

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 & NORTH SHORT TERM BOND & MORTGAGE FUND

December 31, 2012

Par Value	Security	Coupon Rate %	Maturity	Cost	Fair Value	% of Net Assets
AUSTRALIA BONDS						
\$ 7 210	Brookfield Infrastructure Finance Pty Ltd. CAD	3.455	10-Oct-17	\$ 7 210	\$ 7 264	
TOTAL AUSTRALIA BONDS				7 210	7 264	0.2
CANADIAN BONDS						
CORPORATE						
1 000	407 International Inc.	3.880	16-Jun-15	1 000	1 050	
9 298	AltaGas Ltd.	7.420	29-Apr-14	10 021	9 894	
1 380	AltaGas Ltd.	4.100	24-Mar-16	1 449	1 446	
1 437	AltaGas Ltd.	6.940	29-Jun-16	1 656	1 643	
2 463	AltaGas Ltd.	4.600	15-Jan-18	2 660	2 663	
714	AltaLink Investments LP	5.207	16-Dec-16	754	775	
6 080	AltaLink Investments LP	3.674	05-Jun-19	6 080	6 121	
2 000	AltaLink LP	5.430	05-Jun-13	2 117	2 034	
2 920	AltaLink LP	5.243	29-May-18	3 373	3 345	
3 885	American Express Canada Credit Corp.	5.900	02-Apr-13	3 880	3 927	
8 905	American Express Canada Credit Corp.	4.853	03-Oct-14	9 024	9 375	
10 000	Bank of Montreal	3.930	27-Apr-15	10 504	10 477	
20 474	Bank of Montreal	1.890	05-Oct-15	20 473	20 470	
26 760	Bank of Montreal	3.103	10-Mar-16	27 671	27 647	
18 260	Bank of Montreal	3.490	10-Jun-16	18 342	19 103	
56 289	Bank of Montreal	2.960	02-Aug-16	57 117	57 910	
1 185	Bank of Montreal	2.390	12-Jul-17	1 185	1 191	
17 748	Bank of Montreal	2.240	11-Dec-17	17 744	17 671	
353	Bank of Montreal	6.020	02-May-18	418	416	
2 490	Bank of Montreal	4.870	22-Apr-20	2 618	2 650	
3 950	Bank of Montreal	5.100	21-Apr-21	4 211	4 308	
14 610	Bank of Nova Scotia	2.250	08-May-15	14 702	14 756	
29 474	Bank of Nova Scotia	3.610	22-Feb-16	30 928	30 886	
27 855	Bank of Nova Scotia	2.740	01-Dec-16	28 252	28 447	
8 054	Bank of Nova Scotia	2.598	27-Feb-17	8 048	8 166	
12 900	Bank of Nova Scotia	4.100	08-Jun-17	13 934	13 886	
4 436	Bank of Nova Scotia	5.300	31-Jan-18	4 527	4 447	
30 332	Bank of Nova Scotia	4.990	27-Mar-18	30 636	30 565	
9 325	Bank of Nova Scotia	6.000	03-Oct-18	9 788	9 617	
20 115	Bank of Nova Scotia	4.940	15-Apr-19	21 192	20 885	
18 776	bcIMC Realty Corp.	2.650	29-Jun-17	18 844	19 013	
2 457	bcIMC Realty Corp.	5.650	05-Jan-18	2 835	2 820	
3 560	Bell Aliant Regional Communications LP	4.950	26-Feb-14	3 724	3 675	
4 500	Bell Aliant Regional Communications LP	6.290	17-Feb-15	4 805	4 861	
5 504	Bell Canada	4.850	30-Jun-14	5 766	5 747	
13 197	Bell Canada	4.400	16-Mar-18	13 441	14 340	
11 698	Bell Canada	3.350	18-Jun-19	11 679	12 044	
4 550	BMO Subordinated Notes Trust	5.750	26-Sep-22	4 961	5 207	
7 135	British Columbia Ferry Services Inc.	5.740	27-May-14	7 809	7 521	
15 573	Brookfield Asset Management Inc.	3.950	09-Apr-19	15 624	15 961	
9 932	Caisse Centrale Desjardins	3.502	05-Oct-17	10 208	10 433	
5 476	Canada Safeway Ltd.	3.000	31-Mar-14	5 487	5 504	
10 675	Canadian Credit Card Trust	5.365	25-Mar-13	11 335	10 771	
300	Canadian Imperial Bank of Commerce	4.750	22-Dec-14	321	317	
14 807	Canadian Imperial Bank of Commerce	2.200	22-May-15	14 829	14 938	
45 220	Canadian Imperial Bank of Commerce	2.650	08-Nov-16	45 527	46 014	
16 576	Canadian Imperial Bank of Commerce	2.350	18-Oct-17	16 581	16 594	
29 555	Canadian Imperial Bank of Commerce	5.150	06-Jun-18	30 442	29 986	

