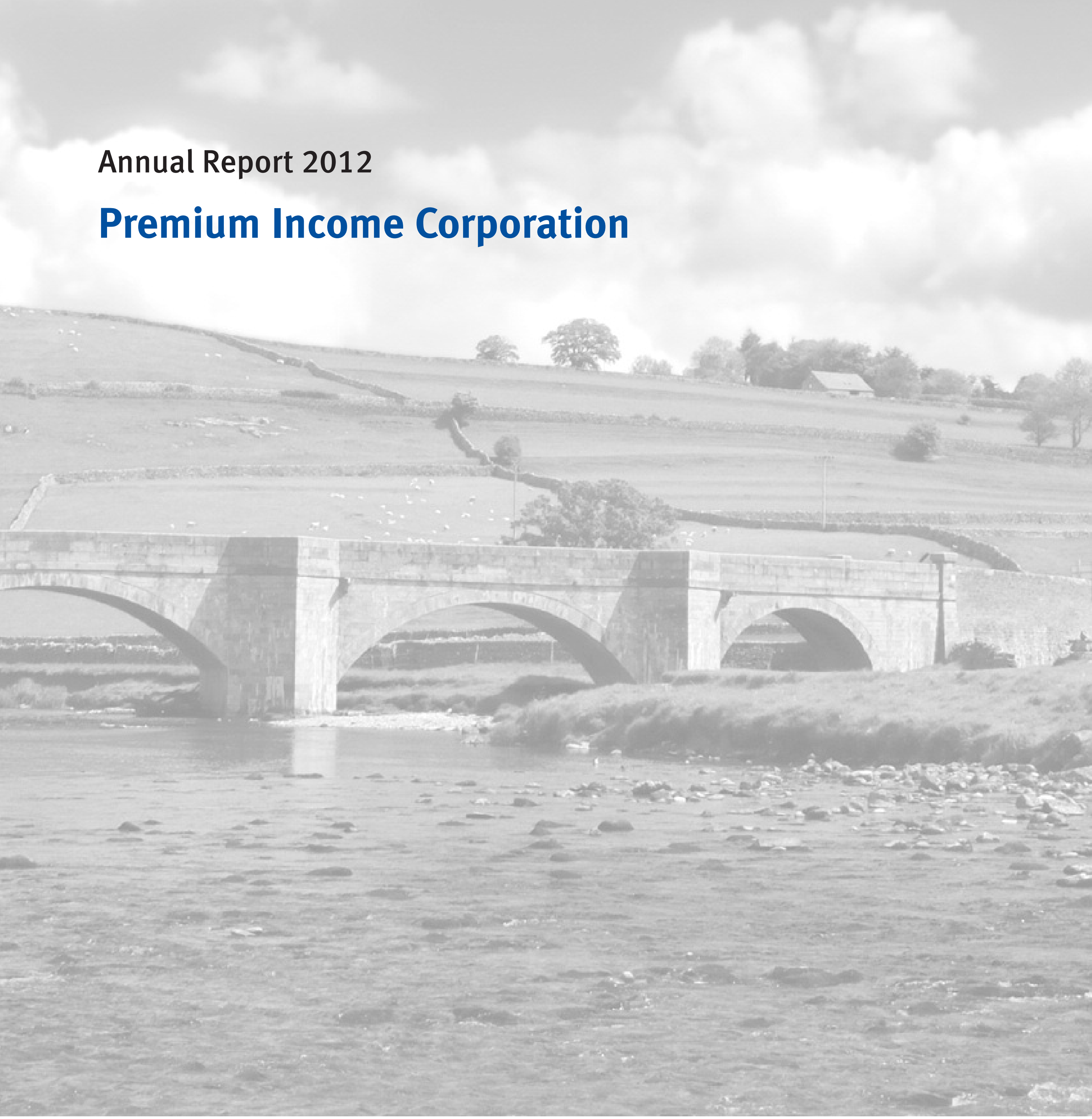
Annual Report 2012

Premium Income Corporation



strathbridge
ASSET MANAGEMENT

Letter to Shareholders

We are pleased to present the 2012 annual report containing the management report of fund performance and the audited financial statements of Premium Income Corporation.

During the year ended October 31, 2012, the Fund paid distributions of $0.86 per Preferred share and $0.81 per Class A share. The net asset value per Unit decreased slightly from $20.81 per Unit to $20.53 per Unit during this period. For a more detailed review of the operations of the Fund, please see the Results of Operations and the Portfolio Manager Report sections.

On November 5, 2012, the Fund announced the filing of the final short form prospectus relating to an offering of rights to holders of its Class A shares and Preferred shares. Each shareholder of record on November 13, 2012 received one right for each Class A share or Preferred share held. Two rights entitle the holder to acquire one Class A share and one Preferred share upon payment of the subscription price of $20.88. The rights commenced trading on November 9, 2012 under the ticker symbol PIC.RT and will remain trading on the Toronto Stock Exchange ("TSX") until the expiry date of December 11, 2012. The exercise of rights by holders will provide the Fund with additional capital that can be used to take advantage of attractive investment opportunities in Canadian banks and is also expected to increase the trading liquidity of the Class A shares and the Preferred shares as well as to reduce the management expense ratio of the Fund. The Manager believes that current markets offer an excellent opportunity for shareholders to increase their exposure to the Fund and its portfolio of the Banks. For the 4th consecutive year, Canadian banks were ranked #1 by the Geneva based World Economic Forum in the "Soundness of Banks" category. All five banks raised their dividend in the third quarter by 3-7 percent. Several banks also announced normal course issuer bids to repurchase shares.

We thank all shareholders for their continued support and encourage shareholders to review the more detailed information contained within the annual report.

John P. Mulvihill
Chairman & CEO,
Strathbridge Asset Management Inc.

The Fund

The Fund is a split share corporation designed to provide Preferred shareholders with cumulative preferential quarterly cash distributions of $0.22 per share, to provide Class A shareholders with quarterly cash distributions of $0.20 per share and to return the original issue price to holders of both Preferred shares and Class A shares upon windup of the Fund. A Unit of the Fund consists of one Preferred share and one Class A share. Once the net asset value ("NAV") per Unit exceeds $25.00, the Class A share distribution will be based on 8.0 percent per annum of the NAV of the Class A share. The shares are listed on the TSX under the ticker symbols PIC.PR.A for the Preferred shares and PIC.A for the Class A shares. To accomplish its objectives, the Fund invests primarily in common shares issued by:

- Bank of Montreal
- The Bank of Nova Scotia
- Canadian Imperial Bank of Commerce
- Royal Bank of Canada
- The Toronto-Dominion Bank

The Fund employs a proprietary investment strategy, Strathbridge Selective Overwriting ("SSO"), to enhance the income generated by the portfolio and to reduce volatility. In addition, the Fund may write cash covered put options in respect of securities in which it is permitted to invest.

The SSO strategy is a quantitative, technical based methodology that identifies appropriate times to write and/or close out option positions compared to writing continuously and rolling options every thirty days. This proprietary process has been developed over many years through various market cycles. The Manager believes the primary benefit to investors is to maximize the total return of the particular portfolio while reducing the level of volatility of the portfolio, thereby increasing the risk-adjusted return.

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Management Report of Fund Performance

This annual management report of fund performance contains the financial highlights for the year ended October 31, 2012 of Premium Income Corporation (the "Fund"). The annual financial statements of the Fund are attached.

Copies of the Fund's proxy voting policies and procedures, proxy voting disclosure record and quarterly portfolio disclosure may be obtained by calling 1-800-725-7172 toll free, by writing to the Fund at Investor Relations, 121 King Street West, Suite 2600, Standard Life Centre, P.O. Box 113, Toronto, Ontario, M5H 3T9, or by visiting our website at www.strathbridge.com. You can also request semi-annual or annual reports at no cost by using one of the above methods.

Investment Objectives and Strategies

The Fund's investment objectives are to:

(1) provide Preferred shareholders with cumulative preferential quarterly cash distributions of $0.22 per share,

(2) provide Class A shareholders with quarterly cash distributions of $0.20 per share, and

(3) return the original issue price to holders of both Preferred shares and Class A shares upon windup of the Fund.

