



Annual Management Report of Fund Performance As at October 31, 2010 Front Street Diversified Income Fund

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 or SEDAR at 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 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 investment objective of the Fund is to provide Shareholders with consistent long term capital growth and the opportunity for income through the selection, management and strategic trading of long and short positions in securities of income trusts, common shares, preferred shares, derivatives and corporate and government debt.

The Investment Advisor, Front Street Investment Management Inc., will also consider positioning the Fund's investment portfolio to reduce its correlation to Canadian equity and fixed-income indices.

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

Most of the Fund's assets will be invested equities and in income producing securities, many 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 and the risks of investing in derivatives.

Equity risk also affected Fund volatility. Equity returns have been volatile in 2010, partly as a result of uneven global economic growth and investor concern that government intervention in the economy (primarily the US Federal Reserve's "quantitative easing" program) is distorting asset valuations.

Interest-rate risk was also a factor, as global central banks generally kept administered rates at very low levels. Should global growth resume or expectations for price inflation appear, even moderately, interest rates generally are likely to rise, negatively impacting bond values.

Credit risk will continue to be a factor for the fund. Although the possibility of an economic "double dip" is low, credit spreads are generally very tight as investors have allocated significant amounts of capital to corporate fixed income products over the last year. Credit risk is not priced for adverse outcomes, potentially having a negative impact on the value of credit instruments.

Economic risk has also impacted the holdings of the Fund. As governments reduce fiscal stimulus or reduce spending to lower national indebtedness, economic growth could slow. The risk of rising taxes, currency manipulation and the possibility of international trade disputes could further erode confidence in the global economy.

The Fund has multiple risks associated with equity and corporate debt markets. Investors whose primary concern is preservation of capital should not be invested in this Fund. The Fund is suitable for investors seeking quarterly 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.

RESULTS OF OPERATIONS

The Fund met its distribution objectives of \$0.55 per annum. The Fund's NAV grew as equity markets rose and credit spreads tightened. Positive contributions from the portfolio came from equity and corporate bond holdings, offset somewhat by cash holdings and short positions.

The outlook for 2011 is for continued volatility as investors assess the price paid for "safe" versus "risky" assets. Significant fund flows into fixed income products have left bonds, generally speaking, more expensive than equities. The prices paid for future earnings appear reasonable, but government purchases of treasury bonds (quantitative easing) leaves some questions as to whether discount rates are distorted. Volatility across many asset classes will continue as market participants struggle with the "inflation vs. deflation" debate: whether high levels of liquidity will lead to inflation or whether the removal of fiscal and / or monetary stimuli will test a fragile economic recovery.

RECENT DEVELOPMENTS

In August, 2008, Front Street Capital 2004, now the Manager of the Fund, announced a proposal to merge certain of the mutual funds that it manages in order to streamline its fund line-up, while continuing to provide a broad selection of investment funds. Specifically, the corporate classes of Front Street Opportunities Fund Ltd. were merged into the corporate classes of Front Street Mutual Funds Limited on October 31, 2008. Securityholder approval for the mergers was obtained on October 15, 2008 and the amalgamated Front Street Mutual Funds Ltd. took effect on November 1, 2008. The Fund itself was merged with Front Street Yield Opportunities Fund, a class of Front Street Opportunity Funds Ltd., with the continuing Fund being Front Street Diversified Income Fund.

The Manager proposed the mergers to benefit investors through the ability to switch tax-free between mutual funds with different investment strategies and objectives, within the context of a more focused, efficient and cost effective structure. The funds merged together as part of the merger all had similar investment objectives and the same portfolio investment advisor.

On November 24, 2009, the shareholders of the Fund approved the special resolutions to authorize the amalgamation of Front Street Mutual Funds Limited with Front Street Special Opportunities Canadian Fund, another mutual fund corporation managed by Front Street Capital 2004. The effective date of the amalgamation was the close of business on December 1, 2009. The merger was accomplished by the amalgamation of these two mutual fund corporations under the Canada Business Corporations Act (Canada). Upon amalgamation, Front Street Mutual Funds Limited was considered to be continuing Fund for securities regulatory purposes. A new class of shares of Front Street Mutual Funds Limited was created, being the Front Street Special Opportunities Canadian Fund.

Ontario sales tax and GST harmonization

Effective July 1, 2010, Ontario provincial sales tax was harmonized with the federal goods and services tax ("GST"), resulting in a federally administered harmonized sales tax of 13% (the "HST"). Prior to that date, management fees and other service fees charged to the Fund were not subject to Ontario Retail Sales Tax ("ORST"). Under Ontario's harmonization with the GST, these services are now subject to an additional tax of 8%. In addition, other operating costs, such as administrative expenses, audit fees, legal fees, and clearing and settlement and back office fees are subject to an additional tax of 8%. However, investment funds in Canada are required to calculate the HST rate using specific rules. These rules require HST to be calculated using the residency of the shareholders and the current value of their interests, rather than the physical location of the Fund manager. These rules will allow the Fund to use a "blended rate" that will reduce the effect of harmonization, to the extent that the Fund has shareholders resident in provinces not subject to HST.

On December 23, 2010, Front Street Mutual Funds Limited (“FSMFL”) and Front Street Resource Performance Fund Ltd. (“FSRPFL”) issued a notice of special meeting of shareholders pertaining to the proposed amalgamation of Front Street Mutual Funds Limited and Front Street Resource Performance Fund Ltd. If the resolution is approved by the shareholders of the FSMFL and FSRPFL, the effective date of the amalgamation will be the close of business on February 28, 2011. The merger will be accomplished by the amalgamation of these two mutual fund corporations under the Canada Business Corporations Act (Canada). Upon amalgamation, FSMFL is considered to be the continuing fund for securities regulatory purposes. A new class of shares of FSMFL will be created, namely Series L of Front Street Resource Fund. Existing shareholders of FSRPFL will receive one share of Series L shares of Front Street Resource Fund class of shares of FSMFL.

International Financial Reporting Standards (“IFRS”)

Effective for its fiscal year commencing November 1, 2012, the Fund must adopt IFRS. In preparation thereof, the Manager continues to monitor and implement the Fund’s changeover plan and will continue to assess the impact of the implementation as new IFRS guidance become available from the International Accounting Standards Board.

The Manager has reviewed the current IFRS against the Fund’s current accounting policies and financial statement presentation under Canadian generally accepted accounting principles (“Canadian GAAP”), and does not expect the adoption of IFRS will have a material effect on the Fund’s net asset value per share for all series of shares. The primary impact of IFRS on accounting policies and implementation decisions will be on the financial statement presentation and note disclosures in the Fund’s financial statements. In particular, the Fund will be required to present a statement of shareholders’ equity and a statement of cash flows, and will be required to include certain additional and enhanced disclosures.

The Fund’s changeover plan includes key activities in (a) preparation of financial statements, (b) information processing and record-keeping, (c) business policy assessment and (d) systems and controls. Based on the Manager’s preliminary analysis, the Manager believes the changeover to IFRS will not materially affect the Fund’s existing business arrangements.