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

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND

December 31, 2012

Par Value	Security	Coupon Rate %	Maturity	Cost	Fair Value	% of Net Assets
CORPORATE (cont.)						
\$ 47 265	Canadian Imperial Bank of Commerce	4.110	30-Apr-20	\$ 48 603	\$ 49 558	
6 200	Capital Desjardins Inc.	5.541	01-Jun-21	6 659	6 836	
11 960	Caterpillar Financial Services Ltd.	5.200	03-Jun-13	12 454	12 147	
11 925	Caterpillar Financial Services Ltd.	2.630	01-Jun-17	11 933	12 079	
2 400	Central 1 Credit Union	4.000	09-Oct-19	2 397	2 438	
7 875	Citigroup Finance Canada Inc.	5.500	21-May-13	7 911	7 988	
5 000	CU Inc.	6.145	22-Nov-17	5 954	5 905	
6 435	Emera Inc.	2.960	13-Dec-16	6 432	6 545	
3 475	Enbridge Gas Distribution Inc.	5.570	29-Jan-14	3 792	3 619	
5 000	Enbridge Inc.	5.170	19-May-16	5 434	5 493	
14 104	Enbridge Inc.	5.000	09-Aug-16	15 491	15 460	
3 690	Enbridge Income Fund Holdings Inc.	2.920	14-Dec-17	3 689	3 681	
1 810	Encana Corp.	5.800	18-Jan-18	2 037	2 051	
150	EPCOR Utilities Inc.	6.750	22-Mar-16	177	171	
3 435	EPCOR Utilities Inc.	5.800	31-Jan-18	3 950	3 967	
1 312	Finning International Inc.	6.020	01-Jun-18	1 532	1 527	
24 408	FortisBC Holdings Inc.	5.560	15-Sep-14	26 450	25 832	
16 203	George Weston Ltd.	5.050	10-Mar-14	17 012	16 772	
5 294	Golden Credit Card Trust	3.824	15-May-15	5 569	5 549	
17 000	HSBC Bank Canada	2.572	23-Nov-15	17 000	17 272	
14 465	HSBC Bank Canada	2.901	13-Jan-17	14 465	14 810	
855	HSBC Bank Canada	3.558	04-Oct-17	858	900	
1 456	Hydro One Inc.	5.000	12-Nov-13	1 556	1 500	
2 265	Hydro One Inc.	4.640	03-Mar-16	2 462	2 458	
1 500	Inter Pipeline Fund	3.839	30-Jul-18	1 500	1 583	
2 550	John Deere Credit Inc.	3.900	29-Jul-13	2 547	2 586	
1 155	Loblaw Companies Ltd.	5.400	20-Nov-13	1 196	1 192	
1 190	Loblaw Companies Ltd.	6.000	03-Mar-14	1 283	1 246	
3 815	Loblaw Companies Ltd.	4.850	08-May-14	3 999	3 964	
4 400	Lower Mattagami Energy LP	2.228	23-Oct-17	4 400	4 408	
2 402	Manitoba Telecom Services Inc.	4.590	01-Oct-18	2 402	2 599	
5 810	Manulife Financial Corporation	4.896	02-Jun-14	6 054	6 040	
4 661	Manulife Financial Corporation	5.161	26-Jun-15	4 938	4 980	
2 609	Manulife Financial Corporation	4.079	20-Aug-15	2 683	2 725	
7 552	Master Credit Card Trust	5.237	21-May-13	8 021	7 664	
8 351	Molson Coors Capital Finance ULC	5.000	22-Sep-15	8 883	8 949	
4 210	National Bank of Canada	4.030	26-May-15	4 210	4 422	
7 848	National Bank of Canada	2.689	21-Aug-17	7 848	7 963	
2 310	National Bank of Canada	5.550	15-Nov-18	2 310	2 385	
5 350	National Bank of Canada	4.700	02-Nov-20	5 629	5 720	
686	Newfoundland Power Inc.	10.550	01-Aug-14	796	771	
3 365	Nova Gas Transmission Ltd.	11.200	01-Jun-14	3 877	3 743	
2 670	Nova Gas Transmission Ltd.	12.200	28-Feb-16	3 569	3 447	
24 295	Nova Scotia Power Inc.	5.750	01-Oct-13	26 219	25 036	
2 939	Ontrea Inc.	4.619	09-Apr-18	2 939	3 203	
4 570	Plenary Health Hamilton LP	3.157	13-Dec-13	4 570	4 616	
3 131	Plenary Properties LTAP LP	3.801	18-Aug-14	3 194	3 203	
22 425	Rogers Communications Inc.	5.800	26-May-16	24 825	24 934	
3 432	Rogers Communications Inc.	3.000	06-Jun-17	3 429	3 500	
42 657	Royal Bank of Canada*	3.360	11-Jan-16	43 599	44 343	
4 569	Royal Bank of Canada*	3.030	26-Jul-16	4 644	4 711	
33 790	Royal Bank of Canada*	2.680	08-Dec-16	33 959	34 427	
7 000	Royal Bank of Canada*	3.660	25-Jan-17	6 942	7 391	
17 342	Royal Bank of Canada*	2.580	13-Apr-17	17 515	17 579	
896	Royal Bank of Canada*	2.364	21-Sep-17	896	898	
11 960	Royal Bank of Canada*	4.840	11-Mar-18	12 480	12 031	

