

# ANNUAL MANAGEMENT REPORT OF FUND PERFORMANCE

## Canadian Equity Funds

# AltaFund Investment Corp.

For the period ended December 31, 2011

This annual management report of fund performance contains financial highlights, but does not contain the annual financial statements of the mutual fund. A copy of the annual financial statements can be obtained on request, and at no cost, by calling 1-888-270-3941 or 514-871-2082, by writing to us at National Bank Securities Advisory Service, 500, Place d'Armes, 12th floor, Montreal, Quebec, H2Y 2W3, by visiting our website at [www.nbc.ca/financial\\_reports](http://www.nbc.ca/financial_reports), by visiting SEDAR's website at [www.sedar.com](http://www.sedar.com), or by contacting your advisor.

You may also contact us using one of these methods to request a copy of the investment fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure.

## Management Discussion of Fund Performance

### Investment Objectives and Strategies

The AltaFund Investment Corp. targets superior long-term capital appreciation by investing primarily in Canadian companies that have significant presence in Western Canada and offer good capital growth potential. Fundamental security selection is a key driver of the investment process. Specific attention is placed on competitive analysis and the quality of a company's business model, operations and financial strength. The strategy relies on a bottom-up approach in which companies with growth potential, attractive valuation, and good management are prioritized.

### Risks

Throughout 2011, the Fund was exposed to equity market volatility, which increased considerably during the second half of the year. Markets reacted to events in Europe, where the risk of sovereign defaults increased considerably and the Middle East, where long-term tyrant regimes from Tunisia to Egypt were toppled.

The global investment risk of each of the Fund's securities remains as described in the latest simplified prospectus. It suits investors who are seeking higher returns, who do not require regular interest income, and who are willing to tolerate a moderate level of risk.

### Results of Operations

For the twelve-month period ended December 31, 2011, the AltaFund Investment Corp. Investor Series units returned -17.48% compared to -8.31% for the Fund's blended benchmark composed of 80% of the S&P/TSX Composite Index (CA\$) (return of -8.71%) and 20% of the S&P/TSX Energy Index (CA\$) (return of -7.10%). Unlike the index, the Fund's performance is calculated after fees and expenses. Please see the Past Performance section for returns of the Advisor Series. Returns of the Advisor Series may vary mainly because of fees and expenses.

Canadian equities surrendered some ground in 2011, after posting solid returns during the last two years and in the process, lagged behind most other global equities, on fears that emerging market economies were beginning to slowdown. Since 2005, the correlation between Canadian stocks and those of emerging markets has increased, largely as a result of the increased trade between the two and Canada's natural reliance on natural resources to grow its economy. Needless to say, investors were not comforted by two consecutive monthly declines in employment during October and November that solidified the view of the central bank, which revised its projection for economic growth in 2012 lower. In doing so, the Bank of Canada also cited the growing pains in Europe, as well as the sub-par performance of the U.S. economy.

Overall, the S&P/TSX Composite Index declined by 8.71% over the period, however, the selling was not widespread. In this context, only five of the ten sectors that make up the index ended with losses, while the other five finished with gains. By and large, stocks of a defensive nature ended with gains, while those that are economically sensitive fell. By sector, Health Care, Telecommunications and Consumer Staples led the way higher, as they posted respective gains of 50.41%, 24.91% and 6.77%. On the other hand, the Technology, Materials, Consumer Discretionary and Energy sectors, led on the downside, by surrendering 52.49%, 21.20%, 15.45% and 9.91% of their value respectively. The index was also held back by the sub-par performance of the Financial Services sector which ended the year with a decline of 2.86%.

Some of the standout winners that really shone during the year included Valeant Pharmaceuticals within Health Care, which increased by 68.53%, as well as TELUS and BCE within Telecom that climbed by 26.74% and 20.18%, respectively. On the downside, shares of Research in Motion declined by a whopping 74.51%, while Lake Shore Gold and Great Basin Gold were the biggest losers within the Materials sector, as they lost 69.23% and 67.80% of their value, respectively.

Under these circumstances, the Fund underperformed its benchmark largely as a result of security selection within the Materials, Industrials, Energy and Financials sectors. As well, performance was negatively impacted by an overweight allocation to the Technology sector and underweight positions in the Financials and Health Care sectors. On the other hand, returns were enhanced by positive security selection within the Technology and Consumer Discretionary sectors.

