

## **Annual Management Report of Fund Performance As at October 31, 2007 Front Street Diversified Income Fund Class**

*This Annual Management Report of Fund Performance contains financial highlights but does not contain the complete annual financial statements for Front Street Diversified Income Fund, a class of shares of Front Street Mutual Funds Limited fund (the "Fund"). The annual financials of the Fund are attached behind this report and you can also get a copy of the interim or annual financial statements at your request, and at no cost, by calling 1-800-513-2832, by writing to us at Front Street Capital 2004, 33 Yonge Street, Suite 600, Toronto, Ontario M5E 1G4 or by visiting our web site at [www.frontstreetcapital.com](http://www.frontstreetcapital.com) or SEDAR at [www.sedar.com](http://www.sedar.com).*

*Security holders may also contact us using one of these methods to request a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure relating to the Fund.*

### **Forward Looking Information**

This Annual Management Report of Fund Performance contains forward-looking information and statements relating, but not limited to, anticipated or prospective financial performance and results of operations of the Fund. Forward looking information involves known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking information. For this purpose, any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking information. Without limiting the foregoing, the words "believes", "anticipates", "plans", "intends", "will", "should", "expects", "projects", and similar expressions are intended to identify forward-looking information.

Although the Fund believes it has a reasonable basis for making the forecasts or projections included in this Annual Management Report of Fund Performance, readers are cautioned not to place undue reliance on such forward-looking information. By its nature, the forward-looking information involves numerous assumptions, inherent risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts and other forward-looking statements will not occur. These factors include, but are not limited to, those associated with the performance of the equity securities market, expectations about interest rates and factors incorporated by reference herein as risk factors.

The above list of important factors affecting forward looking information is not exhaustive, and reference should be made to the other risks discussed in the Fund's filings with Canadian securities regulatory authorities. The forward looking information is given as of the date of this Annual Management Report of Fund Performance, and the Fund undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise.

## Management Discussion of Fund Performance

### INVESTMENT OBJECTIVES AND STRATEGIES

The Fund will seek to provide shareholders with the opportunity to receive monthly distributions targeted to yield of 5.5% per year on the original issue price of the Units and generate capital appreciation on the portfolio with a reduced measure of risk.

The Fund's portfolio consists primarily of securities of income trusts, although the Fund also invests in preferred shares, corporate and government debt securities and common shares.

The Fund's ability to manage risk and volatility through the strategic use of long and short positions is a key element in achieving its investment objective.

The Fund will retain a net long bias to assist its investment strategy.

The Fund's portfolio will consist of securities of Income Trusts, preferred shares and corporate and government debt, although the Fund may also invest in common shares. In managing the portfolio, the Investment Advisor, Front Street Investment Management Inc., intends to use strategies including: investing in undervalued securities, short selling overvalued securities, managing long/short positions, pairs trading, merger arbitrage, convertible arbitrage and participation in restructurings.

From time to time the Fund may invest in other mutual funds and may purchase securities of, or enter into specified derivative transactions for which the underlying interest is based on the securities of other mutual funds. Such investments may be entered into in conjunction with other strategies and investments in a manner considered most appropriate to achieving the Fund's investment objectives stated above and enhancing returns as permitted by securities regulations.

### RISK

The Most of the Fund's assets will be invested in income producing securities, some of which will have equity characteristics. The Fund will therefore be subject to stock market risk. The Fund may also invest in foreign securities that may expose the Fund, to a limited extent, to the risk of investments in foreign securities and foreign currency risk. The Fund may invest in relatively illiquid securities that may expose the Fund to liquidity risk. The Fund may also be exposed to sector risk due to its investments being concentrated in a limited number of sectors. The Fund may also be exposed to the risks of selling securities short, the risks of investing in derivatives, and the risk associated with investing in securities of junior industrial, technology and natural resource companies.