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

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND

December 31, 2012

Par Value	Security	Coupon Rate %	Maturity	Cost	Fair Value	% of Net Assets
CORPORATE (cont.)						
\$ 20 302	Royal Bank of Canada*	5.000	06-Jun-18	\$ 21 090	\$ 20 587	
8 525	Royal Bank of Canada*	5.450	04-Nov-18	9 083	8 784	
860	Royal Bank of Canada*	2.980	07-May-19	868	881	
25 308	Shaw Communications Inc.	7.500	20-Nov-13	27 650	26 547	
5 645	Shaw Communications Inc.	5.700	02-Mar-17	6 150	6 259	
7 682	Sun Life Financial Inc.	5.120	26-Jun-18	8 091	7 795	
8 020	TELUS Corp.	4.950	15-May-14	8 341	8 359	
10 000	TELUS Corp.	5.950	15-Apr-15	10 859	10 883	
8 460	TELUS Corp.	3.650	25-May-16	8 457	8 860	
2 992	TELUS Corp.	4.950	15-Mar-17	3 325	3 300	
27 435	Teranet Holdings LP	3.531	16-Dec-15	27 684	28 378	
1 423	Terasen Gas Inc.	11.800	30-Sep-15	1 851	1 785	
1 575	Terasen Gas Inc.	10.300	30-Sep-16	2 082	2 017	
100	Toronto-Dominion Bank	4.854	13-Feb-13	105	100	
1 070	Toronto-Dominion Bank	2.948	02-Aug-16	1 086	1 105	
59 383	Toronto-Dominion Bank	5.690	03-Jun-18	61 532	60 374	
3 060	Toronto Hydro Corp.	6.110	06-May-13	3 352	3 109	
3 560	Toronto Hydro Corp.	6.110	07-May-13	3 831	3 617	
419	Toronto Hydro Corp.	5.150	14-Nov-17	478	477	
3 830	TransAlta Corp.	6.450	29-May-14	4 150	4 006	
6 615	TransCanada PipeLines Ltd.	5.050	20-Aug-13	7 005	6 762	
2 101	TransCanada PipeLines Ltd.	5.650	15-Jan-14	2 272	2 189	
4 440	TransCanada PipeLines Ltd.	11.100	20-Jun-14	5 400	4 997	
12 433	Union Gas Ltd.	7.900	24-Feb-14	13 698	13 291	
3 170	Union Gas Ltd.	4.640	30-Jun-16	3 420	3 445	
3 538	Veresen Inc.	3.950	14-Mar-17	3 536	3 647	
3 660	Veresen Inc.	4.000	22-Nov-18	3 650	3 761	
15 788	Wells Fargo Financial Canada Corp.	3.970	03-Nov-14	16 535	16 399	
2 730	Wells Fargo Financial Canada Corp.	4.380	30-Jun-15	2 876	2 888	
14 544	Wells Fargo Financial Canada Corp.	2.774	09-Feb-17	14 544	14 792	
14 921	Wells Fargo Financial Canada Corp.	2.944	25-Jul-19	14 926	15 054	
5 914	Westcoast Energy Inc.	8.300	30-Dec-13	6 400	6 284	
8 447	Westcoast Energy Inc.	8.500	23-Nov-15	10 373	9 888	
4 737	Westcoast Energy Inc.	3.280	15-Jan-16	4 804	4 902	
				1 393 199	1 393 856	39.9
FEDERAL						
35 000	Canada Housing Trust No. 1	3.950	15-Jun-13	35 538	35 450	
375	Canada Housing Trust No. 1	3.550	15-Sep-13	393	381	
8 461	Canada Housing Trust No. 1	2.700	15-Dec-13	8 716	8 586	
17 965	Government of Canada	2.250	01-Aug-14	18 308	18 278	
63 180	Government of Canada	1.500	01-Sep-17	63 501	63 515	
				126 456	126 210	3.6
PROVINCIAL/MUNICIPAL						
38 682	Cadillac Fairview Finance Trust	3.240	25-Jan-16	39 590	40 228	
94 542	Province of Ontario	1.900	08-Sep-17	94 500	94 661	
49 412	Province of Ontario	4.200	08-Mar-18	54 762	54 803	
28 027	Province of Quebec	4.500	01-Dec-18	31 604	31 641	
				220 456	221 333	6.4
TOTAL CANADIAN BONDS						
				1 740 111	1 741 399	49.9
UNITED KINGDOM BONDS						
7 202	BAA Funding Ltd. CAD	4.000	03-Jul-19	7 156	7 496	
16 899	National Grid Electricity Transmission Plc. CAD	2.730	20-Sep-17	16 972	17 031	
14 915	National Grid Electricity Transmission Plc. CAD	2.900	26-Nov-19	14 948	14 823	
TOTAL UNITED KINGDOM BONDS						
				39 076	39 350	1.1