Once the net asset value ("NAV") per Unit exceeds $25.00, the Class A share distribution will be based on 8.0 percent per annum of the NAV of the Class A share.

To accomplish its objectives the Fund invests primarily in common shares of Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada and The Toronto-Dominion Bank.

The Fund employs a proprietary investment strategy, Strathbridge Selective Overwriting ("SSO"), to enhance the income generated by the portfolio and to reduce volatility. In addition, the Fund may write cash covered put options in respect of securities in which it is permitted to invest.

The SSO strategy is a quantitative, technical based methodology that identifies appropriate times to write and/or close out option positions compared to writing continuously and rolling options every thirty days. This proprietary process has been developed over many years through various market cycles. The Manager believes the primary benefit to investors is to maximize the total return of the particular portfolio while reducing the level of volatility of the portfolio, thereby increasing the risk-adjusted return.

Risk

Risks associated with an investment in the securities of the Fund are discussed in the Fund's 2012 annual information form, which is available on the Fund's website at www.strathbridge.com or on SEDAR at www.sedar.com. There were no changes to the Fund over the year that materially affected the risks associated with an investment in the securities of the Fund.

Results of Operations

Distributions

For the year ended October 31, 2012, cash distributions of $0.86 per Preferred share and $0.81 per Class A share were paid to the respective classes of shareholders, both unchanged from the prior year. Since the inception of the Fund in October 1996, the Fund has paid total cash distributions of $14.01 per Preferred share and $19.73 per Class A share.

Revenue and Expenses

The Fund's total revenue was $0.91 per Unit for the year ended October 31, 2012, up $0.08 per Unit compared to the prior year. The increase in income per Unit reflected higher dividends declared by Canadian banks in fiscal 2012. Total expenses for 2012 were $0.25 per Unit, down $0.03 per Unit from a year ago, mainly due to lower management and transaction fees partially offset by higher administrative expenses in the current year. In addition, the prior year included non-recurring costs associated with the issue of warrants in May 2011. The Fund had a net realized and unrealized gain of $0.75 per Unit in 2012 as compared to a net realized and unrealized loss of $0.61 per Unit a year earlier.

Net Asset Value

The net asset value per Unit of the Fund decreased 1.3 percent from $20.81 per Unit at October 31, 2011 to $20.53 per Unit at October 31, 2012. The aggregate net asset value of the Fund decreased $2.7 million, from $198.1 million at October 31, 2011 to $195.4 million at October 31, 2012, primarily attributable to cash distributions of $15.9 million to Class A and Preferred shareholders, largely offset by an increase in net assets from operations of $13.2 million during the year.

During the year ended October 31, 2012, the annual total return of the Fund was 6.9 percent reflecting positive operating results from higher dividend income and stronger equity prices. The S&P/TSX Diversified Banks Index (the "Banks Index") total return during the same period was 12.5 percent. As a result of the Fund being limited to a specific universe of stocks and utilizing a covered call writing strategy to generate income, comparison with a market index may not be appropriate. The Banks Index is calculated without the deduction of management fees and fund expenses, whereas the performance of the Fund is calculated after deducting such fees and expenses.

Recent Developments

On January 19, 2012, the Fund filed a Notice of Intention to renew its previous normal course issuer bid to purchase up to 951,755 Class A shares and Preferred shares representing approximately 10 percent of the public float of 9,517,553 Class A shares and Preferred shares as of January 10, 2012. The Fund may purchase up to 190,351 of each respective class of shares in any 30 day period which is 2 percent of the 9,517,553 shares issued and outstanding of each respective class as at January 10, 2012. During the year, nil Class A shares and Preferred shares were purchased by the Fund.

On October 19, 2012, the Fund announced it had filed a preliminary short form prospectus relating to an offering of rights to holders of its Class A shares and Preferred shares. The exercise of rights by holders will provide the Fund with additional capital that can be used to take advantage of attractive investment opportunities in Canadian banks and is also expected to increase the trading liquidity of the Class A shares and the Preferred shares as well as to reduce the management expense ratio of the Fund.

Subsequent to year-end, on November 5, 2012, the Fund announced it filed a final short form prospectus relating to an offering of rights to holders of Class A shares and Preferred shares. Each shareholder of record on November 13, 2012 received one right for each Class A share or Preferred share held, and two rights entitle the holder to acquire one Class A share and one Preferred share upon payment of the subscription price of $20.88. The rights commenced trading on November 9, 2012 under the ticker symbol PIC.RT and will remain trading on the Toronto Stock Exchange until the expiry date of December 11, 2012.

Future Accounting Policy Changes

Strathbridge Asset Management Inc., as the Manager of the Fund, has developed a changeover plan to meet the timetable published by the Canadian Institute of Chartered Accountants (“CICA”) for changeover to International Financial Reporting Standards (“IFRS”).

The changeover plan was prepared to address the requirements and includes disclosures of the qualitative and quantitative impact, if any, of the changeover to IFRS in the 2012 financial statements and the preparation of the 2013 financial statements in accordance with IFRS with comparatives. In January 2011, the Canadian Accounting Standards Board (“AcSB”) approved a two year deferral from IFRS adoption for investment companies applying Accounting Guideline 18 - Investment Companies (“AcG-18”). Subsequently, in December 2011, AcSB extended the deferral for another year to January 1, 2014. As a result, the Fund will adopt IFRS for its fiscal period beginning November 1, 2014 and will issue its first annual financial statements in accordance with IFRS, with comparative information, for the year ending October 31, 2015.

As at October 31, 2012, some anticipated changes to financial reporting include:

- Compliance with the full body of IFRS without industry specific exemptions. Unlike Canadian Generally Accepted Accounting Principles (“Canadian GAAP”) where investment fund accounting was based upon guidance in AcG-18,
- Changes to the presentation of shareholder equity to consider puttable instruments,
- Presentation of comparative information, and
- Additional financial statement note disclosures on the recognition and classification of financial instruments.

Based on the Manager’s current understanding and analysis of IFRS to the accounting policies under Canadian GAAP, the Manager does not anticipate that the transition to IFRS will have a material impact on the Fund’s net assets per Unit, systems and processes, and it is expected that it will mainly result in additional note disclosure in the financial statements.

Related Party Transactions

On October 3, 2011, Mulvihill Capital Management Inc. (“MCM”), the Manager and Investment Manager of the Fund, announced a name change to Strathbridge Asset Management Inc. (“Strathbridge”).

Strathbridge, as the Investment Manager of the Fund, manages the Fund’s investment portfolio in a manner consistent with the investment objectives, strategy and criteria of the Fund pursuant to an Investment Management Agreement made between the Fund and MCM dated October 17, 1996 and amended as of October 8, 2010.

Strathbridge is the Manager of the Fund pursuant to a Management Agreement made between the Fund and MCM dated October 17, 1996 and amended as of October 8, 2010. As such, Strathbridge is responsible for providing or arranging for required administrative services to the Fund.

Strathbridge is paid the fees described under the Management Fees section of this report.

During the year, no recommendations or approvals were required to be sought from the Independent Review Committee ("IRC") concerning related party transactions.

Independent Review Committee

National Instrument 81-107 - Independent Review Committee for Investment Funds (“NI 81-107”) requires all publicly offered investment funds to establish an IRC to whom the Manager must refer conflict of interest matters for review or approval. NI 81-107 also imposes obligations upon the Manager to establish written policies and procedures for dealing with conflict of interest matters, maintaining records in respect of these matters and providing assistance to the IRC in carrying out its functions. Members of the IRC are Robert W. Korthals, Michael M. Koerner and Robert G. Bertram.

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. This information is derived from the Fund's audited annual financial statements.

The net assets per Unit presented in the financial statements differs from the net asset value per Unit calculated weekly, primarily as a result of investments being valued at bid prices for financial statement purposes and at closing prices for weekly net asset value purposes.