RELATED PARTY-TRANSACTIONS

Management fees of \$1,724,605 (2009 - \$741,770) were paid to the Manager during the year. Servicing fees of \$1,211,781 (2009 - \$446,426) were paid to the Manager during the year. Operating costs of \$38,214 (2009 - \$Nil) were paid to the Manager during the year. Performance fees of \$Nil (2009 - \$19,119) were incurred with the Manager during the year. Included in accrued expenses are \$202,959 (2009 - \$114,226) of management fees payable to the Manager. Included in accrued expenses are \$111,468 (2009 - \$37,392) of accrued servicing fees payable to the Manager. Included in accrued expenses are \$3,412 (2009 - \$Nil) of accrued operating costs payable to the Manager. Accrued expenses includes performance fees of \$Nil (2009 - \$19,119) payable to the Manager.

708,207.530 (2009 – 654,661.390) of series B shares outstanding at year end representing 6.72% (2009 – 11.41%) of the total series B shares of the Fund are held by the Partners of the Manager.

36,016.200 (2009 – Nil) of series F shares outstanding at year end representing 1.88% (2009 – Nil%) of the total series F shares of the Fund are held by the Partners of the Manager.

The Fund may place a portion of its portfolio transactions with brokerage firms which are affiliates of the Manager 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. During the year ended October 31, 2010, Tuscarora Capital Inc, a company under common control to the Manager, received \$24,738 (2009 - \$10,119) in commissions on portfolio transactions for the Fund.

Management fees, servicing fees, operating costs and performance fees are measured at the exchange amount of consideration prescribed by the offering documents of the Fund. When related parties enter shareholder transactions with the Fund, the exchange amount of consideration is the transactional NAV available to all other shareholders on the trade date. In the case of brokerage commissions, the exchange amount of consideration is that which is negotiated by the related parties.

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

Series A The Fund's Net Assets per Unit ⁽¹⁾	October 31 2010	October 31 2009	October 31 2008	October 31 2007	October 31 2006
Net assets, beginning of the year	\$ 8.36	\$ 8.13	\$ 9.47	\$ 9.92	\$ 10.00
Increase (decrease) from operations:					
Total revenue	0.31	0.43	0.48	0.44	0.15
Total expenses	(0.23)	(0.21)	(0.30)	(0.39)	(0.32)
Realized gains (losses) for the year	0.63	0.34	(0.17)	0.38	0.04
Unrealized gains (losses) for the year	0.23	0.23	(0.80)	(0.26)	0.69
Total increase (decrease) from operations ⁽²⁾	0.94	0.79	(0.79)	0.17	0.56
Distributions to Shareholders:					
From income (excluding dividends)	—	—	—	—	—
From dividends	—	—	—	—	—
From capital gains	—	—	—	—	—
Return of capital	(0.55)	(0.55)	(0.55)	(0.55)	(0.15)
Total distributions to Shareholders ⁽³⁾	(0.55)	(0.55)	(0.55)	(0.55)	(0.15)
Net assets, end of the year	\$ 8.81	\$ 8.36	\$ 8.13	\$ 9.47	\$ 9.94

- (1) This information is derived from the Fund's audited annual financial statements. The net assets per security presented in the financial statements differ from the net asset value calculated for fund pricing purposes. [An explanation of these differences can be found in the notes to the financial statements]
- (2) Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial year.
- (3) Distributions were paid in cash/reinvested in additional units of the Fund or both.

Ratios and Supplemental Data

Total net asset value (000's) ⁽¹⁾	113,374	31,119	12,309	13,878	5,777
Number of units outstanding ⁽¹⁾	12,854,695	3,713,765	1,502,966	1,461,992	581,171
Management expense ratio ⁽²⁾	2.58%	2.51%	3.31%	3.98%	9.23%
Management expense ratio before waivers or absorptions	2.58%	2.51%	3.31%	3.98%	9.23%
Trading expense ratio ⁽⁵⁾	0.33%	0.55%	0.57%	0.45%	0.61%
Portfolio turnover rate ⁽⁴⁾	143.93%	252.75%	255.67%	347.72	38.23%
Net asset value per unit	\$ 8.82	\$ 8.38	\$ 8.19	\$ 9.49	\$ 9.94

- (1) This information is provided as at end of the year shown
- (2) Management expense ratio is based on total expenses (excluding commissions and other transaction costs) for the stated year and is expressed as an annualized percentage of daily average net assets during the year.
- (3) 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.
- (4) 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 necessary a relationship between a high turnover rate and the performance of a fund.

Series B The Fund's Net Assets per Unit ⁽¹⁾	October 31 2010	October 31 2009	October 31 2008	October 31 2007	October 31 2006
Net assets, beginning of the year	\$ 8.39	\$ 8.14	\$ 9.47	\$ 9.91	\$ 10.00
Increase (decrease) from operations:					
Total revenue	0.32	0.5	0.48	0.43	0.17
Total expenses	(0.22)	(0.22)	(0.30)	(0.39)	(0.38)
Realized gains (losses) for the year	0.66	0.20	(0.18)	0.39	0.04
Unrealized gains (losses) for the year	0.25	0.23	(0.76)	(0.30)	0.85
Total increase (decrease) from operations ⁽²⁾	1.01	0.71	(0.76)	0.13	0.68
Distributions to Shareholders:					
From income (excluding dividends)	—	—	—	—	—
From dividends	—	—	—	—	—
From capital gains	—	—	—	—	—
Return of capital	(0.55)	(0.55)	(0.55)	(0.55)	(0.15)
Total distributions to Shareholders ⁽³⁾ (0.55)	(0.55)	(0.55)	(0.55)	(0.55)	(0.15)
Net assets, end of the year	\$ 8.87	\$ 8.39	\$ 8.14	\$ 9.47	\$ 9.93

- (1) This information is derived from the Fund's audited annual financial statements. The net assets per security presented in the financial statements differ from the net asset value calculated for fund pricing purposes. [An explanation of these differences can be found in the notes to the financial statements]
- (2) Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial year.
- (3) Distributions were paid in cash/reinvested in additional units of the Fund or both.

Ratios and Supplemental Data

Total net asset value (000's) ⁽¹⁾	93,517	48,255	4,349	7,949	10,512
Number of units outstanding ⁽¹⁾	10,535,928	5,738,289	530,657	837,203	1,058,552
Management expense ratio ⁽²⁾	2.54%	2.67%	3.34%	3.99%	10.54%
Management expense ratio before waivers or absorptions	2.54%	2.67%	3.34%	3.99%	10.54%
Trading expense ratio ⁽⁵⁾	0.33%	0.55%	0.57%	0.45%	0.61%
Portfolio turnover rate ⁽⁴⁾	143.93%	252.75%	255.67%	347.72%	38.23%
Net asset value per unit	\$ 8.88	\$ 8.41	\$ 8.20	\$ 9.50	\$ 9.93

- (1) This information is provided as at end of the year shown
- (2) Management expense ratio is based on total expenses (excluding commissions and other transaction costs) for the stated year and is expressed as an annualized percentage of daily average net assets during the year.
- (3) 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.
- (4) 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 necessary a relationship between a high turnover rate and the performance of a fund.