Currency risk proved to have an effect on the Fund's returns, as the Canadian dollar strengthened, relative to the U.S. dollar, over the year. Currency risk impacted principally the Fund's investments that had revenue in U.S. dollars. Volatility in currency markets continues to be high, suggesting uncertainty going forward on this front.

Equity risk also affected Fund volatility. Specifically, the threat of oil-supply disruptions kept the price of oil high. While market volatility was high overall, the high price of oil and gas was a positive factor that contributed to Canadian equity market performance, particularly in the energy sector.

Interest-rate risk was also a factor, as global central banks and bond and equity markets closely monitored the U.S. Federal Reserve's monetary policy activities and public communications for indications as to when the current cycle of monetary policy tightening may be ending. As higher borrowing costs tend to slow the economy, rising interest rates tend to have a negative impact on the outlook for corporate-profit growth and therefore equity market performance.

Credit risk was another factor this year. Specifically, a weakening housing market in the United States finally became a crisis in August of 2007 as assets backed by sub prime mortgages collapsed, impacting global debt and equity markets. As the autumn progressed, the vicious circle caused by deteriorating credit impacted commercial

banks -- holders of bonds and other securities backed by home loans. As a result, lending has been curtailed and the cost of money is higher. Although the Fund did not hold the debt in question, equity markets have been weak due to the general uncertainty and the fact that global growth could decelerate into 2008 as liquidity dries up.

Political risk was also in evidence this year following the Alberta government's announced changes in tax policy in the oil and gas sector in October 2007. This will increase volatility and risk.

The Fund has multiple risks associated with equity markets. Investors whose primary concern is preservation of capital should not be invested in this Fund. The Fund is suitable for investors seeking monthly income and long-term growth with a tolerance for risk and volatility and a long-term investment horizon.

The risks of investing in the Fund are further discussed in the Fund's Annual Information Form dated June 13, 2007.

## **RESULTS OF OPERATIONS**

The Fund met its distribution objectives of 5.5% per annum and was able to maintain its net asset value per unit through the year.

Positive contributions from the portfolio came from REITS, oil and gas royalty trusts and business trusts. Marginal contributions came from the interest sensitive sector.

The outlook for 2007 is for tax policy clarification, moderate interest rate increases and weakness in the royalty sector coupled with natural production declines. Business trusts should perform in line with the economy as it continues to deliver strong results.

## **RECENT DEVELOPMENTS**

The Fund anticipates that volatility will continue in the equity markets for the foreseeable future. The perception exists that inventory levels are tight in most commodity groups leading to an inability to cushion any shocks to the system. Despite this, and even with a changing interest rate and credit environment, economic growth has continued unabated.

## **ADOPTION OF NEW ACCOUNTING STANDARDS**

Effective November 1, 2006, the Fund has adopted Section 3855, "Financial Instruments – Recognition and Measurement" of the CICA Handbook – Accounting, issued by the Canadian Institute of Chartered Accountants ("CICA"), which establishes standards for the fair valuation of investments as well as the accounting treatment of transaction costs. Additionally, Section 14.2 of National Instrument 81-106 ("NI 81-106"), issued by the Canadian Securities Administrators in 2005, requires the daily net asset value of an investment fund to be calculated in accordance with Canadian generally accepted accounting principles ("GAAP").

## **RELATED PARTY-TRANSACTIONS**

The Fund may place a portion of its portfolio transactions with brokerage firms which are affiliates of Front Street Mutual Funds Limited, the manager of the Fund, and the Investment Advisor, provided it determines that these affiliates' trade execution abilities and costs are comparable to those non-affiliated, qualified brokerage firms, on an execution-only basis. For the year ended October 31, 2007, Tuscarora Capital Inc. received \$11,897 in commission on portfolio transactions for the Fund.

## FINANCIAL HIGHLIGHTS

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance since inception. This information is derived from the Fund's audited annual financial statements.