Years ended October 31

	2012	2011	2010	2009	2008
THE FUND'S NET ASSETS PER UNIT					
Net Assets, beginning of year (based on bid prices)(1)	**$ 20.79**	$ 22.53(4)	$ 19.15	$ 19.16	$ 26.16
INCREASE (DECREASE) FROM OPERATIONS					
Total revenue	**0.91**	0.83	0.87	0.70	0.89
Total expenses	**(0.25)**	(0.28)	(0.32)	(0.21)	(0.25)
Realized gain (loss) for the period	**(0.47)**	1.43	0.82	(3.65)	(1.40)
Unrealized gain (loss) for the period	**1.22**	(2.04)	1.53	3.97	(4.48)
Total Increase (Decrease) from Operations(2)	**1.41**	(0.06)	2.90	0.81	(5.24)
DISTRIBUTIONS					
Preferred Share					
From net investment income	**(0.86)**	(0.84)	(0.86)	(0.86)	(0.86)
Non-taxable distributions	**–**	(0.02)	–	–	–
Total Preferred Share Distributions	**(0.86)**	(0.86)	(0.86)	(0.86)	(0.86)
Class A Share					
From capital gains	**–**	–	–	–	(0.90)
From net investment income	**–**	–	(0.60)	(0.45)	–
Non-taxable distributions	**(0.81)**	(0.81)	–	–	–
Total Class A Share Distributions	**(0.81)**	(0.81)	(0.60)	(0.45)	(0.90)
Total Annual Distributions(3)	**(1.67)**	(1.67)	(1.46)	(1.31)	(1.76)
Net Assets, as at October 31 (based on bid prices)(1)	**$ 20.53**	$ 20.79	$ 20.56	$ 19.15	$ 19.16

(1) Net Assets per Unit is the difference between the aggregate value of the assets including the valuation of securities at bid prices and the aggregate value of the liabilities excluding the Redeemable Preferred Share liability, divided by the number of Units then outstanding.
(2) Total increase (decrease) from operations consists of interest and dividend revenue, realized and unrealized gain (loss), less expenses, excluding Preferred share distributions, and is calculated based on the weighted average number of Units outstanding during the year. The schedule is not intended to total to the ending net assets as calculations are based on the weighted average number of Units outstanding during the year.
(3) Distributions to shareholders are based on the number of shares outstanding on the record date for each distribution and were paid in cash.
(4) Net Assets per Unit was adjusted for the consolidation of the Class A shares effective the opening of trading on November 1, 2010. Each shareholder received 0.738208641 new Class A shares for each Class A share held. The total value of a shareholder's investment did not change; however, the number of Class A shares reflected in the shareholder's account declined and the Net Assets per Class A share increased proportionately.

	2012	2011	2010	2009	2008
RATIOS/SUPPLEMENTAL DATA					
Net Asset Value, excluding the Redeemable Preferred Share liability ($millions)(1)	**$ 195.39**	$ 198.09	$ 292.34	$ 279.70	$ 352.11
Net Asset Value ($millions)(1)	**$ 52.63**	$ 55.33	$ 79.25	$ 60.95	$ 76.36
Number of Units outstanding(1)	**9,517,553**	9,517,553	14,206,046	14,575,324	18,345,439
Management expense ratio(2)	**1.17%**	1.15%	1.44%	1.07%	1.08%
Portfolio turnover rate(3)	**53.70%**	81.29%	93.32%	74.20%	11.51%
Trading expense ratio(4)	**0.04%**	0.06%	0.09%	0.08%	0.04%
Net Asset Value per Unit(5)	**$ 20.53**	$ 20.81(6)	$ 20.58	$ 19.19	$ 19.19
Closing market price - Preferred	**$ 15.49**	$ 14.58	$ 15.00	$ 14.90	$ 12.60
Closing market price - Class A	**$ 5.85**	$ 6.03	$ 5.84	$ 4.57	$ 5.30

(1) This information is provided as at October 31. One Unit consists of one Preferred share and one Class A share.
(2) The management expense ratio ("MER") is the sum of all fees and expenses for the stated period, including federal and provincial sales taxes and capital tax but excluding transaction fees, income taxes and Preferred share distributions, divided by the average net asset value excluding the Redeemable Preferred Share liability. The MER for 2011 includes warrant offering costs and special resolution recovery. The MER for 2011 excluding warrant offering costs and special resolution recovery is 1.13%. The MER for 2010 includes the special resolution expense. The MER for 2010 excluding the special resolution expense is 1.10%. The MER, including Preferred share distributions, is 5.34%, 5.02%, 5.60%, 5.81% and 4.99% for 2012, 2011, 2010, 2009 and 2008 respectively.
(3) Portfolio turnover rate is calculated based on the lesser of purchases or sales of investments, excluding short-term investments, divided by the average value of the portfolio securities. The Fund employs an option overlay strategy which can result in higher portfolio turnover by virtue of option exercises, when compared to a conventional equity mutual fund.
(4) Trading expense ratio represents total commissions expressed as a percentage of the daily average net asset value during the year.
(5) Net Asset Value per Unit is the difference between the aggregate value of the assets including the valuation of securities at closing prices and the aggregate value of the liabilities excluding the Redeemable Preferred Share liability, divided by the number of Units then outstanding.
(6) Net Asset Value per Unit was adjusted for the consolidation of the Class A shares effective the opening of trading on November 1, 2010. Each shareholder received 0.738208641 new Class A shares for each Class A share held. The total value of a shareholder's investment did not change; however, the number of Class A shares reflected in the shareholder's account declined and the Net Asset Value per Class A share increased proportionately.

Management Fees

Strathbridge, as the Investment Manager of the Fund, is entitled to fees under the Investment Management Agreement calculated monthly as 1/12 of 0.80 percent of the net asset value of the Fund at each month end. Services received under the Investment Management Agreement include the making of all investment decisions and writing of covered call options in accordance with the investment objectives, strategy and criteria of the Fund. Strathbridge also makes all decisions as to the purchase and sale of securities in the Fund's portfolio and as to the execution of all portfolio and other transactions.

Strathbridge, as the Manager of the Fund, is entitled to fees under the Management Agreement calculated monthly as 1/12 of 0.10 percent of the net asset value of the Fund at each month end. Services received under the Management Agreement include providing or arranging for required administrative services to the Fund.

Past Performance

The following chart sets out the Fund's year-by-year past performance. It is important to note that the:

(1) information shown assumes that all distributions made by the Fund during these periods were reinvested in Units of the Fund,

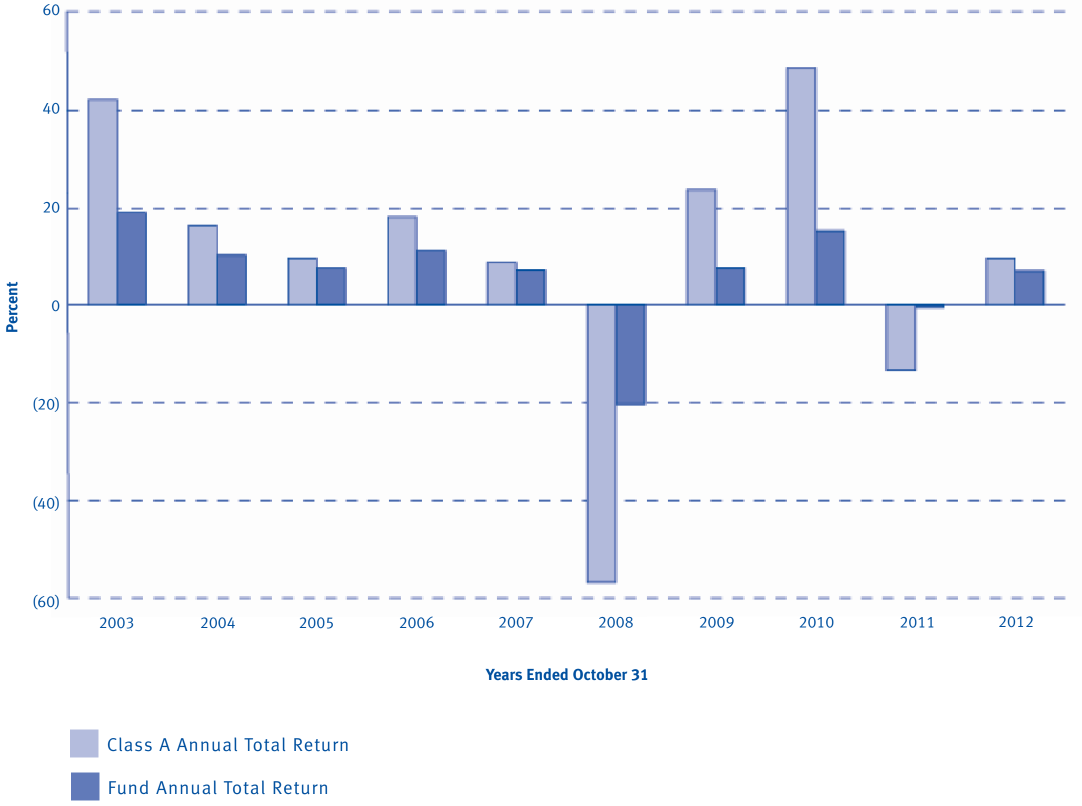
(2) information does not take into account sales, redemptions, distributions or other optional charges that would have reduced returns, and

(3) past performance of the Fund does not necessarily indicate how it will perform in the future.

