

The accompanying financial statements have been prepared by RBC Global Asset Management Inc. ("RBC GAM"), as manager of the Phillips, Hager & North Investment Funds (the "Funds") and approved by the Board of Directors of RBC GAM. We are responsible for the information contained within these financial statements.

We have maintained appropriate procedures and controls to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada (and they include certain amounts that are based on estimates and judgments). The significant accounting policies, which we believe are appropriate for the Funds, are described in Note 3 to the financial statements.

Although the Board of Directors of RBC GAM is solely responsible for approving the financial statements and overseeing management's financial reporting responsibilities, the Financial Advisory Committee of the Board of Governors provides advice to RBC GAM concerning financial reporting, the audit process and internal controls. Please see *The Role of the Board of Governors* at the end of this report.

Deloitte LLP, Independent Registered Chartered Accountants, have performed an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards. Their report is set out on the next page.



Chief Executive Officer  
RBC Global Asset Management Inc.



**Frank Lippa, CPA, CA**  
Chief Financial Officer and Chief Operating Officer  
RBC Global Asset Management Inc.

March 1, 2013

To the Unitholders of:

Phillips, Hager & North Canadian Money Market Fund	Phillips, Hager & North Dividend Income Fund	Phillips, Hager & North Overseas Equity Fund
Phillips, Hager & North \$U.S. Money Market Fund	Phillips, Hager & North Canadian Equity Fund	Phillips, Hager & North Currency-Hedged Overseas Equity Fund
Phillips, Hager & North Short Term Bond & Mortgage Fund	Phillips, Hager & North Community Values Canadian Equity Fund	Phillips, Hager & North Global Equity Fund
Phillips, Hager & North Bond Fund	Phillips, Hager & North Canadian Equity Value Fund	Phillips, Hager & North Community Values Global Equity Fund
Phillips, Hager & North Community Values Bond Fund	Phillips, Hager & North Canadian Equity Underlying Fund	Phillips, Hager & North LifeTime 2015 Fund
Phillips, Hager & North Total Return Bond Fund	Phillips, Hager & North Canadian Growth Fund	Phillips, Hager & North LifeTime 2020 Fund
Phillips, Hager & North Inflation-Linked Bond Fund	Phillips, Hager & North Canadian Income Fund	Phillips, Hager & North LifeTime 2025 Fund
Phillips, Hager & North High Yield Bond Fund	Phillips, Hager & North Vintage Fund	Phillips, Hager & North LifeTime 2030 Fund
Phillips, Hager & North Short Inflation-linked Bond Fund	Phillips, Hager & North U.S. Dividend Income Fund	Phillips, Hager & North LifeTime 2035 Fund
Phillips, Hager & North Long Inflation-linked Bond Fund	Phillips, Hager & North U.S. Multi-Style All-Cap Equity Fund	Phillips, Hager & North LifeTime 2040 Fund
Phillips, Hager & North Monthly Income Fund	Phillips, Hager & North U.S. Equity Fund	Phillips, Hager & North LifeTime 2045 Fund
Phillips, Hager & North Balanced Fund	Phillips, Hager & North Currency-Hedged U.S. Equity Fund	BonaVista Global Balanced Fund
Phillips, Hager & North Community Values Balanced Fund	Phillips, Hager & North U.S. Growth Fund	BonaVista Canadian Equity Value Fund (collectively referred to as the "Funds")

We have audited the accompanying financial statements of each of the Funds, which comprise the statement of investment portfolio as at December 31, 2012, the statements of net assets as at December 31, 2012 and 2011 and the statements of operations and changes in net assets for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the financial statements

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

### Auditor's responsibility

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

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

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

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of each of the Funds as at December 31, 2012 and 2011 and the results of their operations and changes in their net assets for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants, Licensed Public Accountants