### FRONT STREET DIVERSIFIED INCOME FUND CLASS SERIES A

FOR THE YEARS ENDED

	October 31, 2007	October 31, 2006	October 31, 2005	October 31, 2004	October 31, 2003
	\$	\$	\$	\$	\$

#### The Fund's Net Asset (NAV) per Share

<b>Net asset, beginning of year (7)</b>	9.92	10.00	-	-	-
<b>Increase (decrease) from operations:</b>					
Total revenue	0.44	0.15	-	-	-
Total expenses	(0.39)	(0.32)	-	-	-
Realized gains (losses)	0.38	0.04	-	-	-
Unrealized gains (losses)	(0.26)	0.69	-	-	-
<b>Total increase (decrease) from operations <sup>(1)</sup></b>	<b>0.17</b>	<b>0.56</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Distributions:</b>					
From income (excluding dividends)	-	-	-	-	-
From dividends	-	-	-	-	-
From capital gains	-	-	-	-	-
Return of capital	(0.55)	(0.15)	-	-	-
<b>Total distributions <sup>(2)</sup></b>	<b>(0.55)</b>	<b>(0.15)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net asset, end of year (7)</b>	<b>9.47</b>	<b>9.94</b>	<b>-</b>	<b>-</b>	<b>-</b>

#### Ratios and Supplemental Data Series A

Net assets (000's) <sup>(3)</sup>	13,839	5,777	-	-	-
Number of shares outstanding	1,461,992	581,171	-	-	-
Management expense ratio <sup>(4)</sup>	3.98%	9.23%	-	-	-
Management expense ratio before waivers or absorptions	3.98%	9.23%	-	-	-
Portfolio turnover rate <sup>(5)</sup>	347.72%	38.23%	-	-	-
Trading expense ratio <sup>(6)</sup>	0.45%	0.61%	-	-	-



**FRONT STREET DIVERSIFIED INCOME FUND CLASS SERIES B**

FOR THE YEARS ENDED	October 31, 2007	October 31, 2006	October 31, 2005	October 31, 2004	October 31, 2003
	\$	\$	\$	\$	\$
<b>The Fund's Net Asset (NAV) per Share</b>					
<b>Net Asset, beginning of year (7)</b>	9.91	10.00	-	-	-
<b>Increase (decrease) from operations:</b>					
Total revenue	0.43	0.17	-	-	-
Total expenses	(0.39)	(0.38)	-	-	-
Realized gains (losses)	0.39	0.04	-	-	-
Unrealized gains (losses)	(0.30)	0.85	-	-	-
<b>Total increase (decrease) from operations <sup>(1)</sup></b>	<b>0.13</b>	<b>0.68</b>	-	-	-
<b>Distributions:</b>					
From income (excluding dividends)	-	-	-	-	-
From dividends	-	-	-	-	-
From capital gains	-	-	-	-	-
Return of capital	(0.55)	(0.15)	-	-	-
<b>Total distributions <sup>(2)</sup></b>	<b>(0.55)</b>	<b>(0.15)</b>	-	-	-
<b>Net asset, end of year (7)</b>	<b>9.47</b>	<b>9.93</b>	-	-	-
<b>Ratios and Supplemental Data Class B</b>					
Net assets (000's) <sup>(3)</sup>	7,927	10,512	-	-	-
Number of shares outstanding	837,203	1,058,552	-	-	-
Management expense ratio <sup>(4)</sup>	3.99%	10.54%	-	-	-
Management expense ratio before waivers or absorptions	3.99%	10.54%	-	-	-
Portfolio turnover rate <sup>(5)</sup>	347.72%	38.23%	-	-	-
Trading expense ratio <sup>(6)</sup>	0.45%	0.61%	-	-	-