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

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND

December 31, 2012

Par Value	Security	Coupon Rate %	Maturity	Cost	Fair Value	% of Net Assets
UNITED STATES BONDS						
\$ 9 252	Anheuser-Busch InBev Worldwide Inc. CAD	3.650	15-Jan-16	\$ 9 375	\$ 9 690	
22 615	Bank of America Corp. CAD	1.818	01-Jun-16	23 030	21 597	
4 600	Bank of America Corp. CAD	5.450	17-Sep-14	4 720	4 846	
15 757	JPMorgan Chase & Co. CAD	2.920	19-Sep-17	15 795	15 849	
23 477	Molson Coors International LP CAD	3.950	06-Oct-17	23 668	24 705	
TOTAL UNITED STATES BONDS				76 588	76 687	2.2
TOTAL BONDS				1 862 985	1 864 700	53.4
MORTGAGE-BACKED SECURITIES						
26 208	Canadian Mortgage Pools	2.150	01-Oct-14	26 439	26 420	
35 104	Canadian Mortgage Pools	2.300	01-Dec-14	35 512	35 499	
14 806	Canadian Mortgage Pools	2.500	01-Jun-15	14 607	15 054	
11 729	Canadian Mortgage Pools	1.950	01-Sep-15	11 582	11 806	
7 797	Canadian Mortgage Pools	2.170	01-Sep-15	7 756	7 878	
11 080	Canadian Mortgage Pools	2.750	01-Nov-15	11 021	11 353	
10 664	Canadian Mortgage Pools	2.750	01-Jan-16	10 542	10 924	
8 365	Canadian Mortgage Pools	1.500	01-Sep-16	8 120	8 279	
1 711	Canadian Mortgage Pools	1.500	01-Dec-16	1 680	1 691	
12 121	Canadian Mortgage Pools	1.700	01-Aug-17	11 910	11 981	
10 640	Canadian Mortgage Pools	1.950	01-Sep-17	10 570	10 587	
12 985	Canadian Mortgage Pools	1.850	01-Dec-17	12 922	12 926	
485	Solar Trust	5.330	12-May-16	494	484	
TOTAL MORTGAGE-BACKED SECURITIES				163 155	164 882	4.7
MORTGAGES (SCHEDULE A)				471 349	474 768	13.6
SHORT-TERM INVESTMENTS†						
18 900	Bay Street Funding Trust - Class A			18 881	18 881	
15 800	Caisse Centrale Desjardins			15 776	15 776	
24 400	Canadian Master Trust - Series A			24 302	24 302	
8 500	Central 1 Credit Union			8 478	8 478	
34 700	Clarity Trust			34 539	34 539	
62 000	Darwin Receivables Trust - Senior Notes			61 759	61 759	
14 950	Enbridge Inc.			14 936	14 936	
127 900	Fusion Trust			127 517	127 517	
68 500	HSBC Bank Canada			68 335	68 335	
91 600	Inter Pipeline Fund			91 310	91 310	
34 500	King Street Funding Trust			34 462	34 462	
112 075	Merit Trust - Senior Notes			111 616	111 616	
49 680	National Bank of Canada			49 641	49 641	
5 000	OMERS Realty Corp.			4 986	4 986	
133 300	Prime Trust - Senior Notes			132 810	132 810	
45 350	Reliant Trust			45 150	45 150	
14 500	Ridge Trust			14 469	14 469	
500	SOUND Trust			499	499	
112 575	Zeus Receivables Trust - Senior Notes			112 161	112 161	
TOTAL SHORT-TERM INVESTMENTS				971 627	971 627	27.8
TOTAL INVESTMENTS				\$ 3 469 116	3 475 977	99.5
OTHER NET ASSETS					17 469	0.5
NET ASSETS					\$ 3 493 446	100.0