Year-By-Year Returns

The following bar chart illustrates how the Fund's annual total return varied from year to year for each of the past ten years. The chart also shows, in percentage terms, how much an investment made on November 1 in each year would have increased or decreased by the end of the fiscal year.

Annual Total Return



Annual Compound Returns

The following table shows the Fund's historical annual compound return (net of expenses) for the periods ended October 31, 2012, as compared to the performance of the S&P/TSX Diversified Banks Index.

	One Year	Three Years	Five Years	Ten Years
Premium Income Corporation	**6.87 %**	6.98 %	0.92 %	5.75 %
Premium Income Corporation – Preferred	**5.88 %**	5.88 %	5.88 %	5.94 %
Premium Income Corporation – Class A	**9.50 %**	12.08 %	(5.55)%	5.71 %
S&P/TSX Diversified Banks Index(1)	**12.48 %**	10.10 %	4.63 %	12.27 %

(1) The S&P/TSX Diversified Banks Index is a subset of the S&P/TSX Composite Index.

The equity performance benchmark shown here provides an approximate indication of how the Fund's returns compare to a public market index for similar securities. It is important to note that the Fund is not managed in order to match or exceed this index; rather, its objectives are to pay out quarterly dividends and return the original invested amount at the termination date. As a result, the Fund has, from time to time, maintained cash balances in an effort to provide greater net asset value stability and employs a covered option writing strategy to enhance the income generated by the portfolio and reduce volatility.

The Manager believes that in a flat or downward trending market, a portfolio that is subject to covered call option writing will generally provide higher relative returns and lower volatility than one on which no options are written. However, in a rising market, the use of options may have the effect of limiting or reducing the total returns of the Fund, particularly since the premiums associated with writing covered call options may be outweighed by the foregone opportunity of remaining fully invested in the securities comprising the portfolio.

Portfolio Manager Report

North American equity markets continued to climb the proverbial "wall of worry" during the fiscal year ending October 31, 2012. After posting strong returns for the six months ending April 30, 2012 on better economic statistics and the likelihood of a Greece bailout from the European Central Bank ("ECB"), markets took a breather and corrected in the April to July period. However, since the announcement in July 2012 from ECB president Mario Draghi that the central bank would do whatever it takes to preserve the Euro, markets have provided strong returns into fiscal year-end. The Bank of Canada remained on hold during the period due to mixed economic numbers out of Canada along with the U.S. Federal Reserve indicating it will continue to keep its low interest rate policy in place until 2015. The Canadian banks generated steady earnings growth in 2012 on better-than-expected trading revenues and solid commercial loan growth. Capital ratios continued to remain strong as all five banks announced at least one dividend increase during the year and both the Canadian Imperial Bank of Commerce ("CIBC") and the Royal Bank of Canada ("RBC") announced significant normal course issuer bids to repurchase shares. RBC and The Toronto-Dominion Bank ("TD") also announced significant acquisitions near the end of October with RBC acquiring the auto finance and deposit business of Ally Credit Canada Ltd. for $4.1 billion and TD acquiring Target Corporation's U.S. Visa and private label credit card portfolio with a current gross outstanding balance of approximately US$5.9 billion for an undisclosed amount.

The total return for the S&P/TSX Diversified Banks Index (the "Banks Index") for the year was 12.5 percent which significantly outperformed the broader S&P/TSX Composite Index which increased 4.5 percent. The five banks that make up the portfolio experienced varying returns over the period with the Royal Bank of Canada leading the group after 2 years of underperformance, up 22.1 percent while the Bank of Montreal lagged the group, but still returned 5.2 percent during the period.

The annual total return of the Fund, including reinvestment of distributions, for the year ended October 31, 2012 was 6.9 percent. The Fund underperformed the Banks Index for the same period due to some covered call writing and protective put buying during the months of June, July and August when the risks of a European sovereign default were rising. In contrast to a downward expectation, the Banks Index advanced by 6.0 percent during this three month period. The Fund maintained its invested position during the majority of the year and ended 2012 with a cash position of 1 percent, unchanged from 2011 year-end. Volatility was subdued for most of the year; however, due to the increase in the level of volatility in the Canadian banks during the second half of the year, the Fund increased its selective covered-call writing activity as the higher volatility did compensate the Fund enough to justify this activity. The Fund ended 2012 with none of the portfolio subject to covered calls.

The Canadian banks are expected to improve profitability and capital ratios in 2013 due to continued retail earnings growth, better capital market-related revenues and cost efficiencies. Consequently, Canadian banks are likely to continue to return capital to shareholders in the form of dividend growth and share buybacks.

Summary of Investment Portfolio

The composition of the portfolio may change due to ongoing portfolio transactions of the Fund. A quarterly portfolio summary, which includes the percentage of net asset value for each holding, and a monthly portfolio list are available on our website at www.strathbridge.com.

Asset Mix

October 31, 2012

	% OF NET ASSET VALUE*
Financial Institutions	98%
Cash and Short-Term Investments	1%
Other Assets (Liabilities)	1%
	100%

*The Net Asset Value excludes the Redeemable Preferred Share liability.

Portfolio Holdings

October 31, 2012

	% OF NET ASSET VALUE*
Royal Bank of Canada	22%
Canadian Imperial Bank of Commerce	21%
Bank of Montreal	20%
The Toronto-Dominion Bank	18%
The Bank of Nova Scotia	17%
Cash and Short-Term Investments	1%

*The Net Asset Value excludes the Redeemable Preferred Share liability.

Forward-Looking Statements

This report may contain forward-looking statements about the Fund. Forward-looking statements include statements that are predictive in nature, that depend upon or refer to future events or conditions, or that include words such as “expects”, “anticipates”, “intends”, “plans”, “believes”, “estimates” or negative versions thereof and similar expressions. In addition, any statement that may be made concerning future performance, strategies or prospects, and possible future Fund action, is also forward-looking. Forward-looking statements are based on current expectations and projections about future events and are inherently subject to, among other things, risks, uncertainties and assumptions about the Fund and economic factors.

Forward-looking statements are not guarantees of future performance, and actual events and results could differ materially from those expressed or implied in any forward-looking statements made by the Fund. Any number of important factors could contribute to any divergence between what is anticipated and what actually occurs, including, but not limited to, general economic, political and market factors, interest and foreign exchange rates, global equity and capital markets, business competition, technology change, changes in government regulations, unexpected judicial or regulatory proceedings, and catastrophic events.

The above-mentioned list of important factors is not exhaustive. You should consider these and other factors carefully before making any investment decisions and you should avoid placing undue reliance on forward-looking statements. While the Fund currently anticipates that subsequent events and developments may cause the Fund’s views to change, the Fund does not undertake to update any forward-looking statements.

Management's Responsibility for Financial Reporting

The accompanying financial statements of Premium Income Corporation (the "Fund") and all the information in this annual report are the responsibility of the management of Strathbridge Asset Management Inc. (the "Manager"), and have been approved by the Fund's Board of Directors (the "Board").

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include certain amounts that are based on estimates and judgments. Management has ensured that the other financial information presented in this annual report is consistent with the financial statements. The significant accounting policies which management believes are appropriate for the Fund are described in Note 4 of the annual financial statements.

The Manager is also responsible for maintaining a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable financial information.

