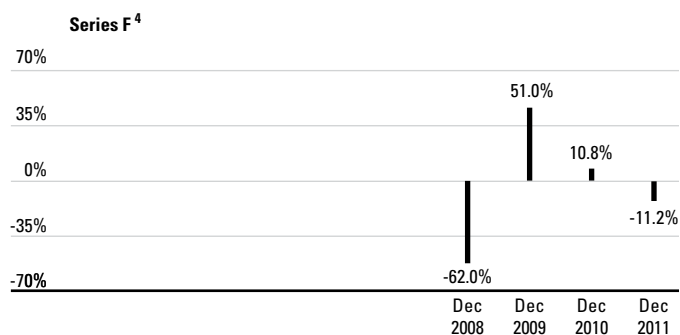
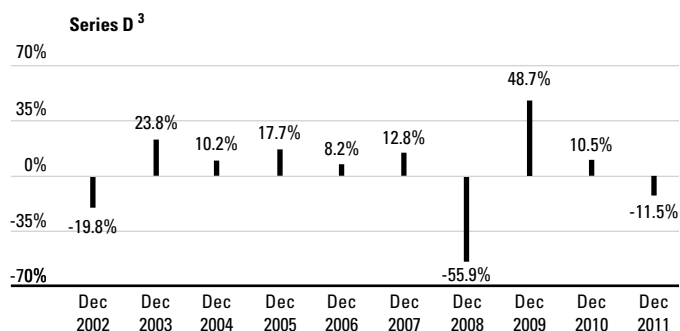
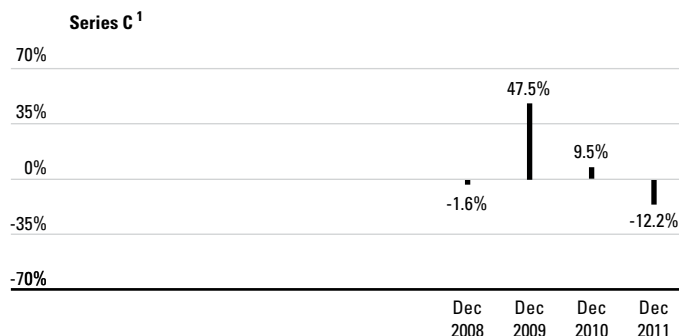
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

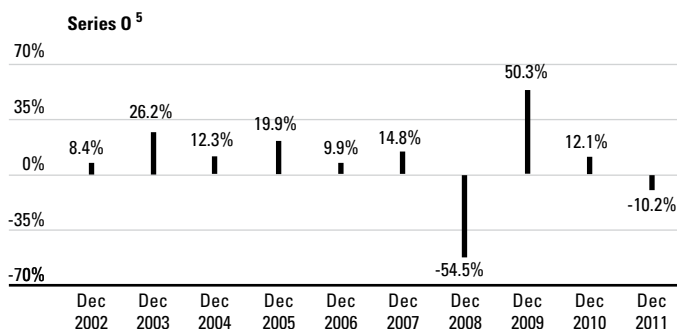
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P/TSX Capped Composite Total Return Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-12.2	12.4	—	—	11.5
Benchmark	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-12.2	—	—	—	-5.5
Benchmark	-8.7	—	—	—	-2.3
Series D <sup>3</sup>	-11.5	13.3	-6.3	0.1	—
Benchmark	-8.7	13.2	1.3	7.0	—
Series F <sup>4</sup>	-11.2	14.1	—	—	-15.1
Benchmark	-8.7	13.2	—	—	-2.5
Series O <sup>5</sup>	-10.2	14.8	-4.6	—	5.3
Benchmark	-8.7	13.2	1.3	—	10.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date April 1986.

<sup>4</sup> Inception date June 2008.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Financials	33.2
Energy	22.3
Industrials	13.7
Materials	13.3
Consumer Discretionary	9.4
Telecommunications	2.9
Consumer Staples	1.5
Health Care	1.1
Information Technology	0.8
Utilities	0.1
Cash/Other	1.7

**Top 25 Holdings**

	% of Net Asset Value
Royal Bank of Canada	6.7
Toronto-Dominion Bank	6.7
Bank of Nova Scotia	5.4
Canadian Imperial Bank of Commerce	4.1
Magna International Inc., Class A	3.7
Cenovus Energy Inc.	3.5
Enerflex Ltd.	3.2
Gildan Activewear Inc., Class A	3.2
SNC-Lavalin Group Inc.	3.1
Teck Resources Ltd., Class B	3.0
Goldcorp Inc.	2.9
Rogers Communications Inc., Class B	2.9
Progress Energy Resources Corp.	2.9
Tourmaline Oil Corp.	2.8
Home Capital Group Inc.	2.7
Bombardier Inc., Class B	2.7
Potash Corporation of Saskatchewan Inc.	2.6
Toromont Industries Ltd.	2.6
Canadian Natural Resources Ltd.	2.6
Manulife Financial Corporation	2.4
Power Corporation of Canada	2.1
Enbridge Inc.	2.1
Brookfield Asset Management Inc., Class A	2.0
Linamar Corp.	1.8
CAE Inc.	1.7
<b>Top 25 Holdings</b>	<b>79.4</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, www.phn.com, or by e-mailing us at info@phn.com.



U.S. EQUITY FUND

**PHILLIPS, HAGER & NORTH  
U.S. DIVIDEND INCOME FUND**

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*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth and income by investing primarily in a well-diversified portfolio of dividend income-producing U.S. securities that have a relatively high yield. To achieve the Fund's investment objective, we invest primarily in large-capitalization dividend-paying U.S. common shares and, to a lesser extent, preferred shares and bonds.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$80.3 million as of December 31, 2011, from \$76.4 million at the end of 2010. Of this change, \$1.8 million was due to net inflows and \$2.1 million to investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 2.4%. Over the same time period, the Fund's benchmark index, the S&P 500 Total Return Index (CDNS), returned 4.3%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

During the reporting period, the U.S. equity markets produced a relatively low return of 2.1% in U.S. dollars, with the majority of the growth coming in the first half of the year. Over the third quarter, market weakness was particularly pronounced as global growth expectations were reduced due to concerns over the growing potential for sovereign defaults in Europe.

Within the market, the leading sectors over the first half of the year reflected ongoing economic recovery, such as the Energy, Industrials and Materials sectors. Over the second half of the year, sectors with a defensive posture, such as the Consumer Staples and Utilities sectors, posted positive returns. For the year, these five sectors were also the sectors with the best returns. However, most of the Fund's best-performing holdings were in other sectors. The top contributors to Fund performance during the reporting period were Pfizer, IBM, Chevron, Intel and McGraw-Hill. Sectors that detracted from the Fund's performance were Financials and Materials. Within the Financials sector, AllianceBernstein, Hudson City Bancorp, New York Community Bancorp, JPMorgan and Allstate detracted significantly from returns.

Overall, we increased the number of holdings in the Fund during the year. We initiated new positions in Noble Energy, Archer Daniels Midland, PepsiCo, Becton Dickinson and Medtronic, which are all companies with solid dividend-growth histories. We eliminated a number of positions in the Fund, including Masco, Home Depot and Allstate.

On account of market prices that overvalue companies, holdings of ConocoPhillips and McGraw-Hill were reduced. We also reduced our position in AllianceBernstein due to financial performance that fell short of expectations. We increased our positions in IBM and Sempra Energy.

### Recent Developments

We expect the U.S. equities markets to continue to face a number of significant challenges, including persistent economic weakness in Europe and parts of Asia and unsettled U.S. fiscal policy as the country heads into an election year. Countering this are strong company balance sheets, robust corporate profitability, reasonable stock valuations and early signs of an improving U.S. economy.

The financial position and performance of many U.S. corporations has prompted significant dividend increases over the past year. Emerging from the credit crisis, banks are rebuilding their capital structures and are increasing dividend payments. As a result, during the reporting period, JPMorgan raised its dividend by 400% and Wells Fargo raised its dividend by 140%. Other notable increases in dividends came from Microsoft (+54%), General Electric (+48%) and Intel (+33%).

We continue to search for opportunities among companies that have the ability to increase their dividend payments, including the large U.S. banks and global "blue-chip" industrial and consumer companies.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series and Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>6.87</b>	<b>0.19</b>	<b>(0.13)</b>	<b>(0.30)</b>	<b>0.36</b>	<b>0.12</b>	–	<b>(0.05)</b>	–	–	<b>(0.05)</b>	<b>6.93</b>	
Dec. 31, 2010	6.60	0.17	(0.13)	(0.13)	0.37	0.28	–	(0.03)	–	–	(0.03)	6.87	
Dec. 31, 2009	6.50	0.19	(0.13)	(0.66)	1.67	1.07	(0.09)	–	–	–	(0.09)	6.60	
Dec. 31, 2008 <sup>3</sup>	5.96 <sup>†</sup>	–	–	–	0.08	0.08	(0.08)	–	–	–	(0.08)	6.50	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>6.87</b>	<b>0.19</b>	<b>(0.13)</b>	<b>(0.30)</b>	<b>0.36</b>	<b>0.12</b>	–	<b>(0.05)</b>	–	–	<b>(0.05)</b>	<b>6.93</b>	
Dec. 31, 2010 <sup>4</sup>	6.64 <sup>†</sup>	0.03	(0.02)	(0.02)	0.06	0.05	–	(0.03)	–	–	(0.03)	6.87	
<b>Series D<sup>5</sup></b>													
<b>Dec. 31, 2011</b>	<b>6.83</b>	<b>0.19</b>	<b>(0.08)</b>	<b>(0.30)</b>	<b>0.36</b>	<b>0.17</b>	–	<b>(0.10)</b>	–	–	<b>(0.10)</b>	<b>6.89</b>	
Dec. 31, 2010	6.57	0.17	(0.08)	(0.13)	0.37	0.33	–	(0.09)	–	–	(0.09)	6.83	
Dec. 31, 2009	6.46	0.19	(0.07)	(1.17)	1.13	0.08	(0.15)	–	–	–	(0.15)	6.57	
Dec. 31, 2008	8.03	0.23	(0.10)	(1.71)	(0.09)	(1.67)	(0.13)	–	–	–	(0.13)	6.46	
Dec. 31, 2007	9.77	0.21	(0.11)	(0.18)	(1.44)	(1.52)	(0.12)	–	–	–	(0.12)	8.03	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>6.81</b>	<b>0.19</b>	<b>(0.06)</b>	<b>(0.30)</b>	<b>0.36</b>	<b>0.19</b>	–	<b>(0.12)</b>	–	–	<b>(0.12)</b>	<b>6.87</b>	
Dec. 31, 2010	6.55	0.17	(0.06)	(0.13)	0.37	0.35	–	(0.11)	–	–	(0.11)	6.81	
Dec. 31, 2009	6.45	0.18	(0.06)	(0.87)	1.68	0.93	(0.16)	–	–	–	(0.16)	6.55	
Dec. 31, 2008 <sup>6</sup>	6.58 <sup>†</sup>	0.03	(0.01)	(0.09)	0.73	0.66	(0.15)	–	–	–	(0.15)	6.45	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>6.83</b>	<b>0.19</b>	<b>(0.01)</b>	<b>(0.31)</b>	<b>0.36</b>	<b>0.23</b>	–	<b>(0.18)</b>	–	–	<b>(0.18)</b>	<b>6.89</b>	
Dec. 31, 2010	6.58	0.18	(0.01)	(0.13)	0.37	0.41	–	(0.17)	–	–	(0.17)	6.83	
Dec. 31, 2009	6.47	0.19	(0.01)	(1.12)	1.13	0.19	(0.22)	–	–	–	(0.22)	6.58	
Dec. 31, 2008	8.02	0.20	(0.01)	(1.48)	(0.01)	(1.30)	(0.20)	–	–	–	(0.20)	6.47	
Dec. 31, 2007	9.73	0.22	–	(0.31)	(1.70)	(1.79)	(0.20)	–	–	–	(0.20)	8.02	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From October 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>6.93</b>	<b>1 280</b>	<b>185</b>	<b>2.06</b>	<b>2.06</b>	<b>16.34</b>	<b>0.04</b>
Dec. 31, 2010	6.87	499	73	2.00	2.00	31.21	0.07
Dec. 31, 2009	6.61	365	55	2.03 <sup>2</sup>	2.26	23.70	0.13
Dec. 31, 2008 <sup>5</sup>	6.50	11	2	2.03	141.47	45.19	0.13
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>6.93</b>	<b>161</b>	<b>23</b>	<b>2.06</b>	<b>2.06</b>	<b>16.34</b>	<b>0.04</b>
Dec. 31, 2010 <sup>6</sup>	6.87	—	—	2.00	2.00	31.21	0.07
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>6.89</b>	<b>40 757</b>	<b>5 915</b>	<b>1.22</b>	<b>1.22</b>	<b>16.34</b>	<b>0.04</b>
Dec. 31, 2010	6.83	41 119	6 021	1.19	1.19	31.21	0.07
Dec. 31, 2009	6.57	43 409	6 603	1.22 <sup>2</sup>	1.22	23.70	0.13
Dec. 31, 2008	6.46	55 857	8 640	1.23	1.23	45.19	0.13
Dec. 31, 2007	8.09	96 918	11 981	1.15	1.15	29.15	0.06
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>6.87</b>	<b>613</b>	<b>89</b>	<b>0.96</b>	<b>0.96</b>	<b>16.34</b>	<b>0.04</b>
Dec. 31, 2010	6.81	397	58	0.94	0.94	31.21	0.07
Dec. 31, 2009	6.55	122	19	0.99 <sup>2</sup>	1.46	23.70	0.13
Dec. 31, 2008 <sup>7</sup>	6.45	68	11	0.91	5.98	45.19	0.13
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>6.89</b>	<b>37 502</b>	<b>5 440</b>	<b>0.08</b>	<b>0.08</b>	<b>16.34</b>	<b>0.04</b>
Dec. 31, 2010	6.83	34 382	5 032	0.08	0.08	31.21	0.07
Dec. 31, 2009	6.58	32 751	4 976	0.08 <sup>2</sup>	0.08	23.70	0.13
Dec. 31, 2008	6.48	40 101	6 193	0.08	0.08	45.19	0.13
Dec. 31, 2007	8.08	55 947	6 928	0.05	0.05	29.15	0.06

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.94%, Series D – 1.16%, Series F – 0.89%, Series O – 0.08%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From October 2008.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

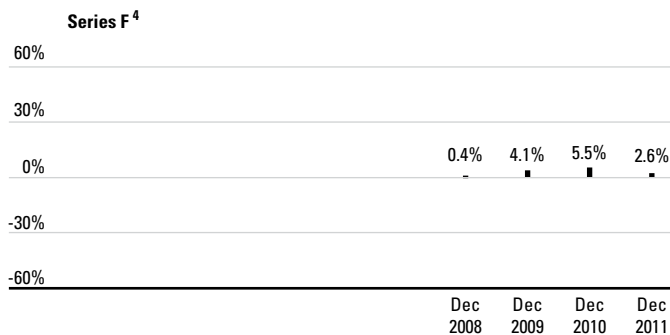
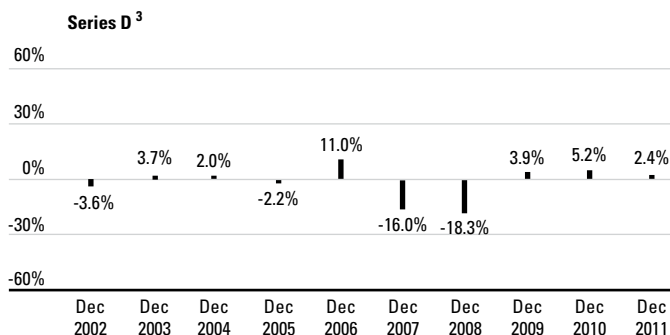
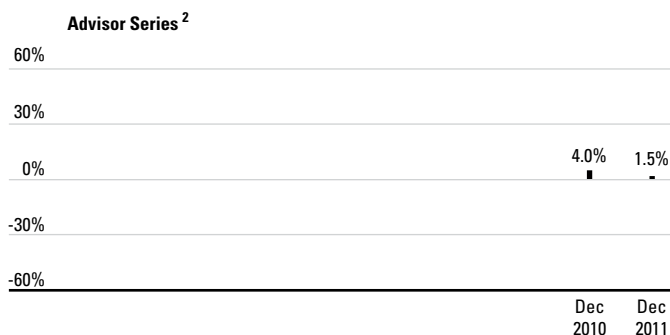
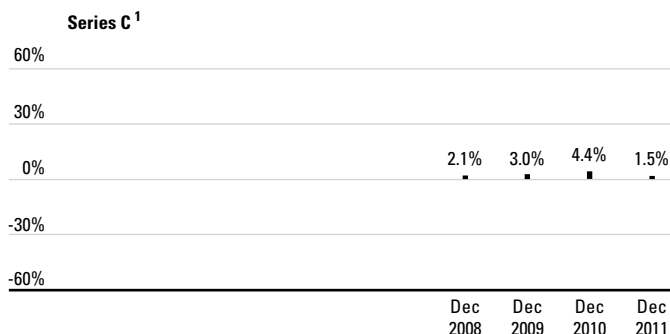
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

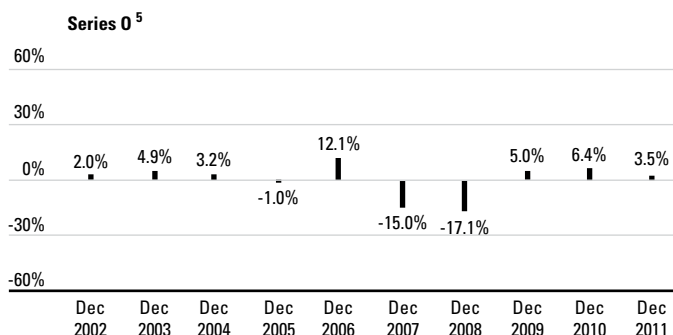
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



## PAST PERFORMANCE (cont.)



## Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

### S&P 500 Total Return Index (CDN\$)

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	1.5	—	—	—	3.6
Benchmark	4.3	—	—	—	7.0
Advisor Series <sup>2</sup>	1.5	—	—	—	4.8
Benchmark	4.3	—	—	—	7.5
Series D <sup>3</sup>	2.4	3.8	-5.1	—	-1.7
Benchmark	4.3	7.0	-2.9	—	0.7
Series F <sup>4</sup>	2.6	—	—	—	4.0
Benchmark	4.3	—	—	—	5.4
Series O <sup>5</sup>	3.5	5.0	-4.0	—	0.0
Benchmark	4.3	7.0	-2.9	—	1.2

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date July 2002.

<sup>4</sup> Inception date October 2008.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008. Although Series A units of the Fund were created in May 2002, units were not offered for sale under a simplified prospectus until July 2002. We are therefore not permitted to disclose performance data for this Fund for any period prior to July 2002.

## INDEX DESCRIPTION

**S&P 500 Total Return Index (CDN\$)** This index is a capitalization weighted index measuring the Canadian dollar performance of 500 widely held common stocks representing all major industries in the United States. This index gives investors a broad measure of the overall performance of the U.S. stock market.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Health Care	16.9
Energy	16.2
Financials	13.7
Consumer Staples	12.2
Information Technology	11.1
Industrials	7.4
Consumer Discretionary	6.9
Materials	4.3
Telecommunications	4.3
Utilities	3.4
Cash/Other	3.6

### Top 25 Holdings

	% of Net Asset Value
Chevron Corp.	5.3
Johnson & Johnson	4.9
Microsoft Corp.	4.9
Exxon Mobil Corp.	4.6
AT&T Inc.	4.3
Pfizer Inc.	4.2
Merck & Co. Inc.	4.1
Wal-Mart Stores Inc.	3.8
Sysco Corp.	3.7
Cash & Cash Equivalents	3.5
Cincinnati Financial Corp.	3.4
Sempra Energy	3.4
PepsiCo Inc.	3.2
Intel Corp.	3.1
International Business Machines	3.1
McGraw-Hill Companies Inc.	2.9
Tidewater Inc.	2.7
Nucor Corp.	2.5
AllianceBernstein HoldingLP	2.4
Leggett & Platt Inc.	2.1
Noble Corp.	2.1
Becton Dickinson & Co.	2.0
JPMorgan Chase & Co.	2.0
Wells Fargo & Company	1.9
American Eagle Outfitters	1.9
Top 25 Holdings	82.0

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

U.S. EQUITY FUND

**PHILLIPS, HAGER & NORTH  
U.S. MULTI-STYLE ALL-CAP  
EQUITY FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

Sub-Advisor: RBC Global Asset Management (U.S.) Inc. ("RBC GAM US")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*



## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing in shares of high-quality U.S. companies. To achieve the Fund's investment objective, we invest in quality businesses that have a sustainable competitive advantage, a history of profitability, a solid financial position, opportunities for growth, and a capable management team. Emphasis is placed on a stock's valuation, with effort to select those with relatively low valuations, given the breadth of the U.S. market.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$876 million as of December 31, 2011, from \$764 million at the end of 2010. Of this change, \$104 million was due to net inflows and \$8 million to investment gains.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -0.3%. Over the same time period, the Fund's benchmark, the Russell 3000 Total Return Index (CDNS), returned 3.2%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The U.S. stock market rose modestly during 2011, with most of the gains coming in the first half of the year. Over the third quarter, market weakness was particularly pronounced, as Europe's sovereign-debt crisis worsened and global growth expectations declined.

The Large Cap Growth Strategy of the Fund lagged its benchmark, the Russell Top 200 Growth Index. Sectors that had a negative impact on performance were Financials, Energy, and Basic Materials. Sectors that contributed to performance were Health Care and Utilities.

The Mid Cap Growth Strategy beat its benchmark, the Russell Mid-Cap Growth Index. The Information Technology, Basic Materials, and Energy sectors had a negative impact on the strategy's performance. Sectors with a positive effect on results were Health Care, Industrials and Utilities.

The Large Cap Value Strategy exceeded its benchmark, the Russell Top 200 Value Index. Results were best in the Financials sector. Other sectors that had a positive impact on performance were Consumer Discretionary and Consumer Staples. The worst-performing sectors were Energy, Health Care and Industrials.

The Mid Cap Value Strategy underperformed its benchmark, the Russell Midcap Value Index. Below-benchmark weights in Utilities, Consumer Staples and real estate investment trusts detracted from performance. Performance in the Financials, Materials, Health Care and Information Technology sectors helped offset the negatives. Overall stock selection was positive for the year.

The U.S. Small Cap Core Strategy outperformed its benchmark, the Russell 2000 Index. Stock selection in the Financials, Consumer Discretionary, Energy and Materials sectors had a positive impact on results. Unfavourable stock selection in the Consumer Staples sector had a negative impact on performance, as did underweight positions in the Utilities and Health Care sectors.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the sub-advisor's view is that Europe muddles through the current crisis. Assuming this outcome, the sub-advisor expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets.

We expect U.S. equity markets to continue to face significant challenges, including persistent economic weakness in Europe and parts of Asia, as well as unsettled U.S. fiscal policy. Countering this are strong company balance sheets, robust profitability, reasonable stock valuations and early signs of an improving U.S. economy. Given the challenges, we have balanced the portfolio between holdings that will benefit significantly from economic growth and those whose performance is steadier in weaker economic conditions. We continue to search for opportunities in both these areas.

### **Related-Party Transactions**

#### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series or Series D units.

#### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

#### ***Brokerage***

The Fund has established standard brokerage agreements at market rates with related-party dealers. These related-party commissions were \$116,000 or 3% of the total transaction costs paid for this Fund. There were no related-party commissions in 2010.

#### ***Sub-Advisor***

RBC GAM US is a sub-advisor of the Fund. The fees paid to RBC GAM US are paid by RBC GAM, not the Fund.

### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

#### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>0.16</b>	<b>(0.21)</b>	<b>(0.07)</b>	<b>0.01</b>	<b>(0.11)</b>	–	–	–	–	–	<b>11.15</b>
Dec. 31, 2010 <sup>3</sup>	10.00 <sup>†</sup>	0.07	(0.10)	0.03	1.11	1.11	–	–	–	–	–	11.28
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>0.16</b>	<b>(0.21)</b>	<b>(0.07)</b>	<b>0.01</b>	<b>(0.11)</b>	–	–	–	–	–	<b>11.15</b>
Dec. 31, 2010 <sup>4</sup>	10.64 <sup>†</sup>	0.01	(0.02)	0.19	0.20	0.38	–	–	–	–	–	11.28
<b>Series D</b>												
<b>Dec. 31, 2011</b>	<b>11.33</b>	<b>0.16</b>	<b>(0.13)</b>	<b>(0.07)</b>	<b>0.01</b>	<b>(0.03)</b>	–	<b>(0.02)</b>	–	–	<b>(0.02)</b>	<b>11.27</b>
Dec. 31, 2010 <sup>3</sup>	10.00 <sup>†</sup>	0.07	(0.06)	0.19	1.11	1.31	–	–	–	–	–	11.33
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>11.33</b>	<b>0.16</b>	<b>(0.10)</b>	<b>(0.07)</b>	<b>0.01</b>	–	–	<b>(0.05)</b>	–	–	<b>(0.05)</b>	<b>11.27</b>
Dec. 31, 2010 <sup>3</sup>	10.00 <sup>†</sup>	0.07	(0.05)	0.19	1.11	1.32	–	–	–	–	–	11.33
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>11.13</b>	<b>0.16</b>	<b>(0.01)</b>	<b>(0.07)</b>	<b>0.01</b>	<b>0.09</b>	–	<b>(0.15)</b>	–	–	<b>(0.15)</b>	<b>11.07</b>
Dec. 31, 2010 <sup>3</sup>	10.00 <sup>†</sup>	0.07	–	0.19	1.11	1.37	–	(0.05)	(0.21)	–	(0.26)	11.13

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2010.