Over the period, the growth and risk profile of the portfolio shifted lower as the outlook for the global economy became less enthusiastic and unforeseen events triggered selling opportunities. Consequently, the weight in economically sensitive sectors including Materials, Energy and Technology was decreased, as exposure to Telecommunications and Utilities stocks, as well as cash were all increased.

Individually, Dollarama, Trilogy Energy, Cameco, EnCana and America Petrogas contributed most on the upside, while Magna International, Enbridge, Crew Energy, Canwel Building Materials and TransCanada contributed most on the downside.

## **Recent Developments**

Heading into 2012, the portfolio manager believes that the European sovereign debt crisis has resulted in extremely fragile markets, where fear tends to trump common sense and as a result, inter-asset correlations have increased considerably. However, he also recognizes that U.S. economic conditions have improved and as such, he has adjusted the strategy to take advantage of this fact. In this respect, the defensive posture of the portfolio has moderated and exposure to low beta companies in defensive industries that exhibit lower earnings variability has been scaled back in favour of companies with strong prospective growth, specifically in the Energy sector.

Overall, the Fund is now overweight in the Energy sector, which should benefit from firming oil prices and expanding demand, as well as Technology and Telecom stocks, which should continue to provide solid earnings growth. On the other hand, the Fund is now underweight in the Financial Services sector, on expectations of lower capital markets activity, as well as slowing sales and trading volumes in investment banking.

The Fund remains positioned in lower risk growth investments, however, the portfolio manager expects its exposures to take on a more bullish stance as U.S. economic data continues to improve relative to the European Union and emerging markets. In this regard, his preference will continue to be the Energy sector over Materials, as Chinese and Indian markets remain weak and base metal prices have yet to exhibit signs of strength, while oil prices remain elevated.

## **Accounting Standards Changes**

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that all publicly accountable enterprises would be required to report under International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB) for fiscal years beginning on or after January 1, 2011. However, in January 2011, the AcSB approved a deferral of the effective date of entry in force of IFRS from January 1, 2011 to January 1, 2013 for investment companies that are currently applying the Accounting Guideline AcG-18 "Investment Companies".

In December 2011, the AcSB decided to defer the date of application of IFRS to January 1, 2014 to ensure that investment companies will not have to modify their actual accounting treatment for entities in which they have control while the IASB is completing the standard about investment companies it plans to publish.

Consequently, the Funds will publish their first audited financial statements in accordance with IFRS for the year ending December 31, 2014 and will present comparative figures in accordance with IFRS for the year ending December 31, 2013, including an opening balance sheet as at January 1, 2013.

In order to prepare for the transition to IFRS, management has established a project, formed a dedicated project team and put in place a formal governance structure. The project team reports on a regular basis to the executive committee and the steering committee, committees that are made up of senior levels of management from all relevant departments. To date, the project has proceeded as planned.

Management has developed a detailed project plan, assessed the resource requirements for its implementation and continued staff training. It has already identified the main differences between existing Canadian GAAP and current IFRS. Exceptions and optional exemptions on the transition date have also been analyzed. In addition, management has identified the following main differences that would likely affect the funds financial statements:

Scope	Current treatment under Canadian GAAP	IFRS treatment
Classification of holders' units/shares – Funds with more than one series.	Units/shares are presented as equity instruments.	Units/shares are presented in liabilities.
Classification of holders' units/shares – Funds with one series.	Units/shares are presented as equity instruments. No distinction is made between retained earnings and the capital issued.	Units/shares are presented as equity instruments. Distinction to be made between retained earnings and the capital issued.
Consolidation of financial statements of controlled entities in the financial statements of the Funds.	The Funds are exempt from consolidation with AcG-18.	Consolidation is applicable for controlling Funds. The financial statements of the two entities have to be consolidated. The Funds must meet very specific criteria to consolidate their financial statements. Consequently, only a minority of the Funds are affected by the consolidation. The consolidation will not affect the data of the Funds' daily evaluations.  However, the IASB issued in August 2011 an exposure draft that will allow for the Funds to be exempt from consolidation under certain conditions.
Presentation of the statement of cash flows in the financial statements.	No statement of cash flows to be presented.	Presentation of the statement of cash flows in the financial statements of each of the Funds.
Future income taxes – Trust Funds.	No future income taxes to be presented.	Recognition of assets or future income taxes liabilities if applicable.

Management has completed an evaluation on how adoption of IFRS will impact information technology and required developments have been made. It is currently assessing how adoption of IFRS will impact operations, internal controls and preparing financial statements.