The Audit Committee meets periodically with management and the independent auditor to discuss internal controls, the financial reporting process, various auditing and financial reporting issues, and to review the annual report, the financial statements and the independent auditor's report. Deloitte & Touche LLP, the Fund's independent auditor, has full and unrestricted access to the Audit Committee and the Board.

John P. Mulvihill
Director
Strathbridge Asset Management Inc.
November 30, 2012

John D. Germain
Director
Strathbridge Asset Management Inc.

To the Shareholders of Premium Income Corporation

We have audited the accompanying financial statements of Premium Income Corporation, which comprise the statement of investments as at October 31, 2012, the statements of financial position as at October 31, 2012 and 2011, and the statements of operations and deficit, changes in net assets and cash flows 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 Premium Income Corporation as at October 31, 2012 and 2011, and the results of its operation, its changes in net assets, and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Licensed Public Accountants
November 30, 2012
Toronto, Ontario

Statements of Financial Position

As at October 31

	2012	2011
ASSETS		
Investments at fair value (cost - $188,643,543; 2011 - $202,600,690)	**$ 192,607,105**	$ 194,975,346
Short-term investments at fair value (cost - $1,196,664; 2011 - $1,995,707)	**1,196,664**	1,995,707
Cash	**387,005**	364,217
Interest and dividends receivable	**903,590**	887,028
Due from brokers - investments	**2,669,549**	–
TOTAL ASSETS	**$ 197,763,913**	$ 198,222,298
LIABILITIES		
Due to brokers - investments	**$ 2,188,028**	$ –
Accrued management fees	**149,073**	151,637
Accrued liabilities	**68,947**	64,951
Redemptions payable	**–**	123,629
Redeemable Preferred shares (Note 6)	**142,763,295**	142,763,295
	145,169,343	143,103,512
EQUITY		
Class A and Class B shares (Note 6)	**130,878,706**	130,878,706
Deficit	**(78,284,136)**	(75,759,920)
	52,594,570	55,118,786
TOTAL LIABILITIES AND EQUITY	**$ 197,763,913**	$ 198,222,298
Number of Units Outstanding (Note 6)	**9,517,553**	9,517,553
Net Assets per Unit		
Preferred Share	**$ 15.00**	$ 15.00
Class A Share - Basic	**5.53**	5.79
Net Assets per Unit (Note 5)	**$ 20.53**	$ 20.79
Net Assets per Class A Share - Diluted	**n/a**	$ 5.79

On Behalf of the Board of Directors

John P. Mulvihill, Director

Robert W. Korthals, Director

The notes are an integral part of the Financial Statements.

Statements of Operations and Deficit

Years ended October 31

	2012	2011
REVENUE		
Dividends	$ 8,617,895	$ 7,829,802
Interest	44,647	74,919
TOTAL REVENUE	8,662,542	7,904,721
EXPENSES (Note 7)		
Management fees	1,783,317	1,905,694
Administrative and other expenses	181,601	130,469
Transaction fees (Note 10)	70,708	135,967
Custodian fees	44,541	47,579
Audit fees	36,139	36,040
Director fees	20,890	21,835
Independent review committee fees	7,871	8,457
Legal fees	6,230	6,696
Shareholder reporting costs	38,364	41,519
Capital tax	–	(213)
Harmonized sales tax	187,264	205,613
Subtotal Expenses	2,376,925	2,539,656
Warrant offering costs (Note 6)	–	150,633
TOTAL EXPENSES	2,376,925	2,690,289
Net Investment Income before Special Resolution Recovery and Distributions	6,285,617	5,214,432
Special resolution recovery (Note 2)	–	112,774
Net Investment Income before Distributions	6,285,617	5,327,206
Preferred share distributions (Note 9)	(8,208,890)	(8,214,013)
Net Investment Loss	(1,923,273)	(2,886,807)
Net realized gain (loss) on investments	(1,944,132)	9,056,123
Net realized gain (loss) on derivatives	(2,510,231)	4,619,566
Net Gain (Loss) on Sale of Investments	(4,454,363)	13,675,689
Net change in unrealized appreciation/depreciation of investments	11,588,906	(19,552,376)
Net Gain (Loss) on Investments	7,134,543	(5,876,687)
NET INCOME (LOSS) FOR THE YEAR	$ 5,211,270	$ (8,763,494)
NET INCOME (LOSS) PER CLASS A SHARE - BASIC		
(based on the weighted average number of Class A shares outstanding during the year of 9,517,553; 2011 - 9,562,135)	$ 0.55	$ (0.92)
NET LOSS PER CLASS A SHARE - DILUTED	n/a	$ (0.92)
DEFICIT		
Balance, beginning of year	$ (75,759,920)	$ (65,269,714)
Net allocations on retractions of Class A shares (Note 6)	–	6,013,602
Net income (loss) for the year	5,211,270	(8,763,494)
Distributions to Class A shares	(7,735,486)	(7,740,314)
BALANCE, END OF YEAR	$ (78,284,136)	$ (75,759,920)

Statements of Changes in Net Assets

Years ended October 31

	2012	2011
NET ASSETS – CLASS A AND B SHARES, BEGINNING OF YEAR	**$ 55,118,786**	$ 78,937,973
Net Investment Income before Distributions	**6,285,617**	5,327,206
Net Gain (Loss) on Investments	**7,134,543**	(5,876,687)
Class A Share Capital Transactions		
Value for Class A shares redeemed (Note 6)	**–**	(7,315,379)
Distributions (Note 9)		
Preferred Shares		
From net investment income	**(8,208,890)**	(7,973,332)
Non-taxable distributions	**–**	(240,681)
Class A Shares		
Non-taxable distributions	**(7,735,486)**	(7,740,314)
	(15,944,376)	(15,954,327)
Change in Net Assets during the Year	**(2,524,216)**	(23,819,187)
NET ASSETS – CLASS A AND B SHARES, END OF YEAR	**$ 52,594,570**	$ 55,118,786

Statements of Cash Flows

Years ended October 31

	2012	2011
CASH AND SHORT-TERM INVESTMENTS, BEGINNING OF YEAR	**$ 2,359,924**	$ 25,290,342
Cash Flows Provided by (Used In) Operating Activities		
Net Investment Income before Distributions	**6,285,617**	5,327,206
Adjustments to Reconcile Net Cash Flows Provided by (Used In) Operating Activities		
Purchase of investment securities	**(103,416,038)**	(166,802,154)
Proceeds from disposition of investment securities	**112,918,822**	189,276,196
(Increase)/decrease in interest and dividends receivable and due from brokers - investments	**(2,686,111)**	43,853,210
Increase/(decrease) in due to brokers - investments, accrued management fees and accrued liabilities	**2,189,460**	(1,111,404)
	9,006,133	65,215,848
Cash Flows Provided by (Used In) Financing Activities		
Distributions to Preferred shares	**(8,208,890)**	(8,214,013)
Distributions to Class A shares	**(7,735,486)**	(7,740,314)
Preferred share redemptions	**(89,100)**	(70,238,295)
Class A share redemptions	**(34,529)**	(7,280,850)
	(16,068,005)	(93,473,472)
Net Increase/(Decrease) in Cash and Short-Term Investments During the Year	**(776,255)**	(22,930,418)
CASH AND SHORT-TERM INVESTMENTS, END OF YEAR	**$ 1,583,669**	$ 2,359,924
Cash and Short-Term Investments comprised of:		
Cash	**$ 387,005**	$ 364,217
Short-Term Investments	**1,196,664**	1,995,707
CASH AND SHORT-TERM INVESTMENTS, END OF YEAR	**$ 1,583,669**	$ 2,359,924

The notes are an integral part of the Financial Statements.