March 1, 2013

Toronto, Ontario

## STATEMENT OF INVESTMENT PORTFOLIO (in \$000s)

## PHILLIPS, HAGER &amp; NORTH U.S. EQUITY FUND

December 31, 2012

Holdings	Security	Cost	Fair Value	% of Net Assets
<b>UNITED STATES EQUITIES</b>				
<b>Consumer Discretionary</b>				
100 800	Darden Restaurants Inc.	\$ 4 461	\$ 4 512	
513 646	General Motors Co.	13 862	14 703	
824 899	Johnson Controls Inc.	23 333	25 128	
252 030	McGraw-Hill Companies Inc.	8 876	13 685	
		50 532	58 028	<b>6.5</b>
<b>Consumer Staples</b>				
807 135	Archer Daniels Midland Co.	24 009	21 949	
269 660	CVS Corp.	9 166	12 955	
423 340	PepsiCo Inc.	27 636	28 776	
452 737	Wal-Mart Stores, Inc.	25 795	30 694	
		86 606	94 374	<b>10.5</b>
<b>Energy</b>				
248 072	Apache Corp.	23 604	19 337	
396 580	Exxon Mobil Corp.	27 616	34 111	
727 285	Nabors Industries Ltd.	15 131	10 439	
572 883	Noble Corp.	20 391	19 806	
306 793	Peabody Energy Corp.	8 547	8 111	
348 802	Valero Energy Corp.	13 748	11 813	
		109 037	103 617	<b>11.5</b>
<b>Financials</b>				
510 155	Aflac Inc.	22 882	26 910	
746 893	AllianceBernstein Holding LP	13 147	12 922	
884 292	Bank of America Corp.	9 496	10 197	
406 610	Berkshire Hathaway Inc., Class B	29 957	36 257	
167 713	Brown & Brown Inc.	3 609	4 239	
630 645	JPMorgan Chase & Co.	23 877	27 553	
163 560	ProAssurance Corp.	6 453	6 855	
141 825	RenaissanceRe Holdings Ltd.	11 072	11 446	
439 927	The Progressive Corp.	9 678	9 219	
934 488	Wells Fargo & Company	26 457	31 751	
		156 628	177 349	<b>19.7</b>
<b>Health Care</b>				
387 482	Becton Dickinson & Co.	29 713	30 095	
461 450	Johnson & Johnson	29 944	32 128	
323 062	Medtronic Inc.	11 986	13 162	
1 032 102	Pfizer Inc.	25 969	25 719	
225 558	Varian Medical Systems Inc.	13 141	15 731	
458 715	VCA Antech Inc.	9 023	9 577	
282 920	Waters Corp.	22 293	24 480	
333 446	WellPoint Inc.	20 631	20 179	
		162 700	171 071	<b>19.0</b>
<b>Industrials</b>				
526 061	Emerson Electric Co.	25 479	27 681	
152 740	Illinois Tool Works Inc.	7 728	9 226	
392 527	Spirit Airlines Inc.	6 748	6 908	
373 897	United Technologies Corp.	28 851	30 455	
		68 806	74 270	<b>8.3</b>

Holdings	Security	Cost	Fair Value	% of Net Assets
<b>Information Technology</b>				
40 860	Apple Inc.	\$ 23 257	\$ 21 626	
1 122 122	Cisco Systems Inc.	24 164	21 911	
380 276	Corning Inc.	4 376	4 763	
38 642	Google Inc., Class A	20 818	27 208	
934 559	Microsoft Corp.	24 372	24 802	
624 866	Oracle Corporation	18 116	20 667	
239 573	QUALCOMM Inc.	11 747	14 750	
405 164	ScanSource Inc.	11 746	12 712	
		138 596	148 439	<b>16.5</b>
<b>Materials</b>				
167 546	Cliffs Natural Resources Inc.	7 995	6 417	
340 280	The Mosaic Co.	18 733	19 139	
		26 728	25 556	<b>2.8</b>
<b>Telecommunication Services</b>				
268 046	AT&T Inc.	7 936	8 977	
783 526	Iridium Communications Inc.	5 341	5 237	
		13 277	14 214	<b>1.6</b>
<b>Utilities</b>				
167 293	Sempra Energy	8 624	11 782	
		8 624	11 782	<b>1.3</b>
<b>TOTAL UNITED STATES EQUITIES</b>				
		821 534	878 700	<b>97.7</b>
<b>SHORT-TERM INVESTMENTS*</b>				
		21 149	21 148	<b>2.4</b>
<b>TOTAL INVESTMENTS</b>				
		\$ 842 683	899 848	<b>100.1</b>
<b>OTHER NET ASSETS (LIABILITIES)</b>				
			(379)	<b>(0.1)</b>
<b>NET ASSETS</b>				
		\$ 899 469		<b>100.0</b>

\* Short-term investments, which may be made up of treasury bills, commercial paper, term deposits and discount notes, earn interest at rates ranging from 0.10% to 0.35% and mature between January 2, 2013 and January 31, 2013.

**Statements of Net Assets** (in \$000s except per unit amounts)

December 31 (see note 2 in the generic notes)	2012	2011
<b>ASSETS</b>		
Investments at fair value	\$ 899 848	\$ 956 085
Cash	26	56
Due from investment dealers	25 886	–
Subscriptions receivable	1 464	2 459
Dividends receivable, interest accrued and other assets	327	975
<b>TOTAL ASSETS</b>	<b>927 551</b>	<b>959 575</b>
<b>LIABILITIES</b>		
Due to investment dealers	26 653	–
Redemptions payable	1 239	1 512
Accounts payable and accrued expenses	190	213
<b>TOTAL LIABILITIES</b>	<b>28 082</b>	<b>1 725</b>
<b>NET ASSETS</b>	<b>\$ 899 469</b>	<b>\$ 957 850</b>
Investments at cost	\$ 842 683	\$ 961 065
<b>NET ASSETS, END OF PERIOD</b>		
<b>SERIES C</b>	<b>\$ 2 914</b>	<b>\$ 2 297</b>
<b>ADVISOR SERIES</b>	<b>\$ 1 005</b>	<b>\$ 709</b>
<b>SERIES B*</b>	<b>\$ –</b>	<b>\$ 20</b>
<b>SERIES D</b>	<b>\$ 162 914</b>	<b>\$ 186 854</b>
<b>SERIES F</b>	<b>\$ 1 411</b>	<b>\$ 1 409</b>
<b>SERIES O</b>	<b>\$ 731 225</b>	<b>\$ 766 561</b>
<b>NET ASSETS PER UNIT, END OF PERIOD</b>		
<b>SERIES C</b>	<b>\$ 31.76</b>	<b>\$ 29.40</b>
<b>ADVISOR SERIES</b>	<b>\$ 31.76</b>	<b>\$ 29.40</b>
<b>SERIES B*</b>	<b>\$ –</b>	<b>\$ 29.40</b>
<b>SERIES D</b>	<b>\$ 31.59</b>	<b>\$ 29.20</b>
<b>SERIES F</b>	<b>\$ 31.72</b>	<b>\$ 29.32</b>
<b>SERIES O</b>	<b>\$ 32.07</b>	<b>\$ 29.65</b>
<b>NET ASSET VALUE (TRANSACTIONAL NAV) PER UNIT, END OF PERIOD (see note 3 in the generic notes)</b>		
<b>SERIES C</b>	<b>\$ 31.77</b>	<b>\$ 29.42</b>
<b>ADVISOR SERIES</b>	<b>\$ 31.77</b>	<b>\$ 29.42</b>
<b>SERIES B*</b>	<b>\$ –</b>	<b>\$ 29.42</b>
<b>SERIES D</b>	<b>\$ 31.60</b>	<b>\$ 29.22</b>
<b>SERIES F</b>	<b>\$ 31.73</b>	<b>\$ 29.33</b>
<b>SERIES O</b>	<b>\$ 32.08</b>	<b>\$ 29.66</b>