**FRONT STREET DIVERSIFIED INCOME FUND CLASS SERIES F**

FOR THE YEARS ENDED	October 31, 2007	October 31, 2006	October 31, 2005	October 31, 2004	October 31, 2003
	\$	\$	\$	\$	\$
<b>The Fund's Net Asset (NAV) per Share</b>					
<b>Net asset, beginning of year (7)</b>	9.96	10.00	-	-	-
<b>Increase (decrease) from operations:</b>					
Total revenue	0.41	0.08	-	-	-
Total expenses	(0.37)	(0.17)	-	-	-
Realized gains (losses)	0.35	0.04	-	-	-
Unrealized gains (losses)	(0.78)	0.18	-	-	-
<b>Total increase (decrease) from operations <sup>(1)</sup></b>	<b>(0.39)</b>	<b>0.13</b>	-	-	-

**FRONT STREET DIVERSIFIED INCOME FUND CLASS SERIES F**

FOR THE YEARS ENDED	October 31, 2007	October 31, 2006	October 31, 2005	October 31, 2004	October 31, 2003
	\$	\$	\$	\$	\$
<b>Distributions:</b>					
From income (excluding dividends)	-	-	-	-	-
From dividends	-	-	-	-	-
From capital gains	-	-	-	-	-
Return of capital	(0.55)	(0.15)	-	-	-
<b>Total distributions</b> <sup>(2)</sup>	(0.55)	(0.15)	-	-	-
<b>Net asset, end of year</b> <sup>(7)</sup>	9.48	9.98	-	-	-
<b>Ratios and Supplemental Data Class F</b>					
Net assets (000's) <sup>(3)</sup>	451	260	-	-	-
Number of shares outstanding	47,596	26,080	-	-	-
Management expense ratio <sup>(4)</sup>	4.02%	7.72%	-	-	-
Management expense ratio before waivers or absorptions	4.02%	7.72%	-	-	-
Portfolio turnover rate <sup>(5)</sup>	347.72%	38.23%	-	-	-
Trading expense ratio <sup>(6)</sup>	0.45%	0.61%	-	-	-

- (1) Net asset and distributions are based on the actual number of shares outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of shares outstanding over the financial period.
- (2) Distributions were paid in cash and/or reinvested in additional shares of the Fund.
- (3) This information is provided as at period end of the year shown.
- (4) Management expense ratio is based on total expenses for the stated year and is expressed as an annualized percentage of daily average net assets during the year. In the year, a series is established, the management expense ratio is annualized from the date of inception to October 31.
- (5) The Fund's portfolio 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 year. The higher a Fund's portfolio turnover rate in a year, the greater the trading costs payable by the Fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a Fund.
- (6) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the year.
- (7) The relief granted by the Canadian securities regulatory authorities from complying with Section 3855 results in a difference between GAAP NAV and Transactional NAV due to the use of different valuation techniques for certain investments. We have adopted the provisions of Section 3855 retroactively without restatement or prior periods. Accordingly, the beginning of year net asset for the current period is adjusted.

**MANAGEMENT AND PERFORMANCE FEES**

The Fund pays Investment Advisor a monthly fee equal to one-twelfth of 2% of net asset value of the applicable series of the Fund, payable monthly in arrears, calculated without regard to any accrual of performance bonuses (as described below) and before payment of such fee.

The Investment Advisor may earn an annual performance bonus (a "Performance Bonus") in each fiscal quarter if the percentage gain in the new asset value of a series of the Fund (as adjusted for any prior return deficiencies) over the preceding calendar quarter or quarters since a performance fee was last payable exceeds the percentage gain or loss of the benchmark (the "Benchmark") over the same period. The Benchmark for the Fund is calculated as follows:

50% of the percentage gain or loss in the S&P/TSX Income Trust Index

- + 50% of the percentage gain or loss in the ScotiaMcLeod Bond Index.

The fee will be equal to this excess return per security multiplied by the number of securities outstanding at the end of the quarter multiplied by 20%, provided that the net asset value per security of the Fund (including distributions) is greater than all previous values at the end of each previous calendar quarter. The starting reference point for the next calendar quarter's calculation will be based on the higher of either the Benchmark performance adjusted net asset value per security or the adjusted actual net asset value per security, both with respect to the previous quarter in which a performance fee was payable.