Statement of Investments

As at October 31, 2012

	Par Value/ Number of Shares	Average Cost	Fair Value	% of Net Assets
SHORT-TERM INVESTMENTS				
Bankers' Acceptances				
Bank of Montreal, 1.13% - December 3, 2012	1,200,000	$ 1,196,664	$ 1,196,664	0.6%
Accrued Interest			2,150	0.0%
TOTAL SHORT-TERM INVESTMENTS		$ 1,196,664	$ 1,198,814	0.6%
INVESTMENTS				
Canadian Common Shares				
Bank of Montreal	650,000	$ 38,372,439	$ 38,363,000	
Canadian Imperial Bank of Commerce	529,600	40,052,226	41,568,304	
Royal Bank of Canada	766,800	42,123,248	43,661,592	
The Bank of Nova Scotia	620,814	33,864,085	33,679,159	
The Toronto-Dominion Bank	435,000	34,304,555	35,335,050	
Total Canadian Common Shares		$ 188,716,553	$ 192,607,105	98.6%
Adjustment for transaction fees		(73,010)		
TOTAL INVESTMENTS		$ 188,643,543	$192,607,105	98.6%
OTHER NET ASSETS			1,551,946	0.8%
TOTAL NET ASSETS, excluding the Redeemable Preferred Share liability			$195,357,865	100.0%

1. Corporate Information

Premium Income Corporation (the "Fund") is a mutual fund corporation incorporated under the laws of the Province of Ontario on August 27, 1996. On September 29, 2010, the shareholders approved a reorganization effective on November 1, 2010 to extend the term of the Fund for an additional seven years. All shares outstanding on November 1, 2017 will be redeemed by the Fund on that date subject to an automatic extension of the term for an additional seven years.

Mulvihill Capital Management Inc. ("MCM") is the Manager as well as the Investment Manager of the Fund. On October 3, 2011, MCM announced a name change to Strathbridge Asset Management Inc. ("Strathbridge").

2. Reorganization

On September 29, 2010, shareholders approved a reorganization effective on November 1, 2010 to extend the term of the Fund an additional seven years to November 1, 2017. As part of the reorganization, shareholders were given a special retraction right to retract their Class A shares or Preferred shares at the net asset value ("NAV") of the Fund on November 1, 2010. This resulted in the Class A shares being consolidated on the basis of 0.738208641 new shares for each old share in order to maintain an equal number of Preferred shares and Class A shares outstanding subsequent to the special retraction. The Fund also made changes to its authorized share capital by adding new classes of shares issuable in series, changing the monthly retraction prices for the Preferred shares and the Class A shares so that they are calculated by reference to market price in addition to NAV and changing the dates by which notice of monthly retractions needs to be provided and by which the retraction amount will be paid. The Fund will also allow for the calculation of a diluted NAV in the event the Fund should ever issue warrants or rights to acquire additional Preferred shares or Class A shares.

In 2010, there was a special resolution expense of $1,018,079 pertaining to the fund extension of which $112,774 was recovered in 2011 as unclaimed solicitation fees.

3. Investment Objectives of the Fund

The Fund's investment objectives are to:

(i) provide Preferred shareholders with cumulative preferential quarterly cash distributions of $0.22 per share,

(ii) provide Class A shareholders with quarterly cash distributions of $0.20 per share, and

(iii) return the original issue price to holders of both Preferred shares and Class A shares upon windup of the Fund.

Once the net asset value ("NAV") per Unit exceeds $25.00, the Class A share distribution will be based on 8.0 percent per annum of the NAV of the Class A share.

To accomplish its objectives the Fund invests primarily in common shares of Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada and The Toronto-Dominion Bank.

The Fund employs a proprietary investment strategy, Strathbridge Selective Overwriting ("SSO"), to enhance the income generated by the portfolio and to reduce volatility. In addition, the Fund may write cash covered put options in respect of securities in which it is permitted to invest.

The SSO strategy is a quantitative, technical based methodology that identifies appropriate times to write and/or close out option positions compared to writing continuously and rolling options every thirty days. This proprietary process has been developed over many years through various market cycles. The Manager believes the primary benefit to investors is to maximize the total return of the particular portfolio while reducing the level of volatility of the portfolio, thereby increasing the risk-adjusted return.

4. Summary of Significant Accounting Policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), which include estimates and assumptions made by management that may affect the reported amounts of assets, liabilities, income and expenses during the reported periods. Primary estimates include valuation of investments. While management believes that the estimates used in preparing its financial statements are reasonable and prudent, actual results could differ from these estimates.

Financial Instruments – Disclosures

The Fund uses a three-tier hierarchy as a framework for disclosing fair value based on inputs used to value the Fund's investments. See additional note disclosures in Note 12.

The significant accounting policies of the Fund are as follows:

Valuation of Investments

Investments are recorded in the financial statements at their fair value which is determined by the closing bid price for long positions and by the closing ask price for short positions from the recognized stock exchange on which the securities are listed or principally traded. If no bid or ask prices are available, the securities are valued at the closing sale price or the Manager may estimate fair value using appropriate and accepted industry valuation techniques including valuation models. The fair value of an investment, determined using valuation models, requires the use of inputs and assumptions based on observable market data including volatility and other applicable rates or prices. In limited circumstances, the fair value of a security may be determined using valuation techniques that are not supported by observable market data. Over-the-counter options are valued using the Black-Scholes valuation model.

Short-term investments are included in the Statement of Investments at their cost. This value together with accrued interest approximates fair value at bid price.

Transaction Fees

Transaction fees have been expensed as incurred and included in the transaction fees line in the Statement of Operations and Deficit. Transaction fees are costs that are directly attributable to portfolio transactions which include fees and commissions paid to brokers and dealers.

Investment Transactions and Income

Investment transactions are accounted for on a trade date basis. Realized gains and losses on the sale of investments and change in unrealized appreciation/depreciation of investments are determined on an average cost basis. Realized gains and losses relating to written options may arise from:

(i) Expiration of written options whereby realized gains are equivalent to the premium received,

(ii) Exercise of written covered call options whereby realized gains or losses are equivalent to the premium received in addition to the realized gain or loss from disposition of the related investments at the exercise price of the option, and

(iii) Closing of written options whereby realized gains or losses are equivalent to the cost of purchasing options to close the positions, net of any premium received.

Realized gains and losses related to options are included in net realized gain (loss) on derivatives.

Realized gains and losses relating to purchased put options may arise from:

(i) Expiration of purchased put options whereby realized losses are equivalent to the premium paid,

(ii) Exercise of purchased put options whereby realized gains or losses are equivalent to the realized gain or loss from disposition of the related investments at the exercise price of the option less the premium paid, and

(iii) Sale of purchased put options whereby realized gains or losses are equivalent to the sale proceeds, net of any premium paid.

Option premiums received are reflected as deferred credits in investments so long as the options are outstanding. Any difference resulting from revaluation is included in net change in unrealized appreciation/depreciation of investments. Premiums received on written put options that are exercised are included in the cost of the security purchased.

Dividend income is recorded on the ex-dividend date. Interest income is recorded daily as it is earned.

Redeemable Preferred Shares

Each Redeemable Preferred share is valued for financial statement purposes at the lesser of: (i) $15.00; and (ii) the net assets of the Fund divided by the number of Preferred shares outstanding.

5. Net Asset Value

The net asset value of the Fund is calculated using the fair value of investments as the close or last trade price. The net assets per Unit is calculated using the fair value of investments at the closing bid price. The net assets per Unit for financial reporting purposes and net asset value per Unit for pricing purposes will not be the same due to the use of different valuation techniques.

The difference between the net asset value per Unit for pricing purposes and the net assets per Unit reflected in the financial statements is as follows:

	2012	2011
Net Asset Value per Unit (for pricing purposes)	**$20.5300**	$20.8130
Difference	**(0.0039)**	(0.0217)
Net Assets per Unit (for financial statement purposes)	**$20.5261**	$20.7913

6. Share Capital

The Fund is authorized to issue an unlimited number of Preferred shares and Class A shares, 1,000 Class B shares, an unlimited number of Class C shares, an unlimited number of Class D shares and an unlimited number of Class E shares, each issuable in series and an unlimited number of Class C Preferred shares, an unlimited number of Class D Preferred shares and an unlimited number of Class E Preferred shares, each issuable in series.