Series F The Fund's Net Assets per Unit ⁽¹⁾	October 31 2010	October 31 2009	October 31 2008	October 31 2007	October 31 2006
Net assets, beginning of the year	\$ 8.38	\$ 8.14	\$ 9.48	\$ 9.96	\$ 10.00
Increase (decrease) from operations:					
Total revenue	0.32	0.36	0.48	0.41	0.08
Total expenses	(0.14)	(0.12)	(0.30)	(0.37)	(0.17)
Realized gains (losses) for the year	0.64	0.48	(0.17)	0.35	0.04
Unrealized gains (losses) for the year	0.28	0.16	(0.73)	(0.78)	0.18
Total increase (decrease) from operations ⁽²⁾	1.10	0.88	(0.72)	(0.39)	0.13
Distributions to Shareholders:					
From income (excluding dividends)	—	—	—	—	—
From dividends	—	—	—	—	—
From capital gains	—	—	—	—	—
Return of capital	(0.55)	(0.55)	(0.55)	(0.55)	(0.15)
Total distributions to Shareholders ⁽³⁾	(0.55)	(0.55)	(0.55)	(0.55)	(0.15)
Net assets, end of the year	\$ 8.87	\$ 8.38	\$ 8.14	\$ 9.48	\$ 9.98

- (1) This information is derived from the Fund's audited annual financial statements. The net assets per security presented in the financial statements differ from the net asset value calculated for fund pricing purposes. [An explanation of these differences can be found in the notes to the financial statements]
- (2) Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial year.
- (3) Distributions were paid in cash/reinvested in additional units of the Fund or both.

Ratios and Supplemental Data

Total net asset value (000's) ⁽¹⁾	17,007	3,093	374	452	260
Number of units outstanding ⁽¹⁾	1,915,979	368,349	45,603	47,596	26,080
Management expense ratio ⁽²⁾	1.63%	1.48%	3.32%	4.02%	7.72%
Management expense ratio before waivers or absorptions	1.63%	1.48%	3.32%	4.02%	7.72%
Trading expense ratio ⁽⁵⁾	0.33%	0.55%	0.57%	0.45%	0.61%
Portfolio turnover rate ⁽⁴⁾	143.93%	252.75%	255.67%	347.72%	38.23%
Net asset value per unit	\$ 8.88	\$ 8.40	\$ 8.20	\$ 9.50	\$ 9.98

- (1) This information is provided as at end of the year shown
- (2) Management expense ratio is based on total expenses (excluding commissions and other transaction costs) for the stated year and is expressed as an annualized percentage of daily average net assets during the year.
- (3) 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.
- (4) 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 necessary a relationship between a high turnover rate and the performance of a fund.

Series X

The Fund's Net Assets per Unit ⁽¹⁾	For the period from commencement of operations on December 3, 2009 to October 31, 2010
Net assets, beginning of the period	8.48*
Increase (decrease) from operations:	
Total revenue	0.27
Total expenses	(0.18)
Realized gains (losses) for the period	0.50
Unrealized gains (losses) for the period	0.04
Total increase (decrease) from operations ⁽²⁾	0.63
Distributions to Shareholders:	
From income (excluding dividends)	—
From dividends	—
From capital gains	—
Return of capital	(0.55)
Total distributions to Shareholders ⁽³⁾	(0.55)
Net assets, end of the period	\$ 8.82

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- (2) Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial period.
- (3) Distributions were paid in cash/reinvested in additional units of the Fund or both.

Ratios and Supplemental Data

Total net asset value (000's) ⁽¹⁾	2,408
Number of units outstanding ⁽¹⁾	272,680
Management expense ratio ⁽²⁾	2.24%
Management expense ratio before waivers or absorptions	2.24%
Trading expense ratio ⁽⁵⁾	0.33%
Portfolio turnover rate ⁽⁴⁾	143.93%
Net asset value per unit	\$ 8.83

- (1) This information is provided as at end of the period shown
- (2) Management expense ratio is based on total expenses (excluding commissions and other transaction costs) for the stated period and is expressed as an annualized percentage of daily average net assets during the period.
- (3) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the period.
- (4) 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 period. The higher a fund's portfolio turnover rate in a period, the greater the trading costs payable by the fund in the period, and the greater the chance of an investor receiving taxable capital gains in the period. There is not necessary a relationship between a high turnover rate and the performance of a fund.

* Initial price

MANAGEMENT AND PERFORMANCE FEES

The Fund pays a monthly management fee equal to 1/12 of 1.25% of the net asset value of the Series A shares and Series X shares and 1/12 of 1% of the net asset value of the Series B and Series F shares calculated and paid at the end of each month in arrears

The Manager may, at its discretion, add a service charge of up to 15% of the costs incurred for any operating and administrative costs charged to the Fund other than management services which are already included in the management fee rate which the Manager receives from the Fund.

The Manager may also earn an annual performance bonus (a “Performance Bonus”) in each fiscal quarter if the percentage gain in the net 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 of the S&P/TSX Composite Index; plus

50% of the percentage gain or loss of the DEX Universe All Corporate 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 “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 monthly at rates set within ranges according to the following table.

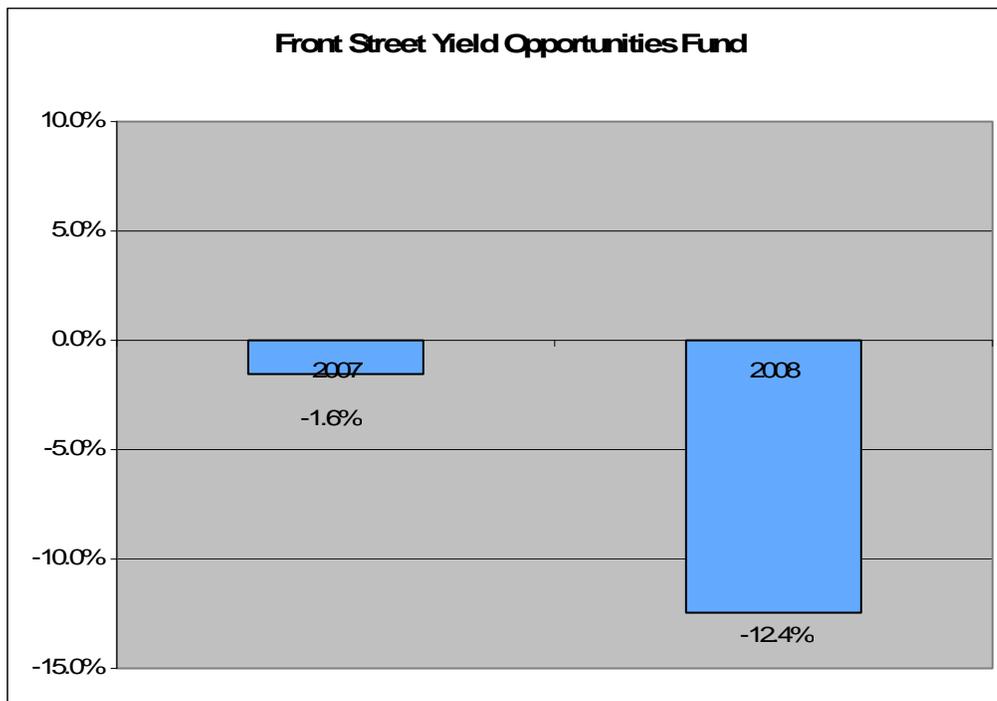
Series	Trailer Annual Rate	Annual Payment per \$1,000 of Fund securities held
A	0.75%	\$10.00
B	1.00%	\$10.00
F	0.00%	Nil
X	0.50%	\$5.00