**Statements of Operations** (in \$000s except per unit amounts)

For the periods ended December 31 (see note 2 in the generic notes)	2012	2011
<b>INCOME (see note 3 in the generic notes)</b>		
Dividends	\$ 21 181	\$ 19 651
Interest	64	70
Foreign withholding taxes	(3 334)	(3 082)
<b>TOTAL INCOME (LOSS)</b>	<b>17 911</b>	<b>16 639</b>
<b>EXPENSES (see notes – Fund Specific Information)</b>		
Management fees	1 917	1 943
Administration fees	335	350
Board of Governors costs	4	4
GST/HST	246	254
<b>TOTAL EXPENSES</b>	<b>2 502</b>	<b>2 551</b>
<b>NET INVESTMENT INCOME (LOSS)</b>	<b>15 409</b>	<b>14 088</b>
<b>REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS</b>		
Net realized gain (loss) on investments	12 570	(78 588)
Net gain (loss) on foreign currencies and other net assets	(222)	339
Change in unrealized gain (loss) on investments	62 145	84 767
Transaction costs	(775)	(784)
<b>NET GAIN (LOSS) ON INVESTMENTS</b>	<b>73 718</b>	<b>5 734</b>
<b>INCREASE (DECREASE) IN NET ASSETS FROM OPERATIONS</b>		
	\$ 89 127	\$ 19 822
<b>INCREASE (DECREASE) IN NET ASSETS FROM OPERATIONS</b>		
<b>SERIES C</b>	<b>\$ 199</b>	<b>\$ 5</b>
<b>ADVISOR SERIES</b>	<b>\$ 64</b>	<b>\$ –</b>
<b>SERIES B*</b>	<b>\$ –</b>	<b>\$ 1</b>
<b>SERIES D</b>	<b>\$ 15 541</b>	<b>\$ 1 905</b>
<b>SERIES F</b>	<b>\$ 126</b>	<b>\$ 1</b>
<b>SERIES O</b>	<b>\$ 73 197</b>	<b>\$ 17 910</b>
<b>INCREASE (DECREASE) IN NET ASSETS FROM OPERATIONS PER UNIT</b>		
<b>SERIES C</b>	<b>\$ 2.44</b>	<b>\$ 0.10</b>
<b>ADVISOR SERIES</b>	<b>\$ 2.44</b>	<b>\$ 0.10</b>
<b>SERIES B*</b>	<b>\$ –</b>	<b>\$ 0.17</b>
<b>SERIES D</b>	<b>\$ 2.65</b>	<b>\$ 0.33</b>
<b>SERIES F</b>	<b>\$ 2.74</b>	<b>\$ 0.40</b>
<b>SERIES O</b>	<b>\$ 3.07</b>	<b>\$ 0.66</b>

\* All outstanding Series B units were redesignated as Series D units effective July 2012.

Approved by the Board of Directors of RBC Global Asset Management Inc.



**John S. Montalbano**  
Director



**Doug Coulter**  
Director

The accompanying notes are an integral part of these financial statements.

## Statements of Changes in Net Assets (in \$000s)

For the periods ended December 31 (see note 2 in the generic notes)	Series C		Advisor Series		Series B*		Series D	
	2012	2011	2012	2011	2012	2011	2012	2011
<b>NET ASSETS – BEGINNING OF PERIOD</b>	\$ 2 297	\$ 943	\$ 709	\$ 4	\$ –	\$ 22	\$ 186 874	\$ 190 672
<b>INCREASE (DECREASE) FROM OPERATIONS</b>	<b>199</b>	<b>5</b>	<b>64</b>	<b>–</b>	<b>–</b>	<b>1</b>	<b>15 541</b>	<b>1 905</b>
Early redemption fees	–	–	–	–	–	–	–	–
Proceeds from units issued	1 812	2 380	276	776	–	–	26 965	42 326
Proceeds from reinvestment of distributions	–	–	–	–	–	–	927	1 141
Payments on redemption of units	(1 394)	(1 031)	(44)	(71)	–	(3)	(66 336)	(47 892)
<b>TOTAL UNIT TRANSACTIONS</b>	<b>418</b>	<b>1 349</b>	<b>232</b>	<b>705</b>	<b>–</b>	<b>(3)</b>	<b>(38 444)</b>	<b>(4 425)</b>
Distributions from net income	–	–	–	–	–	–	(1 057)	(1 298)
Distributions from net gains	–	–	–	–	–	–	–	–
Distributions from capital	–	–	–	–	–	–	–	–
<b>TOTAL DISTRIBUTIONS</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>(1 057)</b>	<b>(1 298)</b>
<b>TOTAL INCREASE (DECREASE) IN NET ASSETS</b>	<b>617</b>	<b>1 354</b>	<b>296</b>	<b>705</b>	<b>–</b>	<b>(2)</b>	<b>(23 960)</b>	<b>(3 818)</b>
<b>NET ASSETS – END OF PERIOD</b>	<b>\$ 2 914</b>	<b>\$ 2 297</b>	<b>\$ 1 005</b>	<b>\$ 709</b>	<b>\$ –</b>	<b>\$ 20</b>	<b>\$ 162 914</b>	<b>\$ 186 854</b>