Preferred shares and Class A shares may be surrendered at any time for retraction on the last day of a month (a "Valuation Date"). Class A shares retracted on a monthly Valuation Date will be entitled to receive a retraction price per share equal to 96 percent of the lesser of: (i) the NAV per Unit on the applicable Valuation Date less the cost to the Fund of purchasing a Preferred share in the market for cancellation; and (ii) the market price per Unit less the cost to the Fund of purchasing a Preferred share in the market for cancellation. Preferred shares retracted on a monthly Valuation Date will be entitled to receive a retraction price per share equal to 96 percent of the lesser of: (i) the NAV per Unit on the applicable Valuation Date less the cost to the Fund of purchasing a Class A share in the market for cancellation; and (ii) the lesser of (a) the market price per Unit less the cost to the Fund of purchasing a Class A share in the market for cancellation and (b) $15.00. In addition, holders of Preferred shares and Class A shares may concurrently retract one Preferred share and one Class A share on an October Valuation Date of each year at a retraction price equal to the NAV per Unit on that date.

Net allocations on retractions of Class A shares represent gains on retractions where the price paid upon retraction is less than the carry ing value of the retracted shares. Under the terms of a Recirculation Agreement, the Fund may, but is not obligated to, require the Recirculation Agent to use its best efforts to find purchasers for any Preferred shares and Class A shares tendered for retraction. The Preferred shares rank in priority to the Class A shares and the Class A shares rank in priority to the Class B shares with respect to the payment of dividends and repayment of capital on the dissolution, liquidation or winding up of the Fund.

The holders of Class B shares are not entitled to receive dividends. The Class B shares are retractable at a price of $1.00 per share. Strathbridge owns all of the issued and outstanding Class B shares.

Class B shares are entitled to one vote per share at any meeting of shareholders while Preferred shares and Class A shares are entitled to vote on certain shareholder matters only.

The Fund's Preferred shares have been classified as liabilities in accordance with Canadian GAAP. Accordingly, net income for the year is stated after Preferred share distributions.

During the year, nil (2011 - 4,688,493) each of Preferred shares and Class A shares were redeemed with a total retraction value of nil (2011 - $77,642,774).

Issued and Outstanding

	2012	2011
9,517,553 Preferred shares (2011 - 9,517,553)	**$ 142,763,295**	$ 142,763,295
9,517,553 Class A shares (2011 - 9,517,553)	**$ 130,877,706**	$ 130,877,706
1,000 Class B shares (2011 - 1,000)	**1,000**	1,000
	$ 130,878,706	$ 130,878,706

On April 28, 2011, the Fund issued 9,523,493 warrants to Class A shareholders, on the basis of one warrant for each Class A share held. Exercisable only on the expiry date, two warrants entitled the holder to subscribe for one Unit (consisting of one Class A share and one Preferred share) of the Fund at a subscription price of $23.65. By the expiry date of December 15, 2011, the warrants issued to Class A shareholders expired worthless and nil warrants were exercised on such date. Warrant offering costs totalling $150,633 were incurred during 2011.

On January 19, 2012, the Fund filed a Notice of Intention to renew its previous normal course issuer bid to purchase up to 951,755 Class A shares and 951,755 Preferred shares representing approximately 10 percent of the public float of 9,517,553 Class A shares and 9,517,553 Preferred shares as of January 10, 2012. The Fund may purchase up to 190,351 of each respective class of shares in any 30 day period which is 2 percent of the 9,517,553 shares issued and outstanding of each respective class as at January 10, 2012. The shares may be purchased for cancellation from January 23, 2012 to January 22, 2013 through the facilities of the Toronto Stock Exchange ("TSX") or other eligible alternative market and may only be purchased at a price per share not exceeding the last net asset value per share. During the year, nil Class A shares and Preferred shares were purchased by the Fund.

7. Management Fees and Expenses

Strathbridge, as Manager under the terms of the Management Agreement and as Investment Manager under terms of the Investment Management Agreement, receives fees payable at annual rates of 0.10 percent and 0.80 percent respectively of the Fund's net asset value, calculated and payable monthly, plus applicable taxes.

The Fund is responsible for all ongoing custodian, manager, legal, accounting and audit fees as well as all other expenses incurred by the Manager in the ordinary course of business relating to the Fund's operations. The Fund is also responsible for commissions and other costs of portfolio transactions and any extraordinary expenses of the Fund which may be incurred from time to time.

8. Income Taxes

The Fund is a "mutual fund corporation" as defined in the Income Tax Act (Canada) (the "Act") and is subject to tax in respect of its net realized capital gains. This tax is refundable in certain circumstances. Also, the Fund is generally subject to a tax of 33 1/3 percent under Part IV of the Act on taxable dividends received in the year. This tax is fully refundable upon payment of sufficient dividends. The Fund is also subject to tax on the amount of its interest income that is not offset by operating expenses and share issue expenses.

The Fund is also a "financial intermediary corporation" as defined in the Act and, as such, is not subject to tax under Part IV.1 of the Act on dividends received nor is it generally liable to tax under Part VI.1 on dividends paid on taxable preferred shares.

The Fund has offset the refundable tax liability with the refund expected upon payment of capital gains or ordinary dividends. As a result, the refundable tax liability is eliminated.

No amount is payable on account of income taxes in 2012 or 2011.

Accumulated non-capital losses of approximately $7.4M (2011 - $5.9M) and capital losses of $38.4M (2011 - $33.5M) are available for utilization against net investment income and realized gains on sale of investments, respectively, in future years. The capital losses can be carried back for 3 years and carried forward indefinitely. The non-capital losses expire as follows:

Expiration Date	Amount (in $M)
2028	**$ 3.3**
2029	**2.2**
2032	**1.9**
Total	**$ 7.4**

9. Distributions

Preferred shares are entitled to a cumulative preferential quarterly dividend of $0.215625 per share payable on the last day of January, April, July and October in each year.

The Fund is permitted to make distributions to holders of Class A and Preferred shares in the form of returns of capital. Return of capital distributions are generally not subject to tax. However, returns of capital reduce the adjusted cost base of the shares in respect of which they are paid.

10. Transaction Fees

Total transaction fees for the year ended October 31, 2012 in connection with portfolio transactions were $70,708 (2011 -

$135,967). Of this amount $34,859 (2011 - $14,334) was directed to cover payment of research services provided to the Investment Manager.

11. Capital Disclosures

Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1535, "Capital Disclosures" requires the disclosure of: (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data and qualitative information about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. The Fund's objectives, policies and processes are described in Note 3, information on the Fund's shareholders' equity is described in Note 6 and Note 9, and the Fund does not have any externally imposed capital requirements.

12. Financial Instruments and Risk Management

The Fund's financial instruments consist of cash, investments, receivables, payables and Redeemable Preferred shares. In accordance with CICA Handbook Section 3862, "Financial Instruments - Disclosures", the Fund uses a three-tier hierarchy as a framework for disclosing fair value based on inputs used to value the Fund's investments. The hierarchy of inputs is summarized below:

(i) Level 1 - for unadjusted quoted prices in active markets for identical assets or liabilities,

(ii) Level 2 - for 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

(iii) Level 3 - for inputs that are based on unobservable market data.

The following is a summary of the inputs used as of October 31, 2012 in valuing the Fund's investments carried at fair value:

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Short-Term Investments	$ –	$ 1,198,814	$ –	$ 1,198,814
Canadian Common Shares	192,607,105	–	–	192,607,105
Total Investments	$ 192,607,105	$ 1,198,814	$ –	$ 193,805,919

The following is a summary of the inputs used as of October 31, 2011 in valuing the Fund's investments and derivatives carried at fair value:

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Short-Term Investments	$ –	$ 1,996,695	$ –	$ 1,996,695
Canadian Common Shares	196,890,595	–	–	196,890,595
Options	–	(1,915,249)	–	(1,915,249)
Total Investments	$ 196,890,595	$ 81,446	$ –	$ 196,972,041

There were no transfers between Level 1 and Level 2 during 2012 and 2011.

The Fund is exposed to various types of risks that are associated with its investment strategies, financial instruments and markets in which it invests. The most important risks include other price risk, liquidity risk, interest rate risk and credit risk.

These risks and related risk management practices employed by the Fund are discussed below:

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 segment. The portfolio consists primarily of equity securities of the major Canadian banks. Net Asset Value per Unit varies as the value of the securities in the portfolio varies. The Fund has no control over the factors that affect the value of the securities in the portfolio, including factors that affect all the companies in the financial services industry. The Fund's market risk is managed by taking a long-term perspective and utilizing an option writing program, as well as by the use of purchased put options.