PAST PERFORMANCE

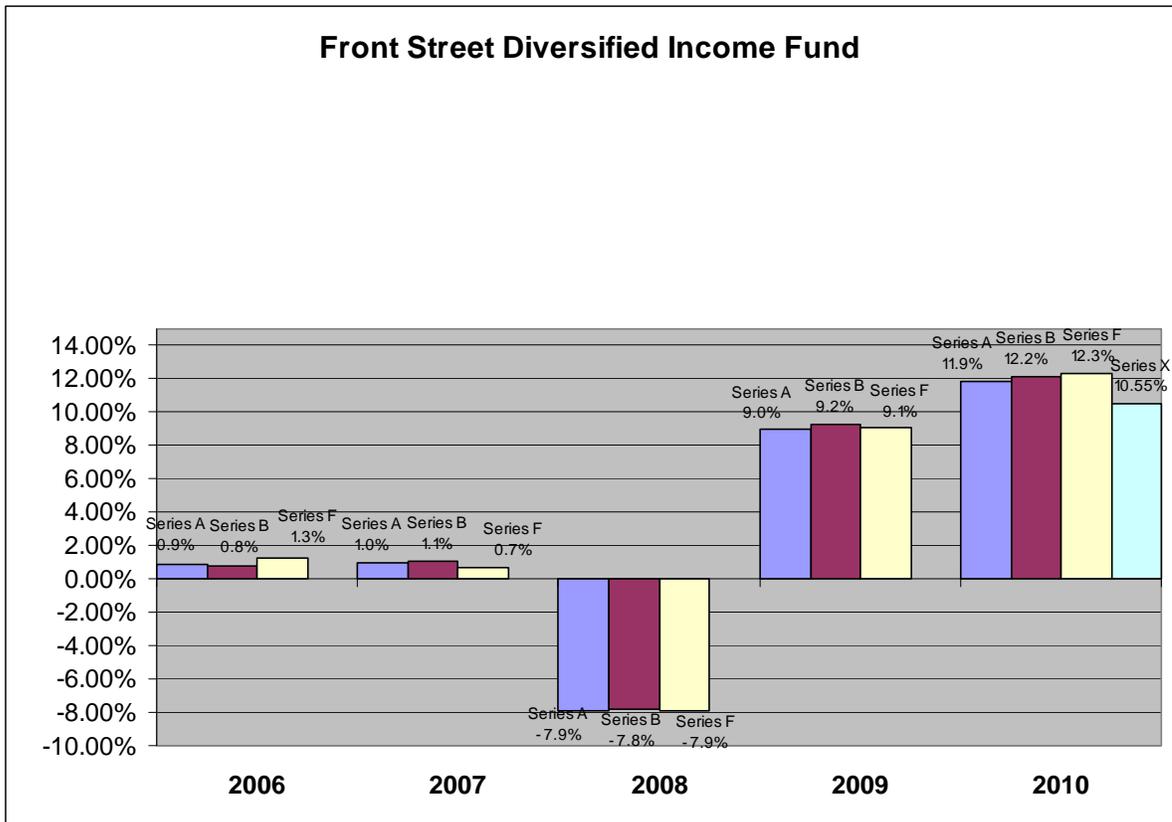
The past performance of the Fund is set out below and includes year-by-year returns.

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 future.



The above chart is the year-by-year returns for Front Street Yield Opportunities Fund, a class of Front Street Opportunity Funds Ltd. The Fund was merged with the continuing Fund being Front Street Diversified Income Fund on November 1, 2008.



The above chart is the year-by year returns for Front Street Diversified Income Fund, a class of Front Street Mutual Funds Ltd. The Fund was merged with the discontinuing Fund being Front Street Yield Opportunities Fund on November 1, 2008

ANNUAL COMPOUND RETURNS

The following table shows the Fund's historical annual compound total return since inception as compared to the performance of the blended benchmark index using 50% of S&P/TSX Composite Index and 50% of DEX Universe All Corporate Bond Index ("Blended Benchmark Index").

	Since amalgamation November 1, 2008
Front Street Diversified Income Fund Series A	10.08%
Front Street Diversified Income Fund Series B	10.35%
Front Street Diversified Income Fund Series F	10.33%
Blended Benchmark Index	13.9%

The above annual compound returns are for Front Street Diversified Income Fund and does not include the returns or performance of the Front Street Yield Opportunities Fund which merged with the continuing Fund being Front Street Diversified Income Fund on November 1, 2008.

Summary of Investment Portfolio as at October 31, 2010

Portfolio by Category

	Percentage of Transactional Net Asset Value
LONG POSITIONS	
Cash and cash equivalents	45.3%
Corporate Bonds	22.5%
United States	13.4%
Financials	8.1%
Energy	5.6%
Consumer Discretionary	2.8%
Information Technology	2.4%
Materials	2.0%
Industrials	1.3%
Telecommunication Services	1.0%
Consumer Staples	1.0%
Utilities	0.6%
Healthcare	0.4%
Provincial Bonds	0.2%
SHORT POSITIONS	
United States	-3.3%
Financials	-2.2%
Government bond	-0.5%
Telecommunication Services	-0.3%
Consumer Discretionary	-0.0%
Written options	-0.0%
OTHERS	
	-0.3%
	100.0%

Top 25 Holdings

	Percentage of Transactional Net Asset Value
LONG POSITIONS	
Glacier Credit Card Trust *	2.3%
Royal Bank of Canada	1.8%
Sanderson Farms Inc.	1.7%
Microsoft Corporation	1.5%
ProShares Short 20+ Year Treasury	1.5%
Tidewater Inc.	1.5%
Sherritt International Corporation *	1.4%
Constellation Energy Group	1.4%
Research In Motion Limited	1.4%
JPMorgan Chase & Company	1.3%
ARC Energy Trust	1.2%
AGF Management Limited 'B'	1.2%
Genworth MI Canada Inc.	1.2%
Pengrowth Energy Trust	1.2%
EnCana Corporation	1.2%
Cardinal Health Inc.	1.2%
Annaly Capital Management Inc.	1.1%
Canadian Tire Corporation 'A'	1.1%
Quad Graphics Inc.	1.0%
Baytex Energy Limited *	1.0%
Ford Credit Canada *	1.0%
Chartwell Seniors Housing Retirement *	0.9%
Hanfeng Evergreen Inc.	0.9%
SHORT POSITIONS	
SPDR S&P 500 ETF Trust	-2.1%
National Bank of Canada	-1.8%
	26.1%
TOTAL TRANSACTIONAL NET ASSET VALUE (000)	\$226,306

* Debt instrument

The information contained in the foregoing list may change due to the ongoing portfolio transactions of the Fund.