<sup>4</sup> From October 2010.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>11.16</b>	<b>448</b>	<b>40</b>	<b>1.95</b>	<b>1.95</b>	<b>218.83</b>	<b>0.41</b>
Dec. 31, 2010 <sup>4</sup>	11.29	156	14	1.94	1.94	125.85	0.31
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>11.16</b>	<b>20</b>	<b>2</b>	<b>1.95</b>	<b>1.95</b>	<b>218.83</b>	<b>0.41</b>
Dec. 31, 2010 <sup>5</sup>	11.29	–	–	1.94	1.94	125.85	0.31
<b>Series D</b>							
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>4 131</b>	<b>366</b>	<b>1.20</b>	<b>1.20</b>	<b>218.83</b>	<b>0.41</b>
Dec. 31, 2010 <sup>4</sup>	11.34	1 371	121	1.16	1.16	125.85	0.31
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>11.28</b>	<b>51</b>	<b>5</b>	<b>0.89</b>	<b>0.89</b>	<b>218.83</b>	<b>0.41</b>
Dec. 31, 2010 <sup>4</sup>	11.34	5	–	0.89	0.89	125.85	0.31
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>11.08</b>	<b>871 508</b>	<b>78 660</b>	<b>0.06</b>	<b>0.06</b>	<b>218.83</b>	<b>0.41</b>
Dec. 31, 2010 <sup>4</sup>	11.14	762 182	68 429	0.05	0.05	125.85	0.31

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2010.

<sup>5</sup> From October 2010.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**Russell 3000 Total Return Index (CDN\$)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-1.1	—	—	—	11.1
Benchmark	3.2	—	—	—	13.1
Advisor Series <sup>2</sup>	-1.1	—	—	—	4.2
Benchmark	3.2	—	—	—	7.1
Series D <sup>1</sup>	-0.3	—	—	—	9.9
Benchmark	3.2	—	—	—	13.1
Series F <sup>1</sup>	0.0	—	—	—	10.1
Benchmark	3.2	—	—	—	13.1
Series O <sup>1</sup>	0.8	—	—	—	11.1
Benchmark	3.2	—	—	—	13.1

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> From June 2010.

<sup>2</sup> From October 2010.

**INDEX DESCRIPTION**

**Russell 3000 Total Return Index (CDN\$)** This index measures the Canadian dollar performance of the largest 3,000 U.S. companies representing approximately 98% of the U.S. equity market. This index provides a broader barometer of the equity market than the S&P 500.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Information Technology	16.7
Financials	15.2
Consumer Discretionary	14.1
Energy	12.0
Industrials	12.0
Health Care	9.6
Consumer Staples	6.3
Materials	6.2
Utilities	3.4
Telecommunications	2.5
Cash/Other	2.0

**Top 25 Holdings**

	% of Net Asset Value
Apple Inc.	2.5
Exxon Mobil Corp.	2.4
Chevron Corp.	2.0
Cash & Cash Equivalents	1.9
Pfizer Inc.	1.7
Philip Morris International Inc.	1.6
Cisco Systems Inc.	1.5
Intel Corp.	1.5
Wells Fargo & Company	1.4
CVS Corp.	1.2
Verizon Communications Inc.	1.2
Kraft Foods Inc., Class A	1.1
JPMorgan Chase & Co.	1.0
Merck & Co. Inc.	1.0
Anadarko Petroleum Corp.	1.0
Occidental Petroleum Corp.	1.0
Chubb Corp.	0.9
Macy's Inc.	0.9
Home Depot Inc.	0.8
General Electric Company	0.8
International Business Machines	0.8
Union Pacific Corp.	0.8
U.S. Bancorp	0.8
Southern Co.	0.8
TJX Companies Inc.	0.8
<b>Top 25 Holdings</b>	<b>31.4</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, www.phn.com, or by e-mailing us at info@phn.com.

U.S. EQUITY FUND

**PHILLIPS, HAGER & NORTH  
U.S. EQUITY FUND**

*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in shares of large-capitalization, high-quality U.S. companies. To achieve the Fund's investment objective, we invest in quality businesses that have a sustainable competitive advantage, a history of profitability, a solid financial position, opportunities for growth, and a capable management team. We place particular emphasis on a company's long-term return on equity, as this measure is a key indicator of a company's ability to consistently generate profits for shareholders. Additional emphasis is placed on a stock's valuation, given the breadth of the U.S. market.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$958.3 million as of December 31, 2011, from \$957.9 million at the end of 2010. Of this change, \$19.6 million was due to net outflows, offset by \$20.1 million of investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned 1.5%. Over the same time period, the Fund's benchmark index, the S&P 500 Total Return Index (CDN\$), returned 4.3%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

During the reporting period, the U.S. equity markets produced a relatively low return of 2.1% in U.S. dollars, with the majority of the growth coming in the first half of the year. Over the third quarter, market weakness was particularly pronounced as global growth expectations were reduced due to concerns over the growing potential for sovereign defaults in Europe.

Within the market, the leading sectors over the first half of the year reflected ongoing economic recovery, such as the Energy, Industrials and Materials sectors. Over the second half of the year, sectors with a defensive posture, such as the Consumer Staples and Utilities sectors, posted positive returns. For the year, these five sectors were also the sectors with the best returns. However, most of the Fund's best-performing holdings were in other sectors. The top contributors

to positive Fund performance during the reporting period were El Paso Corp., Pfizer, Wal-Mart, Intel and McGraw-Hill. Sectors that detracted from the Fund's performance were the Financials and Materials sectors. Within the Financials sector, Allstate and Wells Fargo detracted significantly from returns of the Fund. In the Materials sector, Alcoa and Nucor detracted significantly from returns of the Fund.

Overall, we decreased the number of holdings in the Fund during the year. We entered into new positions in National Oilwell Varco, Danaher, CVS, Varian Medical, VCA Antech, Waters Corp., Aflac, ProAssurance, Amphenol, Google and Iridium. We eliminated a number of positions in the Fund, including ConocoPhillips, Tidewater, Nucor, General Electric, Masco, Norfolk Southern, American Eagle Outfitters, Home Depot, Merck, Allstate, Bank of America, Citigroup, Dell and Motorola.

On account of market prices that overvalue companies, holdings of El Paso Corp., Archer Daniels Midland, PepsiCo, Berkshire Hathaway and Sempra Energy were increased. Concern over longer-term profitability prompted us to decrease positions in Alcoa and Winnebago Industries.

### Recent Developments

We expect the U.S. equities markets to continue to face a number of significant challenges, including persistent economic weakness in Europe and parts of Asia and an unsettled U.S. fiscal policy as the country heads into an election year. Countering this are strong company balance sheets, robust corporate profitability, reasonable stock valuations and early signs of an improving U.S. economy.

Given the recent economic challenges, we have balanced the portfolio between those holdings that are cyclical in nature and that will benefit from ongoing economic growth and those holdings whose performance is steadier through weaker economic conditions. We continue to search for opportunities among companies in both of these areas of the market, and expect to find a number of companies trading at compelling valuation levels near to those that were reached at the market's lows in March 2009.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.



Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>29.22</b>	<b>0.49</b>	<b>(0.56)</b>	<b>(2.33)</b>	<b>2.50</b>	<b>0.10</b>	—	—	—	—	—	<b>29.40</b>
Dec. 31, 2010	27.71	0.51	(0.54)	(1.36)	2.83	1.44	—	—	—	—	—	29.22
Dec. 31, 2009	26.77	0.53	(0.51)	(2.40)	6.32	3.94	(0.12)	—	—	—	(0.12)	27.71
Dec. 31, 2008 <sup>3</sup>	24.67 <sup>†</sup>	0.13	(0.07)	(0.31)	1.13	0.88	(0.02)	—	—	—	(0.02)	26.77
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>29.22</b>	<b>0.49</b>	<b>(0.56)</b>	<b>(2.33)</b>	<b>2.50</b>	<b>0.10</b>	—	—	—	—	—	<b>29.40</b>
Dec. 31, 2010 <sup>4</sup>	28.02 <sup>†</sup>	0.09	(0.09)	(0.23)	0.47	0.24	—	—	—	—	—	29.22
<b>Series B</b>												
<b>Dec. 31, 2011</b>	<b>29.18</b>	<b>0.49</b>	<b>(0.48)</b>	<b>(2.34)</b>	<b>2.50</b>	<b>0.17</b>	—	<b>(0.06)</b>	—	—	<b>(0.06)</b>	<b>29.40</b>
Dec. 31, 2010	27.64	0.51	(0.46)	(1.34)	2.79	1.50	—	(0.06)	—	—	(0.06)	29.18
Dec. 31, 2009	26.68	0.58	(0.44)	(2.98)	0.78	(2.06)	(0.17)	—	—	—	(0.17)	27.64
Dec. 31, 2008	33.90	0.71	(0.52)	(2.20)	(6.13)	(8.14)	(0.17)	—	—	—	(0.17)	26.68
Dec. 31, 2007 <sup>5</sup>	38.80 <sup>†</sup>	0.36	(0.29)	(0.79)	(0.80)	(1.52)	(0.04)	—	—	—	(0.04)	33.90
<b>Series D<sup>6</sup></b>												
<b>Dec. 31, 2011</b>	<b>28.98</b>	<b>0.49</b>	<b>(0.33)</b>	<b>(2.32)</b>	<b>2.49</b>	<b>0.33</b>	—	<b>(0.21)</b>	—	—	<b>(0.21)</b>	<b>29.20</b>
Dec. 31, 2010	27.44	0.51	(0.32)	(1.35)	2.80	1.64	—	(0.20)	—	—	(0.20)	28.98
Dec. 31, 2009	26.51	0.55	(0.30)	(2.70)	3.39	0.94	(0.32)	—	—	—	(0.32)	27.44
Dec. 31, 2008	33.67	0.70	(0.36)	(2.44)	(5.12)	(7.22)	(0.32)	—	—	—	(0.32)	26.51
Dec. 31, 2007	39.42	0.67	(0.44)	(0.51)	(4.65)	(4.93)	(0.28)	—	—	—	(0.28)	33.67
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>29.10</b>	<b>0.49</b>	<b>(0.26)</b>	<b>(2.33)</b>	<b>2.50</b>	<b>0.40</b>	—	<b>(0.29)</b>	—	—	<b>(0.29)</b>	<b>29.32</b>
Dec. 31, 2010	27.56	0.51	(0.25)	(1.36)	2.81	1.71	—	(0.28)	—	—	(0.28)	29.10
Dec. 31, 2009	26.63	0.54	(0.24)	(2.58)	4.87	2.59	(0.39)	—	—	—	(0.39)	27.56
Dec. 31, 2008	33.70	0.74	(0.31)	(3.68)	19.63	16.38	(0.30)	—	—	—	(0.30)	26.63
Dec. 31, 2007 <sup>5</sup>	38.80 <sup>†</sup>	0.33	(0.21)	(1.23)	(3.70)	(4.81)	(0.28)	—	—	—	(0.28)	33.70
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>29.42</b>	<b>0.50</b>	<b>(0.01)</b>	<b>(2.37)</b>	<b>2.54</b>	<b>0.66</b>	—	<b>(0.57)</b>	—	—	<b>(0.57)</b>	<b>29.65</b>
Dec. 31, 2010	27.88	0.52	(0.01)	(1.37)	2.85	1.99	—	(0.57)	—	—	(0.57)	29.42
Dec. 31, 2009	26.93	0.56	(0.01)	(2.76)	3.43	1.22	(0.63)	—	—	—	(0.63)	27.88
Dec. 31, 2008	34.12	0.71	(0.01)	(2.63)	(4.57)	(6.50)	(0.60)	—	—	—	(0.60)	26.93
Dec. 31, 2007	39.88	0.69	(0.01)	(0.75)	(5.22)	(5.29)	(0.67)	—	—	—	(0.67)	34.12

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>29.42</b>	<b>2 298</b>	<b>78</b>	<b>2.07</b>	<b>2.07</b>	<b>49.36</b>	<b>0.08</b>
Dec. 31, 2010	29.23	947	32	2.01	2.01	40.42	0.12
Dec. 31, 2009	27.72	648	23	1.99 <sup>2</sup>	2.05	25.55	0.08
Dec. 31, 2008 <sup>5</sup>	26.79	195	7	1.97	5.48	45.89	0.12
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>29.42</b>	<b>710</b>	<b>24</b>	<b>2.07</b>	<b>2.07</b>	<b>49.36</b>	<b>0.08</b>
Dec. 31, 2010 <sup>6</sup>	29.23	—	—	2.01	2.01	40.42	0.12
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>29.42</b>	<b>20</b>	<b>1</b>	<b>1.71</b>	<b>1.71</b>	<b>49.36</b>	<b>0.08</b>
Dec. 31, 2010	29.19	22	1	1.68	1.68	40.42	0.12
Dec. 31, 2009	27.65	46	2	1.73 <sup>2</sup>	2.90	25.55	0.08
Dec. 31, 2008	26.70	77	3	1.70	2.45	45.89	0.12
Dec. 31, 2007 <sup>7</sup>	34.16	40	1	1.68	23.43	54.18	0.08
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>29.22</b>	<b>186 942</b>	<b>6 398</b>	<b>1.22</b>	<b>1.22</b>	<b>49.36</b>	<b>0.08</b>
Dec. 31, 2010	28.99	190 716	6 579	1.19	1.19	40.42	0.12
Dec. 31, 2009	27.46	203 907	7 426	1.18 <sup>2</sup>	1.18	25.55	0.08
Dec. 31, 2008	26.53	221 192	8 338	1.18	1.18	45.89	0.12
Dec. 31, 2007	33.93	286 604	8 447	1.16	1.16	54.18	0.08
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>29.33</b>	<b>1 410</b>	<b>48</b>	<b>0.95</b>	<b>0.95</b>	<b>49.36</b>	<b>0.08</b>
Dec. 31, 2010	29.10	1 321	45	0.92	0.92	40.42	0.12
Dec. 31, 2009	27.57	1 234	45	0.95 <sup>2</sup>	0.95	25.55	0.08
Dec. 31, 2008	26.65	1 103	41	1.17	1.49	45.89	0.12
Dec. 31, 2007 <sup>7</sup>	33.96	—	—	1.18	1 910.67	54.18	0.08
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>29.66</b>	<b>766 923</b>	<b>25 857</b>	<b>0.02</b>	<b>0.02</b>	<b>49.36</b>	<b>0.08</b>
Dec. 31, 2010	29.43	764 872	25 988	0.02	0.02	40.42	0.12
Dec. 31, 2009	27.90	883 436	31 669	0.02 <sup>2</sup>	0.02	25.55	0.08
Dec. 31, 2008	26.95	965 528	35 825	0.02	0.02	45.89	0.12
Dec. 31, 2007	34.37	961 801	27 980	0.02	0.02	54.18	0.08

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.93%, Series B – 1.69%, Series D – 1.16%, Series F – 0.89%, Series O – 0.02%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.50%	33%	67%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

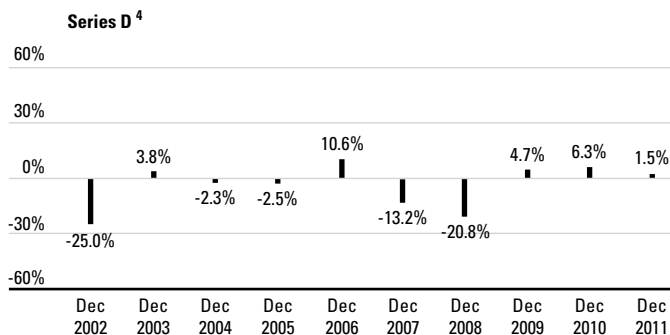
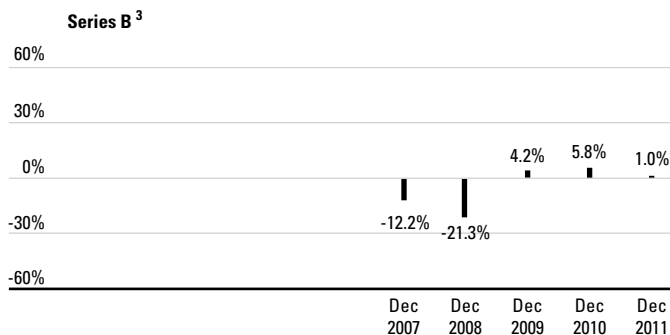
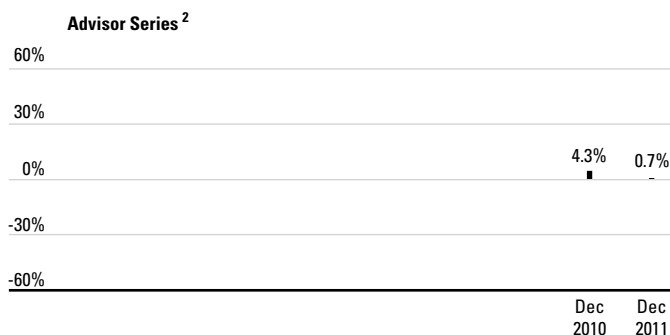
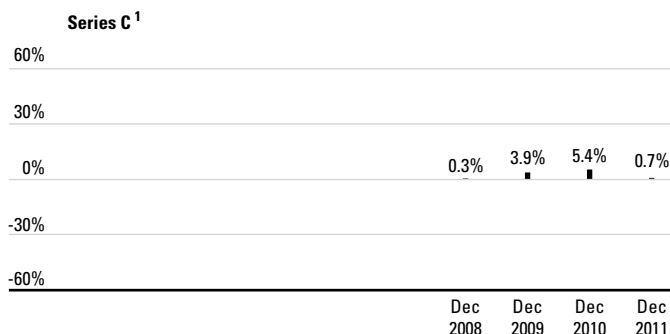
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

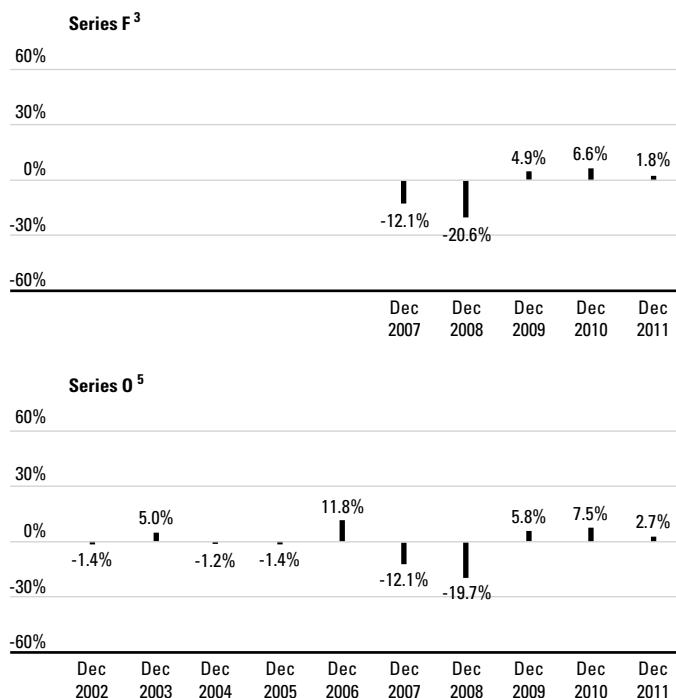
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P 500 Total Return Index (CDN\$)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	0.7	3.3	—	—	5.3
Benchmark	4.3	7.0	—	—	7.0
Advisor Series <sup>2</sup>	0.7	—	—	—	4.3
Benchmark	4.3	—	—	—	7.5
Series B <sup>3</sup>	1.0	3.6	—	—	-5.7
Benchmark	4.3	7.0	—	—	-2.7
Series D <sup>4</sup>	1.5	4.1	-4.9	-4.4	—
Benchmark	4.3	7.0	-2.9	-1.6	—
Series F <sup>3</sup>	1.8	4.4	—	—	-5.0
Benchmark	4.3	7.0	—	—	-2.7
Series O <sup>5</sup>	2.7	5.3	-3.8	—	-0.7
Benchmark	4.3	7.0	-2.9	—	1.2

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date September 1964.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**S&P 500 Total Return Index (CDN\$)** This index is a capitalization weighted index measuring the Canadian dollar performance of 500 widely held common stocks representing all major industries in the United States. This index gives investors a broad measure of the overall performance of the U.S. stock market.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Health Care	17.4
Financials	16.5
Consumer Staples	13.5
Energy	13.3
Information Technology	13.1
Industrials	9.0
Consumer Discretionary	5.6
Materials	3.8
Utilities	3.1
Telecommunications	2.5
Cash/Other	2.2

**Top 25 Holdings**

	% of Net Asset Value
Exxon Mobil Corp.	4.1
Wells Fargo & Company	4.0
Wal-Mart Stores Inc.	3.8
Berkshire Hathaway Inc., Class B	3.5
Johnson & Johnson	3.4
Cisco Systems Inc.	3.4
Microsoft Corp.	3.2
Sysco Corp.	3.2
Sempra Energy	3.1
El Paso Corp.	2.9
Illinois Tool Works Inc.	2.9
Becton Dickinson & Co.	2.9
Pfizer Inc.	2.5
PepsiCo Inc.	2.4
Gilead Sciences Inc.	2.3
United Technologies Corp.	2.3
Archer Daniels Midland Co.	2.3
Cash & Cash Equivalents	2.2
Brown & Brown Inc.	2.2
Google Inc., Class A	2.1
The Progressive Corp.	2.0
JPMorgan Chase & Co.	2.0
WellPoint Inc.	2.0
AT&T Inc.	1.9
Emerson Electric Co.	1.9
<b>Top 25 Holdings</b>	<b>68.5</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

U.S. EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CURRENCY-HEDGED U.S. EQUITY FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with significant long-term capital growth primarily through exposure to a well-diversified portfolio of large-capitalization, high-quality U.S. companies, while minimizing currency risk. To achieve the Fund's investment objective, we invest primarily in units of the Phillips, Hager & North U.S. Equity Fund ("the Underlying Fund"), as well as derivative instruments that are used to hedge against fluctuations in the value of the U.S. dollar relative to the Canadian dollar.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$127.0 million as of December 31, 2011, from \$157.0 million at the end of 2010. Of this change, \$30.6 million was due to net outflows, offset by \$0.6 million of investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units lost 0.8%. Over the same time period, the Fund's benchmark index, the S&P 500 CAD Hedged (US\$), returned 1.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The U.S. stock market rose modestly during 2011, with most of the gains coming in the first half of the year. Over the third quarter, market weakness was particularly pronounced, as Europe's sovereign-debt crisis worsened and global growth expectations declined.

The leading market sectors in the first half of 2011 were Energy, Industrials and Materials, reflecting optimism about an economic recovery. During the second half of the year, sectors with a defensive posture, such as Consumer Staples and Utilities, led the market. For the year, these five sectors posted the strongest performances. However, most of the Fund's best-performing holdings were in other sectors. The top contributors to returns were El Paso Corp., Pfizer, Wal-Mart, Intel and McGraw-Hill. Sectors that detracted from the Fund's performance were Financials and Materials. Within the Financials sector, Allstate and Wells Fargo detracted significantly

from returns. In Materials, Alcoa and Nucor negatively impacted the Fund's performance. Overall, we decreased the number of holdings in the Fund during the year.

The Fund invests primarily in units of the Phillips, Hager & North U.S. Equity Fund, as well as instruments used for hedging currencies. Overall, the U.S. dollar strengthened against the Canadian dollar during the reporting period. This resulted in the Fund underperforming its unhedged version during the reporting period, on a pre-fee basis.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager's view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets.

We expect U.S. equity markets to continue to face significant challenges, including persistent economic weakness in Europe and parts of Asia, as well as unsettled U.S. fiscal policy. Countering this are strong company balance sheets, robust profitability, reasonable stock valuations and early signs of an improving U.S. economy. Given the challenges, we have balanced the portfolio between holdings that will benefit significantly from economic growth and those whose performance is steadier in weaker economic conditions. We continue to search for opportunities in both these areas.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.