The implementation phase has begun. The Funds will produce their statement of financial position (opening balance) as at January 1<sup>st</sup>, 2013 «transition date». In order to present the interim financial statements as at June 30, 2014 under IFRS, the comparative financial statements, those as at June 30, 2013, will be prepared with IFRS over the coming period.

At this point, management does not expect that the transition to IFRS will have a significant impact on net assets or net asset value per unit or the Funds commercial agreements. Rather, it expects that this transition will impact the presentation and disclosure of financial statements. Please note that the requirements in effect at the time of first publication of IFRS financial statements (December 31, 2014), economic conditions prevailing at that date, as well as various choices of accounting policies adopted are factors that will influence the final impact of IFRS on the statement of financial position of the Funds.

## Related Party Transactions

National Bank of Canada (“the Bank”) and its affiliated companies’ roles and responsibilities related to the Fund are as follows:

### Fund Manager

The Fund is managed by National Bank Securities Inc. (“NBS”), which is a wholly-owned subsidiary of the Bank. Therefore, NBS provides or ensures the provision of all general management and administrative services required by the Fund’s current operations, including investment consulting, the arrangement of brokerage contracts for the purchase and sale of the investment portfolio, bookkeeping and other administrative services required by the Fund.

The Fund reimbursed the Fund Manager for operating expenses, at cost, incurred in administering the Fund, including trustee, record-keeping, custodial, legal, audit, investor servicing, and securityholder reporting fees.

As described under the heading Management Fees, the Fund pays annual management fees to NBS as consideration for its services.

### Portfolio Advisor

Management of the Fund’s portfolio has been delegated by NBS to Natcan Investment Management Inc. (“Natcan”), a corporation of which the Bank is the majority shareholder. In that capacity, Natcan provides the Fund with portfolio management services, including trading, carrying out transactions and brokerage services. The fees payable to Natcan are calculated by applying a percentage to the average net asset value under management for each month.

Performance fees may be payable by NBS if the performance criteria set for the National Bank Funds are met.

### Distribution of Fund Units

NBS acts as Distributor for the Fund. In this capacity, NBS buys, sells and swaps securities through Bank branches and the National Bank Securities Advisory Service in Canadian provinces and territories, and through external registered representatives. Fund units are also offered by National Bank Direct Brokerage Inc., CABN Investments Inc. National Bank Financial Inc. and other affiliated entities. Each month, brokers receive a commission representing a percentage of the average daily value of the securities held by their clients.

### Transfer Agent and Custodian

Natcan Trust Company (“NTC”) acts as registrar for the Fund’s securities and the names of unitholders. NTC also acts as the Fund’s custodian. The fees for NTC’s custodial services are based on the standard rates in effect at NTC.

### Brokerage Fees

The Fund may pay broker’s commissions at market rates to a corporation affiliated with NBS. The brokerage fees paid by the Fund for the period are as follows:

	Year ended December 31, 2011
<b>Total brokerage fees</b>	\$238,486.78
<b>Brokerage paid to National Bank Financial</b>	\$7,638.00

### Independent Review Committee Approvals and Recommendations

The Fund followed the standing instructions of its Independent Review Committee with respect to one or more of the following transactions:

- a) Purchasing or holding the securities of a related issuer, in particular, those of National Bank of Canada;
- b) Investing in the securities of an issuer when an entity related to the manager acts as an underwriter for the placement or at any time during the 60-day period after the end of the placement;
- c) Purchasing or selling securities to another investment fund managed by the manager or a company in the same group;
- d) Purchasing or selling debt securities on the secondary market, through related brokers that are main brokers in the Canadian debt securities market (in accordance with an exemption received from the Canadian Securities Administrators);
- e) Entering into foreign exchange transactions (including both spot transactions and forward transactions) with National Bank of Canada.

The manager has implemented policies and procedures to make sure that the conditions applicable to each of the above transactions are met. The applicable standing instructions require that these transactions be carried out in accordance with National Bank Securities policies, which specify, in particular, that investment decisions pertaining to these related party transactions must be made free from any influence by an entity related to National Bank Securities and without taking into account any consideration relevant to an entity related to National Bank Securities. Furthermore, the investment decisions must represent the business judgment of the securities advisor, uninfluenced by considerations other than the best interest of the Fund and must achieve a fair and reasonable result for the Fund.