* Investment in related party (see note 7 in the generic notes).

† Short-term investments, which may be made up of treasury bills, commercial paper, term deposits and discount notes, and are grouped by issuer, earn interest at rates ranging from 1.00% to 1.30% and mature between January 2, 2013 and June 17, 2013.

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

December 31, 2012

**SCHEDULE A
 MORTGAGES**

Number of Loans	Interest Rate (%)	Principal 2013	2014	2015	2016	2017	2018	2019	Cost	Fair Value	% of Net Assets
1	1.75-1.99	\$ 1 832	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 1 832	\$ 1 826	
1	2.50-2.74	–	–	672	–	–	–	–	672	677	
10	3.00-3.24	9 219	8 271	–	–	20 343	–	–	37 924	37 625	
17	3.25-3.49	437	7 319	1 025	7 417	20 953	19 436	20 010	76 869	76 091	
31	3.50-3.74	3 180	–	2 555	8 403	33 874	4 325	50 129	102 902	102 384	
38	3.75-3.99	21 632	15 499	4 858	349	15 604	7 054	–	65 188	65 348	
19	4.00-4.24	9 204	5 670	12 289	9 385	–	–	224	36 885	37 338	
20	4.25-4.49	334	–	51 300	7 245	3 874	–	–	63 024	64 286	
17	4.50-4.74	1 208	795	12 661	4 540	8 223	5 600	–	33 240	34 523	
14	4.75-4.99	2 804	1 226	4 290	1 064	5 424	5 728	–	20 625	21 362	
5	5.00-5.24	1 941	–	4 502	–	–	–	–	6 477	6 659	
3	5.25-5.49	6 189	–	–	–	–	1 447	–	7 673	7 809	
7	5.50-5.74	1 857	1 141	–	7 809	–	–	–	10 864	11 466	
3	5.75-5.99	2 535	2 063	–	–	–	–	–	4 606	4 680	
4	6.00-6.24	1	2 028	–	–	525	–	–	2 568	2 694	
190		\$ 62 373	\$ 44 012	\$ 94 152	\$ 46 212	\$ 108 820	\$ 43 590	\$ 70 363	\$ 471 349	\$ 474 768	13.6

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND
Statements of Net Assets (in \$000s except per unit amounts)