FRONT STREET DIVERSIFIED INCOME FUND

**FINANCIAL STATEMENTS
OCTOBER 31, 2010 AND 2009**

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MANAGEMENT REPORT

Management's Responsibility for Financial Reporting

The accompanying financial statements of Front Street Diversified Income Fund of Front Street Mutual Funds Limited have been prepared by the management of Front Street Capital 2004, the Manager of the Fund, and approved by the Board of Directors of Front Street Mutual Funds Limited. The Manager is responsible for the information and representations contained in these financial statements.

The Manager maintains processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include certain amounts that are based on estimates and judgments. The significant accounting policies, which the Manager believes are appropriate for the Fund, are described in note 2 to the financial statements.

The Board of Directors of Front Street Mutual Funds Limited is responsible for reviewing the financial statements, the adequacy of internal controls, the audit process and financial reporting with the Manager and the external auditors. The Board of Directors approves the audited financial statements for publication.

Segal LLP are the external auditors of Front Street Diversified Income Fund. They are appointed by the Manager of the Fund. The external auditors have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the shareholders their opinion on the financial statements. Their report is set out below.

On behalf of Management of Front Street Capital 2004,
Manager of the Fund



Gary P. Selke
Management Committee Member
Front Street Capital 2004



Normand G. Lamarche
Management Committee Member
Front Street Capital 2004

January 19, 2011
Toronto, Ontario

SEGAL LLP
2005 Sheppard Ave E, No. 500
Toronto, Ontario M2J 5B4

Phone. 416 391 4499
Fax. 416 391 3280
Toll Free. 1 800 206 7307
info@segalllp.com

A MEMBER OF DFK INTERNATIONAL

AUDITORS' REPORT

To the Shareholders of Front Street Diversified Income Fund (the "Fund") of Front Street Mutual Funds Limited

We have audited the statements of net assets of the Front Street Diversified Income Fund, (the "Fund") as at October 31, 2010 and 2009 and the statements of operations and changes in net assets for the years then ended and the statement of investment portfolio as at October 31, 2010. These financial statements are the responsibility of the Manager of the Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Manager, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at October 31, 2010 and 2009 and the results of its operations and changes in its net assets for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
January 19, 2011

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF NET ASSETS AS AT OCTOBER 31, 2010 AND 2009

	2010	2009
ASSETS		
Investments, at fair value (cost - \$135,322,295; 2009 - \$58,753,997)	\$ 138,903,738	\$ 58,561,733
Cash and cash equivalents	102,423,701	28,353,015
Accounts receivable relating to shares issued	2,200,408	1,218,192
Accounts receivable relating to portfolio assets sold	1,473,026	2,617,038
Amounts receivable relating to accrued income	1,128,326	507,362
	<u>\$ 246,129,199</u>	<u>\$ 91,257,340</u>
LIABILITIES		
Obligations from portfolio assets sold short, at fair value	\$ 14,359,741	\$ 2,929,921
Liabilities for portfolio assets purchased	3,553,964	5,116,749
Distributions payable	871,630	204,257
Accrued expenses	665,745	393,863
Accounts payable relating to shares redeemed	578,948	111,262
Forward contracts, at fair value, note 10	13,796	202,340
	<u>20,043,824</u>	<u>8,958,392</u>
Net assets representing shareholders' equity	<u>\$ 226,085,375</u>	<u>\$ 82,298,948</u>
Net assets applicable to outstanding shares allocated as follows:		
Net assets, Series A	\$ 113,263,558	\$ 31,056,196
Shares outstanding, Series A, note 3	12,854,695	3,713,765
Net assets per share, Series A	<u>\$ 8.81</u>	<u>\$ 8.36</u>
Net assets, Series B	\$ 93,425,906	\$ 48,155,562
Shares outstanding, Series B, note 3	10,535,928	5,738,289
Net assets per share, Series B	<u>\$ 8.87</u>	<u>\$ 8.39</u>
Net assets, Series F	\$ 16,990,709	\$ 3,087,190
Shares outstanding, Series F, note 3	1,915,979	368,349
Net assets per share, Series F	<u>\$ 8.87</u>	<u>\$ 8.38</u>
Net assets, Series X	\$ 2,405,202	\$ —
Shares outstanding, Series X, note 3	272,680	—
Net assets per share, Series X	<u>\$ 8.82</u>	<u>\$ —</u>

On behalf of the Board of Front Street Mutual Funds Limited:



Gary P. Selke
Chief Executive Officer and Director



David A. Conway
Chief Financial Officer

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF OPERATIONS

FOR THE YEARS ENDED OCTOBER 31, 2010 AND 2009

	2010	2009
Investment income		
Interest	\$ 3,900,123	\$ 2,444,407
Dividends	1,410,628	1,128,022
Less: Foreign withholding taxes	(52,490)	(112,431)
	<u>5,258,261</u>	<u>3,459,998</u>
Expenses		
Management fees, notes 4 and 7	1,724,605	741,770
Servicing fees, notes 4 and 7	1,211,781	446,426
Administration fees	464,275	43,687
Compensatory dividends	144,317	128,088
Audit fees	54,662	82,182
Legal fees	49,938	84,911
Operating costs, notes 4 and 7	38,214	—
Securityholder reporting costs	36,420	56,707
Independent review committee	10,262	16,421
Performance fees, notes 4 and 7	—	19,119
	<u>3,734,474</u>	<u>1,619,311</u>
Net investment income for the year	<u>1,523,787</u>	<u>1,840,687</u>
Net realized and unrealized gains on investments		
Net realized gain on sale of investments	10,227,070	387,632
Gain from derivatives	853,239	1,682,396
Transaction costs, notes 6 and 7	(473,439)	(319,236)
Change in the unrealized appreciation of the value of investments	3,875,461	1,606,088
Net gain on investments for the year	<u>14,482,331</u>	<u>3,356,880</u>
Net increase in net assets from operations for the year	<u>\$ 16,006,118</u>	<u>\$ 5,197,567</u>
Increase in net assets from operations applicable to outstanding shares allocated as follows:		
Increase in net assets from operations, Series A	\$ 7,220,878	\$ 1,623,635
Increase in net assets from operations per share, Series A	<u>\$ 0.94</u>	<u>\$ 0.79</u>
Increase in net assets from operations, Series B	\$ 7,736,152	\$ 3,428,366
Increase in net assets from operations per share, Series B	<u>\$ 1.01</u>	<u>\$ 0.71</u>
Increase in net assets from operations, Series F	\$ 915,335	\$ 145,566
Increase in net assets from operations per share, Series F	<u>\$ 1.10</u>	<u>\$ 0.88</u>
Increase in net assets from operations, Series X	\$ 133,753	\$ -
Increase in net assets from operations per share, Series X	<u>\$ 0.63</u>	<u>\$ -</u>