**Registered Plan Trust Services**

NTC receives a fixed amount per registered account for services provided as trustee for registered plans.

**Administrative and Operating Services**

The Bank provides the Fund with certain services, including accounting, reporting and portfolio valuation services. The costs incurred for these services are paid by the manager to the Bank.

# Financial Highlights

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance for the past five years.

## Investor Series/Advisor Series\*

\*The Advisor Series was created on June 1, 2009.

### The Fund's Shareholder's equity per Share<sup>(1)</sup>

	2011	2010	2009	2008	2007
Shareholder's equity, beginning of year	\$ 41.50	\$ 36.22	\$ 26.11	\$ 39.97	\$ 35.81
<b>Increase (decrease) from operations</b>					
Total revenue	\$ 0.57	\$ 0.63	\$ 0.74	\$ 0.77	\$ 0.83
Total expenses	\$ (0.93)	\$ (0.87)	\$ (0.70)	\$ (0.99)	\$ (1.03)
Realized gains (losses)	\$ 1.89	\$ 3.68	\$ 0.85	\$ 0.59	\$ 5.18
Unrealized gains (losses)	\$ (8.62)	\$ 1.79	\$ 9.37	\$ (14.07)	\$ (0.77)
Transaction costs on purchase and sale investments	\$ (0.17)	\$ (0.21)	\$ (0.16)	\$ (0.07)	\$ (0.03)
<b>Total increase (decrease) from operations<sup>(2)</sup></b>	<b>\$ (7.26)</b>	<b>\$ 5.02</b>	<b>\$ 10.10</b>	<b>\$ (13.77)</b>	<b>\$ 4.18</b>
<b>Distributions:</b>					
From income (excluding dividends)	\$ —	\$ —	\$ —	\$ —	\$ —
From dividends	\$ —	\$ —	\$ 0.04	\$ —	\$ —
From capital gains	\$ —	\$ —	\$ —	\$ —	\$ —
Return of capital	\$ —	\$ —	\$ —	\$ —	\$ —
<b>Total annual distributions<sup>(3)</sup></b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 0.04</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Net Assets as at December 31 of years shown</b>	<b>\$ 34.24</b>	<b>\$ 41.50</b>	<b>\$ 36.22</b>	<b>\$ 26.11</b>	<b>\$ 39.97</b>

<sup>(1)</sup> This information is derived from the Fund's audited annual financial statements. The net asset value per security presented in the financial statements differ from the net asset value calculated for security pricing purposes. The differences are explained in the notes to the financial statements.

<sup>(2)</sup> Net assets and distributions are based on the actual number of shares outstanding at the relevant time. The increase or decrease from operations is based on the average number of shares outstanding over the financial period.

<sup>(3)</sup> Distributions were paid in cash or reinvested in additional shares of the Fund, or both.

### Ratios and Supplemental Data

	2011	2010	2009	2008	2007
Total net asset value (000's) <sup>(1)</sup>	\$ 46,009	\$ 60,290	\$ 57,495	\$ 44,175	\$ 72,039
Number of shares outstanding <sup>(1)</sup>	1,340,539	1,449,527	1,580,725	1,687,375	1,800,076
Management expense ratio <sup>(2)</sup>	2.42 %	2.37 %	2.33 %	2.65 %	2.71 %
Management expense ratio before waivers or absorptions	2.43 %	2.40 %	2.39 %	2.73 %	2.71 %
Trading expense ratio <sup>(3)</sup>	0.44 %	0.59 %	0.53 %	0.18 %	0.09 %
Portfolio turnover rate <sup>(4)</sup>	108.96 %	125.85 %	138.89 %	72.21 %	32.27 %
Net asset value per share	\$ 34.32	\$ 41.59	\$ 36.37	\$ 26.18	\$ 40.02

<sup>(1)</sup> This information is provided as at December 31 of years shown.

<sup>(2)</sup> Management expense ratio is based on total expenses for the period indicated (excluding commissions and other portfolio transaction costs) and is expressed as an annualized percentage of the daily average net asset value during the period.

<sup>(3)</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value during the period.

<sup>(4)</sup> The Fund's portfolio's turnover rate indicates how actively the Fund's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the period. The higher a Fund's portfolio turnover rate in a year, the greater the trading costs payable by the Fund in the period, and the greater the chance of an investor receiving taxable capital gains in the period. There is not necessarily a relationship between a high turnover rate and the performance of a fund.