For the periods ended December 31 <sup>1</sup> (see note 2 in the generic notes)	Series F		Series O		Total	
	2012	2011	2012	2011	2012	2011
<b>NET ASSETS – BEGINNING OF PERIOD</b>	\$ 1 409	\$ 1 321	\$ 766 561	\$ 764 695	\$ 957 850	\$ 957 657
<b>INCREASE (DECREASE) FROM OPERATIONS</b>	<b>126</b>	<b>1</b>	<b>73 197</b>	<b>17 910</b>	<b>89 127</b>	<b>19 822</b>
Early redemption fees	–	–	–	–	–	–
Proceeds from units issued	1 005	1 029	148 957	223 503	179 015	270 014
Proceeds from reinvestment of distributions	8	8	12 800	14 088	13 735	15 237
Payments on redemption of units	(1 124)	(936)	(256 917)	(239 109)	(325 815)	(289 042)
<b>TOTAL UNIT TRANSACTIONS</b>	<b>(111)</b>	<b>101</b>	<b>(95 160)</b>	<b>(1 518)</b>	<b>(133 065)</b>	<b>(3 791)</b>
Distributions from net income	(13)	(14)	(13 373)	(14 526)	(14 443)	(15 838)
Distributions from net gains	–	–	–	–	–	–
Distributions from capital	–	–	–	–	–	–
<b>TOTAL DISTRIBUTIONS</b>	<b>(13)</b>	<b>(14)</b>	<b>(13 373)</b>	<b>(14 526)</b>	<b>(14 443)</b>	<b>(15 838)</b>
<b>TOTAL INCREASE (DECREASE) IN NET ASSETS</b>	<b>2</b>	<b>88</b>	<b>(35 336)</b>	<b>1 866</b>	<b>(58 381)</b>	<b>193</b>
<b>NET ASSETS – END OF PERIOD</b>	<b>\$ 1 411</b>	<b>\$ 1 409</b>	<b>\$ 731 225</b>	<b>\$ 766 561</b>	<b>\$ 899 469</b>	<b>\$ 957 850</b>

\* All outstanding Series B units were redesignated as Series D units effective July 2012.

December 31, 2012

**Financial instrument risk and capital management  
(see note 4 in the generic notes)****Currency risk (% of net assets)**

The table below summarizes the Fund's net exposure (after hedging, if any) to currency risk as at:

	December 31 2012	December 31 2011
Currency		
United States dollar	100.1	99.8
Total	100.1	99.8

As at December 31, 2012, if the Canadian dollar had strengthened or weakened by 1% in relation to the above currency, with all other factors kept constant, the Fund's net assets may have decreased or increased, respectively, by approximately 1.0% (December 31, 2011 – 1.0%). In practice, actual results could differ from this sensitivity analysis and the difference could be material.

**Other price risk (% impact on net assets)**

The table below shows the impact of a 1% change in the broad-based index (noted below) on the Fund's net assets, using a 36-month historical correlation of data of the Fund's return and the index, with all other factors kept constant, as at:

	December 31 2012	December 31 2011
S&P 500 Total Return Index (CAD)	+ or - 1.1	+ or - 1.2

Since historical correlation may not be representative of future correlation, actual results could differ from this sensitivity analysis and the difference could be material.

**Fair value hierarchy (\$000s except % amounts)  
(see note 3 in the generic notes)**

The following is a summary of the inputs used as of December 31, 2012 and 2011 in the valuation of the Fund's financial instruments carried at fair value.

December 31, 2012	Level 1	Level 2	Level 3	Total
<b>Equities</b>	<b>878 700</b>	–	–	<b>878 700</b>
<b>Mutual fund units</b>	–	–	–	–
<b>Fixed-income and debt securities</b>	–	–	–	–
<b>Short-term investments</b>	–	<b>21 148</b>	–	<b>21 148</b>
<b>Derivatives – assets</b>	–	–	–	–
<b>Derivatives – liabilities</b>	–	–	–	–
<b>Total financial instruments</b>	<b>878 700</b>	<b>21 148</b>	–	<b>899 848</b>
<b>% of total portfolio</b>	<b>97.6</b>	<b>2.4</b>	–	<b>100.0</b>

December 31, 2011	Level 1	Level 2	Level 3	Total
Equities	935 939	–	–	935 939
Mutual fund units	–	–	–	–
Fixed-income and debt securities	–	–	–	–
Short-term investments	–	20 146	–	20 146
Derivatives – assets	–	–	–	–
Derivatives – liabilities	–	–	–	–
Total financial instruments	935 939	20 146	–	956 085
% of total portfolio	97.9	2.1	–	100.0

For the periods ended December 31, 2012 and 2011, there were no transfers of financial instruments between Level 1 and Level 2.