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF CHANGES IN NET ASSETS FOR THE YEARS ENDED OCTOBER 31, 2010 AND 2009

	2010	2009
Series A		
Net assets, beginning of year	\$ 31,056,196	\$ 12,222,988
Net increase in net assets from operations	7,220,878	1,623,635
Distributions to shareholders		
Return of capital	(4,857,711)	(1,289,099)
Shareholder transactions		
Proceeds from the issuance of shares	81,020,149	18,609,189
Aggregate amounts paid on the redemption of shares	(4,644,073)	(1,208,028)
Shares issued on reinvestment of distributions	3,468,119	1,097,511
	79,844,195	18,498,672
Net increase in net assets for the year	82,207,362	18,833,208
Net assets, end of year	\$ 113,263,558	\$ 31,056,196
Series B		
Net assets, beginning of year	\$ 48,155,562	\$ 4,318,778
Net increase in net assets from operations	7,736,152	3,428,366
Distributions to shareholders		
Return of capital	(4,544,545)	(2,703,763)
Shareholder transactions		
Proceeds from the issuance of shares	53,188,874	49,097,963
Aggregate amounts paid on the redemption of shares	(14,961,568)	(8,446,587)
Shares issued on reinvestment of distributions	3,851,431	2,460,805
	42,078,737	43,112,181
Net increase in net assets for the year	45,270,344	43,836,784
Net assets, end of year	\$ 93,425,906	\$ 48,155,562

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF CHANGES IN NET ASSETS FOR THE YEARS ENDED OCTOBER 31, 2010 AND 2009

	2010	2009
Series F		
Net assets, beginning of year	\$ 3,087,190	\$ 371,328
Net increase in net assets from operations	915,335	145,566
Distributions to shareholders		
Return of capital	(570,860)	(108,579)
Shareholder transactions		
Proceeds from the issuance of shares	14,183,313	2,896,311
Aggregate amounts paid on the redemption of shares	(1,009,296)	(314,856)
Shares issued on reinvestment of distributions	385,027	97,420
	13,559,044	2,678,875
Net increase in net assets for the year	13,903,519	2,715,862
Net assets, end of year	\$ 16,990,709	\$ 3,087,190
Series X		
Net assets, beginning of year	\$ -	\$ -
Net increase in net assets from operations	133,753	-
Distributions to shareholders		
Return of capital	(125,143)	-
Shareholder transactions		
Proceeds from the issuance of shares	4,072,729	-
Aggregate amounts paid on the redemption of shares	(1,786,026)	-
Shares issued on reinvestment of distributions	109,889	-
	2,396,592	-
Net increase in net assets for the year	2,405,202	-
Net assets, end of year	\$ 2,405,202	\$ -

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF CHANGES IN NET ASSETS FOR THE YEARS ENDED OCTOBER 31, 2010 AND 2009

	2010	2009
Total		
Net assets, beginning of year	\$ 82,298,948	\$ 16,913,094
Net increase in net assets from operations	16,006,118	5,197,567
Distributions to shareholders		
Return of Capital	(10,098,259)	(4,101,441)
Shareholder transactions		
Proceeds from the issuance of shares	152,465,065	70,603,463
Aggregate amounts paid on the redemption of shares	(22,400,963)	(9,969,471)
Shares issued on reinvestment of distributions	7,814,466	3,655,736
	137,878,568	64,289,728
Net increase in net assets for the year	143,786,427	65,385,854
Net assets, end of year	\$ 226,085,375	\$ 82,298,948

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Energy (5.6%)			
ARC Energy Trust	130,000	\$ 2,651,226	\$ 2,800,200
EnCana Corporation	93,000	2,760,966	2,674,582
Flint Energy Services Limited	102,300	1,143,333	1,621,455
Pengrowth Energy Trust	220,000	2,093,540	2,688,400
Phoenix Technology Income Fund	195,000	1,625,812	2,029,950
Savanna Energy Services Corporation	165,000	913,293	958,650
		<u>\$ 11,188,170</u>	<u>\$ 12,773,237</u>
Materials (2.0%)			
Canam Group Inc.	241,600	\$ 1,761,453	\$ 1,932,800
Compton Petroleum Corporation Warrants	200,000	46,000	7,000
Great Western Minerals Group Limited	176,000	70,560	77,440
Hanfeng Evergreen Inc.	310,018	2,058,617	2,108,122
ISEE3D Inc.	1,000,000	750,000	400,000
		<u>\$ 4,686,630</u>	<u>\$ 4,525,362</u>
Consumer Discretionary (2.8%)			
Canadian Tire Corporation 'A'	41,500	\$ 2,293,035	\$ 2,470,495
Cervus Equipment Corporation	155,216	1,622,495	1,955,722
REDF II Hospitality Fund Limited Partnership	2,000	2,000,000	2,000,000
		<u>\$ 5,915,530</u>	<u>\$ 6,426,217</u>
Consumer Staples (1.0%)			
Quad Graphics Inc.	50,279	\$ 2,463,669	\$ 2,267,848

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Financials (8.1%)			
AGF Management Limited 'B'	165,000	\$ 2,475,855	\$ 2,730,750
Centurion Apartment Properties Limited Exch-B	171,914	1,642,868	1,719,140
Centurion Apartment Properties Limited REIT-A	200	1,911	2,000
Genworth MI Canada Inc.	100,000	2,553,991	2,716,000
Gluskin Sheff + Associates Inc.	100,600	1,780,078	1,962,706
Manulife Financial Corporation	110,000	1,401,565	1,419,000
MI Developments Inc. 'A'	100,800	1,296,022	1,481,760
Parkbridge Lifestyles Communities Inc.	75,000	546,000	544,500
Royal Bank of Canada	74,200	3,989,276	4,035,737
Urbana Corporation 'A'	1,247,600	1,527,295	1,534,548
Urbanfund Corporation	666,666	224,492	143,333
		<u>\$ 17,439,353</u>	<u>\$ 18,289,474</u>
Healthcare (0.4%)			
FutureMed Healthcare Income Fund	128,500	\$ 957,555	\$ 1,007,440
Industrials (1.3%)			
Badger Income Fund	59,050	\$ 827,429	\$ 1,003,850
Bird Construction Income Fund	50,000	1,607,598	1,850,000
Whitemud Resources Incorporated Warrants	160,000	-	24,694
		<u>\$ 2,435,027</u>	<u>\$ 2,878,544</u>
Information Technology (2.4%)			
Aastra Technologies Limited	50,000	\$ 1,044,160	\$ 1,059,000
Call Genie Inc. Warrants	264,000	-	8,792
Radiant Communications Corporation	142,000	146,299	103,660
Research In Motion Limited	53,000	2,949,791	3,074,000
TransGaming Inc.	950,000	681,480	750,500
TransGaming Inc. Warrants	375,000	-	81,860
Wi-LAN Inc.	72,300	192,133	347,763
		<u>\$ 5,013,863</u>	<u>\$ 5,425,575</u>