# Management Fees

The Fund pays annual management fees to the Manager for its management services. The fees are calculated based on a percentage of the Fund’s daily net asset value before applicable taxes and are paid on a monthly basis. A portion of the management fees paid by the Fund covers trailer fees and sales commissions paid to brokers. The remainder of the management fees primarily covers investment management and general administration services. The breakdown of major services provided in consideration of the management fees, expressed as an approximate percentage of the management fees is as follows:

Series		Management Fee	Distribution	Others <sup>†</sup>
Investor Series		2.00%	25.00%	75.00%
Advisor Series*	Front end	2.00%	25.00%	75.00%
	Back end		62.50%	37.50%
	Low-Load 1 to 3 years 4 years plus		25.00%	75.00%
			50.00%	50.00%

<sup>(\*)</sup> Excluding sales commissions paid on the Advisor Series with low load and back end fees, which are not paid for out of the management fees.

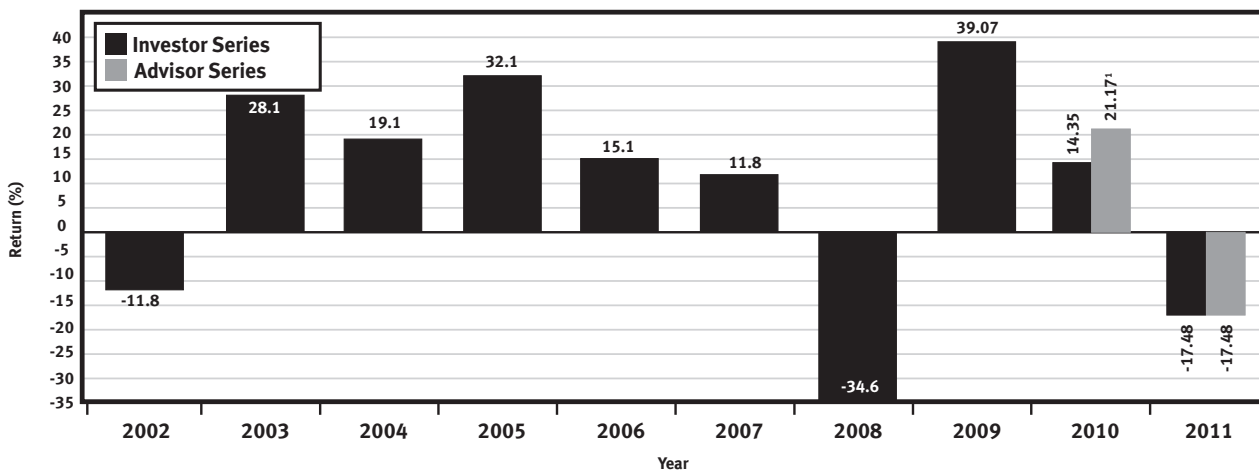
<sup>(†)</sup> Includes all costs related to management, investment advisory services, general administration and profit.

# Past Performance

Information on the Fund’s past performance is presented in the graphs below. The graphs assume that fund distributions during the periods presented were reinvested in full in additional fund securities and do not take into account sales, redemption charges, distributions, or optional charges that would have reduced returns. Past performance of a Fund or series of a Fund does not necessarily indicate how it will perform in the future.

## Annual Returns

The following bar chart shows the Fund’s annual performance in each of the last years shown and illustrates how the Fund’s performance has changed from year to year. It shows in percentage terms how an investment made on the first day of the period would have increased or decreased by the last day of the period for each year.



<sup>1</sup>Returns for the Advisor Series from June 1st, 2010 (inception date) to December 31, 2010.

## Annual Compounded Performance

The following table shows the AltaFund Investment Corp. annual compound total return for the indicated periods ended on December 31, 2011. The annual compound total return is compared to the Fund's blended benchmark composed of 80% of the S&P/TSX Composite Index (CA\$) and 20% of the S&P/TSX Energy Index (CA\$) calculated on the same compound basis. A discussion of the Fund's relative performance in comparison to the index (or indices) can be found in the *Results of Operations* Section of this report.

Investor Series <sup>1</sup>	10 years	5 years	3 years	1 year
AltaFund Investment Corp.	7.22%	-0.83%	9.48%	-17.48%
S&P/TSX Composite Index (CA\$) (80%) S&P/TSX Energy Index (CA\$) (20%)	–	2.10%	15.00%	-8.31%
S&P/TSX Composite Index (CA\$)	7.03%	1.30%	13.18%	-8.71%
S&P/TSX Energy Index (CA\$)	–	4.25%	21.59%	-7.10%

<sup>1</sup>Inception date: July 17, 1986; prior to April 1, 1991, the fund carried on business as a closed end investment corporation.