**Management fees (see note 7 in the generic notes)**

No management fees are payable by the Fund with respect to Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

Management fees of the other series of the Fund are calculated at the following annual percentages, before GST/HST, of the daily net asset value of each series of the Fund.

Series C	1.75%
Advisor Series	1.75%
Series B	1.50%
Series D	1.00%
Series F	0.75%

December 31, 2012

**Operating expenses (see note 7 in the generic notes)**

Administration fees payable by each series of the Fund are calculated at the following annual percentages, before GST/HST, of the daily net asset value of each series of the Fund.

Series C	0.10%
Advisor Series	0.10%
Series B	0.10%
Series D	0.10%
Series F	0.10%
Series O	0.02%

**Initial investments (\$000s except unit amounts)**

Royal Bank of Canada, or one of its subsidiaries, held the following investments in the Fund as at:

	December 31 2012	December 31 2011
<b>Units held</b>		
Series C	19	19
Advisor Series	36	36
Series B	–	19
Series D	19	–
Series F	19	19
<b>Value of all units</b>	<b>\$ 3</b>	<b>\$ 3</b>

**Taxes (\$000s) (see note 5 in the generic notes)**

The capital losses as at December 31, 2012 for the Fund were \$560 441. The Fund had no non-capital losses.

**Unitholders' equity (000s)**

The unitholders' equity of the Fund includes amounts representing units, undistributed net income (loss), realized gain (loss) on investments and unrealized gain (loss) on investments. There is no limitation on the number of units available for issue. Units are purchased and redeemed at the transactional NAV per unit.

For the periods ended December 31  
(see note 2 in the generic notes)

	2012	2011
<b>Series C</b>		
Opening units	78	32
Issued number of units	59	81
Reinvested number of units	–	–
Redeemed number of units	(45)	(35)
Ending number of units	92	78
<b>Advisor Series</b>		
Opening units	24	–
Issued number of units	9	27
Reinvested number of units	–	–
Redeemed number of units	(1)	(3)
Ending number of units	32	24
<b>Series B</b>		
Opening units	–	1
Issued number of units	–	–
Reinvested number of units	–	–
Redeemed number of units	–	–
Ending number of units	–	1
<b>Series D</b>		
Opening units	6 399	6 579
Issued number of units	879	1 451
Reinvested number of units	29	39
Redeemed number of units	(2 150)	(1 671)
Ending number of units	5 157	6 398
<b>Series F</b>		
Opening units	48	45
Issued number of units	32	37
Reinvested number of units	–	–
Redeemed number of units	(36)	(34)
Ending number of units	44	48
<b>Series O</b>		
Opening units	25 857	25 988
Issued number of units	4 754	7 565
Reinvested number of units	398	472
Redeemed number of units	(8 211)	(8 168)
Ending number of units	22 798	25 857

December 31, 2012

**Transaction costs (\$000s except %)**

Transaction costs, including brokerage commissions, in consideration of portfolio transactions for the periods ended:

	December 31 2012		December 31 2011	
	\$	%	\$	%
Total transaction costs	<b>775</b>	<b>100</b>	784	100
Related-party brokerage commissions*	<b>2</b>	–	–	–
Commission arrangements†	<b>190</b>	<b>25</b>	190	24

\* See note 7 in the generic notes.

† Commission arrangements are part of commission amounts paid to dealers. The Fund uses commission arrangements (formerly known as “soft dollars”) for research and/or order execution goods and services.

**Investments by other related Investment Funds  
(000s) (see note 7 in the generic notes)**

The following outstanding units of the Fund were held by the following related Investment Funds as at:

	December 31 2012	December 31 2011
<b>Series 0</b>		
Phillips, Hager & North Currency-Hedged		
U.S. Equity Fund	<b>3 204</b>	4 244
Phillips, Hager & North Balanced Fund	<b>2 889</b>	3 511
Phillips, Hager & North Balanced Pension Trust	<b>5 341</b>	6 664
Phillips, Hager & North Global Equity Fund	<b>1 717</b>	1 926
Total	<b>13 151</b>	16 345

## 1. The Funds

The mutual funds (“Fund” or “Funds”) are open-ended mutual fund trusts governed by the laws of the Province of British Columbia and governed by a Master Declaration of Trust. RBC GAM is the manager and portfolio advisor of the Funds.

The Funds may issue an unlimited number of units in some or all of Series C, Advisor Series, Series H, Series B, Series D, Series F, Series I and Series O.

Series C units are available to investors who purchase units from authorized third-party dealers.

Advisor Series units are available to all investors with an initial sales charge or low-load sales charge option. Under the initial sales charge option, investors pay a sales commission ranging from 0% to 5% of the amount invested. Under the low-load sales charge option, investors do not pay a commission.

Series H units have lower fees than Series C units and are only available to investors who invest and maintain the required minimum balance.

Series B units were previously available to investors who purchased units from authorized third-party dealers. All outstanding Series B units were redesignated as Series D units effective July 2012.

Series D units are available to all investors and may be purchased, switched or redeemed through Phillips, Hager & North Investment Funds Ltd. (“PH&N IF”) or certain other authorized dealers (primarily discount brokers).