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Telecommunication Services (1.0%)			
BCE Inc.	19,500	\$ 654,496	\$ 665,925
DHX Media Limited	1,050,000	1,358,660	1,365,000
Hemisphere GPS Inc.	147,960	169,308	134,644
		<u>\$ 2,182,464</u>	<u>\$ 2,165,569</u>
Utilities (0.6%)			
Boralex Inc. 'A'	150,000	\$ 1,194,047	\$ 1,257,000
Corporate Bonds (22.5%)			
AG Growth International 7.00%, December 31, 2014	1,000,000	\$ 1,000,000	\$ 1,085,000
Airgas Inc. 4.50%, September 15, 2014	500,000	536,476	546,980
Algonquin Power & Utilities Corporation 7.50%, Convertible, January 01, 2012	405,300	425,565	462,407
Archer Daniels 6.25%, Preferred Convertible, June 1, 2011	27,000	1,126,019	1,189,226
Artis Real Estate Investment Trust 5.00%, Debenture, November 30, 2014	150,000	1,388,265	1,388,265
Atlantic Power Corporation 5.60%, June 30, 2017	1,000,000	1,000,000	1,003,000
Baytex Energy Limited 9.15%, August 26, 2016	2,000,000	2,200,000	2,191,740
Boralex Inc. 6.75%, June 30, 2017	1,118,460	1,126,289	1,152,573
Bunge Limited Finance Corporation 5.10%, July 15, 2015	500,000	511,590	543,327
Bunge NA Finance LP 5.90%, April 1, 2017	1,000,000	1,050,652	1,115,861
Call Genie Inc. 12.00%, Convertible, October 12, 2012	550,000	550,000	550,000
Canacol Energy Limited 8.00%, June 30, 2015	500,000	500,000	854,550

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Corporate Bonds (22.5%) (continued)			
Canam Manac Group Inc. 6.25%, October 31, 2015	1,000,000	1,000,000	1,023,500
Chartwell Seniors Housing Retirement 5.90%, May 1, 2012	1,100,000	1,112,326	1,123,100
Chartwell SR REI 6.00%, December 1, 2011	1,000,000	1,014,250	1,003,700
Cineplex Galaxy 6.00%, Convertible, December 31, 2012	484,000	423,928	544,210
Duke Funding Limited Floating Rate, August 7, 2033	2,000,000	705,709	152,865
Extencicare REIT 5.70%, June 30, 2014	995,000	741,274	1,007,438
Fairborne Energy 6.50%, December 31, 2011	1,081,000	1,009,984	1,105,431
Fairfax Financial Holdings 7.38%, April 15, 2018	505,000	518,851	536,882
First Uranium Corporation 7.00%, March 31, 2013	100,000	100,000	88,000
Ford Credit Canada 7.50%, August 18, 2015	2,000,000	2,015,000	2,150,560
Fusion Trust Floating Rate, November 15, 2010	1,500,000	1,500,000	1,500,000
Glacier Credit Card Trust 5.03%, February 20, 2013	5,000,000	5,354,000	5,317,800
Graoch Associates #161 Limited Partnership, October 31, 2010	300,000	318,255	244,583
Graoch Associates #171 Limited Partnership, April 30, 2010	2,000,000	2,121,701	1,834,376
Great-West Life Annuity Floating Rate, May 16, 2046	2,000,000	1,947,948	1,950,207
Harvest Energy Trust 7.25 %, September 30, 2013	373,000	245,992	383,258

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Corporate Bonds (22.5%) (continued)			
Holloway REIT CV			
8.00%, August 1, 2011	1,313,000	1,313,507	1,175,135
IBI Income Fund			
7.00%, December 31, 2014	1,000,000	1,000,000	1,060,100
IXIS ABS CDO Limited 2005-A1 B2L			
October 12, 2040	2,000,000	602,268	509,549
Jazz Air Income Fund			
9.50%, December 31, 2014	1,000,000	1,000,000	1,140,000
MicroPlanet Technology Corporation			
12.00%, October 14, 2011	750,000	750,000	750,000
Perpetual Energy Inc.			
6.50%, June 30 2012	1,111,000	1,123,499	1,111,111
Premium Brands			
7.00%, December 31, 2014	1,000,000	1,000,000	1,065,100
Progress Energy Resource			
6.25%, September 30, 2011	1,000,000	1,025,601	1,016,000
Rocky Mountain Dealership			
7.00%, September 30, 2017	1,000,000	1,000,000	1,070,000
Royal Host Real Estate Investment Trust			
6.00%, October 31, 2015	669,000	571,033	528,510
Scott's Real Estate Investment Trust			
7.75%, December 31, 2014	500,000	500,000	516,000
Sherritt International Corporation			
7.88%, November 26, 2012	3,000,000	3,170,000	3,155,070
Starling Finance PLC CDO			
Floating Rate, September 20, 2014	2,000,000	1,040,100	600,000
Superior Plus Income Fund			
5.75%, Convertible, December 31, 2012	925,000	820,866	934,250
The Brick Group Income Fund			
12.00%, May 30, 2014	700,000	637,625	749,000
Trinidad Drilling Limited			
7.75% Convertible Debentures, July 31, 2012	700,000	572,721	707,000

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Corporate Bonds (22.5%) (continued)			
Uranium One			
4.25%, December 31, 2011	200,000	145,250	196,300
Whitehorse CDO			
Variable Rate, May 01, 2018	2,000,000	1,442,203	965,270
Whitemud Resources Incorporated			
12.00%, Debentures, July 31, 2012	800,000	800,000	800,000
Yellow Media Inc.			
6.25%, October 1, 2017	1,000,000	960,642	980,000
		<u>\$ 51,019,389</u>	<u>\$ 51,077,234</u>
Provincial Bonds (0.2%)			
Province of Quebec		\$	
3.3%, December 1, 2013	416,000	492,538	514,559
		<u>\$ 492,538</u>	<u>\$ 514,559</u>
Global Equities (13.4%)			
United States (13.4%)			
Annaly Capital Management Inc.	140,000	\$ 2,535,660	\$ 2,521,044
API Technologies Corporation	200,000	228,289	193,629
Cardinal Health Inc.	75,000	2,470,342	2,651,438
Constellation Energy Group	100,000	3,148,831	3,081,752
Fidelity National Financial Inc.	140,000	1,880,923	1,907,547
JPMorgan Chase & Company	75,000	3,147,789	2,876,149
Lafayette Square CDO Limited	3,000	1,981,464	1,375,782
Microsoft Corporation	125,000	3,148,096	3,393,596
Monsanto Company	30,000	1,517,762	1,816,644
ProShares Short 20+ Year Treasury	78,000	3,261,470	3,336,974
Sanderson Farms Inc.	90,000	4,001,633	3,850,355
Tidewater Inc.	70,000	3,011,801	3,290,769
		<u>\$ 30,334,060</u>	<u>\$ 30,295,679</u>
Total Long Positions (61.3%)		<u>\$ 135,322,295</u>	<u>\$ 138,903,738</u>
Government of Canada Bonds (-0.5%)			
Government of Canada			
3.50%, June 1, 2013	(10,000)	\$ (1,083,590)	\$ (1,050,300)