## DEALER COMPENSATION

Brokers, dealers and advisors may be paid a share of the management fee – called a “trailer commission”, for assets that their sales representatives place in the Series A and Series B Fund securities. The Fund may, at its discretion, negotiate, change the terms and conditions of, or discontinue the trailer commission with brokers, dealers and advisors.

The trailer commission is calculated as a percentage of assets each broker, dealer or advisor has placed in the Fund series. The trailer commission is calculated based on the closing balance of client accounts for each calendar month. The trailer commission will not be paid if the assets are removed from the Funds. Trailer commissions are paid quarterly at rates set within ranges according to the following table.

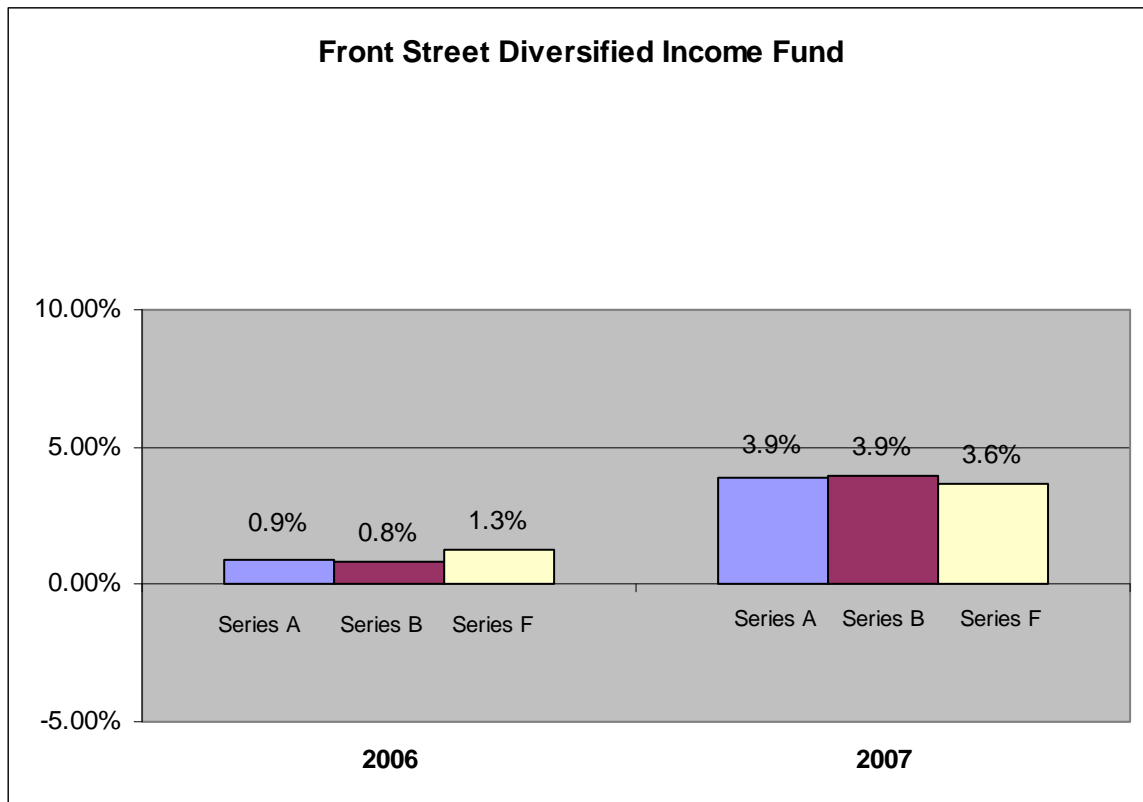
Series	Trailer Annual Rate	Annual Payment per \$1,000 of Fund securities held
A	0.75%	\$10.00
B	1.00%	\$10.00
F	0.00%	Nil

## PAST PERFORMANCE

The past performance of the Fund is set out below and includes year-to-date returns.