***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>7.12</b>	<b>0.12</b>	<b>(0.14)</b>	<b>0.17</b>	<b>(0.22)</b>	<b>(0.07)</b>	–	–	<b>(0.01)</b>	–	<b>(0.01)</b>	<b>7.00</b>	
Dec. 31, 2010	6.64	0.13	(0.13)	0.35	0.33	0.68	–	–	(0.17)	–	(0.17)	7.12	
Dec. 31, 2009	5.99	0.34	(0.12)	0.90	0.98	2.10	(0.03)	–	(0.35)	–	(0.38)	6.64	
Dec. 31, 2008 <sup>3</sup>	5.54 <sup>†</sup>	0.42	(0.02)	(0.06)	(0.26)	0.08	–	–	–	–	–	5.99	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>7.12</b>	<b>0.12</b>	<b>(0.14)</b>	<b>0.17</b>	<b>(0.22)</b>	<b>(0.07)</b>	–	–	<b>(0.01)</b>	–	<b>(0.01)</b>	<b>7.00</b>	
Dec. 31, 2010 <sup>4</sup>	6.83 <sup>†</sup>	0.02	(0.02)	0.06	0.06	0.12	–	–	(0.17)	–	(0.17)	7.12	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>7.04</b>	<b>0.12</b>	<b>(0.12)</b>	<b>0.17</b>	<b>(0.22)</b>	<b>(0.05)</b>	–	–	<b>(0.01)</b>	–	<b>(0.01)</b>	<b>6.94</b>	
Dec. 31, 2010	6.57	0.13	(0.11)	0.34	0.33	0.69	–	(0.01)	(0.17)	–	(0.18)	7.04	
Dec. 31, 2009	5.92	0.15	(0.10)	0.68	0.31	1.04	(0.04)	–	(0.35)	–	(0.39)	6.57	
Dec. 31, 2008	9.73	0.27	(0.13)	(3.34)	(2.19)	(5.39)	(0.06)	–	–	–	(0.06)	5.92	
Dec. 31, 2007 <sup>5</sup>	9.73 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	9.73	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>7.02</b>	<b>0.12</b>	<b>(0.08)</b>	<b>0.17</b>	<b>(0.21)</b>	–	–	<b>(0.04)</b>	<b>(0.01)</b>	–	<b>(0.05)</b>	<b>6.92</b>	
Dec. 31, 2010	6.55	0.13	(0.08)	0.34	0.33	0.72	–	(0.05)	(0.17)	–	(0.22)	7.02	
Dec. 31, 2009	5.91	0.16	(0.07)	0.81	0.60	1.50	(0.08)	–	(0.35)	–	(0.43)	6.55	
Dec. 31, 2008	9.73	0.55	(0.10)	(2.01)	0.33	(1.23)	(0.09)	–	–	–	(0.09)	5.91	
Dec. 31, 2007	10.74	0.20	(0.15)	1.31	(1.26)	0.10	(0.08)	–	(0.99)	–	(1.07)	9.73	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>7.07</b>	<b>0.12</b>	<b>(0.06)</b>	<b>0.17</b>	<b>(0.22)</b>	<b>0.01</b>	–	<b>(0.06)</b>	<b>(0.01)</b>	–	<b>(0.07)</b>	<b>6.97</b>	
Dec. 31, 2010	6.61	0.13	(0.06)	0.34	0.33	0.74	–	(0.07)	(0.17)	–	(0.24)	7.07	
Dec. 31, 2009	5.97	0.20	(0.06)	0.74	0.42	1.30	(0.10)	–	(0.36)	–	(0.46)	6.61	
Dec. 31, 2008	9.73	2.26	(0.06)	(0.82)	2.42	3.80	(0.07)	–	–	–	(0.07)	5.97	
Dec. 31, 2007 <sup>5</sup>	9.73 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	9.73	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>7.09</b>	<b>0.12</b>	<b>(0.01)</b>	<b>0.17</b>	<b>(0.22)</b>	<b>0.06</b>	–	<b>(0.12)</b>	<b>(0.01)</b>	–	<b>(0.13)</b>	<b>6.99</b>	
Dec. 31, 2010	6.61	0.13	(0.01)	0.35	0.33	0.80	–	(0.13)	(0.17)	–	(0.30)	7.09	
Dec. 31, 2009	5.98	0.14	(0.01)	0.59	0.54	1.26	(0.16)	–	(0.36)	–	(0.52)	6.62	
Dec. 31, 2008	9.82	0.31	(0.01)	(2.22)	(0.77)	(2.69)	(0.15)	–	–	–	(0.15)	5.98	
Dec. 31, 2007	10.81	0.33	(0.02)	1.37	(2.18)	(0.50)	(0.19)	–	(1.01)	–	(1.20)	9.82	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From December 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>7.00</b>	<b>813</b>	<b>116</b>	<b>2.10</b>	<b>2.10</b>	<b>24.49</b>	<b>0.08</b>
Dec. 31, 2010	7.12	536	75	2.03	2.03	21.46	0.12
Dec. 31, 2009	6.64	279	42	1.97 <sup>2</sup>	2.50	70.08	0.10
Dec. 31, 2008 <sup>5</sup>	5.99	12	2	2.13	63.03	57.66	0.17
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>7.00</b>	<b>146</b>	<b>21</b>	<b>2.10</b>	<b>2.10</b>	<b>24.49</b>	<b>0.08</b>
Dec. 31, 2010 <sup>6</sup>	7.12	—	—	2.03	2.03	21.46	0.12
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>6.94</b>	<b>15</b>	<b>2</b>	<b>1.82</b>	<b>1.82</b>	<b>24.49</b>	<b>0.08</b>
Dec. 31, 2010	7.04	15	2	1.74	1.74	21.46	0.12
Dec. 31, 2009	6.57	14	2	1.72 <sup>2</sup>	6.05	70.08	0.10
Dec. 31, 2008	5.92	12	2	1.86	10.53	57.66	0.17
Dec. 31, 2007 <sup>7</sup>	9.73	—	—	—	—	33.18	—
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>6.92</b>	<b>42 322</b>	<b>6 118</b>	<b>1.25</b>	<b>1.25</b>	<b>24.49</b>	<b>0.08</b>
Dec. 31, 2010	7.02	69 691	9 928	1.19	1.19	21.46	0.12
Dec. 31, 2009	6.55	70 521	10 760	1.22 <sup>2</sup>	1.22	70.08	0.10
Dec. 31, 2008	5.91	40 692	6 881	1.32	1.32	57.66	0.17
Dec. 31, 2007	9.73	10 214	1 050	1.38	1.38	33.18	—
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>6.97</b>	<b>1 191</b>	<b>171</b>	<b>0.98</b>	<b>0.98</b>	<b>24.49</b>	<b>0.08</b>
Dec. 31, 2010	7.07	1 323	187	0.93	0.93	21.46	0.12
Dec. 31, 2009	6.61	1 138	172	0.93 <sup>2</sup>	1.03	70.08	0.10
Dec. 31, 2008	5.97	680	114	1.07	2.50	57.66	0.17
Dec. 31, 2007 <sup>7</sup>	9.73	—	—	—	—	33.18	—
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>6.99</b>	<b>82 513</b>	<b>11 812</b>	<b>0.14</b>	<b>0.14</b>	<b>24.49</b>	<b>0.08</b>
Dec. 31, 2010	7.09	85 345	12 040	0.11	0.11	21.46	0.12
Dec. 31, 2009	6.62	81 782	12 345	0.11 <sup>2</sup>	0.11	70.08	0.10
Dec. 31, 2008	5.98	48 962	8 186	0.21	0.21	57.66	0.17
Dec. 31, 2007	9.82	26 345	2 683	0.20	0.20	33.18	—

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.95%, Series B – 1.70%, Series D – 1.18%, Series F – 0.92%, Series O – 0.13%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From December 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.50%	33%	67%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

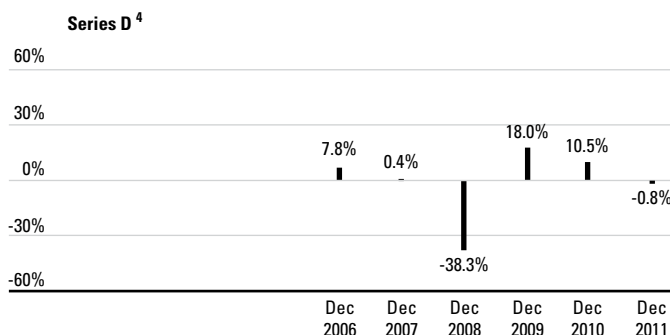
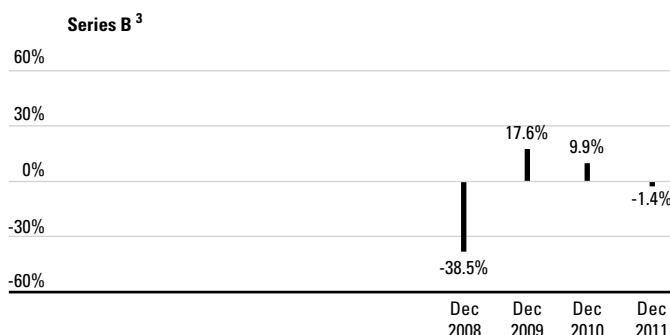
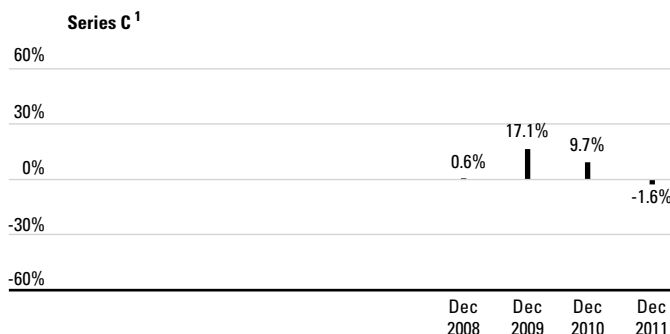
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

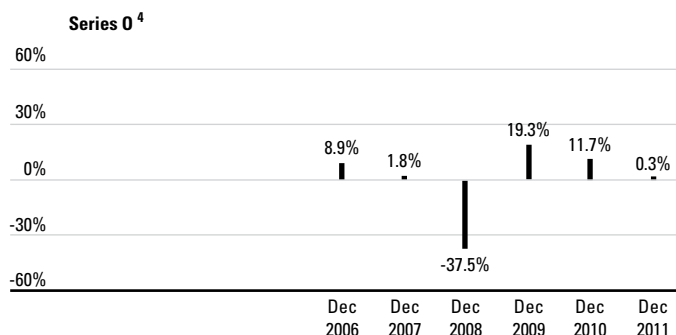
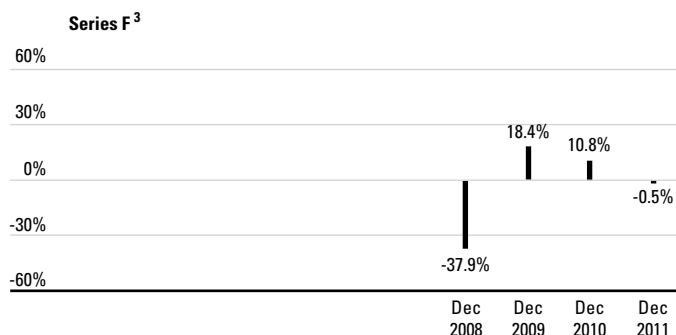
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P 500 CAD Hedged (US\$)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-1.6	8.1	—	—	10.1
Benchmark	1.7	12.7	—	—	12.8
Advisor Series <sup>2</sup>	-1.6	—	—	—	4.3
Benchmark	1.7	—	—	—	7.2
Series B <sup>3</sup>	-1.4	8.4	—	—	-5.9
Benchmark	1.7	12.7	—	—	-3.3
Series D <sup>4</sup>	-0.8	9.0	-4.3	—	-2.6
Benchmark	1.7	12.7	-1.9	—	0.3
Series F <sup>3</sup>	-0.5	9.3	—	—	-5.1
Benchmark	1.7	12.7	—	—	-3.3
Series O <sup>4</sup>	0.3	10.2	-3.2	—	-1.4
Benchmark	1.7	12.7	-1.9	—	0.3

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date December 2007.

<sup>4</sup> Inception date June 2006

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**S&P 500 CAD Hedged (US\$)** This index is a capitalization weighted index measuring the performance of 500 widely held common stocks representing all major industries in the United States. This index gives investors a broad measure of the overall performance of the U.S. stock market. The index is calculated by hedging beginning-of-period balance using rolling one-month forward contracts.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Health Care	17.6
Financials	16.7
Consumer Staples	13.7
Energy	13.5
Information Technology	13.2
Industrials	9.2
Consumer Discretionary	5.7
Materials	3.8
Utilities	3.1
Telecommunications	2.6
Cash/Other	0.9

**Top 25 Holdings\***

	% of Net Asset Value
Exxon Mobil Corp.	4.1
Wells Fargo & Company	4.0
Wal-Mart Stores Inc.	3.8
Berkshire Hathaway Inc., Class B	3.5
Johnson & Johnson	3.4
Cisco Systems Inc.	3.4
Microsoft Corp.	3.2
Sysco Corp.	3.2
Sempra Energy	3.1
El Paso Corp.	2.9
Illinois Tool Works Inc.	2.9
Becton Dickinson & Co.	2.9
Pfizer Inc.	2.5
PepsiCo Inc.	2.4
Gilead Sciences Inc.	2.3
United Technologies Corp.	2.3
Archer Daniels Midland Co.	2.3
Cash & Cash Equivalents	2.2
Brown & Brown Inc.	2.2
Google Inc., Class A	2.1
The Progressive Corp.	2.0
JPMorgan Chase & Co.	2.0
WellPoint Inc.	2.0
AT&T Inc.	1.9
Emerson Electric Co.	1.9
<b>Top 25 Holdings</b>	<b>68.5</b>

\* The Fund invests substantially all of its assets directly in the Phillips, Hager & North U.S. Equity Fund. The Top 25 Holdings, shown above, are the proportionate holdings of the Phillips, Hager & North U.S. Equity Fund.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

U.S. EQUITY FUND

**PHILLIPS, HAGER & NORTH  
U.S. GROWTH FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in a well-diversified portfolio of shares of large-capitalization, high-quality North American companies, with an emphasis on U.S. stocks. Where applicable, Canadian and Mexican securities that possess particularly attractive fundamentals will be added to the portfolio. However, the Fund's assets are primarily allocated to U.S. securities. To achieve the Fund's investment objective, we invest in businesses that we believe have a sustainable competitive advantage, promising growth opportunities, a history of profitability, a solid financial position, and a capable management team.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$104.9 million as of December 31, 2011, from \$90.2 million at the end of 2010. Of this change, \$14.6 million was due to net inflows and \$0.1 million to investment returns.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -0.3%. Over the same time period, the Fund's benchmark index, the S&P 500 Total Return Index (CDN\$), returned 4.3%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

During the reporting period, the U.S. equity markets produced a relatively low return of 2.1% in U.S. dollars, with the majority of the growth coming in the first half of the year. Over the third quarter, market weakness was particularly pronounced as global growth expectations were reduced due to concerns over the growing potential for sovereign defaults in Europe.

Within the market, the leading sectors over the first half of the year reflected ongoing economic recovery, such as the Energy, Industrials and Materials sectors. Over the second half of the year, sectors with a defensive posture, such as the Consumer Staples and Utilities sectors, posted positive returns. For the year, these five sectors were also the sectors with the best returns. However, most of the Fund's best-performing holdings were in other sectors. The top contributors

to positive Fund performance during the reporting period were IBM, Wal-Mart, Google, Johnson & Johnson and Intel. Sectors that detracted from the Fund's performance were the Financials and Materials sectors. Within the Financials sector, Aflac and Wells Fargo detracted significantly from returns of the Fund. In the Materials sector, Nabors Industries, Chesapeake Energy and Winnebago Industries detracted significantly from returns.

Overall, we decreased the number of holdings in the Fund during the year. We initiated new positions in Chesapeake Energy, National Oilwell Varco, PepsiCo, Becton Dickinson, Waters, Amphenol, Google, and Iridium. We eliminated a number of positions in the Fund, including Masco, American Eagle Outfitters, AutoZone, Home Depot, True Religion, Merck, Pfizer, Allstate, Dell, Motorola and AT&T. On account of market prices that overvalue companies, holdings of Mosaic, Wesco and Intel were reduced.

### Recent Developments

We expect the U.S. equities markets to continue to face a number of significant challenges, including persistent economic weakness in Europe and parts of Asia and an unsettled U.S. fiscal policy as the country heads into an election year. Countering this are strong company balance sheets, robust corporate profitability, reasonable stock valuations and early signs of an improving U.S. economy.

The slow economic recovery both in the United States and abroad, together with U.S. domestic political uncertainty, has combined to depress valuation levels in the U.S. market. There is an increasing opportunity in growth stocks as the valuation premium that has historically been applied to these companies has declined over the past several years. We are placing greater emphasis on stocks in this "bargain growth" category.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.



Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series and Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>10.92</b>	<b>0.15</b>	<b>(0.21)</b>	<b>(0.51)</b>	<b>0.44</b>	<b>(0.13)</b>	–	–	–	–	–	<b>10.81</b>
Dec. 31, 2010	10.24	0.17	(0.20)	(0.19)	0.90	0.68	–	–	–	–	–	10.92
Dec. 31, 2009	9.69	0.19	(0.20)	(0.60)	2.21	1.60	(0.07)	–	–	–	(0.07)	10.24
Dec. 31, 2008 <sup>3</sup>	8.89 <sup>†</sup>	0.05	(0.03)	(0.26)	1.69	1.45	(0.01)	–	–	–	(0.01)	9.69
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>10.92</b>	<b>0.15</b>	<b>(0.21)</b>	<b>(0.51)</b>	<b>0.44</b>	<b>(0.13)</b>	–	–	–	–	–	<b>10.81</b>
Dec. 31, 2010 <sup>4</sup>	10.56 <sup>†</sup>	0.03	(0.03)	(0.03)	0.15	0.12	–	–	–	–	–	10.92
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>10.90</b>	<b>0.16</b>	<b>(0.12)</b>	<b>(0.52)</b>	<b>0.44</b>	<b>(0.04)</b>	–	<b>(0.04)</b>	–	–	<b>(0.04)</b>	<b>10.82</b>
Dec. 31, 2010	10.15	0.17	(0.12)	(0.19)	0.90	0.76	–	(0.02)	–	–	(0.02)	10.90
Dec. 31, 2009	9.60	0.26	(0.12)	(0.67)	1.15	0.62	(0.15)	–	–	–	(0.15)	10.15
Dec. 31, 2008	11.64	0.22	(0.14)	(1.20)	(1.01)	(2.13)	(0.11)	–	–	–	(0.11)	9.60
Dec. 31, 2007	13.32	0.25	(0.16)	0.14	(1.90)	(1.67)	(0.03)	–	–	–	(0.03)	11.64
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>11.01</b>	<b>0.16</b>	<b>(0.10)</b>	<b>(0.52)</b>	<b>0.45</b>	<b>(0.01)</b>	–	<b>(0.07)</b>	–	–	<b>(0.07)</b>	<b>10.94</b>
Dec. 31, 2010	10.26	0.17	(0.09)	(0.19)	0.90	0.79	–	(0.05)	–	–	(0.05)	11.01
Dec. 31, 2009	9.71	0.25	(0.09)	(0.69)	1.71	1.18	(0.18)	–	–	–	(0.18)	10.26
Dec. 31, 2008 <sup>6</sup>	6.58 <sup>†</sup>	0.07	(0.02)	(0.08)	2.47	2.44	(0.02)	–	–	–	(0.02)	9.71
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>11.12</b>	<b>0.16</b>	<b>(0.01)</b>	<b>(0.53)</b>	<b>0.45</b>	<b>0.07</b>	–	<b>(0.17)</b>	–	–	<b>(0.17)</b>	<b>11.05</b>
Dec. 31, 2010	10.36	0.17	(0.01)	(0.19)	0.92	0.89	–	(0.15)	–	–	(0.15)	11.12
Dec. 31, 2009	9.80	0.27	(0.01)	(0.65)	1.06	0.67	(0.27)	–	–	–	(0.27)	10.36
Dec. 31, 2008	11.86	0.22	(0.01)	(1.22)	(1.21)	(2.22)	(0.21)	–	–	–	(0.21)	9.80
Dec. 31, 2007	13.55	0.27	(0.01)	0.05	(3.00)	(2.69)	(0.16)	–	–	–	(0.16)	11.86

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From October 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.81</b>	<b>495</b>	<b>46</b>	<b>2.00</b>	<b>2.00</b>	<b>29.47</b>	<b>0.06</b>
Dec. 31, 2010	10.93	332	30	1.98	1.98	38.82	0.09
Dec. 31, 2009	10.24	253	25	2.06 <sup>2</sup>	2.25	19.23	0.07
Dec. 31, 2008 <sup>5</sup>	9.70	21	2	2.04	44.18	39.61	0.11
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.81</b>	<b>93</b>	<b>9</b>	<b>2.00</b>	<b>2.00</b>	<b>29.47</b>	<b>0.06</b>
Dec. 31, 2010 <sup>6</sup>	10.93	—	—	1.98	1.98	38.82	0.09
<b>Series D<sup>7</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.83</b>	<b>56 550</b>	<b>5 222</b>	<b>1.22</b>	<b>1.22</b>	<b>29.47</b>	<b>0.06</b>
Dec. 31, 2010	10.90	49 817	4 571	1.19	1.19	38.82	0.09
Dec. 31, 2009	10.16	46 561	4 584	1.24 <sup>2</sup>	1.24	19.23	0.07
Dec. 31, 2008	9.61	48 530	5 048	1.25	1.25	39.61	0.11
Dec. 31, 2007	11.73	81 411	6 940	1.22	1.22	39.47	0.10
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.94</b>	<b>366</b>	<b>33</b>	<b>0.96</b>	<b>0.96</b>	<b>29.47</b>	<b>0.06</b>
Dec. 31, 2010	11.01	330	30	0.93	0.93	38.82	0.09
Dec. 31, 2009	10.26	303	30	1.02 <sup>2</sup>	1.02	19.23	0.07
Dec. 31, 2008 <sup>8</sup>	9.72	347	36	1.05	4.03	39.61	0.11
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>11.05</b>	<b>47 454</b>	<b>4 293</b>	<b>0.08</b>	<b>0.08</b>	<b>29.47</b>	<b>0.06</b>
Dec. 31, 2010	11.12	39 796	3 578	0.08	0.08	38.82	0.09
Dec. 31, 2009	10.37	31 530	3 041	0.08 <sup>2</sup>	0.08	19.23	0.07
Dec. 31, 2008	9.81	30 576	3 116	0.08	0.08	39.61	0.11
Dec. 31, 2007	11.95	49 302	4 127	0.07	0.07	39.47	0.10

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.94%, Series D – 1.16%, Series F – 0.90%, Series O – 0.08%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> Series D was known as Series A prior to November 17, 2008.

<sup>8</sup> From October 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

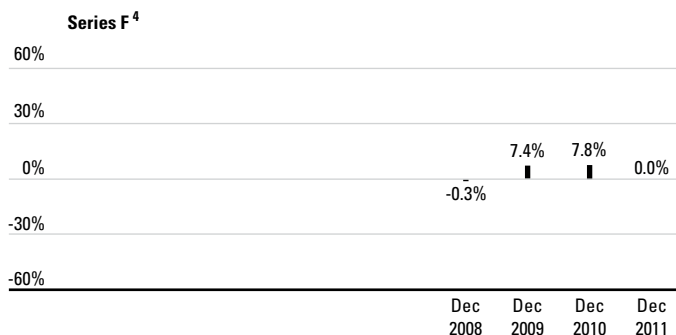
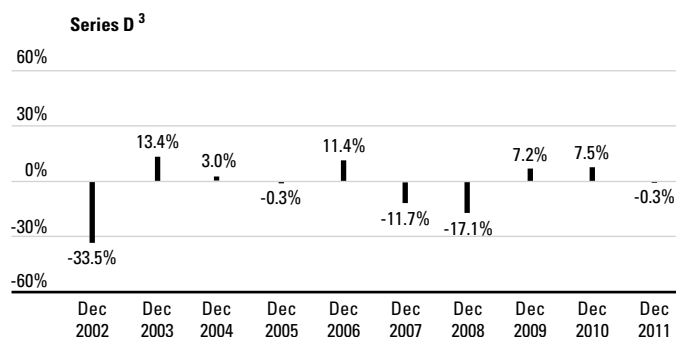
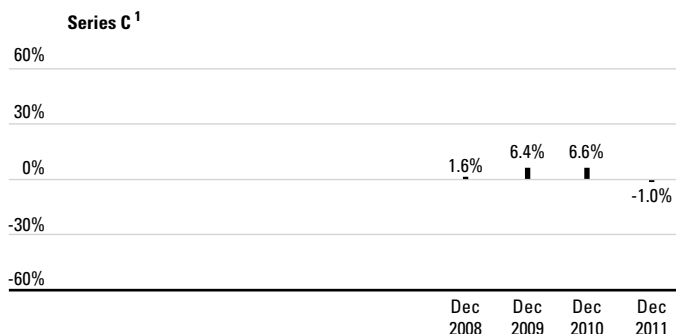
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

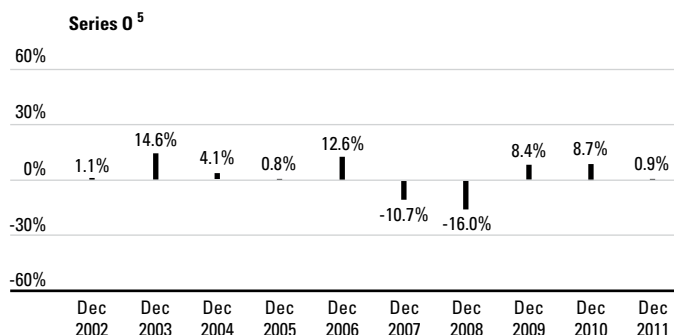
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



### PAST PERFORMANCE (cont.)



### Annual Compound Returns (%)

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

S&P 500 Total Return Index (CDN\$)

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-1.0	3.9	—	—	4.4
Benchmark	4.3	7.0	—	—	7.0
Advisor Series <sup>2</sup>	-1.0	—	—	—	2.1
Benchmark	4.3	—	—	—	7.5
Series D <sup>3</sup>	-0.3	4.8	-3.4	-3.2	—
Benchmark	4.3	7.0	-2.9	-1.6	—
Series F <sup>4</sup>	0.0	5.0	—	—	4.6
Benchmark	4.3	7.0	—	—	5.4
Series O <sup>5</sup>	0.9	5.9	-2.3	—	2.2
Benchmark	4.3	7.0	-2.9	—	1.2

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date September 1992.

<sup>4</sup> Inception date October 2008.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

### INDEX DESCRIPTION

**S&P 500 Total Return Index (CDN\$)** This index is a capitalization weighted index measuring the Canadian dollar performance of 500 widely held common stocks representing all major industries in the United States. This index gives investors a broad measure of the overall performance of the U.S. stock market.

### SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

#### Investment Mix

	% of Net Asset Value
Information Technology	24.5
Financials	15.7
Health Care	14.2
Industrials	12.8
Consumer Discretionary	9.0
Energy	8.3
Consumer Staples	7.4
Materials	5.2
Telecommunications	0.8
Cash/Other	2.1

#### Top 25 Holdings

	% of Net Asset Value
International Business Machines	4.4
Microsoft Corp.	4.2
Brown & Brown Inc.	4.1
The Progressive Corp.	4.1
Varian Medical Systems Inc.	4.1
Danaher Corp.	3.7
United Technologies Corp.	3.6
Cisco Systems Inc.	3.5
Wal-Mart Stores Inc.	3.4
Wells Fargo & Company	3.1
Johnson & Johnson	3.1
General Electric Company	3.0
Google Inc., Class A	2.9
Carmax Inc.	2.8
Becton Dickinson & Co.	2.7
Scansource Inc.	2.7
Sysco Corp.	2.6
Commercial Metals Co.	2.5
Johnson Controls Inc.	2.4
McGraw-Hill Companies Inc.	2.3
Tidewater Inc.	2.2
Gilead Sciences Inc.	2.2
Aflac Inc.	2.2
QUALCOMM Inc.	2.2
Waters Corp.	2.1
Top 25 Holdings	76.1

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

INTERNATIONAL EQUITY FUND

**PHILLIPS, HAGER & NORTH  
OVERSEAS EQUITY FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

Sub-Advisor: Sky Investment Counsel Inc. ("Sky")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing in common stocks in companies located in countries outside North America, including countries in Europe, the Far East (including Japan), and Australia. To achieve the Fund's investment objective, we invest in companies that are attractively valued, possess sound fundamentals and have a strong market position.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$835.9 million as of December 31, 2011, from \$1.05 billion at the end of 2010. Of this change, \$2.1 million was due to net outflows and \$215.4 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -20.4%. Over the same period, the Fund's benchmark, the MSCI EAFE Total Return Index (CDN \$), returned -10.3%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Overseas markets faced challenges this year as renewed pessimism meant investors focused less on valuation and more on holdings with defensive characteristics. We believe that the recent performance of stocks has been primarily a function of a stock's perceived riskiness rather than its fundamental strength.

It has been a difficult year for our process, which focuses on buying companies at low valuations. A significant detractor from Fund performance came from Cable & Wireless Worldwide, a U.K.-based telecommunications company that experienced significant share price declines. Despite the challenges, we continue to see value in this company.

Other stocks that negatively affected Fund performance included Renault and Thomas Cook. Renault is attractively valued at 0.3 times book value and has investments in Nissan, Daimler and Volvo which exceed the market value of the company, and we still see value in the company. Thomas Cook saw its business weaken from tougher economic conditions as well as adverse weather events and political uncertainty at many of its destinations.

With the uncertainty of the political outcome in Europe affecting global confidence and growth, our strategy has been to increase exposure to businesses that can pay healthy dividends as well as those which have some visibility to their revenues.

One of the most meaningful changes we made to the Fund came from increasing exposure to the Health Care sector. Pharmaceutical companies are trading at low valuations on a historical basis and provide defensive growth characteristics as well as attractive dividend yields. Our holdings in each of Sanofi, Roche and Novartis have dividend yields of between 4% and 5%. Furthermore, pharmaceutical companies will benefit from the trends of an aging population in developed countries.

Overall, we plan to focus on companies that are attractively valued with good dividend yields, where businesses are strong enough to weather tough economic conditions.

### Recent Developments

In Europe, we have witnessed greater political will to come to a unified solution as the consequences of failing to reach a unified solution are unfavourable for all countries concerned. In Asia, there is a risk that China may be facing a property bubble. In any case, it is likely that growth in that region will be lower than it has been in the last few years.

Share prices have corrected as a result of these factors. Despite the fact that governments continue to hold too much debt, the majority of companies have sound balance sheets. There are many good-quality companies selling at low prices today and, for the first time in many years, dividend yields are higher than bond yields in many countries.

The Fund is positioned to benefit from attractive dividend yields and from potential share-price increases of companies which are selling at historically low valuations.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

***Sub-Advisor***

Sky is the sub-advisor and provides investment advice for the Fund. RBC GAM has a non-controlling interest in Sky. The fees paid to Sky are paid by RBC GAM and not the Fund.

***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>10.36</b>	<b>0.37</b>	<b>(0.20)</b>	<b>(0.42)</b>	<b>(1.94)</b>	<b>(2.19)</b>	–	<b>(0.21)</b>	–	–	<b>(0.21)</b>	<b>7.97</b>	
Dec. 31, 2010	10.12	0.29	(0.20)	0.63	(0.39)	0.33	–	(0.04)	–	–	(0.04)	10.36	
Dec. 31, 2009	8.24	0.35	(0.19)	0.09	2.73	2.98	(0.11)	–	–	–	(0.11)	10.12	
Dec. 31, 2008 <sup>3</sup>	7.84 <sup>†</sup>	0.03	(0.02)	(0.51)	2.36	1.86	(0.26)	–	–	–	(0.26)	8.24	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>10.36</b>	<b>0.37</b>	<b>(0.20)</b>	<b>(0.42)</b>	<b>(1.94)</b>	<b>(2.19)</b>	–	<b>(0.21)</b>	–	–	<b>(0.21)</b>	<b>7.97</b>	
Dec. 31, 2010 <sup>4</sup>	10.48 <sup>†</sup>	0.05	(0.03)	0.10	(0.06)	0.06	–	(0.04)	–	–	(0.04)	10.36	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>10.34</b>	<b>0.38</b>	<b>(0.19)</b>	<b>(0.42)</b>	<b>(1.94)</b>	<b>(2.17)</b>	–	<b>(0.22)</b>	–	–	<b>(0.22)</b>	<b>7.96</b>	
Dec. 31, 2010	10.10	0.29	(0.19)	0.63	(0.39)	0.34	–	(0.06)	–	–	(0.06)	10.34	
Dec. 31, 2009	8.20	0.32	(0.18)	(0.33)	2.19	2.00	(0.13)	–	–	–	(0.13)	10.10	
Dec. 31, 2008	12.42	0.42	(0.21)	(3.08)	(1.29)	(4.16)	(0.27)	–	–	–	(0.27)	8.20	
Dec. 31, 2007 <sup>5</sup>	14.26 <sup>†</sup>	0.11	(0.13)	(0.59)	(0.48)	(1.09)	(0.09)	–	(0.18)	–	(0.27)	12.42	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>10.29</b>	<b>0.37</b>	<b>(0.13)</b>	<b>(0.42)</b>	<b>(1.94)</b>	<b>(2.12)</b>	–	<b>(0.28)</b>	–	–	<b>(0.28)</b>	<b>7.91</b>	
Dec. 31, 2010	10.06	0.29	(0.13)	0.63	(0.39)	0.40	–	(0.13)	–	–	(0.13)	10.29	
Dec. 31, 2009	8.18	0.32	(0.11)	(0.31)	2.15	2.05	(0.20)	–	–	–	(0.20)	10.06	
Dec. 31, 2008	12.36	0.46	(0.15)	(3.08)	(1.18)	(3.95)	(0.33)	–	–	–	(0.33)	8.18	
Dec. 31, 2007	14.29	0.37	(0.21)	1.13	(2.76)	(1.47)	(0.16)	–	(0.19)	–	(0.35)	12.36	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>9.81</b>	<b>0.36</b>	<b>(0.09)</b>	<b>(0.40)</b>	<b>(1.85)</b>	<b>(1.98)</b>	–	<b>(0.29)</b>	–	–	<b>(0.29)</b>	<b>7.55</b>	
Dec. 31, 2010	9.59	0.28	(0.10)	0.60	(0.37)	0.41	–	(0.15)	–	–	(0.15)	9.81	
Dec. 31, 2009	7.80	0.27	(0.09)	0.09	1.71	1.98	(0.21)	–	–	–	(0.21)	9.59	
Dec. 31, 2008	12.38	0.13	(0.08)	(7.28)	14.30	7.07	(0.34)	–	–	–	(0.34)	7.80	
Dec. 31, 2007 <sup>5</sup>	14.26 <sup>†</sup>	0.13	(0.10)	(0.20)	(1.97)	(2.14)	(0.15)	–	(0.18)	–	(0.33)	12.38	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>10.50</b>	<b>0.38</b>	<b>(0.01)</b>	<b>(0.43)</b>	<b>(1.99)</b>	<b>(2.05)</b>	–	<b>(0.40)</b>	–	–	<b>(0.40)</b>	<b>8.08</b>	
Dec. 31, 2010	10.27	0.30	(0.01)	0.64	(0.40)	0.53	–	(0.27)	–	–	(0.27)	10.50	
Dec. 31, 2009	8.36	0.32	–	(0.26)	2.16	2.22	(0.32)	–	–	–	(0.32)	10.27	
Dec. 31, 2008	12.60	0.46	(0.01)	(3.39)	(0.90)	(3.84)	(0.44)	–	–	–	(0.44)	8.36	
Dec. 31, 2007	14.54	0.36	(0.01)	0.87	(2.83)	(1.61)	(0.34)	–	(0.19)	–	(0.53)	12.60	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From June 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>7.97</b>	<b>2 433</b>	<b>305</b>	<b>2.21</b>	<b>2.21</b>	<b>65.57</b>	<b>0.34</b>
Dec. 31, 2010	10.36	1 765	170	2.16	2.16	76.17	0.34
Dec. 31, 2009	10.14	1 174	116	2.09 <sup>2</sup>	2.16	75.28	0.36
Dec. 31, 2008 <sup>5</sup>	8.25	41	5	1.90	57.52	110.38	0.55
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>7.97</b>	<b>522</b>	<b>65</b>	<b>2.21</b>	<b>2.21</b>	<b>65.57</b>	<b>0.34</b>
Dec. 31, 2010 <sup>6</sup>	10.36	42	4	2.16	2.16	76.17	0.34
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>7.96</b>	<b>113</b>	<b>14</b>	<b>2.09</b>	<b>2.09</b>	<b>65.57</b>	<b>0.34</b>
Dec. 31, 2010	10.34	197	19	2.05	2.05	76.17	0.34
Dec. 31, 2009	10.12	219	22	1.98 <sup>2</sup>	2.23	75.28	0.36
Dec. 31, 2008	8.23	213	26	2.01	2.28	110.38	0.55
Dec. 31, 2007 <sup>7</sup>	12.48	411	33	1.99	2.62	70.75	0.46
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>7.92</b>	<b>213 563</b>	<b>26 982</b>	<b>1.39</b>	<b>1.39</b>	<b>65.57</b>	<b>0.34</b>
Dec. 31, 2010	10.29	316 624	30 758	1.35	1.35	76.17	0.34
Dec. 31, 2009	10.07	342 829	34 038	1.28 <sup>2</sup>	1.28	75.28	0.36
Dec. 31, 2008	8.20	293 479	35 784	1.41	1.41	110.38	0.55
Dec. 31, 2007	12.42	533 070	42 906	1.46	1.46	70.75	0.46
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>7.55</b>	<b>3 931</b>	<b>521</b>	<b>1.10</b>	<b>1.10</b>	<b>65.57</b>	<b>0.34</b>
Dec. 31, 2010	9.81	4 385	447	1.08	1.08	76.17	0.34
Dec. 31, 2009	9.61	3 312	345	1.04 <sup>2</sup>	1.05	75.28	0.36
Dec. 31, 2008	7.83	1 081	138	1.05	1.54	110.38	0.55
Dec. 31, 2007 <sup>7</sup>	12.44	16	1	1.46	13.29	70.75	0.46
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>8.08</b>	<b>615 435</b>	<b>76 209</b>	<b>0.09</b>	<b>0.09</b>	<b>65.57</b>	<b>0.34</b>
Dec. 31, 2010	10.51	730 600	69 548	0.09	0.09	76.17	0.34
Dec. 31, 2009	10.28	617 249	60 029	0.04 <sup>2</sup>	0.04	75.28	0.36
Dec. 31, 2008	8.38	494 318	58 977	0.09	0.09	110.38	0.55
Dec. 31, 2007	12.66	624 438	49 325	0.07	0.07	70.75	0.46

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 2.09%, Series B – 2.00%, Series D – 1.31%, Series F – 1.05%, Series O – 0.08%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From June 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.85%	54%	46%
Advisor Series	1.85%	54%	46%
Series B	1.75%	29%	71%
Series D	1.10%	23%	77%
Series F	0.85%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

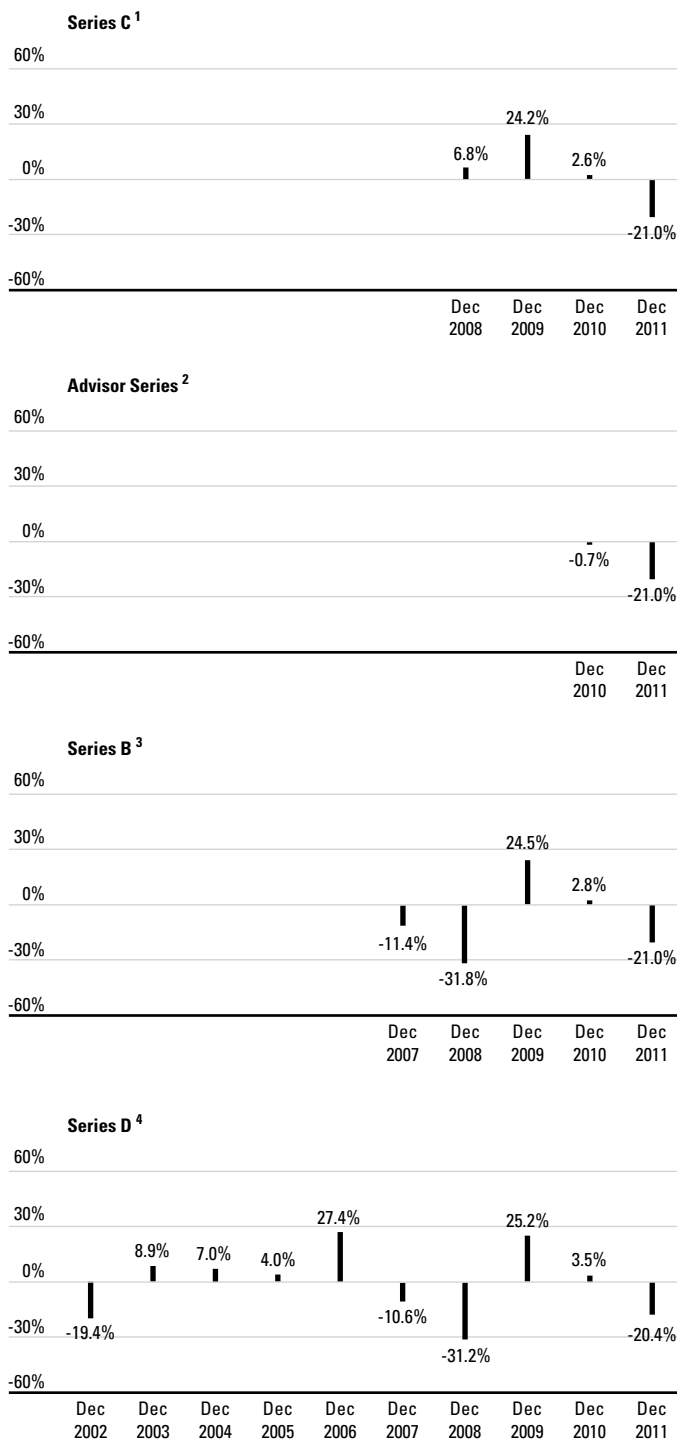
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

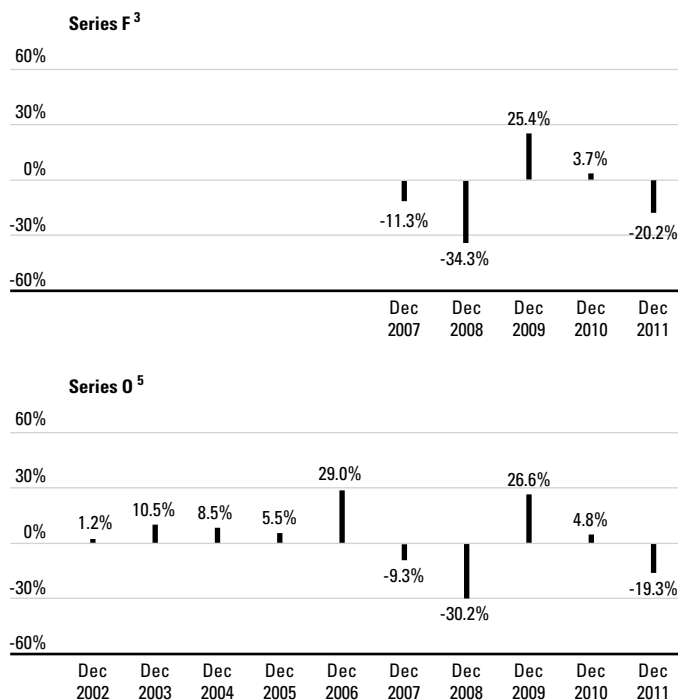
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**MSCI EAFE Total Return Index (CDN\$)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-21.0	0.2	—	—	2.4
Benchmark	-10.3	1.0	—	—	2.7
Advisor Series <sup>2</sup>	-21.0	—	—	—	-18.8
Benchmark	-10.3	—	—	—	-8.4
Series B <sup>3</sup>	-21.0	0.4	—	—	-10.4
Benchmark	-10.3	1.0	—	—	-8.2
Series D <sup>4</sup>	-20.4	1.0	-8.7	-2.3	—
Benchmark	-10.3	1.0	-7.2	0.1	—
Series F <sup>3</sup>	-20.2	1.3	—	—	-10.5
Benchmark	-10.3	1.0	—	—	-8.2
Series O <sup>5</sup>	-19.3	2.3	-7.5	—	1.3
Benchmark	-10.3	1.0	-7.2	—	2.3

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2007.

<sup>4</sup> Inception date December 2000.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**MSCI EAFE Total Return Index (CDN\$)** This index is a broad measure of the Canadian dollar performance of stocks from developed equity markets covering countries in Europe, Australasia and the Far East.

## SUMMARY OF INVESTMENT PORTFOLIO

*(after consideration of derivative products, if any)*

As at December 31, 2011

### Investment Mix – Sectors

	% of Net Asset Value
Health Care	16.6
Financials	16.5
Industrials	14.3
Telecommunication Services	12.3
Energy	12.1
Consumer Discretionary	10.0
Utilities	6.3
Consumer Staples	4.1
Materials	3.8
Information Technology	1.7
Cash/Other	2.3

### Investment Mix – Countries/Regions

	% of Net Asset Value
Europe ex U.K. Equities	42.0
U.K. Equities	24.4
Japan Equities	13.9
Pacific ex. Japan Equities	10.0
Latin America Equities	5.0
U.S. Equities	1.7
Middle East & Africa Equities	0.7
Cash/Other	2.3

## Top 25 Holdings

	% of Net Asset Value
Sanofi	5.3
ENI S.p.A.	5.0
Roche Holdings AG Genussscheine	4.5
Cable & Wireless Worldwide Plc.	3.8
Teva Pharmaceutical Industries Ltd. ADR	3.5
GDF Suez	3.3
Nippon Telegraph & Telephone Corp.	3.2
Catlin Group Ltd.	3.2
G4S Plc.	3.1
Renault S.A.	3.1
Firstgroup Plc.	3.1
China Mobile (Hong Kong) Ltd.	2.6
Cia de Saneamento Basico do Estado de Sao Paulo ADR	2.5
UBS AG	2.4
Casino Guichard Perrachon S.A.	2.4
Carillion Plc.	2.4
Sankyo Co. Ltd.	2.3
Vodafone Group Plc.	2.1
Cash & Cash Equivalents	2.1
Novartis AG	2.0
Petroleo Brasileiro S.A. ADR	2.0
Mitsubishi Corp.	1.7
Transocean Ltd.	1.7
Macquarie Group Ltd.	1.6
Muenchener Rueckversicherungs-Gesellschaft AG	1.5
<b>Top 25 Holdings</b>	<b>70.4</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

INTERNATIONAL EQUITY FUND

**PHILLIPS, HAGER & NORTH  
CURRENCY-HEDGED OVERSEAS  
EQUITY FUND**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth primarily through exposure to a diversified portfolio of companies located in countries outside North America, including countries in Europe, the Far East (including Japan), and Australia, while minimizing fluctuations in the value of foreign currencies relative to the Canadian dollar. To achieve the Fund's investment objective, we invest primarily in units of the Phillips, Hager & North Overseas Equity Fund (the "Underlying Fund"), as well as derivative instruments that are used to hedge against fluctuations in the value of foreign currencies relative to the Canadian dollar.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$186.2 million as of December 31, 2011, from \$204.5 million at the end of 2010. Of this change, \$47.5 million was due to investment losses, offset by \$29.2 million of net inflows.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -22.0%. Over the same period, the Fund's benchmark, the MSCI EAFE Total Return Index (local currency), returned -12.2%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

Overseas markets faced challenges this year as renewed pessimism meant investors focused less on valuation and more on holdings with defensive characteristics. It was a difficult year for our process, which focuses on buying companies at low valuations. A significant detractor to Fund performance was Cable & Wireless Worldwide, a U.K.-based telecommunications company whose stock declined significantly. Despite the challenges, we continue to see value in this company.

Other stocks that negatively affected performance included automaker Renault and Thomas Cook, the travel and vacation-package company. The book value of Renault, which has investments in Nissan, Daimler and Volvo, exceeds the market value of the company, and we still see value in the stock. Thomas Cook's business weakened because of tougher economic conditions, as well as bad weather and political uncertainty at many of its destinations.

With the crisis in Europe affecting global confidence and growth, our strategy was to increase exposure to businesses that can pay healthy dividends and offer more predictable revenues. As a result, one of the most significant changes we made to the Fund was to increase exposure to the Health Care sector. Pharmaceutical companies are trading at low valuations on a historical basis, and can provide earnings growth in a slow economy, as well as attractive dividend yields. Our holdings in Sanofi, Roche and Novartis had dividend yields of 4% to 5%. Furthermore, pharmaceutical companies should benefit from the trends of an aging population in developed countries.

The Fund invests primarily in units of the Phillips, Hager & North Overseas Equity Fund as well as instruments used for hedging currencies. Overall, the Canadian dollar weakened against the EAFE local currencies in 2011. This resulted in the Fund outperforming its unhedged version during the reporting period, on a pre-fee basis.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in our view is that Europe muddles through the current crisis. Assuming this outcome, we expect any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets.

We believe that the recent performance of stocks has been primarily a function of their perceived riskiness rather than fundamental strength. When investors begin to recognize company-specific differences and value the stocks accordingly, we should see valuations begin to rise. There are many good-quality companies selling at low prices today and, for the first time in many years, dividend yields are higher than bond yields. We plan to continue to focus on companies that are attractively valued with good dividend yields and businesses that are strong enough to weather tough economic conditions.

### **Related-Party Transactions**

#### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients’ Series C, Advisor Series or Series D units.

#### ***Trustee and Custodian***

RBC Dexia Investor Services Trust (“RBC Dexia”) is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund’s property on behalf of unitholders and holds the assets of the Fund.

#### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors (“BoG”) in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

#### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

#### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

**Change in Net Assets Per Unit (\$)**

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>8.72</b>	<b>0.35</b>	<b>(0.16)</b>	<b>(0.32)</b>	<b>(1.86)</b>	<b>(1.99)</b>	–	<b>(0.16)</b>	–	–	<b>(0.16)</b>	<b>6.59</b>
Dec. 31, 2010	8.22	0.24	(0.17)	0.56	0.05	0.68	–	(0.03)	(0.04)	–	(0.07)	8.72
Dec. 31, 2009	5.94	0.73	(0.16)	(0.20)	2.19	2.56	(0.07)	–	–	–	(0.07)	8.22
Dec. 31, 2008 <sup>3</sup>	6.01 <sup>†</sup>	0.32	(0.02)	(0.24)	0.13	0.19	(0.25)	–	–	–	(0.25)	5.94
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>8.72</b>	<b>0.35</b>	<b>(0.16)</b>	<b>(0.32)</b>	<b>(1.86)</b>	<b>(1.99)</b>	–	<b>(0.16)</b>	–	–	<b>(0.16)</b>	<b>6.59</b>
Dec. 31, 2010 <sup>4</sup>	8.53 <sup>†</sup>	0.04	(0.03)	0.09	0.01	0.11	–	(0.03)	(0.04)	–	(0.07)	8.72
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>8.49</b>	<b>0.34</b>	<b>(0.10)</b>	<b>(0.31)</b>	<b>(1.84)</b>	<b>(1.91)</b>	–	<b>(0.21)</b>	–	–	<b>(0.21)</b>	<b>6.41</b>
Dec. 31, 2010	8.01	0.24	(0.11)	0.56	0.05	0.74	–	(0.10)	(0.04)	–	(0.14)	8.49
Dec. 31, 2009	5.92	0.26	(0.09)	(0.01)	2.22	2.38	(0.14)	–	–	–	(0.14)	8.01
Dec. 31, 2008	10.75	1.15	(0.11)	(1.84)	(3.13)	(3.93)	(0.27)	–	–	–	(0.27)	5.92
Dec. 31, 2007	11.64	0.34	(0.21)	1.04	(1.95)	(0.78)	(0.12)	–	(0.58)	–	(0.70)	10.75
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>8.56</b>	<b>0.34</b>	<b>(0.08)</b>	<b>(0.31)</b>	<b>(1.84)</b>	<b>(1.89)</b>	–	<b>(0.23)</b>	–	–	<b>(0.23)</b>	<b>6.46</b>
Dec. 31, 2010	8.08	0.24	(0.08)	0.56	0.05	0.77	–	(0.13)	(0.04)	–	(0.17)	8.56
Dec. 31, 2009	5.98	0.24	(0.07)	(0.04)	1.97	2.10	(0.17)	–	–	–	(0.17)	8.08
Dec. 31, 2008	10.75	5.51	(0.08)	(0.41)	0.31	5.33	(0.23)	–	–	–	(0.23)	5.98
Dec. 31, 2007 <sup>6</sup>	10.75 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	10.75
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>8.60</b>	<b>0.34</b>	<b>(0.01)</b>	<b>(0.32)</b>	<b>(1.86)</b>	<b>(1.85)</b>	–	<b>(0.30)</b>	–	–	<b>(0.30)</b>	<b>6.49</b>
Dec. 31, 2010	8.12	0.24	(0.01)	0.56	0.05	0.84	–	(0.21)	(0.04)	–	(0.25)	8.60
Dec. 31, 2009	6.01	0.25	(0.01)	(0.03)	2.16	2.37	(0.24)	–	–	–	(0.24)	8.12
Dec. 31, 2008	10.83	0.75	(0.01)	(1.57)	(3.30)	(4.13)	(0.33)	–	–	–	(0.33)	6.01
Dec. 31, 2007	11.71	0.30	(0.02)	1.07	(1.43)	(0.08)	(0.27)	–	(0.60)	–	(0.87)	10.83

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From December 2007.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>6.59</b>	<b>474</b>	<b>72</b>	<b>2.30</b>	<b>2.30</b>	<b>22.35</b>	<b>0.34</b>
Dec. 31, 2010	8.72	369	42	2.24	2.24	20.15	0.34
Dec. 31, 2009	8.22	150	18	2.12 <sup>2</sup>	3.27	35.60	0.56
Dec. 31, 2008 <sup>5</sup>	5.94	1	–	2.43	234.15	39.02	1.02
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>6.59</b>	<b>11</b>	<b>2</b>	<b>2.30</b>	<b>2.30</b>	<b>22.35</b>	<b>0.34</b>
Dec. 31, 2010 <sup>6</sup>	8.72	–	–	2.24	2.24	20.15	0.34
<b>Series D<sup>7</sup></b>							
<b>Dec. 31, 2011</b>	<b>6.41</b>	<b>42 109</b>	<b>6 573</b>	<b>1.48</b>	<b>1.48</b>	<b>22.35</b>	<b>0.34</b>
Dec. 31, 2010	8.49	59 969	7 067	1.44	1.44	20.15	0.34
Dec. 31, 2009	8.01	52 624	6 573	1.35 <sup>2</sup>	1.35	35.60	0.56
Dec. 31, 2008	5.92	33 779	5 707	1.58	1.58	39.02	1.02
Dec. 31, 2007	10.75	6 421	597	1.78	1.78	22.01	–
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>6.46</b>	<b>794</b>	<b>123</b>	<b>1.21</b>	<b>1.21</b>	<b>22.35</b>	<b>0.34</b>
Dec. 31, 2010	8.56	626	73	1.17	1.17	20.15	0.34
Dec. 31, 2009	8.08	415	51	1.07 <sup>2</sup>	1.24	35.60	0.56
Dec. 31, 2008	5.98	318	53	1.33	3.93	39.02	1.02
Dec. 31, 2007 <sup>8</sup>	10.75	–	–	–	–	22.01	–
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>6.49</b>	<b>142 835</b>	<b>22 010</b>	<b>0.25</b>	<b>0.25</b>	<b>22.35</b>	<b>0.34</b>
Dec. 31, 2010	8.60	143 589	16 697	0.24	0.24	20.15	0.34
Dec. 31, 2009	8.12	106 324	13 096	0.15 <sup>2</sup>	0.15	35.60	0.56
Dec. 31, 2008	6.01	74 410	12 388	0.25	0.25	39.02	1.02
Dec. 31, 2007	10.83	33 911	3 131	0.22	0.22	22.01	–

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 2.16%, Series D – 1.40%, Series F – 1.14%, Series O – 0.23%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> Series D was known as Series A prior to November 17, 2008.