Series F units are available to investors who have fee-based accounts with their dealer.

Series I units have lower fees than Series F units and are only available to investors who invest and maintain the required minimum balance and who have accounts with dealers who have signed a fee-based agreement with RBC GAM.

Series O units are only available to large private or institutional investors as may be determined from time to time on a case-by-case basis. Series O units may only be purchased, switched or redeemed through RBC GAM or, in certain circumstances, PH&N IF.

## 2. Financial year/period

The information provided in these financial statements and notes thereto is for the 12-month periods ended or as at December 31, 2012 and 2011. In the year a Fund or series is

established, “period” represents the period from inception to December 31 of that fiscal year.

## 3. Summary of significant accounting policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”), which include estimates and assumptions made by management that may affect the reported amounts of assets (primarily valuation of investments), liabilities, income and expenses during the reported periods. Actual results may differ from estimates. The significant accounting policies of the Funds are as follows:

**Valuation of Investments** The valuation methods used to calculate the daily net asset value to transact units of the Funds (“transactional NAV”), as described in the Funds’ Annual Information Form, are not identical to the GAAP valuation methods used to determine the financial statement net assets (“net assets”) described below. The primary difference between net assets and transactional NAV relates to valuation of actively traded securities at bid prices for net assets and at last sale prices for transactional NAV.

In accordance with the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3862, *Financial Instruments – Disclosures*, the Funds’ financial instruments are measured at fair value using a three-tier hierarchy based on inputs used to value the Funds’ investments and derivatives. The hierarchy of inputs is summarized below:

*Level 1* – quoted prices (unadjusted) in active markets for identical assets or liabilities;

*Level 2* – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

*Level 3* – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Changes in valuation methods may result in transfers into or out of an investment’s assigned level.

The three-tier hierarchy of investments and derivatives is included in “Notes to Financial Statements – Fund Specific Information.”

Investments are recorded at fair value, which is determined as follows:

*Equities* – Common shares, preferred shares and exchange-traded funds are valued at the closing bid price recorded by the security exchange on which the security is principally traded.

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*Fixed-Income and Debt Securities* – Bonds, mortgage-backed securities and debentures are valued at the closing bid price quoted by major dealers in such securities.

Mortgages are valued at a principal amount, which produces a yield equivalent to the prevailing rate of return on mortgages of similar type and term.

*Short-Term Investments* – Short-term investments are valued at their cost including applicable foreign exchange translations. This value, together with accrued interest, approximates fair value using closing bid prices.

*Options* – Listed options are valued at the closing bid price on the recognized exchange on which the option is traded for the long positions and the ask price for the short positions. The premium received for written options is recorded as a credit in the Statement of Investment Portfolio and adjusted daily to the fair value of the written option.

*Forward Contracts* – Forward contracts are valued at the gain or loss that would arise as a result of closing the position at the valuation date. Any gain or loss at the close of business on each valuation date is recorded in the Statements of Operations. The net receivable/payable on forward contracts is recorded separately in the Statements of Net Assets. Realized gain (loss) on foreign exchange contracts is included in “Net gain (loss) on foreign currencies and other net assets” in the Statements of Operations.

*Futures Contracts* – Futures contracts entered into by the Funds are financial agreements to purchase or sell a financial instrument at a contracted price on a specified future date. However, the Funds do not intend to purchase or sell the financial instrument on the settlement date; rather, they intend to close out each futures contract before settlement by entering into equal, but offsetting, futures contracts. Futures contracts are valued at the gain or loss that would arise as a result of closing the position at the valuation date. Any gain or loss at the close of business on each valuation date is recorded as “Net gain (loss) from futures contracts” in the Statements of Operations. The net receivable/payable on futures contracts is recorded separately in the Statements of Net Assets.

*Mutual Fund Unit Valuation* – Units of Funds are valued at their respective transactional NAV per unit received from fund companies on the relevant valuation dates.

*Fair Valuation of Investments (including unlisted securities)* – If the valuation methods described above are not appropriate, RBC GAM will estimate the fair value of an investment using established fair valuation procedures, such as consideration of public information, broker quotes, valuation models, fundamental analysis, matrix pricing, discounts from market prices of similar securities or discounts applied due to restrictions on the disposition of securities, and external fair value service providers.

Procedures are in place to determine the fair value of foreign securities traded in countries outside North America daily, to avoid stale prices and to take into account, among other things, any significant events occurring after the close of a foreign market. This fair valuation process takes into account the last quoted price of the security and adjusts the price based on inputs such as related indices, changes in foreign markets and American Depository Receipts (“ADR”) prices. These securities are classified as Level 2.

**Foreign Exchange** The value of investments and other assets and liabilities in foreign currencies is translated into Canadian dollars (U.S. dollars in the case of the Phillips, Hager & North \$U.S. Money Market Fund) at the rate of exchange on each valuation date. Purchases and sales of investments, income and expenses are translated at the rate of exchange prevailing on the respective dates of such transactions. Realized foreign exchange gains/losses are included in “Net gain (loss) on foreign currencies and other net assets” in the Statements of Operations.

**Valuation of Series** A different net asset value is calculated for each series of units of a Fund. The net asset value of a particular series of units is computed by calculating the value of the series’ proportionate share of the assets and liabilities of the Fund common to all series less the liabilities of the Fund attributable only to that series. Expenses directly attributable to a series are charged to that series. Other expenses are allocated proportionately to each series based upon the relative net asset value of each series. Expenses are accrued daily.