With respect to the charts displayed below, please note the following:

- (a) the returns or performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional shares of the Fund;
- (b) the return or performance information does not take into account sales, redemption, distribution or other optional charges or income taxes payable that would have reduced returns or performance; and
- (c) how the Fund has performed in the past does not necessarily indicate how it will perform in the future.



#### ANNUAL COMPOUND RETURNS

The following table shows the Fund's historical annual compound total return since inception as compared to the performance of the S&P/TSX Income Trust Index.

	<b>Since Inception June 22, 2006</b>
Front Street Diversified Income Fund Series A	1.87%
Front Street Diversified Income Fund Series B	1.89%
S&P/TSX Capped Income Trust Index	-7.17%
	<b>Since Inception August 11, 2006</b>
Front Street Diversified Income Fund Series F	1.98%
S&P/TSX Capped Income Trust Index	-14.25%

The S&P/TSX Capped Income Trust Index is a modified-market cap weighted index and represents a broad-based composite Index which may encompass any or all GICS sectors of the income trust market place.

**FRONT STREET DIVERSIFIED INCOME FUND CLASS**

Summary of Investment Portfolio as at October 31, 2007

	<b>% of Total</b>
<b>Cash and Cash Equivalents</b>	<b>34.9</b>
<b>LONG POSITIONS</b>	
Government Bonds	15.6
Financials	13.0
Energy	10.6
Corporate Bonds	8.2
Consumer Discretionary	3.3
Industrials	2.4
Materials	2.0
Utilities	2.0
Consumer Staples	1.8
Telecommunication Services	1.7
Health Care	1.3
Information Technology	0.3
<b>SHORT POSITIONS</b>	
Consumer Discretionary	(0.5)
Industrials	(0.4)
Energy	(1.1)
Index Fund	(1.2)
<b>Total Investments Portfolio</b>	<b>59.0</b>
<b>Total Investments Portfolio Including Cash and Cash Equivalents</b>	<b>93.9</b>
<b>Other Assets</b>	<b>6.1</b>
<b>Total Net assets</b>	<b>100.0</b>

*Top 25 Investments*

<b>LONG POSITIONS</b>	
Canada Mortgage & Housing Corporation 5.30% December 3, 2007	5.9%
Province of Quebec Real Return 3.30% December 1, 2013	4.8%
Canadian Imperial Bank of Commerce	2.4%
Power Corporation of Canada	2.2%
Vermilion Energy Trust	2.1%
Holloway Lodging Real Estate Investment Trust 8.00% August 1, 2011	2.1%
Baytex Energy Trust	2.1%
British Columbia Municipal Financial Authority 5.50% March 24, 2008	2.0%
Province of Manitoba 5.25% March 2, 2009	2.0%
NAL Oil & Gas Trust	1.8%
Royal Host Real Estate Investment Trust Debentures 6.00% October 31, 2015	1.8%
Pembina Pipeline Income Fund	1.6%
ATCO Limited	1.5%
TimberWest Forest Corporation	1.3%
Extencicare Real Estate Investment Trust	1.3%
Saskatchewan Wheat Pool Inc.	1.3%
Linamar Corporation	1.3%
Major Drilling Group International Inc.	1.2%
Citigroup/Starling/Botticelli CDO Notes September 22, 2014	1.2%
Centurion Apartment Properties Limited Partnership	1.1%
Canadian Apartment Properties Real Estate Investment Trust	1.1%
Duke Funding Limited 2003-5A 4A Floating Rate August 7, 2033	1.0%
Allied Properties Real Estate Investment Trust	1.0%
Primaris Retail Real Estate Investment Trust	1.0%
<b>SHORT POSITIONS</b>	
iShares S&P/TSX 60 Index Fund ETF	-1.2%

The information contained in the foregoing list may change due to the ongoing portfolio transactions of the Fund. A quarterly update may be obtained by contacting the Investment Advisor.