<sup>8</sup> From December 2007.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.85%	54%	46%
Advisor Series	1.85%	54%	46%
Series D	1.10%	23%	77%
Series F	0.85%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

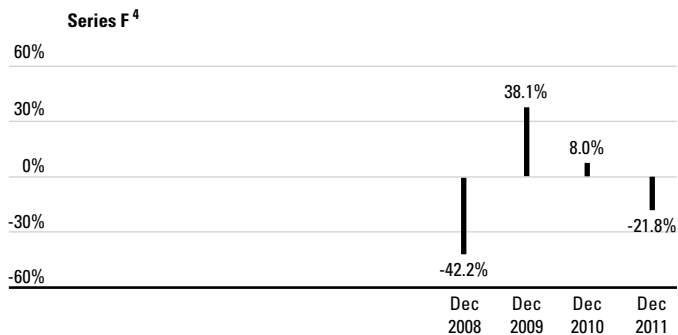
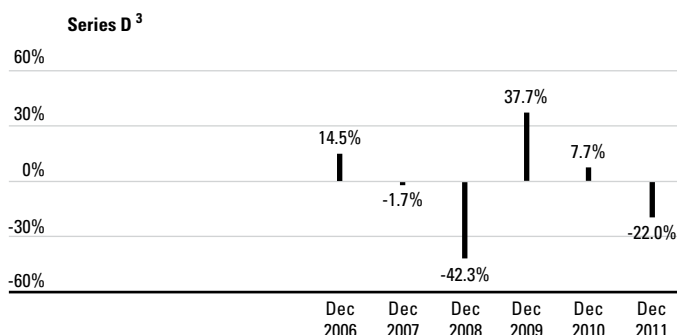
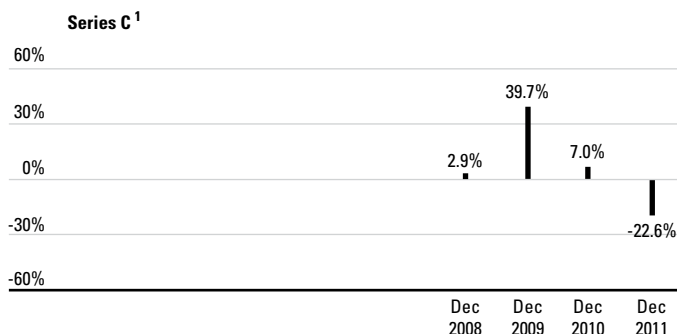
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

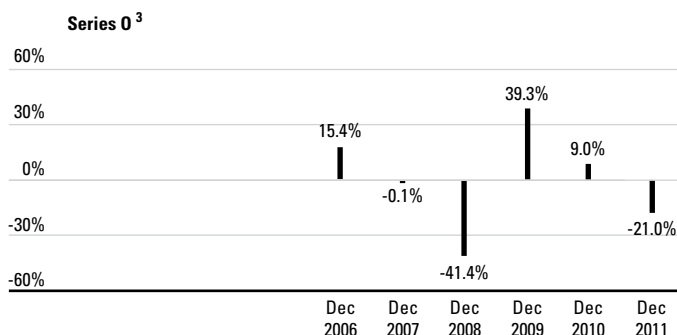
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**MSCI EAFE Total Return Index (local currency)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-22.6	5.0	—	—	5.8
Benchmark	-12.2	4.7	—	—	5.0
Advisor Series <sup>2</sup>	-22.6	—	—	—	-17.6
Benchmark	-12.2	—	—	—	-7.7
Series D <sup>3</sup>	-22.0	5.0	-8.1	—	-5.1
Benchmark	-12.2	4.7	-6.6	—	-4.0
Series F <sup>4</sup>	-21.8	5.3	—	—	-9.4
Benchmark	-12.2	4.7	—	—	-9.0
Series O <sup>3</sup>	-21.0	6.2	-6.8	—	-3.8
Benchmark	-12.2	4.7	-6.6	—	-4.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2006.

<sup>4</sup> Inception date December 2007.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**MSCI EAFE Total Return Index (local currency)** This index is a broad measure of the local currency performance of major stock markets in Europe, Australasia and the Far East.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix – Sectors**

	% of Net Asset Value
Health Care	16.3
Financials	16.2
Industrials	14.0
Telecommunication Services	12.0
Energy	11.8
Consumer Discretionary	9.8
Utilities	6.2
Consumer Staples	4.0
Materials	3.8
Information Technology	1.7
Cash/Other	4.2

**Investment Mix – Countries/Regions**

	% of Net Asset Value
Europe ex U.K. Equities	41.2
U.K. Equities	24.0
Japan Equities	13.6
Pacific ex Japan Equities	9.8
Latin America Equities	4.9
U.S. Equities	1.6
Middle East & Africa Equities	0.7
Cash/Other	4.2

**SUMMARY OF INVESTMENT PORTFOLIO (cont.)**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Top 25 Holdings\***

	% of Net Asset Value
Sanofi	5.3
ENI S.p.A.	5.0
Roche Holdings AG Genusscheine	4.5
Cable & Wireless Worldwide Plc.	3.8
Teva Pharmaceutical Industries Ltd. ADR	3.5
GDF Suez	3.3
Nippon Telegraph & Telephone Corp.	3.2
Catlin Group Ltd.	3.2
G4S Plc.	3.1
Renault S.A.	3.1
Firstgroup Plc.	3.1
China Mobile (Hong Kong) Ltd.	2.6
Cia de Saneamento Basico do Estado de Sao Paulo ADR	2.5
UBS AG	2.4
Casino Guichard Perrachon S.A.	2.4
Carillion Plc.	2.4
Sankyo Co. Ltd.	2.3
Vodafone Group Plc.	2.1
Cash & Cash Equivalents	2.1
Novartis AG	2.0
Petroleo Brasileiro S.A. ADR	2.0
Mitsubishi Corp.	1.7
Transocean Ltd.	1.7
Macquarie Group Ltd.	1.6
Muenchener Rueckversicherungs-Gesellschaft AG	1.5
<b>Top 25 Holdings</b>	<b>70.4</b>

\* The Fund invests substantially all of its assets directly in the Phillips, Hager & North Overseas Equity Fund. The Top 25 Holdings, shown above, are the proportionate holdings of the Phillips, Hager & North Overseas Equity Fund.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly, and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

GLOBAL EQUITY FUND

**PHILLIPS, HAGER & NORTH  
GLOBAL EQUITY FUND**

*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

Sub-Advisor: *Sky Investment Counsel Inc. ("Sky")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in common stocks of companies in the world's largest industrialized countries outside Canada, including the United States and countries in Europe, the Far East (including Japan), and Australia. To achieve the Fund's investment objective, we invest primarily in companies that we believe have sound fundamentals, a strong market position, a history of profitability, a capable management team, and attractive valuations. As at May 2011, the Fund primarily invests its net assets in other funds managed by RBC GAM.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$103.5 million as of December 31, 2011, from \$157.0 million at the end of 2010. Of this change, \$40.3 million was due to net outflows and \$13.2 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -9.6%. Over the same time period, the Fund's benchmark index, the MSCI World ex-Canada Total Return Index (CDNS), returned -3.1%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe's crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank ("ECB") would rescue the Eurozone's financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

The Fund's U.S. component, the Phillips, Hager & North U.S. Equity Fund, outperformed the allocation to Europe and developed markets in Asia, which is represented by the Phillips, Hager & North Overseas Equity Pension Trust. The U.S. fund posted a small single-digit gain, while the overseas segment had a significant loss.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager's view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the economy to significantly decouple from the U.S.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Sub-Advisor*

Sky is the sub-advisor and provides investment advice for the Fund. RBC GAM has a non-controlling interest in Sky. The fees paid to Sky are paid by RBC GAM and not the Fund.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>8.21</b>	<b>0.30</b>	<b>(0.15)</b>	<b>(0.31)</b>	<b>(0.74)</b>	<b>(0.90)</b>	–	<b>(0.23)</b>	–	–	<b>(0.23)</b>	<b>7.13</b>	
Dec. 31, 2010	7.87	0.21	(0.15)	0.28	0.03	0.37	–	(0.03)	–	–	(0.03)	8.21	
Dec. 31, 2009	7.07	0.13	(0.15)	0.16	0.36	0.50	(0.08)	–	–	–	(0.08)	7.87	
Dec. 31, 2008 <sup>3</sup>	6.57 <sup>†</sup>	0.02	(0.02)	(0.15)	0.61	0.46	(0.02)	–	–	–	(0.02)	7.07	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>8.21</b>	<b>0.30</b>	<b>(0.15)</b>	<b>(0.31)</b>	<b>(0.74)</b>	<b>(0.90)</b>	–	<b>(0.23)</b>	–	–	<b>(0.23)</b>	<b>7.13</b>	
Dec. 31, 2010 <sup>4</sup>	8.10 <sup>†</sup>	0.03	(0.03)	0.05	0.01	0.06	–	(0.03)	–	–	(0.03)	8.21	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>8.28</b>	<b>0.28</b>	<b>(0.16)</b>	<b>(0.29)</b>	<b>(0.69)</b>	<b>(0.86)</b>	–	<b>(0.25)</b>	–	–	<b>(0.25)</b>	<b>7.18</b>	
Dec. 31, 2010	7.93	0.21	(0.16)	0.28	0.03	0.36	–	(0.03)	–	–	(0.03)	8.28	
Dec. 31, 2009	7.14	0.22	(0.15)	(0.49)	1.30	0.88	(0.08)	–	–	–	(0.08)	7.93	
Dec. 31, 2008	9.62	0.30	(0.18)	(1.39)	(0.95)	(2.22)	(0.02)	–	–	–	(0.02)	7.14	
Dec. 31, 2007 <sup>5</sup>	9.62 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	9.62	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>8.23</b>	<b>0.30</b>	<b>(0.09)</b>	<b>(0.31)</b>	<b>(0.74)</b>	<b>(0.84)</b>	–	<b>(0.30)</b>	–	–	<b>(0.30)</b>	<b>7.15</b>	
Dec. 31, 2010	7.89	0.21	(0.09)	0.28	0.03	0.43	–	(0.11)	–	–	(0.11)	8.23	
Dec. 31, 2009	7.10	0.21	(0.09)	(0.61)	1.00	0.51	(0.14)	–	–	–	(0.14)	7.89	
Dec. 31, 2008	9.56	0.27	(0.12)	(1.46)	(0.40)	(1.71)	(0.07)	–	–	–	(0.07)	7.10	
Dec. 31, 2007	11.06	0.23	(0.17)	0.33	(1.91)	(1.52)	(0.02)	–	–	–	(0.02)	9.56	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>8.31</b>	<b>0.31</b>	<b>(0.07)</b>	<b>(0.32)</b>	<b>(0.75)</b>	<b>(0.83)</b>	–	<b>(0.32)</b>	–	–	<b>(0.32)</b>	<b>7.22</b>	
Dec. 31, 2010	7.97	0.21	(0.07)	0.29	0.03	0.46	–	(0.13)	–	–	(0.13)	8.31	
Dec. 31, 2009	7.19	0.17	(0.07)	–	1.95	2.05	(0.17)	–	–	–	(0.17)	7.97	
Dec. 31, 2008	9.62	0.30	(0.08)	(1.61)	4.73	3.34	(0.01)	–	–	–	(0.01)	7.19	
Dec. 31, 2007 <sup>5</sup>	9.62 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	9.62	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>8.36</b>	<b>0.30</b>	<b>(0.01)</b>	<b>(0.31)</b>	<b>(0.73)</b>	<b>(0.75)</b>	–	<b>(0.39)</b>	–	–	<b>(0.39)</b>	<b>7.26</b>	
Dec. 31, 2010	8.02	0.21	(0.01)	0.29	0.03	0.52	–	(0.21)	–	–	(0.21)	8.36	
Dec. 31, 2009	7.22	0.22	(0.01)	(0.57)	1.20	0.84	(0.23)	–	–	–	(0.23)	8.02	
Dec. 31, 2008	9.66	0.27	(0.01)	(1.60)	(0.68)	(2.02)	(0.15)	–	–	–	(0.15)	7.22	
Dec. 31, 2007	11.16	0.22	(0.01)	0.12	(1.81)	(1.48)	(0.15)	–	–	–	(0.15)	9.66	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From December 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>7.13</b>	<b>1 582</b>	<b>222</b>	<b>2.16</b>	<b>2.16</b>	<b>218.65</b>	<b>0.12</b>
Dec. 31, 2010	8.21	1 835	223	2.07	2.07	66.87	0.23
Dec. 31, 2009	7.88	1 495	190	1.99 <sup>2</sup>	2.59	44.06	0.22
Dec. 31, 2008 <sup>5</sup>	7.09	10	1	2.13	35.44	98.29	0.37
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>7.13</b>	<b>122</b>	<b>17</b>	<b>2.16</b>	<b>2.16</b>	<b>218.65</b>	<b>0.12</b>
Dec. 31, 2010 <sup>6</sup>	8.21	–	–	2.07	2.07	66.87	0.23
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>7.18</b>	<b>–</b>	<b>–</b>	<b>2.16</b>	<b>2.16</b>	<b>218.65</b>	<b>0.12</b>
Dec. 31, 2010	8.28	21	2	2.07	2.07	66.87	0.23
Dec. 31, 2009	7.94	19	2	2.08 <sup>2</sup>	7.04	44.06	0.22
Dec. 31, 2008	7.15	17	2	2.14	9.40	98.29	0.37
Dec. 31, 2007 <sup>7</sup>	9.62	–	–	–	–	56.12	0.32
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>7.15</b>	<b>36 198</b>	<b>5 065</b>	<b>1.30</b>	<b>1.30</b>	<b>218.65</b>	<b>0.12</b>
Dec. 31, 2010	8.24	47 857	5 811	1.24	1.24	66.87	0.23
Dec. 31, 2009	7.90	51 455	6 513	1.26 <sup>2</sup>	1.26	44.06	0.22
Dec. 31, 2008	7.12	90 626	12 732	1.48	1.48	98.29	0.37
Dec. 31, 2007	9.62	68 490	7 121	1.56	1.56	56.12	0.32
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>7.22</b>	<b>156</b>	<b>22</b>	<b>1.00</b>	<b>1.00</b>	<b>218.65</b>	<b>0.12</b>
Dec. 31, 2010	8.32	172	21	0.99	0.99	66.87	0.23
Dec. 31, 2009	7.98	94	12	1.02 <sup>2</sup>	2.08	44.06	0.22
Dec. 31, 2008	7.20	15	2	1.08	150.57	98.29	0.37
Dec. 31, 2007 <sup>7</sup>	9.62	–	–	–	–	56.12	0.32
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>7.26</b>	<b>65 409</b>	<b>9 013</b>	<b>0.15</b>	<b>0.15</b>	<b>218.65</b>	<b>0.12</b>
Dec. 31, 2010	8.36	107 129	12 811	0.12	0.12	66.87	0.23
Dec. 31, 2009	8.03	100 800	12 558	0.09 <sup>2</sup>	0.09	44.06	0.22
Dec. 31, 2008	7.24	124 180	17 162	0.12	0.12	98.29	0.37
Dec. 31, 2007	9.71	118 165	12 164	0.09	0.09	56.12	0.32

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.99%, Series B – 2.00%, Series D – 1.22%, Series F – 0.95%, Series O – 0.12%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From December 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series B	1.75%	29%	71%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

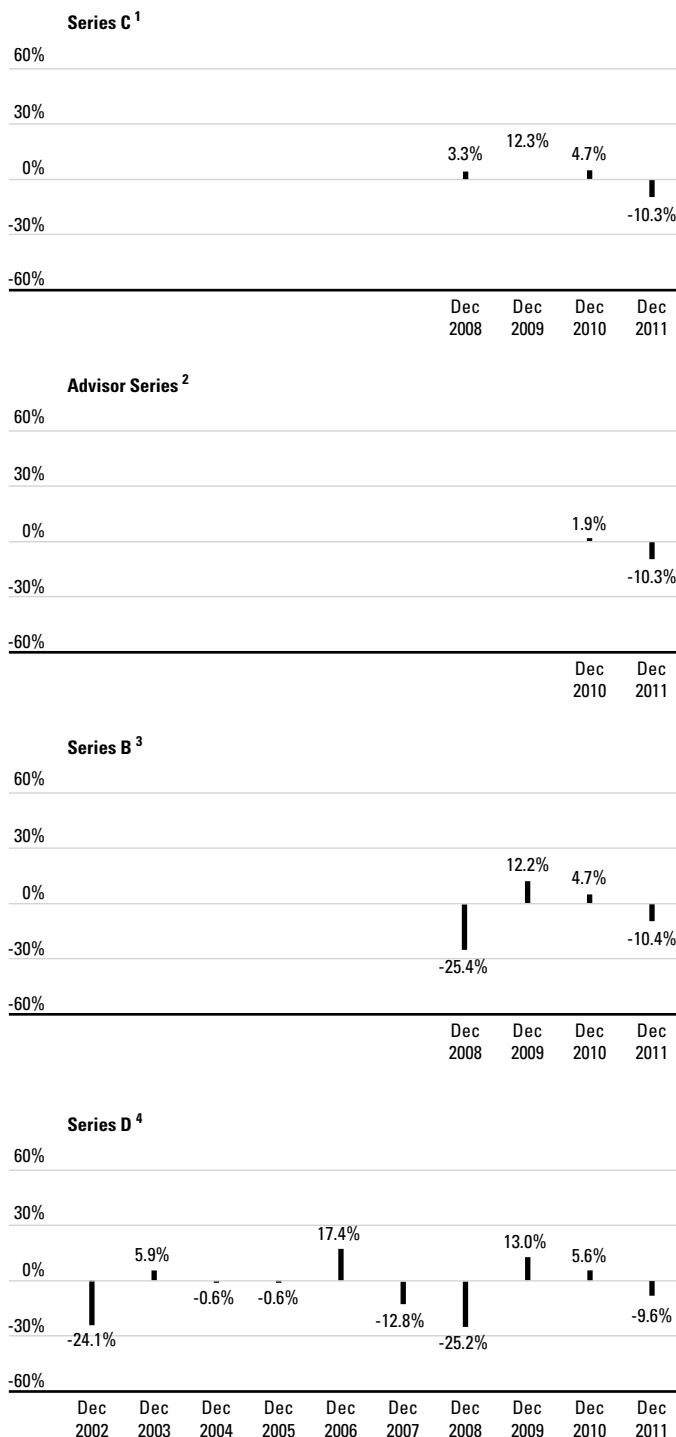
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

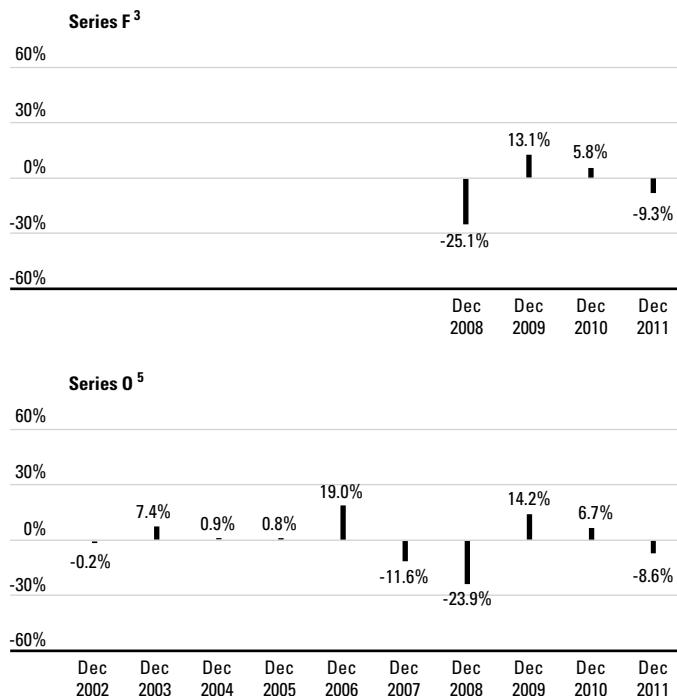
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**MSCI World ex Canada Total Return Index (CDN\$)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-10.3	1.8	—	—	2.8
Benchmark	-3.1	4.0	—	—	4.8
Advisor Series <sup>2</sup>	-10.3	—	—	—	-7.5
Benchmark	-3.1	—	—	—	-0.6
Series B <sup>3</sup>	-10.4	1.7	—	—	-5.9
Benchmark	-3.1	4.0	—	—	-4.5
Series D <sup>4</sup>	-9.6	2.6	-6.8	-4.1	—
Benchmark	-3.1	4.0	-5.1	-1.1	—
Series F <sup>3</sup>	-9.3	2.8	—	—	-5.0
Benchmark	-3.1	4.0	—	—	-4.5
Series O <sup>5</sup>	-8.6	3.7	-5.6	—	-0.3
Benchmark	-3.1	4.0	-5.1	—	1.4

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date December 2007.

<sup>4</sup> Inception date December 2000.

<sup>5</sup> Inception date October 2002.

Series D was known as Series A prior to November 17, 2008. Although Series A units of the Fund were created in September 2000, units were not offered for sale under a simplified prospectus until December 2000. We are therefore not permitted to disclose performance data for this Fund for any period prior to December 2000.

**INDEX DESCRIPTION**

**MSCI World ex Canada Total Return Index (CDN\$)** This index is the capitalization weighted index measuring the Canadian dollar performance of selected companies listed on stock exchanges in countries around the world (ex Canada),

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*  
As at December 31, 2011

**Investment Mix – Sectors**

	% of Net Asset Value
Health Care	17.1
Financials	16.4
Energy	12.7
Industrials	11.3
Consumer Staples	9.3
Information Technology	8.0
Consumer Discretionary	7.6
Telecommunication Services	6.8
Utilities	4.4
Materials	3.7
Cash/Other	2.8

**Investment Mix – Countries/Regions**

	% of Net Asset Value
U.S. Equities	55.0
Europe ex U.K. Equities	18.4
U.K. Equities	10.8
Japan Equities	6.2
Pacific ex. Japan Equities	4.4
Latin America Equities	2.1
Middle East & Africa Equities	0.3
Cash/Other	2.8

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North U.S. Equity Fund	55.2
Phillips, Hager & North Overseas Equity Pension Trust	44.2
Cash & Cash Equivalents	0.6
Total	100.0

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

GLOBAL EQUITY FUND

**PHILLIPS, HAGER & NORTH  
COMMUNITY VALUES GLOBAL  
EQUITY FUND**

*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

Sub-Advisor: *Sky Investment Counsel Inc. ("Sky")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in common stocks of companies in the world's largest industrialized countries outside Canada, including the United States and countries in Europe, the Far East (including Japan), and Australia. Our intention is that the securities of companies that conduct themselves in a socially responsible manner will be included in the portfolio. To achieve the Fund's investment objective, we invest primarily in companies that we believe have sound fundamentals, a strong market position, a history of profitability, a capable management team, and attractive valuations.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value increased to \$63.6 million as of December 31, 2011, from \$63.1 million at the end of 2010. Of this change, \$7.0 million was due to net inflows, offset by \$6.5 million of investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -10.5%. Over the same time period, the Fund's benchmark index, the MSCI World ex-Canada Total Return Index (CDN\$), returned -3.1%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe's crisis largely soured investors on stocks until the fourth quarter. The U.S. stock market rose modestly during 2011, with most of the gains coming in the first half of the year. Market weakness was particularly pronounced during the third quarter, as Europe's crisis worsened and global growth expectations declined.