December 31 (see note 2 in the generic notes)	2012	2011
ASSETS		
Investments at fair value	\$ 3 475 977	\$ 2 761 334
Cash	377	371
Subscriptions receivable	4 112	5 164
Dividends receivable, interest accrued and other assets	18 207	15 340
TOTAL ASSETS	3 498 673	2 782 209
LIABILITIES		
Due to investment dealers	3 129	–
Redemptions payable	1 380	2 637
Accounts payable and accrued expenses	718	655
TOTAL LIABILITIES	5 227	3 292
NET ASSETS	\$ 3 493 446	\$ 2 778 917
Investments at cost	\$ 3 469 116	\$ 2 749 928
NET ASSETS, END OF PERIOD		
SERIES C	\$ 317 878	\$ 334 238
ADVISOR SERIES	\$ 36 641	\$ 27 675
SERIES H	\$ 42 654	\$ –
SERIES B†	\$ –	\$ 358
SERIES D	\$ 269 989	\$ 290 420
SERIES F	\$ 114 991	\$ 121 077
SERIES I	\$ 19 529	\$ –
SERIES O	\$ 2 691 764	\$ 2 005 149
NET ASSETS PER UNIT, END OF PERIOD		
SERIES C	\$ 10.50	\$ 10.53
ADVISOR SERIES	\$ 10.50	\$ 10.53
SERIES H	\$ 10.51	\$ –
SERIES B†	\$ –	\$ 10.61
SERIES D	\$ 10.47	\$ 10.49
SERIES F	\$ 10.45	\$ 10.48
SERIES I	\$ 10.45	\$ –
SERIES O	\$ 10.17	\$ 10.19
NET ASSET VALUE (TRANSACTIONAL NAV) PER UNIT, END OF PERIOD (see note 3 in the generic notes)		
SERIES C	\$ 10.51	\$ 10.54
ADVISOR SERIES	\$ 10.51	\$ 10.54
SERIES H	\$ 10.52	\$ –
SERIES B†	\$ –	\$ 10.62
SERIES D	\$ 10.47	\$ 10.50
SERIES F	\$ 10.46	\$ 10.49
SERIES I	\$ 10.45	\$ –
SERIES O	\$ 10.17	\$ 10.20

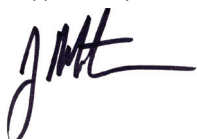
Statements of Operations (in \$000s except per unit amounts)

For the periods ended December 31 (see note 2 in the generic notes)*	2012	2011
INCOME (see note 3 in the generic notes)		
Interest	\$ 94 349	\$ 80 057
TOTAL INCOME (LOSS)	94 349	80 057
EXPENSES (see notes – Fund Specific Information)		
Management fees	5 998	5 081
Administration fees	1 549	1 170
Board of Governors costs	4	4
GST/HST	774	653
TOTAL EXPENSES	8 325	6 908
NET INVESTMENT INCOME (LOSS)	86 024	73 149
REALIZED AND UNREALIZED GAIN (LOSS)		
ON INVESTMENTS		
Net realized gain (loss) on investments	(4 840)	7 045
Change in unrealized gain (loss) on investments	(4 745)	9 787
NET GAIN (LOSS) ON INVESTMENTS	(9 585)	16 832
INCREASE (DECREASE) IN NET ASSETS		
FROM OPERATIONS	\$ 76 439	\$ 89 981
INCREASE (DECREASE) IN NET ASSETS		
FROM OPERATIONS		
SERIES C	\$ 5 364	\$ 8 752
ADVISOR SERIES	\$ 613	\$ 429
SERIES H	\$ 217	\$ –
SERIES B†	\$ –	\$ 12
SERIES D	\$ 6 137	\$ 9 947
SERIES F	\$ 2 701	\$ 3 828
SERIES I	\$ 130	\$ –
SERIES O	\$ 61 277	\$ 67 013
INCREASE (DECREASE) IN NET ASSETS		
FROM OPERATIONS PER UNIT		
SERIES C	\$ 0.16	\$ 0.31
ADVISOR SERIES	\$ 0.16	\$ 0.31
SERIES H	\$ 0.07	\$ –
SERIES B†	\$ –	\$ 0.35
SERIES D	\$ 0.22	\$ 0.37
SERIES F	\$ 0.22	\$ 0.37
SERIES I	\$ 0.09	\$ –
SERIES O	\$ 0.26	\$ 0.41

* Series H and Series I launched July 2012.

† 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.

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND
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 H		Series B†	
	2012	2011	2012	2011	2012	2011	2012	2011
NET ASSETS – BEGINNING OF PERIOD	\$ 334 238	\$ 293 606	\$ 27 675	\$ 7 652	\$ –	\$ –	\$ –	\$ 412
INCREASE (DECREASE) FROM OPERATIONS	5 364	8 752	613	429	217	–	–	12
Early redemption fees	–	–	–	–	–	–	–	–
Proceeds from units issued	130 351	168 399	31 544	22 008	46 166	–	–	–
Proceeds from reinvestment of distributions	5 669	6 232	612	369	325	–	–	9
Payments on redemption of units	(151 556)	(135 917)	(23 090)	(2 376)	(3 722)	–	–	(66)
TOTAL UNIT TRANSACTIONS	(15 536)	38 714	9 066	20 001	42 769	–	–	(57)
Distributions from net income	(6 188)	(6 550)	(713)	(384)	(332)	–	–	(9)
Distributions from net gains	–	(284)	–	(23)	–	–	–	–
Distributions from capital	–	–	–	–	–	–	–	–
TOTAL DISTRIBUTIONS	(6 188)	(6 834)	(713)	(407)	(332)	–	–	(9)
TOTAL INCREASE (DECREASE) IN NET ASSETS	(16 360)	40 632	8 966	20 023	42 654	–	–	(54)
NET ASSETS – END OF PERIOD	\$ 317 878	\$ 334 238	\$ 36 641	\$ 27 675	\$ 42 654	\$ –	\$ –	\$ 358