**Investment Transactions** Investment transactions are accounted for as of the trade date. Transaction costs, such as brokerage commissions, incurred by the Funds are recorded in the Statements of Operations for the period. The period change in the difference between fair value and average cost of securities represents unrealized gains and losses. The basis of determining the cost of portfolio assets, and realized and unrealized gains and losses on investments, is average cost.

**Income Recognition** Dividend income is recognized on the ex-dividend date and interest income is recognized on an accrual basis. “Other income (loss)” includes income from income trusts. Distributions received from income trusts are recognized based on the nature of the underlying components, such as income, capital gains and return of capital. “Other revenue” includes income earned by a Fund from investments in underlying funds.

#### **Increase (Decrease) in Net Assets from Operations**

**Per Unit** Increase (decrease) in net assets from operations per unit in the Statements of Operations represents the increase (decrease) in net assets from operations by series, divided by the average units outstanding per series during the period.

**Early Redemption Fees** Early redemption fees (short-term trading fees) are paid directly to the Fund and are designed to deter excessive trading and its associated costs. With the exception of money market funds, a Fund may apply a fee of 2% of the current value of units if the unitholder redeems or switches out units within seven days of purchasing or previously switching into a Fund.

**Foreign Currencies** The following is a list of abbreviations used in the Statement of Investment Portfolio:

AUD – Australian Dollar	JPY – Japanese Yen
CAD – Canadian Dollar	NOK – Norwegian Krone
CHF – Swiss Franc	SGD – Singapore Dollar
EUR – Euro	USD – United States Dollar
GBP – Pound Sterling	

#### **4. Financial instrument risk and capital management**

RBC GAM is responsible for managing each Fund’s capital, which is its net assets and consists primarily of its financial instruments.

A Fund’s investment activities expose it to a variety of financial risks. RBC GAM seeks to minimize potential adverse effects of these risks on a Fund’s performance by employing professional, experienced portfolio advisors, daily monitoring of the Fund’s holdings and market events, diversifying its investment portfolio within the constraints of its investment objectives, and, in some cases, periodically hedging certain risk exposures through the use of derivatives. To assist in managing risks, RBC GAM also uses internal guidelines, maintains a governance structure that oversees each Fund’s investment activities and monitors compliance with the Fund’s investment strategies, internal guidelines and securities regulations.

#### **Liquidity risk**

Liquidity risk is the possibility that investments in a Fund cannot be readily converted into cash when required. A Fund is exposed to daily cash redemptions of redeemable units. Liquidity risk is managed by investing the majority of a Fund’s assets in investments that are traded in an active market and that can be readily disposed. In accordance with securities regulations, a Fund must maintain at least 90% of its assets in liquid investments. In addition, a Fund aims to retain sufficient cash and cash equivalent positions to maintain liquidity, and has the ability to borrow up to 5% of its net assets for the purpose of funding redemptions.

#### **Credit risk**

Credit risk is the risk that a loss could arise from a security issuer or counterparty not being able to meet its financial obligations. The carrying amount of investments and other assets represents the maximum credit risk exposure as disclosed in a Fund’s Statements of Net Assets. The fair value of fixed-income and debt securities includes a consideration of the credit worthiness of the debt issuer. Credit risk exposure to over-the-counter derivative instruments is based on a Fund’s unrealized gain on the contractual obligations with the counterparty. Credit risk exposure is mitigated for those Funds participating in a securities lending program (see note 6). RBC GAM monitors each Fund’s credit exposure and counterparty ratings daily.

#### **Interest rate risk**

Interest rate risk is the risk that the fair value of a Fund’s interest-bearing investments will fluctuate due to changes in market interest rates. The value of fixed-income and debt securities, such as bonds, debentures, mortgages or other income-producing securities, is affected by interest rates. Generally, the value of these securities increases if interest rates fall and decreases if interest rates rise.

#### **Currency risk**

Currency risk is the risk that the value of investments denominated in currencies, other than the functional currency of a Fund, will fluctuate due to changes in foreign exchange rates. The value of investments denominated in a currency other than Canadian dollars is affected by changes in the value of the Canadian dollar or a Fund’s functional currency, in relation to the value of the currency in which the investment is denominated. When the value of the Canadian dollar falls in relation to foreign currencies, then the value of foreign investments rises. When the value of the Canadian dollar rises, the value of foreign investments falls.

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**Other price risk**

Other price risk is the risk that the value of financial instruments will fluctuate as a result of changes in market prices (other than those arising from interest rate or currency risk), whether caused by factors specific to an individual investment, its issuer, or all factors affecting all instruments traded in a market or market segment.

**5. Taxes**

The Funds qualify as open-ended mutual fund trusts or unit trusts under the *Income Tax Act* (Canada). In general, the Funds are subject to income tax, however, no income tax is payable on net income and/or net realized capital gains which are distributed to unitholders. In addition, for mutual fund trusts, income taxes payable on net realized capital gains are refundable on a formula basis when units of the Funds are redeemed.

Capital losses are available to be carried forward indefinitely and applied against future capital gains. Non-capital losses may be carried forward to reduce future taxable income for up to 10 years, with the exception of non-capital losses realized in 2006 and later years, which may be carried forward up to 20 years.