The leading U.S. market sectors in the first half of 2011 were Energy, Industrials and Materials, reflecting optimism about an economic recovery. During the second half of the year, sectors with a defensive posture, such as Consumer Staples and Utilities, led the market. These five sectors posted the strongest performance. However, most of the Fund's best-performing holdings were in other sectors. The top contributors to returns were El Paso Corp., HollyFrontier, CVS Caremark, McGraw-Hill and Scansource.

Overseas markets faced challenges this year as renewed pessimism meant investors focused less on valuations and more on holdings with defensive characteristics. It was a difficult year for our process, which focuses on buying companies at low valuations. A significant detractor from Fund performance was Cable & Wireless Worldwide, a U.K.-based telecommunications company whose stock declined significantly. Despite the challenges, we continue to see value in this company. Other stocks that negatively impacted performance included automaker Renault and Thomas Cook, the travel and vacation-package company.

With the crisis in Europe affecting global confidence and growth, our strategy was to increase exposure to businesses that can pay healthy dividends and offer more predictable revenues. As a result, one of the most significant changes we made to the Fund was to increase exposure to the Health Care sector. Pharmaceutical companies are trading at low valuations on a historical basis, and can provide earnings growth in a slow economy, as well as attractive dividend yields. Our holdings in Sanofi, Roche and Novartis had dividend yields of 4% to 5%. Furthermore, pharmaceutical companies should benefit from the trend of an aging population in developed countries.

### Recent Developments

We expect U.S. equity markets to continue to face a number of significant challenges, including persistent economic weakness in Europe and parts of Asia, as well as unsettled U.S. fiscal policy. Countering this are strong company balance sheets, robust profitability, reasonable stock valuations and early signs of an improving U.S. economy. Given the challenges, we have balanced the portfolio between holdings that will benefit significantly from economic growth and those whose performance is steadier in weaker economic conditions. We continue to search for opportunities in both these areas, and expect to find a number of companies trading at compelling valuations levels near those reached at the market lows of March 2009.

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager's view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the economy to significantly decouple from the U.S.

#### **Related-Party Transactions**

##### ***Manager, Portfolio Advisor and Registrar***

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

##### ***Sub-Advisor***

Sky is the sub-advisor and provides investment advice for the Fund. RBC GAM has a non-controlling interest in Sky. The fees paid to Sky are paid by RBC GAM and not the Fund.

##### ***Distributor***

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series or Series D units.

##### ***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

##### ***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

##### ***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

##### ***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

**Change in Net Assets Per Unit (\$)**

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>8.66</b>	<b>0.24</b>	<b>(0.16)</b>	<b>(0.26)</b>	<b>(0.76)</b>	<b>(0.94)</b>	–	<b>(0.08)</b>	–	–	<b>(0.08)</b>	<b>7.61</b>
Dec. 31, 2010	8.23	0.20	(0.17)	0.15	0.27	0.45	–	–	–	–	–	8.66
Dec. 31, 2009	7.11	0.14	(0.16)	0.36	0.98	1.32	(0.01)	–	–	–	(0.01)	8.23
Dec. 31, 2008 <sup>3</sup>	6.68 <sup>†</sup>	0.03	(0.02)	(0.36)	0.91	0.56	(0.12)	–	–	–	(0.12)	7.11
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>8.66</b>	<b>0.24</b>	<b>(0.16)</b>	<b>(0.26)</b>	<b>(0.76)</b>	<b>(0.94)</b>	–	<b>(0.08)</b>	–	–	<b>(0.08)</b>	<b>7.61</b>
Dec. 31, 2010 <sup>4</sup>	8.53 <sup>†</sup>	0.03	(0.03)	0.03	0.04	0.07	–	–	–	–	–	8.66
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>8.60</b>	<b>0.24</b>	<b>(0.10)</b>	<b>(0.26)</b>	<b>(0.76)</b>	<b>(0.88)</b>	–	<b>(0.14)</b>	–	–	<b>(0.14)</b>	<b>7.56</b>
Dec. 31, 2010	8.18	0.21	(0.10)	0.16	0.27	0.54	–	(0.07)	–	–	(0.07)	8.60
Dec. 31, 2009	7.07	0.18	(0.10)	(0.53)	1.50	1.05	(0.07)	–	–	–	(0.07)	8.18
Dec. 31, 2008	10.03	0.31	(0.12)	(1.74)	(1.29)	(2.84)	(0.20)	–	–	–	(0.20)	7.07
Dec. 31, 2007	12.31	0.25	(0.19)	0.24	(2.15)	(1.85)	(0.04)	–	(0.50)	–	(0.54)	10.03
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>8.59</b>	<b>0.23</b>	<b>(0.08)</b>	<b>(0.26)</b>	<b>(0.74)</b>	<b>(0.85)</b>	–	<b>(0.16)</b>	–	–	<b>(0.16)</b>	<b>7.55</b>
Dec. 31, 2010	8.13	0.21	(0.07)	0.16	0.27	0.57	–	(0.10)	–	–	(0.10)	8.59
Dec. 31, 2009	7.03	0.18	(0.08)	(0.49)	1.55	1.16	(0.09)	–	–	–	(0.09)	8.13
Dec. 31, 2008	10.09	0.32	(0.08)	(1.74)	(0.62)	(2.12)	(0.20)	–	–	–	(0.20)	7.03
Dec. 31, 2007 <sup>6</sup>	10.09 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	10.09
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>8.74</b>	<b>0.24</b>	<b>(0.01)</b>	<b>(0.27)</b>	<b>(0.78)</b>	<b>(0.82)</b>	–	<b>(0.23)</b>	–	–	<b>(0.23)</b>	<b>7.67</b>
Dec. 31, 2010	8.31	0.21	(0.01)	0.16	0.28	0.64	–	(0.17)	–	–	(0.17)	8.74
Dec. 31, 2009	7.18	0.19	(0.02)	(0.51)	1.55	1.21	(0.16)	–	–	–	(0.16)	8.31
Dec. 31, 2008	10.15	0.31	(0.02)	(1.78)	(1.22)	(2.71)	(0.26)	–	–	–	(0.26)	7.18
Dec. 31, 2007	12.44	0.25	(0.03)	0.25	(2.12)	(1.65)	(0.20)	–	(0.50)	–	(0.70)	10.15

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From December 2007.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>7.61</b>	<b>378</b>	<b>50</b>	<b>2.11</b>	<b>2.11</b>	<b>95.36</b>	<b>0.18</b>
Dec. 31, 2010	8.66	399	46	2.09	2.09	54.06	0.23
Dec. 31, 2009	8.24	90	11	2.05 <sup>2</sup>	4.92	59.28	0.22
Dec. 31, 2008 <sup>5</sup>	7.12	1	–	1.94	227.72	71.55	0.36
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>7.61</b>	<b>67</b>	<b>9</b>	<b>2.11</b>	<b>2.11</b>	<b>95.36</b>	<b>0.18</b>
Dec. 31, 2010 <sup>6</sup>	8.66	–	–	2.09	2.09	54.06	0.23
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>7.56</b>	<b>5 655</b>	<b>748</b>	<b>1.28</b>	<b>1.28</b>	<b>95.36</b>	<b>0.18</b>
Dec. 31, 2010	8.60	6 213	722	1.27	1.27	54.06	0.23
Dec. 31, 2009	8.19	5 895	720	1.33 <sup>2</sup>	1.41	59.28	0.22
Dec. 31, 2008	7.08	5 719	807	1.35	1.64	71.55	0.36
Dec. 31, 2007	10.10	7 943	787	1.65	1.85	62.03	0.27
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>7.55</b>	<b>40</b>	<b>5</b>	<b>1.01</b>	<b>1.01</b>	<b>95.36</b>	<b>0.18</b>
Dec. 31, 2010	8.59	1	–	0.95	0.95	54.06	0.23
Dec. 31, 2009	8.14	11	1	1.06 <sup>2</sup>	3.16	59.28	0.22
Dec. 31, 2008	7.04	25	4	0.89	3.58	71.55	0.36
Dec. 31, 2007 <sup>7</sup>	10.09	–	–	–	–	62.03	0.27
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>7.68</b>	<b>57 418</b>	<b>7 478</b>	<b>0.18</b>	<b>0.18</b>	<b>95.36</b>	<b>0.18</b>
Dec. 31, 2010	8.74	56 484	6 464	0.17	0.17	54.06	0.23
Dec. 31, 2009	8.32	44 894	5 396	0.21 <sup>2</sup>	0.21	59.28	0.22
Dec. 31, 2008	7.20	37 990	5 276	0.25	0.25	71.55	0.36
Dec. 31, 2007	10.22	26 595	2 603	0.23	0.23	62.03	0.27

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.97%, Series B – 2.12%, Series D – 1.21%, Series F – 0.94%, Series O – 0.16%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From December 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

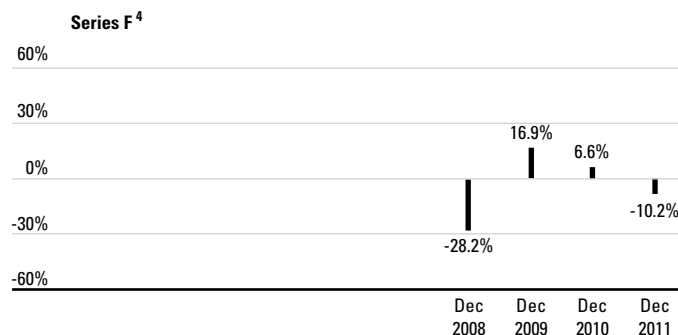
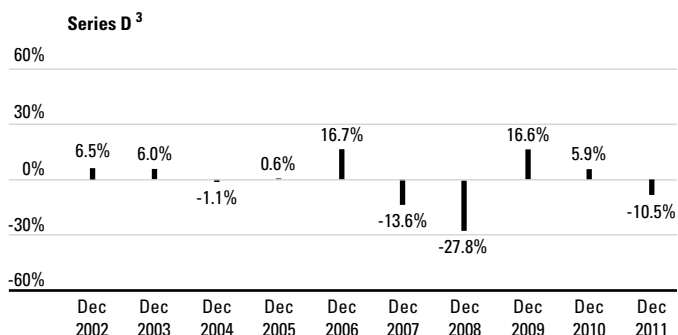
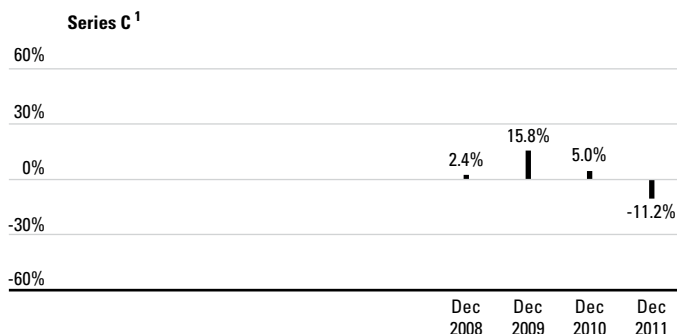
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

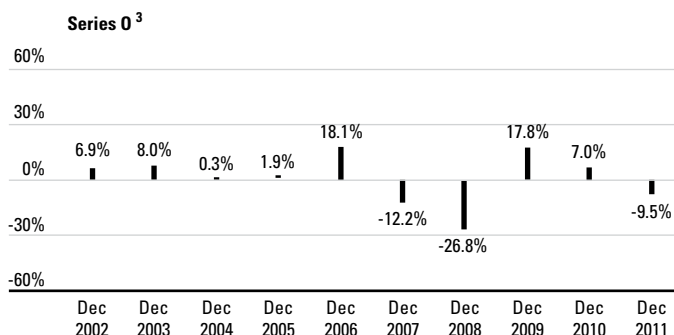
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**MSCI World ex Canada Total Return Index (CDN\$)**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-11.2	2.6	-	-	3.3
Benchmark	-3.1	4.0	-	-	4.8
Advisor Series <sup>2</sup>	-11.2	-	-	-	-8.5
Benchmark	-3.1	-	-	-	-0.6
Series D <sup>3</sup>	-10.5	3.4	-7.2	-	-1.1
Benchmark	-3.1	4.0	-5.1	-	2.0
Series F <sup>4</sup>	-10.2	3.8	-	-	-5.3
Benchmark	-3.1	4.0	-	-	-4.5
Series O <sup>3</sup>	-9.5	4.5	-6.0	-	0.2
Benchmark	-3.1	4.0	-5.1	-	2.0

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date September 2002.

<sup>4</sup> Inception date December 2007.

Series D was known as Series A prior to November 17, 2008. Although the Fund was prospectused in August 2002, Series A and Series O units were not offered for sale until September 2002. We are therefore not permitted to disclose performance data for this Fund for any period prior to September 2002.

**INDEX DESCRIPTION**

**MSCI World ex Canada Total Return Index (CDN\$)** This index is the capitalization weighted index measuring the Canadian dollar performance of selected companies listed on stock exchanges in countries around the world (ex Canada).

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix – Sectors**

	% of Net Asset Value
Health Care	18.0
Financials	14.4
Energy	11.9
Industrials	11.9
Consumer Discretionary	8.5
Information Technology	8.4
Consumer Staples	8.2
Materials	6.1
Telecommunication Services	5.5
Utilities	2.5
Cash/Other	4.6

**Investment Mix – Countries/Regions**

	% of Net Asset Value
U.S. Equities	52.2
Europe ex U.K. Equities	18.1
U.K. Equities	13.3
Pacific ex. Japan Equities	5.7
Japan Equities	4.2
Latin America Equities	1.0
Middle East & Africa Equities	0.9
Cash/Other	4.6

**SUMMARY OF INVESTMENT PORTFOLIO (cont.)**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Top 25 Holdings**

	% of Net Asset Value
Cash & Cash Equivalents	4.5
Sanofi	2.9
Sysco Corp.	2.9
The Progressive Corp.	2.4
Royal Dutch Shell Plc. ADR, Class A	2.4
Roche Holdings AG Genussscheine	2.2
Teva Pharmaceutical Industries Ltd. ADR	2.2
Illinois Tool Works Inc.	2.2
Johnson & Johnson	2.1
Cisco Systems Inc.	2.0
Scansource Inc.	1.9
Carillion Plc.	1.7
Tidewater Inc.	1.7
Microsoft Corp.	1.7
Nippon Telegraph & Telephone Corp.	1.6
El Paso Corp.	1.6
Cable & Wireless Worldwide Plc.	1.6
Varian Medical Systems Inc.	1.6
Danaher Corp.	1.5
Sempra Energy	1.5
Catlin Group Ltd.	1.5
CVS Corp.	1.4
Johnson Controls Inc.	1.4
Commercial Metals Co.	1.4
HollyFrontier Corp.	1.4
<b>Top 25 Holdings</b>	<b>49.3</b>

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2015 FUND™**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2015 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds (“ETFs”), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund’s overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$598,000 as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe’s crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank (“ECB”) would rescue the Eurozone’s financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager’s view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe’s crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn’t clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series D</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.28<sup>†</sup></b>	<b>0.15</b>	<b>(0.05)</b>	<b>0.06</b>	<b>0.04</b>	<b>0.20</b>	<b>(0.12)</b>	<b>(0.07)</b>	<b>(0.21)</b>	<b>–</b>	<b>(0.40)</b>	<b>10.19</b>	
<b>Series O</b>													
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.39</b>	<b>(0.01)</b>	<b>0.17</b>	<b>0.11</b>	<b>0.66</b>	<b>(0.18)</b>	<b>(0.10)</b>	<b>(0.21)</b>	<b>–</b>	<b>(0.49)</b>	<b>10.15</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.19</b>	<b>212</b>	<b>21</b>	<b>0.98</b>	<b>0.98</b>	<b>11.83</b>	<b>0.17</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>10.15</b>	<b>386</b>	<b>38</b>	<b>0.09</b>	<b>0.09</b>	<b>11.83</b>	<b>0.17</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.

## FINANCIAL HIGHLIGHTS (cont.)

### Management Fees

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

Series D	Management Fees	Breakdown of Services	
		Distribution	Other*
	0.80%	31%	69%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

## PAST PERFORMANCE

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)

As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Bonds	48.8
U.S. Equities	18.6
Overseas Equities	13.2
Canadian Equities	11.7
Mortgages	0.2
Cash/Other	7.5

### Top 25 Holdings\*

	% of Net Asset Value
Phillips, Hager & North Long Inflation-linked Bond Fund	25.5
Phillips, Hager & North Bond Fund	20.9
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	14.6
RBC International Equity Fund	7.0
Phillips, Hager & North Overseas Equity Fund	6.7
Phillips, Hager & North Canadian Equity Value Fund	6.1
Phillips, Hager & North Canadian Equity Underlying Fund	6.0
Phillips, Hager & North High Yield Bond Fund	5.2
Vanguard Real Estate Investment Trust Fund	4.1
Phillips, Hager & North Short Inflation-linked Bond Fund	2.6
Cash & Cash Equivalents	0.9
Phillips, Hager & North Canadian Money Market Fund	0.4
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2020 FUND™**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2020 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds (“ETFs”), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund’s overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$1.2 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe’s crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank (“ECB”) would rescue the Eurozone’s financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager’s view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe’s crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn’t clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series D</b>												
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.31<sup>†</sup></b>	<b>0.14</b>	<b>(0.05)</b>	<b>0.05</b>	<b>0.08</b>	<b>0.22</b>	<b>(0.10)</b>	<b>(0.07)</b>	<b>(0.15)</b>	<b>–</b>	<b>(0.32)</b>	<b>10.41</b>
<b>Series O</b>												
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.51</b>	<b>(0.01)</b>	<b>0.19</b>	<b>0.29</b>	<b>0.98</b>	<b>(0.17)</b>	<b>(0.11)</b>	<b>(0.15)</b>	<b>–</b>	<b>(0.43)</b>	<b>10.35</b>

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.41</b>	<b>504</b>	<b>48</b>	<b>1.06</b>	<b>1.06</b>	<b>32.24</b>	<b>0.18</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>10.35</b>	<b>721</b>	<b>70</b>	<b>0.09</b>	<b>0.09</b>	<b>32.24</b>	<b>0.18</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series D	0.85%	29%	71%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Bonds	48.7
U.S. Equities	20.0
Overseas Equities	13.7
Canadian Equities	12.1
Mortgages	0.1
Cash/Other	5.4

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North Long Inflation-linked Bond Fund	37.3
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	15.2
Phillips, Hager & North Bond Fund	7.3
RBC International Equity Fund	7.3
Phillips, Hager & North Overseas Equity Fund	7.0
Phillips, Hager & North Canadian Equity Value Fund	6.3
Phillips, Hager & North Canadian Equity Underlying Fund	6.3
Vanguard Real Estate Investment Trust Fund	5.0
Phillips, Hager & North High Yield Bond Fund	4.9
Phillips, Hager & North Short Inflation-linked Bond Fund	2.5
Cash & Cash Equivalents	0.5
Phillips, Hager & North Canadian Money Market Fund	0.4
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2025 FUND™**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*



## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2025 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds (“ETFs”), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund’s overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$1.5 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe’s crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank (“ECB”) would rescue the Eurozone’s financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager’s view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe’s crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn’t clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series D</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.31<sup>†</sup></b>	<b>0.14</b>	<b>(0.05)</b>	<b>0.09</b>	<b>0.11</b>	<b>0.29</b>	<b>(0.08)</b>	<b>(0.06)</b>	<b>(0.15)</b>	<b>–</b>	<b>(0.29)</b>	<b>10.44</b>	
<b>Series O</b>													
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.44</b>	<b>(0.01)</b>	<b>0.28</b>	<b>0.35</b>	<b>1.06</b>	<b>(0.15)</b>	<b>(0.10)</b>	<b>(0.15)</b>	<b>–</b>	<b>(0.40)</b>	<b>10.38</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.44</b>	<b>383</b>	<b>37</b>	<b>1.08</b>	<b>1.08</b>	<b>26.17</b>	<b>0.19</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>10.39</b>	<b>1 104</b>	<b>106</b>	<b>0.09</b>	<b>0.09</b>	<b>26.17</b>	<b>0.19</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series D	0.90%	28%	72%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Bonds	47.5
U.S. Equities	20.6
Overseas Equities	14.3
Canadian Equities	12.7
Cash/Other	4.9

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North Long Inflation-linked Bond Fund	40.7
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	15.8
RBC International Equity Fund	7.6
Phillips, Hager & North Overseas Equity Fund	7.3
Phillips, Hager & North High Yield Bond Fund	7.0
Phillips, Hager & North Canadian Equity Value Fund	6.6
Phillips, Hager & North Canadian Equity Underlying Fund	6.6
Vanguard Real Estate Investment Trust Fund	4.9
Phillips, Hager & North Bond Fund	2.3
Cash & Cash Equivalents	0.8
Phillips, Hager & North Canadian Money Market Fund	0.4
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2030 FUND™**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2030 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds ("ETFs"), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$1.0 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe's crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank ("ECB") would rescue the Eurozone's financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager's view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe's crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn't clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series D</b>												
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.29<sup>†</sup></b>	<b>0.15</b>	<b>(0.06)</b>	<b>0.07</b>	<b>0.08</b>	<b>0.24</b>	<b>(0.08)</b>	<b>(0.06)</b>	<b>(0.18)</b>	<b>–</b>	<b>(0.32)</b>	<b>10.30</b>
<b>Series O</b>												
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.37</b>	<b>(0.01)</b>	<b>0.17</b>	<b>0.20</b>	<b>0.73</b>	<b>(0.14)</b>	<b>(0.11)</b>	<b>(0.18)</b>	<b>–</b>	<b>(0.43)</b>	<b>10.24</b>

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.30</b>	<b>58</b>	<b>6</b>	<b>1.16</b>	<b>1.16</b>	<b>25.67</b>	<b>0.19</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>10.24</b>	<b>955</b>	<b>93</b>	<b>0.09</b>	<b>0.09</b>	<b>25.67</b>	<b>0.19</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.



**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series D	0.95%	26%	74%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)  
As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Bonds	43.9
U.S. Equities	22.0
Overseas Equities	15.6
Canadian Equities	13.8
Cash/Other	4.7

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North Long Inflation-linked Bond Fund	37.5
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	17.3
Phillips, Hager & North High Yield Bond Fund	8.6
RBC International Equity Fund	8.3
Phillips, Hager & North Overseas Equity Fund	7.9
Phillips, Hager & North Canadian Equity Value Fund	7.2
Phillips, Hager & North Canadian Equity Underlying Fund	7.1
Vanguard Real Estate Investment Trust Fund	4.9
Cash & Cash Equivalents	0.7
Phillips, Hager & North Canadian Money Market Fund	0.5
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2035 FUND™**

*December 31, 2011*

**Portfolio Manager** *RBC Global Asset Management Inc. ("RBC GAM")*

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2035 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds (“ETFs”), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund’s overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$887,000 as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe’s crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank (“ECB”) would rescue the Eurozone’s financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager’s view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe’s crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn’t clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series D</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.25<sup>†</sup></b>	<b>0.15</b>	<b>(0.06)</b>	<b>0.07</b>	<b>(0.02)</b>	<b>0.14</b>	<b>(0.08)</b>	<b>(0.06)</b>	<b>(0.13)</b>	<b>–</b>	<b>(0.27)</b>	<b>10.20</b>	
<b>Series O</b>													
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.37</b>	<b>(0.01)</b>	<b>0.17</b>	<b>(0.06)</b>	<b>0.47</b>	<b>(0.14)</b>	<b>(0.12)</b>	<b>(0.13)</b>	<b>–</b>	<b>(0.39)</b>	<b>10.14</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.20</b>	<b>112</b>	<b>11</b>	<b>1.24</b>	<b>1.24</b>	<b>10.15</b>	<b>0.23</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>10.14</b>	<b>775</b>	<b>76</b>	<b>0.09</b>	<b>0.09</b>	<b>10.15</b>	<b>0.23</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series D	1.00%	25%	75%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
Bonds	39.1
U.S. Equities	23.8
Overseas Equities	17.3
Canadian Equities	15.3
Cash/Other	4.5

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North Long Inflation-linked Bond Fund	33.4
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	19.1
RBC International Equity Fund	9.2
Phillips, Hager & North Overseas Equity Fund	8.8
Phillips, Hager & North Canadian Equity Value Fund	7.9
Phillips, Hager & North Canadian Equity Underlying Fund	7.9
Phillips, Hager & North High Yield Bond Fund	7.7
Vanguard Real Estate Investment Trust Fund	4.9
Cash & Cash Equivalents	0.7
Phillips, Hager & North Canadian Money Market Fund	0.4
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2040 FUND™**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2040 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds (“ETFs”), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund’s overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$1.3 million as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe’s crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank (“ECB”) would rescue the Eurozone’s financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager’s view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe’s crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn’t clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.