For the periods ended December 31 (see note 2 in the generic notes)*	Series D		Series F		Series I	
	2012	2011	2012	2011	2012	2011
NET ASSETS – BEGINNING OF PERIOD	\$ 290 778	\$ 272 465	\$ 121 077	\$ 103 655	\$ –	\$ –
INCREASE (DECREASE) FROM OPERATIONS	6 137	9 947	2 701	3 828	130	–
Early redemption fees	2	–	–	–	–	–
Proceeds from units issued	73 834	92 573	67 977	72 684	23 763	–
Proceeds from reinvestment of distributions	6 163	7 125	2 216	2 448	140	–
Payments on redemption of units	(100 038)	(83 631)	(75 953)	(58 314)	(4 306)	–
TOTAL UNIT TRANSACTIONS	(20 039)	16 067	(5 760)	16 818	19 597	–
Distributions from net income	(6 887)	(7 812)	(3 027)	(3 120)	(198)	–
Distributions from net gains	–	(247)	–	(104)	–	–
Distributions from capital	–	–	–	–	–	–
TOTAL DISTRIBUTIONS	(6 887)	(8 059)	(3 027)	(3 224)	(198)	–
TOTAL INCREASE (DECREASE) IN NET ASSETS	(20 789)	17 955	(6 086)	17 422	19 529	–
NET ASSETS – END OF PERIOD	\$ 269 989	\$ 290 420	\$ 114 991	\$ 121 077	\$ 19 529	\$ –

For the periods ended December 31 (see note 2 in the generic notes)*	Series O		Total	
	2012	2011	2012	2011
NET ASSETS – BEGINNING OF PERIOD	\$ 2 005 149	\$ 1 321 095	\$ 2 778 917	\$ 1 998 885
INCREASE (DECREASE) FROM OPERATIONS	61 277	67 013	76 439	89 981
Early redemption fees	4	1	6	1
Proceeds from units issued	1 520 622	1 073 190	1 894 257	1 428 854
Proceeds from reinvestment of distributions	67 020	55 135	82 145	71 318
Payments on redemption of units	(894 017)	(454 699)	(1 252 682)	(735 003)
TOTAL UNIT TRANSACTIONS	693 629	673 627	723 726	765 170
Distributions from net income	(68 291)	(54 837)	(85 636)	(72 712)
Distributions from net gains	–	(1 749)	–	(2 407)
Distributions from capital	–	–	–	–
TOTAL DISTRIBUTIONS	(68 291)	(56 586)	(85 636)	(75 119)
TOTAL INCREASE (DECREASE) IN NET ASSETS	686 615	684 054	714 529	780 032
NET ASSETS – END OF PERIOD	\$ 2 691 764	\$ 2 005 149	\$ 3 493 446	\$ 2 778 917

* Series H and Series I launched July 2012.

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

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

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND

December 31, 2012

**Financial instrument risk and capital management
(see note 4 in the generic notes)****Credit risk (%)**

The table below summarizes the Fund's credit risk exposure grouped by credit ratings as at:

Rating	December 31 2012	December 31 2011
AAA	14.2	27.9
AA	34.7	26.5
A	17.1	15.2
BBB	15.0	15.0
D	–	0.1
Unrated*	19.0	15.3
Total	100.0	100.0

* Mortgages represent 100% (December 31, 2011 – 100%) of the unrated above. 9.9% (December 31, 2011 – 11.6%) of the mortgages are Canada Mortgage and Housing Corporation ("CMHC") guaranteed mortgages, and therefore have the backing of an AAA rated issuer. To manage the credit risk on the remaining 90.1% (December 31, 2011 – 88.4%), which are conventional mortgages, the Fund only purchases mortgages that are no more than 75% of the value of the property and the net income generated by the property must be at least 1.2x the income required to pay the monthly debt service requirements. These statistics are monitored on an ongoing basis both at the individual security level and on an aggregate level.