**6. Securities lending revenue**

Certain of the Funds lend portfolio securities from time to time in order to earn additional income. Income from securities lending is included in the Statements of Operations of a Fund. Each such Fund will have entered into a securities lending program with its custodian, RBC Investor Services Trust ("RBC IS"). The aggregate market value of all securities loaned by a Fund cannot exceed 50% of the assets of a Fund. The Fund receives collateral, with an approved credit rating of at least A, of at least 102% of the value of securities on loan. The Fund is indemnified by RBC IS for any collateral credit or market loss. As such, the credit risk associated with securities lending is considered minimal.

**7. Administrative and other related-party transactions****Manager and Registrar**

RBC GAM is an indirect wholly-owned subsidiary of Royal Bank of Canada ("Royal Bank"). RBC GAM is the manager and registrar of the Funds. RBC GAM is responsible for the Funds' day-to-day operations, provides investment advice and portfolio management services to the Funds and appoints distributors for the Funds. RBC GAM, as registrar,

also keeps records of who owns units of the Funds. RBC GAM is paid a management fee by the Funds as compensation for its services. No management fees are paid by the Funds with respect to Series O units. Series O unitholders pay a negotiated fee directly to RBC GAM for investment-counselling services.

The Funds pay a fixed administration fee to RBC GAM. RBC GAM in turn pays certain operating expenses of the Funds. These expenses include regulatory filing fees and other day-to-day operating expenses including, but not limited to, recordkeeping, accounting and fund valuation costs, custody fees, audit and legal fees, and the costs of preparing and distributing annual and semi-annual reports, prospectuses, statements and investor communications.

Notwithstanding the fixed administration fee, the Funds also pay certain operating expenses directly, including the costs related to the Board of Governors ("BoG") of the Funds and the cost of any new government or regulatory requirements introduced and any borrowing costs (collectively, *other fund costs*), and taxes (including, but not limited to, GST/HST). Other Fund costs will be allocated among each series of units of a fund in accordance with the services used. RBC GAM may, in some years and in certain cases, absorb a portion of operating expenses. The decision to absorb the operating expenses is reviewed annually and determined at the discretion of RBC GAM, without notice to unitholders.

Certain Funds may invest in units of other Funds managed by RBC GAM or its affiliates.

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

**Portfolio Advisor**

With the exception of the BonaVista Global Balanced Fund and the BonaVista Canadian Equity Value Fund, RBC GAM is the principal portfolio advisor of the Funds. BonaVista Asset Management Ltd. ("BonaVista"), a subsidiary of RBC GAM, is the principal portfolio advisor for the BonaVista Global Balanced Fund and the BonaVista Canadian Equity Value Fund. Sky Investment Counsel Inc. ("Sky") is the sub-advisor for the Phillips, Hager & North Overseas Equity Fund and the non-North American equity assets of the Phillips, Hager & North Balanced Fund, the Phillips, Hager & North Global Equity Fund and the Phillips, Hager & North Community Values Global Equity Fund. RBC GAM has a non-controlling interest in Sky. The fees paid to BonaVista and Sky are paid by RBC GAM and not the Funds.

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**Distributors**

RBC GAM, PH&N IE, Royal Mutual Funds Inc., RBC Direct Investing Inc. and RBC Dominion Securities Inc. are the principal distributors of, or distribute certain series of units of, the Funds. Dealers receive an ongoing commission based on the total value of their clients' Series C, Advisor Series, Series H, Series B or Series D units.

**Brokerage**

The Funds have established standard brokerage agreements at market rates with related-party dealers.

**Trustee and Custodian**

RBC IS is the trustee and custodian of the Funds. RBC IS is paid custodial fees for holding the assets of the Funds, and trustee fees for acting as the trustee. The fees paid to RBC IS are paid by RBC GAM and not the Funds.

**Other Related-Party Transactions**

Pursuant to applicable securities legislation, the Funds relied on the standing instructions from the BoG in its capacity as the Independent Review Committee with respect to one or more of the following related-party 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 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 Funds, (iii) is in compliance with RBC GAM policies and procedures, and (iv) achieves a fair and reasonable result for the Funds. RBC GAM policy requires that an investment decision in respect of Inter-Fund Trading is in the best interests of each Fund.

**8. Future accounting changes*****International Financial Reporting Standards***

The Funds will be required to adopt the International Financial Reporting Standards ("IFRS") beginning in their fiscal 2014 year. In preparation to meet the requirements, RBC GAM has taken the following steps in managing the transition to IFRS:

- (a) established a committee for the development and implementation of a transition plan and to provide oversight of the transition to IFRS;
- (b) commenced activities to identify key issues and the likely impacts resulting from the adoption of IFRS; and
- (c) initiated analysis to reconfigure accounting systems used by the Funds.

The key elements of the plan currently include disclosure of the quantitative impact, if any, in the comparative 2013 financial statements and the preparation of the 2014 financial statements in accordance with IFRS.

Since IFRS standards are constantly evolving, the major qualitative impacts based on standards approved to date are the addition of a cash flow statement and the impact of classification of puttable instruments, the units of the Fund, as a liability or as an equity.

Regardless of the financial statement impacts, RBC GAM has presently determined that there will be no quantitative impact to the transactional NAV of each series as a result of the changeover to IFRS.

**9. Comparative figures**

In the Statements of Operations, "Board of Governors costs" for certain funds, which were reimbursed by the manager for the prior period, have been reflected to conform with the presentation in the current year.