***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series D</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.18<sup>†</sup></b>	<b>0.13</b>	<b>(0.06)</b>	<b>0.05</b>	<b>(0.18)</b>	<b>(0.06)</b>	<b>(0.05)</b>	<b>(0.06)</b>	<b>(0.10)</b>	<b>–</b>	<b>(0.21)</b>	<b>9.91</b>	
<b>Series O</b>													
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.32</b>	<b>(0.01)</b>	<b>0.12</b>	<b>(0.44)</b>	<b>(0.01)</b>	<b>(0.10)</b>	<b>(0.13)</b>	<b>(0.10)</b>	<b>–</b>	<b>(0.33)</b>	<b>9.85</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>9.90</b>	<b>117</b>	<b>12</b>	<b>1.28</b>	<b>1.28</b>	<b>13.87</b>	<b>0.28</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>9.84</b>	<b>1 203</b>	<b>122</b>	<b>0.10</b>	<b>0.10</b>	<b>13.87</b>	<b>0.28</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series D	1.05%	24%	76%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
U.S. Equities	28.4
Bonds	26.6
Overseas Equities	21.6
Canadian Equities	19.0
Cash/Other	4.4

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	23.7
Phillips, Hager & North Long Inflation-linked Bond Fund	22.7
RBC International Equity Fund	11.5
Phillips, Hager & North Overseas Equity Fund	11.0
Phillips, Hager & North Canadian Equity Value Fund	9.9
Phillips, Hager & North Canadian Equity Underlying Fund	9.9
Phillips, Hager & North High Yield Bond Fund	5.2
Vanguard Real Estate Investment Trust Fund	4.9
Cash & Cash Equivalents	0.8
Phillips, Hager & North Canadian Money Market Fund	0.4
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).

TARGET DATE FUND

**PHILLIPS, HAGER & NORTH  
LIFETIME 2045 FUND™**

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

**A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to achieve a balance of income and long-term capital growth relative to its target retirement date of 2045 by investing primarily in investment funds that hold equity, fixed income, income trust and money market securities and exchange traded funds (“ETFs”), or by investing directly in such securities.

The Fund invests primarily in underlying funds. The Fund seeks to achieve its investment strategies by investing in three broad asset classes: equities, fixed income, and Canadian or U.S. ETFs, either directly or indirectly through underlying funds. ETFs purchased by the Fund will initially be limited to those that track the investment performance of broad based real estate investment trust indices but may include other ETFs where permitted by applicable securities laws. At all times, the Fund will use a dynamic asset mix or glide path that adjusts the asset mix of the Fund on a quarterly basis relative to its target date.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund’s overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund was launched on January 10, 2011, and its net asset value was \$659,000 as of December 31, 2011. Investment performance is not provided for a fund that has been available for less than a year.

The Eurozone sovereign-debt crisis and resulting economic fallout dominated global capital markets for much of 2011, especially in the second half of the year. U.S. stocks started 2011 on a positive note, but the Japanese earthquake and related tsunami, political uprisings in the Middle East and the intensification of Europe’s crisis largely soured investors on stocks until the fourth quarter. Investors spent much of the second half of 2011 worrying whether the European Central Bank (“ECB”) would rescue the Eurozone’s financial system in the forceful way that the U.S. Federal Reserve Board handled the financial collapse in 2008-2009. While the ECB made progress in stabilizing the situation, concerns remained that the steps would only temporarily alleviate the stress.

### Recent Developments

The current investment environment is characterized by two divergent potential outcomes. The most likely scenario in the portfolio manager’s view is that Europe muddles through the current crisis. Assuming this outcome, the portfolio manager expects any recession in Europe to be relatively mild and for North America to avoid recession. The alternate outcome is for Europe’s crisis to escalate, with negative consequences for high-risk assets and further declines in bond yields. Global conditions should remain modest but positive, buoyed by firmer economic growth outside developed markets. While Canada appears relatively healthy, it would be unusual for the Canadian economy to significantly decouple from the U.S. economy. Therefore, the portfolio manager expects a downshift in Canadian economic growth in 2012.

Although growth in 2012 will likely remain weak, severely depressed stock-market valuations provide upside potential. Most major countries continue to enjoy near-record-low bond yields. It isn’t clear how long the perfect storm depressing yields will last, but we believe it will be difficult for yields to move sustainably lower unless the feared collapse of the Eurozone becomes reality. We expect yields to rise in any environment that includes modest growth and progress toward crisis resolution.

### Related-Party Transactions

#### *Manager, Portfolio Advisor and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada (“Royal Bank”) and is the manager, principal portfolio advisor and registrar of the Fund. RBC GAM is responsible for the Fund’s day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 period since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series D</b>													
<b>Dec. 31, 2011<sup>3</sup></b>	<b>10.14<sup>†</sup></b>	<b>0.13</b>	<b>(0.06)</b>	<b>0.03</b>	<b>(0.20)</b>	<b>(0.10)</b>	<b>(0.04)</b>	<b>(0.08)</b>	<b>(0.08)</b>	<b>–</b>	<b>(0.20)</b>	<b>9.74</b>	
<b>Series O</b>													
<b>Dec. 31, 2011<sup>4</sup></b>	<b>10.00<sup>†</sup></b>	<b>0.32</b>	<b>(0.01)</b>	<b>0.07</b>	<b>(0.50)</b>	<b>(0.12)</b>	<b>(0.08)</b>	<b>(0.16)</b>	<b>(0.08)</b>	<b>–</b>	<b>(0.32)</b>	<b>9.69</b>	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From June 2011.

<sup>4</sup> From January 2011.

<sup>†</sup> Initial offering net asset value per unit.

### Ratios and Supplemental Data

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>2</sup>	Trading Expense Ratio (%) <sup>3</sup>
<b>Series D</b>							
<b>Dec. 31, 2011<sup>4</sup></b>	<b>9.74</b>	<b>122</b>	<b>13</b>	<b>1.33</b>	<b>1.33</b>	<b>17.32</b>	<b>0.31</b>
<b>Series O</b>							
<b>Dec. 31, 2011<sup>5</sup></b>	<b>9.69</b>	<b>537</b>	<b>55</b>	<b>0.10</b>	<b>0.10</b>	<b>17.32</b>	<b>0.31</b>

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>3</sup> 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. The trading expense ratio is not applicable to fixed-income transactions.

<sup>4</sup> From June 2011.

<sup>5</sup> From January 2011.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series D	1.10%	23%	77%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

Investment performance in respect of a fund that has been available for less than one year is not provided. Series O units of this Fund were launched January 2011 and Series D units were launched June 2011.

**SUMMARY OF INVESTMENT PORTFOLIO**

*(after consideration of derivative products, if any)*

*As at December 31, 2011*

**Investment Mix**

	% of Net Asset Value
U.S. Equities	30.8
Overseas Equities	23.5
Canadian Equities	20.9
Bonds	20.7
Cash/Other	4.1

**Top 25 Holdings\***

	% of Net Asset Value
Phillips, Hager & North U.S Multi-Style All Cap Equity Fund	25.9
Phillips, Hager & North Long Inflation-linked Bond Fund	17.7
RBC International Equity Fund	12.5
Phillips, Hager & North Overseas Equity Fund	11.9
Phillips, Hager & North Canadian Equity Underlying Fund	10.9
Phillips, Hager & North Canadian Equity Value Fund	10.8
Vanguard Real Estate Investment Trust Fund	5.1
Phillips, Hager & North High Yield Bond Fund	4.1
Cash & Cash Equivalents	0.7
Phillips, Hager & North Canadian Money Market Fund	0.4
<b>Total</b>	<b>100.0</b>

\* The Fund holds fewer than 25 holdings.

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



BALANCED FUND

## BONAVISTA GLOBAL BALANCED FUND

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December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

Portfolio Advisor: BonaVista Asset Management Ltd. ("BonaVista")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

### **A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital appreciation and income by primarily investing in a balanced global portfolio of Canadian and foreign equities, fixed income securities and money market instruments. To achieve the Fund's fundamental investment objectives, we invest primarily in common stocks of high quality companies, bonds of the Canadian government, provincial government, and high quality Canadian corporations and money market securities including asset backed commercial paper.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$4.1 million as of December 31, 2011, from \$6.6 million at the end of 2010. Of this change, \$2 million was due to net outflows and \$0.5 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -6.7%, which underperformed the benchmark return of 0.6% and the broad-based benchmark return of 9.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The Fund's performance during the year was primarily driven by its asset-mix structure, including an overexposure to equities and underexposure to bonds, relative to the benchmark. This asset mix position worked well during the first part of the year, but hindered performance in the latter half of the year as global economic uncertainties intensified.

The decision to hold an overweight position in equities relative to bonds is based on our view that equities represent good value, based on historical metrics such as selling at reasonable price/earnings multiples, increasing earnings, strong balance sheets and good yields. We continue to view the bond market as expensive, given that interest rates are near record lows.

### Recent Developments

Recent economic data from the United States indicates that a double-dip recession will most likely not materialize. Likewise, economic data from Germany also points to a better-than-expected economic environment. Although many challenges still exist, we believe a better economic environment will do much to improve the mood of the markets. We plan to maintain the asset mix structure of the Fund in anticipation of improvements in returns in equity markets.

While risks remain, we believe markets have accounted for many of these risks in market prices. We will continue to maintain our approach, while keeping a watchful eye on developments in Europe, the United States and the rest of the global economy.

### Related-Party Transactions

#### *Manager and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Principal Portfolio Advisor*

BonaVista, a subsidiary of RBC GAM, is the principal portfolio advisor for the Fund and provides investment advice and portfolio management services to the Fund. The fees paid to BonaVista are paid by RBC GAM and not the Fund.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series B or Series D units.

***Trustee and Custodian***

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

***Other Related-Party Transactions***

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

***Related-Party Trading Activities***

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

***Inter-Fund Trading***

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year	
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total		
<b>Series C</b>													
<b>Dec. 31, 2011</b>	<b>11.04</b>	<b>0.29</b>	<b>(0.25)</b>	<b>0.04</b>	<b>(1.00)</b>	<b>(0.92)</b>	–	<b>(0.08)</b>	–	–	<b>(0.08)</b>	<b>10.12</b>	
Dec. 31, 2010	10.26	0.28	(0.23)	0.14	0.62	0.81	(0.01)	(0.04)	–	–	(0.05)	11.04	
Dec. 31, 2009	8.52	0.29	(0.21)	(0.03)	2.17	2.22	(0.03)	(0.05)	–	–	(0.08)	10.26	
Dec. 31, 2008 <sup>3</sup>	8.21 <sup>†</sup>	0.10	(0.02)	(0.11)	0.78	0.75	(0.02)	(0.01)	–	–	(0.03)	8.52	
<b>Advisor Series</b>													
<b>Dec. 31, 2011</b>	<b>11.04</b>	<b>0.29</b>	<b>(0.25)</b>	<b>0.04</b>	<b>(1.00)</b>	<b>(0.92)</b>	–	<b>(0.08)</b>	–	–	<b>(0.08)</b>	<b>10.12</b>	
Dec. 31, 2010 <sup>4</sup>	10.75 <sup>†</sup>	0.05	(0.04)	0.02	0.24	0.27	(0.01)	(0.02)	–	–	(0.03)	11.04	
<b>Series B</b>													
<b>Dec. 31, 2011</b>	<b>10.74</b>	<b>0.27</b>	<b>(0.19)</b>	<b>0.04</b>	<b>(0.94)</b>	<b>(0.82)</b>	–	<b>(0.13)</b>	–	–	<b>(0.13)</b>	<b>9.89</b>	
Dec. 31, 2010	10.74	0.12	(0.09)	0.05	(0.10)	(0.02)	(0.03)	–	–	–	(0.03)	10.69	
Dec. 31, 2009	8.28	0.28	(0.16)	(0.03)	1.73	1.82	(0.05)	(0.07)	–	–	(0.12)	9.97	
Dec. 31, 2008	10.75	0.34	(0.17)	(0.56)	(2.54)	(2.93)	(0.06)	(0.04)	–	–	(0.10)	8.28	
Dec. 31, 2007 <sup>5</sup>	10.75 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	10.75	
<b>Series D<sup>6</sup></b>													
<b>Dec. 31, 2011</b>	<b>10.97</b>	<b>0.30</b>	<b>(0.13)</b>	<b>0.05</b>	<b>(1.04)</b>	<b>(0.82)</b>	–	<b>(0.19)</b>	–	–	<b>(0.19)</b>	<b>10.05</b>	
Dec. 31, 2010	10.17	0.28	(0.13)	0.14	0.61	0.90	(0.04)	(0.11)	–	–	(0.15)	10.97	
Dec. 31, 2009	8.44	0.29	(0.11)	(0.03)	1.70	1.85	(0.07)	(0.10)	–	–	(0.17)	10.17	
Dec. 31, 2008	10.73	0.33	(0.12)	(0.33)	(1.89)	(2.01)	(0.11)	(0.07)	–	–	(0.18)	8.44	
Dec. 31, 2007	10.95	0.31	(0.14)	0.32	(0.68)	(0.19)	(0.07)	(0.04)	(0.21)	–	(0.32)	10.73	
<b>Series F</b>													
<b>Dec. 31, 2011</b>	<b>10.97</b>	<b>0.31</b>	<b>(0.08)</b>	<b>0.05</b>	<b>(1.06)</b>	<b>(0.78)</b>	–	<b>(0.21)</b>	–	–	<b>(0.21)</b>	<b>10.09</b>	
Dec. 31, 2010	10.16	0.27	(0.07)	0.13	0.60	0.93	(0.06)	(0.13)	–	–	(0.19)	10.97	
Dec. 31, 2009	8.43	0.29	(0.09)	(0.03)	1.76	1.93	(0.09)	(0.11)	–	–	(0.20)	10.16	
Dec. 31, 2008	10.75	0.37	(0.09)	(0.74)	(3.02)	(3.48)	(0.12)	(0.08)	–	–	(0.20)	8.43	
Dec. 31, 2007 <sup>5</sup>	10.75 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	10.75	
<b>Series O</b>													
<b>Dec. 31, 2011</b>	<b>10.72</b>	<b>0.31</b>	<b>(0.02)</b>	<b>0.05</b>	<b>(1.08)</b>	<b>(0.74)</b>	–	<b>(0.30)</b>	–	–	<b>(0.30)</b>	<b>9.82</b>	
Dec. 31, 2010	9.96	0.27	(0.02)	0.13	0.59	0.97	(0.08)	(0.19)	–	–	(0.27)	10.72	
Dec. 31, 2009	8.28	0.28	(0.01)	(0.03)	1.72	1.96	(0.12)	(0.16)	–	–	(0.28)	9.96	
Dec. 31, 2008	10.65	0.28	(0.02)	(0.31)	(2.38)	(2.43)	(0.21)	(0.15)	–	–	(0.36)	8.28	
Dec. 31, 2007	10.94	0.28	(0.02)	0.25	(0.29)	0.22	(0.19)	(0.11)	(0.23)	–	(0.53)	10.65	

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> From December 2007.

<sup>6</sup> Series D was known as Series A prior to November 17, 2008.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>10.13</b>	<b>126</b>	<b>12</b>	<b>2.33</b>	<b>2.33</b>	<b>62.39</b>	<b>0.08</b>
Dec. 31, 2010	11.06	363	33	2.26	2.26	61.74	0.06
Dec. 31, 2009	10.27	182	18	2.28 <sup>2</sup>	3.41	62.99	0.09
Dec. 31, 2008 <sup>5</sup>	8.53	35	4	2.23	11.39	109.55	0.16
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>10.13</b>	<b>1</b>	<b>–</b>	<b>2.33</b>	<b>2.33</b>	<b>62.39</b>	<b>0.08</b>
Dec. 31, 2010 <sup>6</sup>	11.06	–	–	2.26	2.26	61.74	0.06
<b>Series B</b>							
<b>Dec. 31, 2011</b>	<b>9.90</b>	<b>70</b>	<b>7</b>	<b>1.76</b>	<b>1.76</b>	<b>62.39</b>	<b>0.08</b>
Dec. 31, 2010	10.76	1 196	111	1.73	1.73	61.74	0.06
Dec. 31, 2009	9.99	1 392	139	1.76 <sup>2</sup>	2.48	62.99	0.09
Dec. 31, 2008	8.29	1 140	138	1.77	2.50	109.55	0.16
Dec. 31, 2007 <sup>7</sup>	10.75	–	–	–	–	44.28	0.05
<b>Series D<sup>8</sup></b>							
<b>Dec. 31, 2011</b>	<b>10.06</b>	<b>3 160</b>	<b>314</b>	<b>1.31</b>	<b>1.31</b>	<b>62.39</b>	<b>0.08</b>
Dec. 31, 2010	10.98	4 660	424	1.35	1.35	61.74	0.06
Dec. 31, 2009	10.19	4 674	459	1.23 <sup>2</sup>	2.03	62.99	0.09
Dec. 31, 2008	8.45	3 573	423	1.25	2.14	109.55	0.16
Dec. 31, 2007	10.75	3 092	288	1.25	2.55	44.28	0.05
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>10.10</b>	<b>–</b>	<b>–</b>	<b>0.96</b>	<b>0.96</b>	<b>62.39</b>	<b>0.08</b>
Dec. 31, 2010	10.99	1	–	0.98	0.98	61.74	0.06
Dec. 31, 2009	10.17	1	–	0.93 <sup>2</sup>	58.92	62.99	0.09
Dec. 31, 2008	8.44	1	–	0.99	120.90	109.55	0.16
Dec. 31, 2007 <sup>7</sup>	10.75	–	–	–	–	44.28	0.05
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>9.84</b>	<b>739</b>	<b>75</b>	<b>0.18</b>	<b>0.18</b>	<b>62.39</b>	<b>0.08</b>
Dec. 31, 2010	10.73	357	33	0.17	0.17	61.74	0.06
Dec. 31, 2009	9.97	571	57	0.18 <sup>2</sup>	0.98	62.99	0.09
Dec. 31, 2008	8.29	464	56	0.20	0.98	109.55	0.16
Dec. 31, 2007	10.66	1 348	126	0.20	1.26	44.28	0.05

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 2.21%, Series B – 1.69%, Series D – 1.17%, Series F – 0.86%, Series O – 0.12%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> From December 2007.

<sup>8</sup> Series D was known as Series A prior to November 17, 2008.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	2.00%	50%	50%
Advisor Series	2.00%	50%	50%
Series B	1.50%	33%	67%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

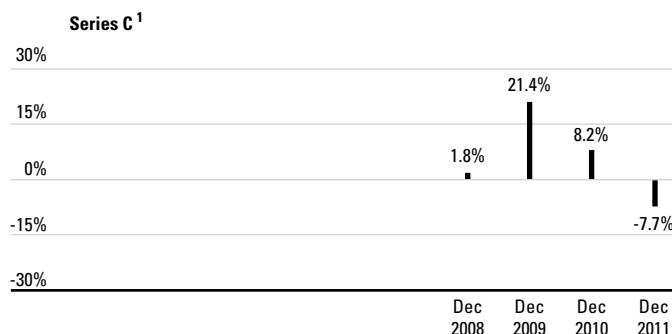
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

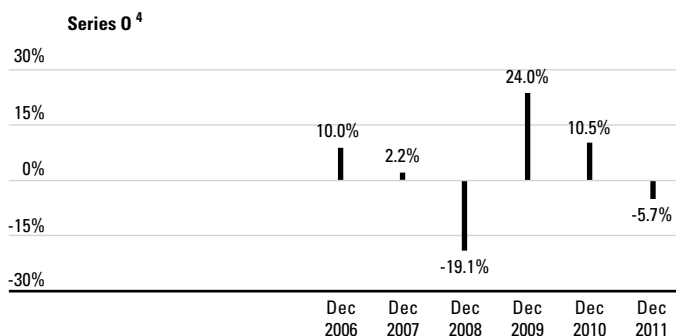
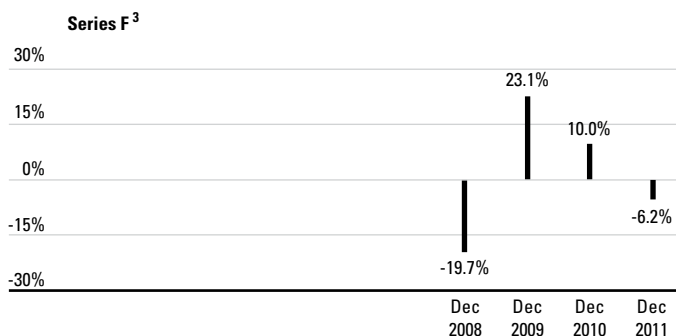
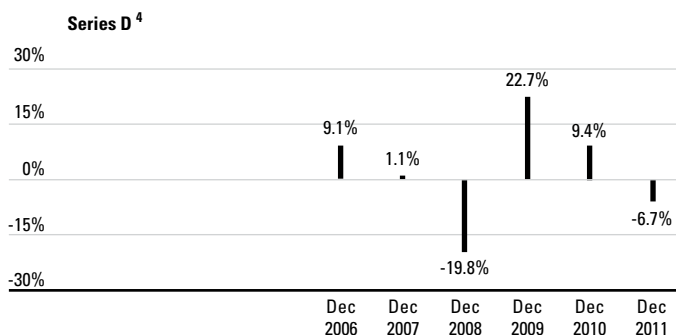
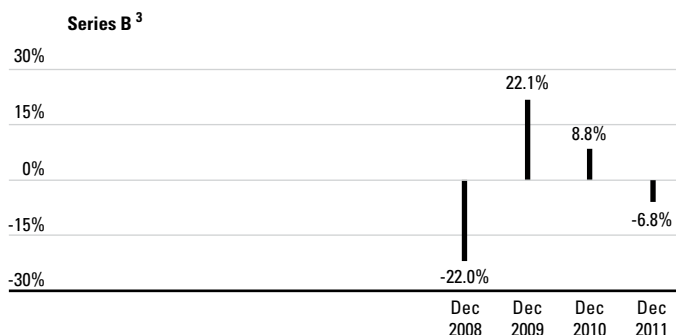
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmarks:

The blended benchmark (the "Benchmark") is composed of:

- 45% DEX Universe Bond Index
- 35% S&P/TSX Capped Composite Total Return Index
- 10% S&P 500 Total Return Index (CDNS)
- 10% MSCI EAFE Total Return Index (CDNS)

The broad-based index is the DEX Universe Bond Index.

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-7.7	6.7	—	—	7.1
Benchmark	0.6	9.0	—	—	9.1
Broad-based index	9.7	7.3	—	—	8.1
Advisor Series <sup>2</sup>	-7.7	—	—	—	-4.0
Benchmark	0.6	—	—	—	2.5
Broad-based index	9.7	—	—	—	7.4
Series B <sup>3</sup>	-6.8	7.4	—	—	-0.8
Benchmark	0.6	9.0	—	—	2.4
Broad-based index	9.7	7.3	—	—	7.1
Series D <sup>4</sup>	-6.7	7.8	0.3	—	1.9
Benchmark	0.6	9.0	2.7	—	4.3
Broad-based index	9.7	7.3	6.4	—	6.8
Series F <sup>3</sup>	-6.2	8.3	—	—	0.5
Benchmark	0.6	9.0	—	—	2.4
Broad-based index	9.7	7.3	—	—	7.1
Series O <sup>4</sup>	-5.7	8.9	1.3	—	3.0
Benchmark	0.6	9.0	2.7	—	4.3
Broad-based index	9.7	7.3	6.4	—	6.8

The returns of each series may vary because of differences in management fees and expenses. The Benchmark and broad-based index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark and broad-based index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date December 2007.

<sup>4</sup> Inception date June 2006.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**DEX Universe Bond Index** This index is designed as a broad measure of the Canadian investment-grade fixed-income market, and includes bonds with maturities of at least one year.

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**S&P 500 Total Return Index (CDNS)** This index is a capitalization weighted index measuring the Canadian dollar performance of 500 widely held common stocks representing all major industries in the United States. This index gives investors a broad measure of the overall performance of the U.S. stock market.

**MSCI EAFE Total Return Index (CDNS)** This index is a broad measure of the Canadian dollar performance of stocks from developed equity markets covering countries in Europe, Australasia and the Far East.

## SUMMARY OF INVESTMENT PORTFOLIO

(after consideration of derivative products, if any)  
As at December 31, 2011

### Investment Mix

	% of Net Asset Value
Canadian Equities	42.1
Bonds	30.4
U.S. Equities	11.8
Overseas Equities	11.6
Cash/Other	4.1

### Top 25 Holdings

	% of Net Asset Value
Phillips, Hager & North Overseas Equity Fund	12.0
Cash & Cash Equivalents	3.7
Toronto-Dominion Bank	2.6
Suncor Energy Inc.	2.5
Bank of Nova Scotia	2.4
Canadian Imperial Bank of Commerce	2.3
Canada Housing Trust No. 1 3.350% Dec 15 20	2.1
Canada Housing Trust No. 1 3.800% Jun 15 21	1.9
Canadian Natural Resources Ltd.	1.9
Peel Regional Municipality 5.100% Jun 29 40	1.8
Canadian National Railway Co.	1.7
Bank of Montreal	1.7
CDP Financial Inc. 4.600% Jul 15 20	1.6
Teck Resources Ltd., Class B	1.6
Province of British Columbia 3.250% Dec 18 21	1.5
Royal Bank of Canada	1.5
Government of Canada 2.500% Sep 1 13	1.5
TMX Group Inc.	1.4
American Express Canada Credit Corp. 4.853% Oct 3 14	1.4
Teranet Holdings LP 3.531% Dec 16 15	1.4
Province of Ontario 3.150% Jun 2 22	1.4
Magna International Inc., Class A	1.3
Government of Canada 5.750% Jun 1 33	1.3
Government of Canada 3.000% Dec 1 15	1.3
Wells Fargo Financial Canada Corp. 3.970% Nov 3 14	1.3
Top 25 Holdings	55.1

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, [www.phn.com](http://www.phn.com), or by e-mailing us at [info@phn.com](mailto:info@phn.com).



CANADIAN EQUITY FUND

## BONAVISTA CANADIAN EQUITY VALUE FUND

December 31, 2011

**Portfolio Manager** RBC Global Asset Management Inc. ("RBC GAM")

Portfolio Advisor: BonaVista Asset Management Ltd. ("BonaVista")

The Board of Directors of RBC Global Asset Management Inc. approved this annual management report of fund performance on March 6, 2012.