Interest rate risk (%)

The table below summarizes the Fund's exposure to interest rate risk by remaining term to maturity as at:

Term to maturity	December 31 2012	December 31 2011
Less than 1 year	18.1	16.4
1 – 5 years	69.9	77.1
5 – 10 years	12.0	6.5
> 10 years	–	–
Total	100.0	100.0

As at December 31, 2012, had prevailing interest rates risen or lowered by 1%, with all other factors kept constant, the Fund's net assets may have decreased or increased, respectively, by approximately 2.1% (December 31, 2011 – 2.0%). In practice, actual results could differ from this sensitivity analysis and the difference could be material.

Please see the generic notes at the back of the financial statements.

**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
Equities	–	–	–	–
Mutual fund units	–	–	–	–
Fixed-income and debt securities	–	2 504 350	–	2 504 350
Short-term investments	–	971 627	–	971 627
Derivatives – assets	–	–	–	–
Derivatives – liabilities	–	–	–	–
Total financial instruments	–	3 475 977	–	3 475 977
% of total portfolio	–	100.0	–	100.0

December 31, 2011	Level 1	Level 2	Level 3	Total
Equities	–	–	–	–
Mutual fund units	–	–	–	–
Fixed-income and debt securities	–	2 042 530	–	2 042 530
Short-term investments	–	718 804	–	718 804
Derivatives – assets	–	–	–	–
Derivatives – liabilities	–	–	–	–
Total financial instruments	–	2 761 334	–	2 761 334
% of total portfolio	–	100.0	–	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	1.00%
Advisor Series	1.00%
Series H	0.90%
Series B	0.75%
Series D	0.50%
Series F	0.50%
Series I	0.40%

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND

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	0.05%
Advisor Series	0.05%
Series H	0.05%
Series B	0.05%
Series D	0.05%
Series F	0.05%
Series I	0.05%
Series O	0.05%

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
Units held		
Series C	50	49
Advisor Series	99	97
Series H	96	–
Series B	–	48
Series D	50	–
Series F	50	49
Series I	96	–
Value of all units	\$ 5	\$ 3

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

The capital losses as at December 31, 2012 for the Fund were \$4 858. 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
Series C		
Opening units	31 740	28 085
Issued number of units	12 368	15 995
Reinvested number of units	539	594
Redeemed number of units	(14 385)	(12 934)
Ending number of units	30 262	31 740
Advisor Series		
Opening units	2 628	732
Issued number of units	2 994	2 086
Reinvested number of units	59	35
Redeemed number of units	(2 192)	(225)
Ending number of units	3 489	2 628
Series H		
Opening units	–	–
Issued number of units	4 383	–
Reinvested number of units	31	–
Redeemed number of units	(354)	–
Ending number of units	4 060	–
Series B		
Opening units	–	39
Issued number of units	–	–
Reinvested number of units	–	1
Redeemed number of units	–	(6)
Ending number of units	–	34
Series D		
Opening units	27 708	26 142
Issued number of units	7 029	8 828
Reinvested number of units	588	681
Redeemed number of units	(9 526)	(7 977)
Ending number of units	25 799	27 674
Series F		
Opening units	11 557	9 962
Issued number of units	6 481	6 930
Reinvested number of units	212	234
Redeemed number of units	(7 243)	(5 569)
Ending number of units	11 007	11 557
Series I		
Opening units	–	–
Issued number of units	2 267	–
Reinvested number of units	13	–
Redeemed number of units	(411)	–
Ending number of units	1 869	–
Series O		
Opening units	196 807	130 633
Issued number of units	148 927	105 326
Reinvested number of units	6 587	5 429
Redeemed number of units	(87 525)	(44 581)
Ending number of units	264 796	196 807

PHILLIPS, HAGER & NORTH SHORT TERM BOND & MORTGAGE FUND

December 31, 2012

**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
Series 0		
RBC Select Choices Conservative Portfolio	2 190	2 046
RBC Select Choices Balanced Portfolio	2 132	2 129
Phillips, Hager & North PRisM Balanced Fund	44 945	23 217
RBC Monthly Income Bond Fund	43 953	8 899
RBC Select Very Conservative Portfolio	52 970	35 182
RBC Select Very Conservative Class	164	–
Total	146 354	71 473

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.

December 31, 2012

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.

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.

December 31, 2012

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.