Approximately 99 percent (2011 - 99 percent) of the Fund's net assets, excluding the Redeemable Preferred Share liability, held at October 31, 2012 were publicly traded equities. If equity prices on the exchange increased or decreased by 10 percent as at October 31, 2012, the net assets, excluding the Redeemable Preferred Share liability, of the Fund would have increased or decreased by $19.3M (2011 - $19.7M) respectively or 9.9 percent (2011 - 9.9 percent) of the net assets, excluding the Redeemable Preferred Share liability, all other factors remaining constant. In practice, actual trading results may differ and the difference could be material.

Liquidity Risk

Liquidity risk is the possibility that investments in the Fund cannot be readily converted into cash when required. To manage this risk, the Fund invests the majority of its assets in investments that are traded in an active market and can be easily disposed of. In addition, the Fund aims to retain sufficient cash and short-term investments to maintain liquidity and to meet its obligations when due. Liabilities are payable within one year except the Redeemable Preferred Share liability which matures on November 1, 2017 (see Note 6).

Cash is required to fund redemptions. Following the reorganization of the Fund, shareholders must surrender shares at least 10 business days prior to a valuation date and receive payment on or before 10 business days following such valuation date. Therefore the Fund has a maximum of 20 business days to generate sufficient cash to fund redemptions mitigating liquidity issues.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a financial instrument. The financial instruments which potentially expose the Fund to interest rate risk are the short-term fixed income securities. The Fund has minimal sensitivity to change in rates since they are usually held to maturity and short-term in nature.

Credit Risk

The Fund is subject to the credit risk that its counterparty (whether a clearing corporation, in the case of exchange traded instruments, or other third party, in the case of over-the-counter instruments) may be unable to meet its obligations. The Fund manages these risks through the use of various risk limits and trading strategies.

The credit risk is mitigated by dealing with counterparties that have a credit rating that is not below the level of approved credit ratings as set out in National Instrument 81-102.

The following are the credit ratings for the counterparties to derivative financial instruments that were authorized for trading with the Fund during the current year based on Standard & Poor's credit rating as of October 31, 2012:

Dealer	Long-Term Local Currency Rating	Short-Term Local Currency Rating
Bank of Montreal	A+	A-1
Canadian Imperial Bank of Commerce	A+	A-1
Citigroup Inc.	A-	A-2
Deutsche Bank	A+	A-1
National Bank of Canada	A	A-1
Royal Bank of Canada	AA-	A-1+
The Bank of Nova Scotia	AA-	A-1+
The Toronto-Dominion Bank	AA-	A-1+
UBS AG	A	A-1

The following are the credit ratings for the counterparties to derivative financial instruments that were authorized for trading with the Fund during the prior year based on Standard & Poor's credit ratings as of October 31, 2011:

Dealer	Long-Term Local Currency Rating	Short-Term Local Currency Rating
Bank of Montreal	A+	A-1
Canadian Imperial Bank of Commerce	A+	A-1
Citigroup Inc.	A	A-1
National Bank of Canada	A	A-1
Royal Bank of Canada	AA-	A-1+
The Toronto-Dominion Bank	AA-	A-1+

The following is the credit rating for short-term investments held by the Fund based on Standard & Poor’s credit ratings as of October 31, 2012:

Type of Short-Term Investment	Rating	% of Short-Term Investments
Bankers’ Acceptances	A-1	100%
Total		100%

The following is the credit rating for short-term investments held by the Fund based on Standard & Poor’s credit ratings as of October 31, 2011:

Type of Short-Term Investment	Rating	% of Short-Term Investments
Bankers’ Acceptances	A-1+	100%
Total		100%

The carrying amount of these investments represents their maximum credit risk exposure, as they will be settled in the short-term.

13. Future Accounting Policy Changes

The Fund was required to adopt International Financial Reporting Standards (“IFRS”) for the year beginning on January 1, 2011. In January 2011, the Canadian Accounting Standards Board (“AcSB”) approved a two year deferral from IFRS adoption for investment companies applying Accounting Guideline 18 - Investment Companies. Subsequently, in December 2011, AcSB extended the deferral for another year to January 1, 2014. As a result, the Fund will adopt IFRS for the year beginning on November 1, 2014 and will issue its first annual statements, with comparative information, for the year ending October 31, 2015.

14. Subsequent Event

On November 5, 2012, the Fund announced the filing of the final short form prospectus relating to an offering of rights to holders of its Class A shares and Preferred shares. Each shareholder of record on November 13, 2012 received one right for each Class A share or Preferred share held. Two rights entitle the holder to acquire one Class A share and one Preferred share upon payment of the subscription price of $20.88. The rights commenced trading on November 9, 2012 under the ticker symbol PIC.RT and will remain trading on the TSX until the expiry date of December 11, 2012.

Statement of Corporate Governance Practices

The Board of Directors of the Fund is responsible for the overall stewardship of the Fund's business and affairs. The Fund has investment objectives and investment strategies that are set out in the prospectus of the Fund. The Fund's manager, Strathbridge Asset Management Inc. (the "Manager"), administers many functions associated with the operations of the Fund pursuant to a management agreement entered into at the time the Fund issued its shares to the public. Under this agreement the Manager is responsible for certain day to day operations of the Fund including the payment of distributions on its shares and attending to the retraction or redemption of its shares in accordance with their terms.

The Board consists of five directors, three of whom are independent of the Fund. The Board believes that the number of directors is appropriate for the Fund and only directors independent of the Fund are compensated. Amounts paid as compensation are reviewed for adequacy to ensure that they realistically reflect the responsibilities and risk involved in being an effective director. Individual directors may engage an outside advisor at the expense of the Fund in appropriate circumstances subject to the approval of the Board.

To assist the Board in its monitoring of the Fund's financial reporting and disclosure, the Board has established, and hereby continues the existence of, a committee of the Board known as the Audit Committee. The Audit Committee consists of three members, all of whom are independent of the Fund. The responsibilities of the Audit Committee include, but are not limited to, review of the annual financial statements and the annual audit performed by the independent auditor and oversight of the Fund's compliance with tax and securities laws and regulations. The Audit Committee has direct communication channels with the independent auditor to discuss and review specific issues as appropriate.

The Board is responsible for developing the Fund's approach to governance issues and, together with the Investment Manager, has established a best practices governance procedure.

The Fund maintains an Investor Relations line (toll free: 1-800-725-7172 or email: info@strathbridge.com) and website (www.strathbridge.com) to respond to inquiries from shareholders.

Board of Directors

John P. Mulvihill
Chairman & CEO,
Strathbridge Asset Management Inc.

John D. Germain
Senior Vice-President & Chief Financial Officer
Strathbridge Asset Management Inc.

Michael M. Koerner[1,2]
Corporate Director

Robert W. Korthals[1,2]
Corporate Director

Robert G. Bertram[1,2]
Corporate Director

[1] Audit Committee Member
[2] Independent Review Committee Member

Information

Independent Auditor:
Deloitte & Touche LLP
Brookfield Place
181 Bay Street, Suite 1400
Toronto, Ontario
M5J 2V1

Transfer Agent:
Computershare Investor Services Inc.
100 University Avenue, 8th Floor
Toronto, Ontario
M5J 2Y1

Shares Listed:
Toronto Stock Exchange
trading under
PIC.A/PIC.PR.A

Custodian:
RBC Investor Services Trust
RBC Centre
155 Wellington Street West, 2nd Floor
Toronto, Ontario
M5V 3L3

Visit our website at www.strathbridge.com for additional information on all Strathbridge Investment Funds.

Investment Funds Managed by Strathbridge Asset Management Inc.

UNIT TRUSTS
Canadian Utilities & Telecom Income Fund
Core Canadian Dividend Trust
Gold Participation and Income Fund
Premier Canadian Income Fund
Top 10 Canadian Financial Trust

SPLIT SHARES
Premium Income Corporation
S Split Corp.
Top 10 Split Trust
World Financial Split Corp.

PRINCIPAL PROTECTED FUNDS
Government Strip Bond Trust

Head Office:

Strathbridge Asset Management Inc.
121 King Street West, Suite 2600
Standard Life Centre, P.O. Box 113
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M5H 3T9

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Fax: 416 681-3901
Email: info@strathbridge.com

Contact your broker directly for address changes.

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