### **A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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*This annual management report of fund performance ("MRFP") contains financial highlights but does not contain the complete annual financial statements of the Fund. You can get a copy of the financial statements at your request, and at no cost, by calling 1-800-661-6141, by writing to us at RBC Global Asset Management Inc., Phillips, Hager & North Investment Management, Investment Funds Centre, 20th Floor, 200 Burrard Street, Vancouver, B.C., V6C 3N5, or by visiting our website at [www.rbcgam.com/reports](http://www.rbcgam.com/reports) or SEDAR at [www.sedar.com](http://www.sedar.com). Security holders 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.*

*Phillips, Hager & North Investment Management is an operating division within RBC Global Asset Management Inc., the manager of the Fund and an indirect wholly-owned subsidiary of Royal Bank of Canada.*

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objective and Strategies

The Fund seeks to provide investors with long-term capital growth by investing primarily in common shares of large-capitalization, high-quality Canadian companies and income trusts. To achieve the Fund's investment objective, we invest in companies that we believe have a superior management team, a leadership position within their industry, a high level of profitability compared to their peers, and strong earnings potential.

### Risk

There were no significant changes to the investment objective and strategies that affected the Fund's overall level of risk during the reporting period. The risks of investing in the Fund and the suitability of the Fund for particular investors remains as discussed in the Simplified Prospectus.

### Results of Operations

The Fund's net asset value decreased to \$15.6 million as of December 31, 2011, from \$21.5 million at the end of 2010. Of this change, \$3.1 million was due to net outflows and \$2.7 million to investment losses.

During the one-year period ending December 31, 2011, the Fund's Series D units returned -13.5%. Over the same period, the Fund's benchmark, the S&P/TSX Capped Composite Total Return Index, returned -8.7%. The Fund's return is after the deduction of fees and expenses. See the Financial Highlights section for the management expense ratios and the Past Performance section for the returns of the other series, which may vary because of differences in management fees and expenses.

The Fund's underperformance during the year was primarily driven by an overweight position in diversified materials stocks, which, as a group, significantly underperformed the market.

The structure of the portfolio did not change significantly over the year. However, the volatility which has been present in the equity market gave us opportunities at different times to both reduce and eliminate positions, as well as add to some of our favourite holdings at what appear to be attractive prices.

During the second half of the reporting period, we entered into a position in Potash Corporation of Saskatchewan. Potash is the world's largest producer of potash fertilizer.

We also initiated a position in Methanex, a global supplier of methanol (a fuel additive) that operates in five countries.

### Recent Developments

Recent economic data from the United States indicates that a double-dip recession will most likely not materialize. Likewise, economic data from Germany points to a better-than-expected economic environment. Although many challenges still exist, we believe a better economic environment will do much to improve the mood of the markets.

While risks remain, we believe markets already reflect many of these risks. We will continue to maintain our approach, while keeping a watchful eye on developments in Europe, the United States and the rest of the global economy.

### Related-Party Transactions

#### *Manager and Registrar*

RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank") and is the manager and registrar of the Fund. RBC GAM is responsible for the Fund's day-to-day operations, provides investment advice and portfolio management services to the Fund and appoints distributors for the Fund. RBC GAM, as registrar, also keeps the records of who owns the units of the Fund. RBC GAM is paid a management fee by the Fund as compensation for its services. The Fund pays a fixed administration fee to RBC GAM, which, in turn, pays certain operating expenses of the Fund.

Affiliates of RBC GAM that provide services to the Fund in the course of their normal businesses are discussed below.

#### *Principal Portfolio Advisor*

BonaVista, a subsidiary of RBC GAM, is the principal portfolio advisor for the Fund and provides investment advice and portfolio management services to the Fund. The fees paid to BonaVista are paid by RBC GAM and not the Fund.

#### *Distributor*

Phillips, Hager & North Investment Funds Ltd., Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are affiliates of RBC GAM and are the principal distributor of, or distribute certain series of units of, the Fund. Dealers receive an ongoing commission based on the total value of their clients' Series C, or Series D units.

#### *Trustee and Custodian*

RBC Dexia Investor Services Trust ("RBC Dexia") is the trustee and custodian of the Fund. The fees paid to RBC Dexia are paid by RBC GAM and not the Fund.

RBC Dexia holds title to the Fund's property on behalf of unitholders and holds the assets of the Fund.

**Brokerage**

The Fund has established standard brokerage agreements at market rates with related-party dealers. There were no related-party commissions.

**Other Related-Party Transactions**

Pursuant to applicable securities legislation, the Fund relied on the standing instructions from the Board of Governors ("BoG") in its capacity as the Independent Review Committee with respect to one or more of the following transactions:

*Related-Party Trading Activities*

- (a) trades in securities of Royal Bank;
- (b) investments in the securities of issuers for which a related-party dealer acted as an underwriter during the distribution of such securities and the 60-day period following the conclusion of such distribution of the underwritten securities to the public;
- (c) purchases of equity and debt securities from or sales of equity or debt securities to a related-party dealer, where it acted as principal; and

*Inter-Fund Trading*

- (d) purchases or sales of securities of an issuer from or to another investment fund or managed account managed by RBC GAM.

The applicable standing instructions require that Related-Party Trading Activities and Inter-Fund Trading be conducted in accordance with RBC GAM policy and that RBC GAM advise the BoG of a material breach of any standing instruction. RBC GAM policy requires that an investment decision in respect of Related-Party Trading Activities (i) is made in the best interests of the Fund and free from any influence of Royal Bank or its associates or affiliates and without taking into account any consideration relevant to Royal Bank or its affiliates or associates, (ii) represents the business judgment of the portfolio manager, uninfluenced by considerations other than the best interests of the Fund, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Fund. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each 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 or for the periods since inception. This information is derived from the Fund's audited annual financial statements. "Net Assets" are calculated in accordance with Canadian generally accepted accounting principles, which are used to prepare the financial statements (see table below). "Net Asset Value" is derived from the valuation method disclosed in the Phillips, Hager & North Funds' Annual Information Form and is used for transactional purposes (see Ratios and Supplemental Data). All other calculations for the purposes of this MRFP are made using Net Asset Value.

### Change in Net Assets Per Unit (\$)

For the Year/ Period Ended	Net Assets Beginning of Year/Period	Increase (Decrease) from Operations <sup>1</sup>					Annual Distributions <sup>2</sup>					Net Assets End of Year
		Total Revenue (Loss)	Total Expenses	Realized Gains (Losses)	Unrealized Gains (Losses)	Total	From Income (Excluding Dividends)	From Dividends	From Capital Gains	Return of Capital	Total	
<b>Series C</b>												
<b>Dec. 31, 2011</b>	<b>11.34</b>	<b>0.27</b>	<b>(0.21)</b>	<b>0.08</b>	<b>(1.76)</b>	<b>(1.62)</b>	–	<b>(0.02)</b>	–	–	<b>(0.02)</b>	<b>9.71</b>
Dec. 31, 2010	9.94	0.22	(0.20)	0.03	1.35	1.40	–	–	–	–	–	11.34
Dec. 31, 2009	6.94	0.25	(0.19)	(0.16)	3.15	3.05	–	–	–	–	–	9.94
Dec. 31, 2008 <sup>3</sup>	6.98 <sup>†</sup>	0.04	(0.02)	(0.03)	(0.03)	(0.04)	–	–	–	–	–	6.94
<b>Advisor Series</b>												
<b>Dec. 31, 2011</b>	<b>11.34</b>	<b>0.27</b>	<b>(0.21)</b>	<b>0.08</b>	<b>(1.76)</b>	<b>(1.62)</b>	–	<b>(0.02)</b>	–	–	<b>(0.02)</b>	<b>9.71</b>
Dec. 31, 2010 <sup>4</sup>	10.57 <sup>†</sup>	0.04	(0.03)	0.01	0.23	0.25	–	–	–	–	–	11.34
<b>Series D<sup>5</sup></b>												
<b>Dec. 31, 2011</b>	<b>11.41</b>	<b>0.27</b>	<b>(0.13)</b>	<b>0.08</b>	<b>(1.76)</b>	<b>(1.54)</b>	–	<b>(0.11)</b>	–	–	<b>(0.11)</b>	<b>9.77</b>
Dec. 31, 2010	9.94	0.22	(0.12)	0.03	1.36	1.49	–	(0.02)	–	–	(0.02)	11.41
Dec. 31, 2009	6.90	0.21	(0.10)	(0.36)	3.24	2.99	–	(0.02)	–	–	(0.02)	9.94
Dec. 31, 2008	11.28	0.23	(0.12)	(0.35)	(4.04)	(4.28)	–	(0.04)	–	–	(0.04)	6.90
Dec. 31, 2007	11.21	0.24	(0.15)	0.59	(0.40)	0.28	–	–	(0.48)	–	(0.48)	11.28
<b>Series F</b>												
<b>Dec. 31, 2011</b>	<b>11.42</b>	<b>0.27</b>	<b>(0.10)</b>	<b>0.08</b>	<b>(1.79)</b>	<b>(1.54)</b>	–	<b>(0.14)</b>	–	–	<b>(0.14)</b>	<b>9.79</b>
Dec. 31, 2010	9.91	0.22	(0.06)	0.03	1.36	1.55	–	(0.06)	–	–	(0.06)	11.42
Dec. 31, 2009	6.88	0.21	(0.08)	(0.39)	3.33	3.07	–	(0.04)	–	–	(0.04)	9.91
Dec. 31, 2008	11.30	0.22	(0.09)	(0.59)	(7.13)	(7.59)	–	(0.06)	–	–	(0.06)	6.88
Dec. 31, 2007 <sup>6</sup>	11.30 <sup>†</sup>	–	–	–	–	–	–	–	–	–	–	11.30
<b>Series O</b>												
<b>Dec. 31, 2011</b>	<b>11.56</b>	<b>0.27</b>	<b>(0.01)</b>	<b>0.08</b>	<b>(1.81)</b>	<b>(1.47)</b>	–	<b>(0.21)</b>	–	–	<b>(0.21)</b>	<b>9.90</b>
Dec. 31, 2010	10.07	0.22	(0.01)	0.04	1.38	1.63	–	(0.15)	–	–	(0.15)	11.56
Dec. 31, 2009	7.00	0.22	(0.01)	(0.37)	3.07	2.91	–	(0.12)	–	–	(0.12)	10.07
Dec. 31, 2008	11.38	0.23	(0.02)	(0.39)	(4.39)	(4.57)	–	(0.10)	–	–	(0.10)	7.00
Dec. 31, 2007	11.30	0.24	(0.02)	0.69	(0.82)	0.09	–	(0.11)	(0.49)	–	(0.60)	11.38

<sup>1</sup> 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. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>2</sup> Distributions are reinvested in additional units of the Fund or paid in cash.

<sup>3</sup> From November 2008.

<sup>4</sup> From October 2010.

<sup>5</sup> Series D was known as Series A prior to November 17, 2008.

<sup>6</sup> From December 2007.

<sup>†</sup> Initial offering net asset value per unit.

**FINANCIAL HIGHLIGHTS (cont.)**

**Ratios and Supplemental Data**

As at	Net Asset Value Per Unit (\$)	Net Asset Value (\$000s)	Number of Units Outstanding (000s)	Management Expense Ratio (%) <sup>1</sup>	MER Before Absorption (%) <sup>1</sup>	Portfolio Turnover Rate (%) <sup>3</sup>	Trading Expense Ratio (%) <sup>4</sup>
<b>Series C</b>							
<b>Dec. 31, 2011</b>	<b>9.73</b>	<b>113</b>	<b>12</b>	<b>2.11</b>	<b>2.11</b>	<b>9.72</b>	<b>0.04</b>
Dec. 31, 2010	11.36	140	12	2.01	2.01	7.46	0.02
Dec. 31, 2009	9.96	151	15	1.99 <sup>2</sup>	4.18	33.37	0.06
Dec. 31, 2008 <sup>5</sup>	6.96	1	–	2.03	242.71	31.86	0.09
<b>Advisor Series</b>							
<b>Dec. 31, 2011</b>	<b>9.73</b>	<b>1</b>	<b>–</b>	<b>2.11</b>	<b>2.11</b>	<b>9.72</b>	<b>0.04</b>
Dec. 31, 2010 <sup>6</sup>	11.36	–	–	2.01	2.01	7.46	0.02
<b>Series D<sup>7</sup></b>							
<b>Dec. 31, 2011</b>	<b>9.79</b>	<b>6 801</b>	<b>695</b>	<b>1.24</b>	<b>1.24</b>	<b>9.72</b>	<b>0.04</b>
Dec. 31, 2010	11.43	10 600	927	1.21	1.21	7.46	0.02
Dec. 31, 2009	9.96	12 479	1 253	1.23 <sup>2</sup>	1.47	33.37	0.06
Dec. 31, 2008	6.92	8 284	1 198	1.25	1.55	31.86	0.09
Dec. 31, 2007	11.30	8 583	760	1.25	1.58	16.10	0.09
<b>Series F</b>							
<b>Dec. 31, 2011</b>	<b>9.80</b>	<b>3</b>	<b>–</b>	<b>0.95</b>	<b>0.95</b>	<b>9.72</b>	<b>0.04</b>
Dec. 31, 2010	11.45	1	–	0.89	0.89	7.46	0.02
Dec. 31, 2009	9.93	1	–	0.94 <sup>2</sup>	68.56	33.37	0.06
Dec. 31, 2008	6.90	1	–	0.98	133.29	31.86	0.09
Dec. 31, 2007 <sup>8</sup>	11.30	–	–	–	–	16.10	0.09
<b>Series O</b>							
<b>Dec. 31, 2011</b>	<b>9.92</b>	<b>8 707</b>	<b>878</b>	<b>0.13</b>	<b>0.13</b>	<b>9.72</b>	<b>0.04</b>
Dec. 31, 2010	11.58	10 801	933	0.12	0.12	7.46	0.02
Dec. 31, 2009	10.09	5 115	507	0.18 <sup>2</sup>	0.38	33.37	0.06
Dec. 31, 2008	7.02	2 954	421	0.20	0.41	31.86	0.09
Dec. 31, 2007	11.39	3 916	344	0.20	0.44	16.10	0.09

<sup>1</sup> The management expense ratio ("MER") is based on expenses for the stated period, excluding commissions and other portfolio transaction costs, and is expressed as an annualized percentage of the daily average net asset value during the period. RBC GAM may, at its discretion and without notice to unitholders, waive or absorb certain operating expenses. MER includes the waiver or absorption by RBC GAM of certain operating expenses, while the MER before absorption shows the MER prior to operating expenses being waived or absorbed by RBC GAM.

<sup>2</sup> Effective November 1, 2009, a fixed administration fee was introduced in respect of each series of the Fund. If the fixed administration fee would have been in effect throughout 2009, the adjusted MER for each series of the Fund would be: Series C – 1.93%, Series D – 1.16%, Series F – 0.89%, Series O – 0.11%.

<sup>3</sup> The Fund's portfolio turnover rate gives an indication of the level of activity employed by the portfolio manager. 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 the 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 high turnover rate and the performance of the Fund. The portfolio turnover rate is not applicable to money market funds.

<sup>4</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as a percentage of daily average net asset value during the period. The trading expense ratio is not applicable to fixed-income transactions.

<sup>5</sup> From November 2008.

<sup>6</sup> From October 2010.

<sup>7</sup> Series D was known as Series A prior to November 17, 2008.

<sup>8</sup> From December 2007.

**FINANCIAL HIGHLIGHTS (cont.)**

**Management Fees**

RBC GAM is the manager, portfolio advisor and registrar of the Fund. Management fees paid by each series of the Fund are calculated at the applicable annual percentages, before HST, of the daily value of the net assets of each series of the Fund. The breakdown of the services received in consideration of the management fees for each series, as a percentage of the management fees, is as follows:

	Management Fees	Breakdown of Services	
		Distribution	Other*
Series C	1.75%	57%	43%
Advisor Series	1.75%	57%	43%
Series D	1.00%	25%	75%
Series F	0.75%	—	100%

Series O – no management fees are paid by the Fund in respect of Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

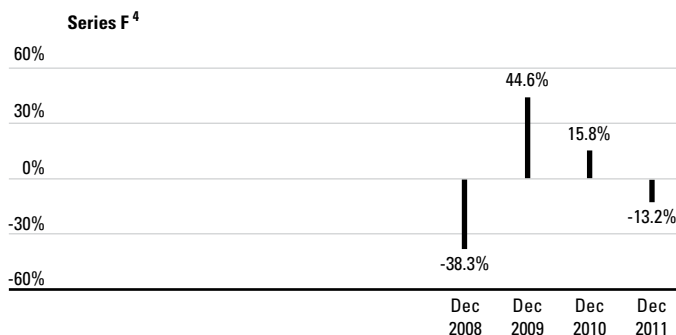
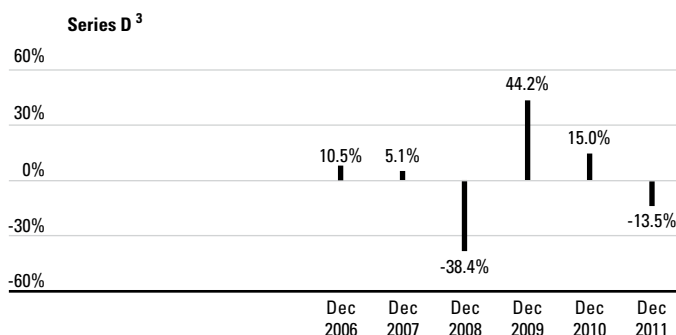
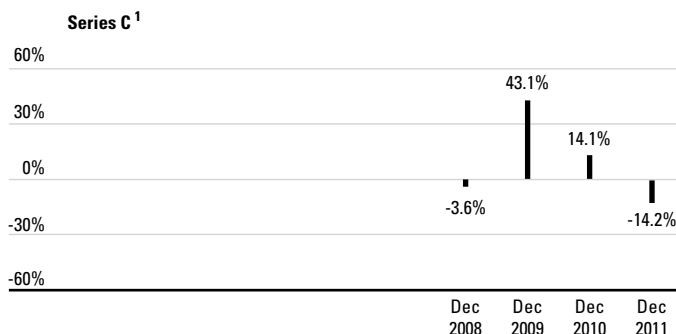
\* Includes all costs related to management, investment advisory services, general administration and profit.

**PAST PERFORMANCE**

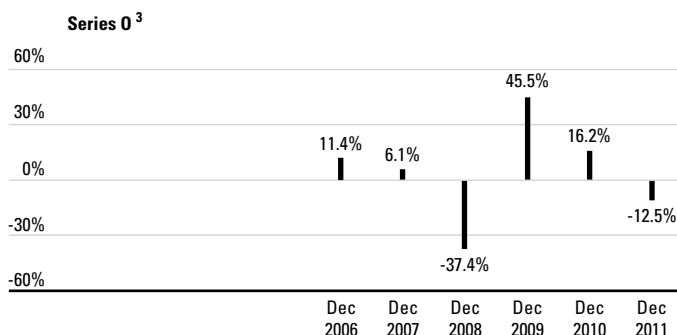
The performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund and would be lower if distributions were not reinvested. The performance information does not take into account sales, redemption, distribution, or optional charges, or income taxes payable that would have reduced returns or performance. Past performance does not necessarily indicate how the Fund may perform in the future. A fund with more than 10 years of performance history is only permitted to disclose the past 10 years.

**Year-by-Year Returns (%)**

The bar chart indicates the Fund's performance for each of the years shown, and illustrates how the Fund's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made on the first day of each financial year would have grown or decreased by the end of the financial year.



**PAST PERFORMANCE (cont.)**



**Annual Compound Returns (%)**

The table shows the annual compound returns for each series of the Fund and for each of the periods indicated ended on December 31, 2011, compared with the following benchmark:

**S&P/TSX Capped Composite Total Return Index**

	Past Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception
Series C <sup>1</sup>	-14.2	11.9	—	—	10.2
Benchmark	-8.7	13.2	—	—	11.8
Advisor Series <sup>2</sup>	-14.2	—	—	—	-6.7
Benchmark	-8.7	—	—	—	-2.3
Series D <sup>3</sup>	-13.5	12.8	-1.5	—	0.5
Benchmark	-8.7	13.2	1.3	—	3.4
Series F <sup>4</sup>	-13.2	13.3	—	—	-2.7
Benchmark	-8.7	13.2	—	—	-0.7
Series O <sup>3</sup>	-12.5	14.0	-0.3	—	1.7
Benchmark	-8.7	13.2	1.3	—	3.4

The returns of each series may vary because of differences in management fees and expenses. The Benchmark index returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark index.

<sup>1</sup> Inception date November 2008.

<sup>2</sup> Inception date October 2010.

<sup>3</sup> Inception date June 2006.

<sup>4</sup> Inception date December 2007.

Series D was known as Series A prior to November 17, 2008.

**INDEX DESCRIPTION**

**S&P/TSX Capped Composite Total Return Index** This index is the amended capitalization weighted index measuring the performance of selected securities listed on the Toronto Stock Exchange, with no individual stock exceeding 10% of the overall weight.

**SUMMARY OF INVESTMENT PORTFOLIO**

(after consideration of derivative products, if any)

As at December 31, 2011

**Investment Mix**

	% of Net Asset Value
Financials	35.1
Energy	19.5
Materials	15.2
Industrials	9.0
Consumer Discretionary	8.1
Information Technology	5.6
Telecommunications	3.7
Consumer Staples	3.3
Cash/Other	0.5

**Top 25 Holdings**

	% of Net Asset Value
Bank of Nova Scotia	6.1
Toronto-Dominion Bank	6.1
Suncor Energy Inc.	6.0
Canadian Imperial Bank of Commerce	5.5
Canadian Natural Resources Ltd.	4.6
Canadian National Railway Co.	4.0
Teck Resources Ltd., Class B	3.9
Bank of Montreal	3.9
Royal Bank of Canada	3.7
Agrium Inc.	3.1
Magna International Inc., Class A	2.5
Open Text Corp.	2.3
Manulife Financial Corporation	2.2
TMX Group Inc.	2.1
Rogers Communications Inc., Class B	2.1
Talisman Energy Inc.	2.0
Quadra FNX Mining Ltd.	2.0
Inmet Mining Corp.	1.9
National Bank of Canada	1.9
Cenovus Energy Inc.	1.9
Canadian Tire Corp. Ltd., Class A	1.8
Canadian Pacific Railway Ltd.	1.8
Saputo Group Inc.	1.6
Nexen Inc.	1.6
Sun Life Financial Inc.	1.6
Top 25 Holdings	76.2

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the Fund. It is updated quarterly and may be obtained by calling our Investment Funds Centre at 1-800-661-6141, by viewing on our website, www.phn.com, or by e-mailing us at info@phn.com.

December 31, 2011

On January 1, 2011, the Board of Governors became the independent review committee of the Phillips, Hager & North investment funds. The Board of Governors was first established in 1994 to provide advice to RBC Global Asset Management Inc. regarding conflicts of interest in fund management. All of the members of the Board of Governors are independent of RBC Global Asset Management Inc. and RBC Financial Group.

In its capacity as the independent review committee, the Board of Governors provides input on conflict of interest matters in respect of RBC Global Asset Management Inc. and the Phillips, Hager & North investment funds. At least once per year, the Board of Governors reviews and assesses the adequacy and effectiveness of the fund manager's policies and procedures relating to conflict of interest matters.

The Board of Governors is responsible for reviewing and assessing the independence of its members, the compensation of its members, and the effectiveness of the Board of Governors, its subcommittees and its members. In order to effectively manage its workload, the Board of Governors has three subcommittees: the Financial Advisory Committee, the Investment Conflicts Committee and the Governance Committee.

The Board of Governors has also been asked by RBC Global Asset Management Inc. to maintain its important role of providing advice on other issues relating to the management of the Phillips, Hager & North investment funds. This includes the role of the Financial Advisory Committee of the Board of Governors to provide advice concerning financial reporting, the audit process and financial internal controls.

The annual report of the Board of Governors describing its activities as the independent review committee of the Phillips, Hager & North investment funds is available under Mutual Fund Governance at [www.rbcgam.com](http://www.rbcgam.com) and on SEDAR at [www.sedar.com](http://www.sedar.com).

If you have any questions or comments about the Board of Governors or its committees, please let us know by contacting Nancy Church, Secretary to the Board of Governors, at the address below.



**Lloyd R. McGinnis, OC, PEng**  
Chair of the Board of Governors

**Board of Governors**  
Attention: Nancy Church  
RBC Global Asset Management Inc.  
P.O. Box 7500, Station A  
Toronto, Ontario M5W 1P9

## Board of Governors

**Lloyd R. McGinnis**  
**Chair of the Board of Governors**  
**Director**  
Airport Site Development  
Winnipeg Airports Authority

**Michael G. Thorley<sup>1,4</sup>**  
**Vice Chair of the Board of Governors**  
Retired Lawyer  
Toronto, Ontario

**Selwyn B. Kossuth<sup>1,3</sup>**  
Financial Consultant  
Mississauga, Ontario

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Corporate Director and Consultant  
Toronto, Ontario

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Consultants Ltd.  
Victoria, British Columbia

**Elaine C. Phénix<sup>5</sup>**  
President  
Phénix Capital Inc.  
Montreal, Quebec

**Mary C. Ritchie<sup>2,3</sup>**  
President  
Richford Holdings Ltd.  
Edmonton, Alberta

**Joseph P. Shannon<sup>6</sup>**  
President  
Atlantic Corporation  
Port Hawkesbury, Nova Scotia

**James W. Yuel<sup>6</sup>**  
Chair  
PIC Investment Group Inc.  
Saskatoon, Saskatchewan

<sup>1</sup> Member of the Financial Advisory Committee

<sup>2</sup> Chair of the Financial Advisory Committee

<sup>3</sup> Member of the Investment Conflicts Committee

<sup>4</sup> Chair of the Investment Conflicts Committee

<sup>5</sup> Chair of the Governance Committee

<sup>6</sup> Member of the Governance Committee



**RBC Global Asset Management Inc.**

P.O. Box 7500, Station A  
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**Phillips, Hager & North Investment Management**

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**RBC Global  
Asset Management**