Advisor Series <sup>2</sup>	Since inception	1 year
AltaFund Investment Corp.	-0.31%	-17.48%
S&P/TSX Composite Index (CA\$) (80%) S&P/TSX Energy Index (CA\$) (20%)	4.95%	-8.31%
S&P/TSX Composite Index (CA\$)	4.88%	-8.71%
S&P/TSX Energy Index (CA\$)	9.05%	-7.10%

<sup>2</sup>Inception date: June 1, 2010.

The S&P/TSX Composite Index is composed of over 300 Canadian stocks and is designed to represent the Canadian equity market. The S&P/TSX Energy Index is capitalization weighted and consists of companies listed in the Canadian energy sector. The weight of a company is capped at 25% of the market capitalization of the Index.

# Summary of Investment Portfolio

## Portfolio Top Holdings

	% of Net Asset Value
Suncor Energy Inc. ....	6.7
Toronto-Dominion Bank .....	5.0
Canadian Natural Resources Ltd.....	4.7
Goldcorp Inc.....	4.2
Athabasca Oil Sands Corp.....	3.4
BCE Inc. ....	3.3
Bank of Montreal. ....	2.8
Dollarama Inc. ....	2.8
Potash Corporation of Saskatchewan Inc.....	2.8
Google Inc., Class A .....	2.5
Americas Petrogas Inc. ....	2.5
Telus Corp., non-voting .....	2.4
Apple Inc. ....	2.4
Barrick Gold Corp. ....	2.3
Tourmaline Oil Corp.....	2.2
Trilogy Energy Corp.....	2.2
Canadian Imperial Bank of Commerce .....	2.1
Celtic Exploration Ltd.....	2.1
Aurora Oil & Gas Ltd. ....	2.1
Crew Energy Inc. ....	2.1
Baytex Energy Corp. ....	2.1
Royal Bank of Canada.....	2.1
Cenovus Energy Inc. ....	1.9
Whitecap Resources Inc. ....	1.8
Shoppers Drug Mart Corp. ....	1.7
	70.2

Fund net asset value..... \$46,008,623

The Summary of Investment Portfolio may change due to ongoing portfolio transactions of the investment fund. A quarterly update is available. Consult our Web site [www.nbc.ca/financial\\_reports](http://www.nbc.ca/financial_reports).

## Sector Allocation

	% of Net Asset Value
Energy .....	43.4
Materials .....	18.1
Financials.....	15.4
Information Technology .....	6.8
Telecommunication Services .....	5.7
Consumer Discretionary .....	4.0
Consumer Staples.....	2.3
Industrials .....	2.1
Utilities.....	1.6
Cash and cash equivalents .....	0.6

## Asset Mix

	% of Net Asset Value
Canadian Equities.....	86.2
Global Equities .....	13.2
Cash and cash equivalents .....	0.6

### Notes on forward-looking statements

This report may contain forward-looking statements concerning the Fund, its future performance, its strategies or prospects or about future events or circumstances. Such forward-looking statements include, among others, statements with respect to our beliefs, plans, expectations, estimates and intentions. The use of the expressions "foresee", "intend", "anticipate", "estimate", "assume", "believe" and "expect" and other similar terms and expressions indicate forward-looking statements.

By their very nature, forward-looking statements imply the use of assumptions and necessarily involve inherent risks and uncertainties. Consequently, there is a significant risk that the explicit or implicit forecasts contained in these forward-looking statements might not materialize or that they may not prove to be accurate in the future. A number of factors could cause future results, conditions or events to differ materially from the objectives, expectations, estimates or intentions expressed in such forward-looking statements. Such differences might be caused by several factors, including changes in Canadian and worldwide economic and financial conditions (in particular interest and exchange rates and the prices of other financial instruments), market trends, new regulatory provisions, competition, changes in technology and the potential impact of conflicts and other international events.

The foregoing list of factors is not exhaustive. Before making any investment decision, investors and others relying on our forward-looking statements should carefully consider the foregoing factors and other factors. We caution readers not to rely unduly on these forward-looking statements. We assume no obligation to update forward-looking statements in the light of new information, future events or other circumstances unless applicable legislation so provides.