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

STATEMENT OF INVESTMENT PORTFOLIO AS AT OCTOBER 31, 2010

	Number of Shares/ Par Value/ Units	Cost \$	Fair Value \$
Consumer Discretionary (-0.0%)			
Cineplex Galaxy Income Fund	(5,000)	<u>\$ (93,850)</u>	<u>\$ (105,950)</u>
Financials (-2.2%)			
National Bank of Canada	(61,000)	\$ (3,936,458)	\$ (4,095,540)
RioCan Real Estate Investment Trust	(40,000)	<u>(905,452)</u>	<u>(923,200)</u>
		<u>\$ (4,841,910)</u>	<u>\$ (5,018,740)</u>
Telecommunication Services (-0.3%)			
Telus Corporation	(14,000)	<u>\$ (645,158)</u>	<u>\$ (632,800)</u>
United States (-3.3%)			
Archer-Daniels-Midland Company	(12,000)	\$ (385,546)	\$ (407,476)
Energy Select Sector SPDR Fund	(23,000)	(1,310,521)	(1,390,885)
Financial Select Sector SPDR Fund	(60,000)	(898,438)	(889,061)
SPDR S&P 500 ETF Trust	(40,000)	<u>(4,670,523)</u>	<u>(4,831,747)</u>
		<u>\$ (7,265,028)</u>	<u>\$ (7,519,169)</u>
Written Options (-0.0%)			
Monsanto Company Nov/60 WCO	(100)	\$ (11,585)	\$ (20,382)
Research In Motion Nov/60 WCO	(100)	<u>(11,000)</u>	<u>(12,400)</u>
		<u>\$ (22,585)</u>	<u>\$ (32,782)</u>
Total Short Positions (-6.3%)		<u>\$ (13,952,121)</u>	<u>\$ (14,359,741)</u>
Unrealized Loss on Forward Foreign			
Currency Contract, note 10 (0.0%)		<u>-</u>	<u>\$ (13,796)</u>
Transaction costs, note 2		<u>\$ (224,443)</u>	
Total Investments (55.0%)		<u>\$ 121,145,731</u>	124,530,201
Cash and cash equivalents (45.3%)			102,423,701
Other assets less other liabilities (-0.3%)			<u>(868,527)</u>
Net assets (100.0%)			<u>\$ 226,085,375</u>

See accompanying notes to the financial statements

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

1. THE FUND

Front Street Diversified Income Fund Class (the "Fund") is a class of shares of Front Street Mutual Funds Limited (the "Corporation"), a mutual fund corporation incorporated under the Canada Business Corporations Act on April 11, 2006, and is authorized to issue an unlimited number of classes of shares in multiple series. Reference is made to the Fund's Simplified Prospectus for additional information on the Fund's structure. Series A commenced operations on June 22, 2006. Series B commenced operations on June 22, 2006. Series F commenced operations on August 11, 2006. Series X commenced operations on December 3, 2009.

At a special meeting held on October 15, 2008, the applicable securityholders approved the special resolutions authorizing the amalgamation of Front Street Mutual Funds Limited and Front Street Opportunity Funds Ltd. to form Front Street Mutual Funds Limited pursuant to an amalgamation agreement entered into as of October 31, 2008 and the filing of such articles of amalgamation with an effective date of November 1, 2008. Pursuant to the amalgamation, the Fund amalgamated with Front Street Yield Opportunities Fund to form Front Street Diversified Income Fund. Each former shareholder of Front Street Diversified Income Fund Class received one share of the Front Street Diversified Income Fund. Each former shareholder of Front Street Yield Opportunities Fund received 0.9259 shares for each Series A; 0.9243 shares for each Series B and 0.9262 shares for each Series F, share respectively.

The transactional net asset value of the Front Street Yield Opportunities Fund acquired was as follows:

Total assets	\$ 39,887,291
Total liabilities	3,341,927
Net assets representing shareholders' equity	36,545,364

Aggregate consideration was paid through the issuance of the following shares:

	Shares	Transactional NAV
Series A	3,886	\$ 31,745
Series B	4,446,180	36,233,820
Series F	<u>34,378</u>	<u>279,799</u>
	<u>4,484,444</u>	<u>\$ 36,545,364</u>

Summary financial information for Front Street Yield Opportunities Fund, for the period ended October 31, 2008 is as follows:

Investment income	\$ 3,686,271
Total expenses	1,921,937
Net realized and unrealized loss on investments	8,625,834
Net decrease in net assets from operations for the year	6,861,500

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

1. THE FUND (Continued...)

On November 24, 2009 the shareholders of Front Street Mutual Funds Limited (the "Corporation") approved the special resolutions to authorize the amalgamation of the corporation with Front Street Special Opportunities Canadian Fund Ltd., another mutual fund corporation managed by Front Street Capital 2004. The effective date of the amalgamation was the close of business on December 1, 2009. The merger was accomplished by the amalgamation of these two mutual fund corporations under the Canada Business Corporations Act (Canada).

Upon amalgamation, Front Street Mutual Funds Limited was considered to be the continuing Fund for securities regulatory purposes. A new class of shares of Front Street Mutual Funds Limited was created, namely Front Street Special Opportunities Canadian Fund (of which Series A, B, F, X and Y shares were created). Existing shareholders of the Series A, Series B and Series F of Front Street Special Opportunities Canadian Fund Ltd. received Series X, Series Y and Series F shares respectively of the Front Street Special Opportunities Canadian Fund class of shares of Front Street Mutual Funds Limited.

The foregoing financial statements and accompanying notes to the financial statements presented herein are for the Fund. Separate financial statements of each of the other classes of shares of the Corporation have also been prepared as at October 31, 2010.

Front Street Capital 2004 is the manager of the Fund (the "Manager"). Front Street Investment Management Inc. (the "Investment Advisor") has been retained by the Manager, on behalf of the Fund, to provide investment advisory and portfolio management services to the Fund. NBCN Inc. is the custodian. Citigroup Fund Services Canada, Inc. provides fund accounting services and shareholder recordkeeping services.

The Fund's investment objective is to provide Fund securityholders with consistent long term capital growth and the opportunity for income through selection, management and strategic trading of long and short positions in securities of income trusts, common shares, preferred shares, derivatives and corporate and government debt.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The following is a summary of the significant accounting policies followed by the Fund:

a) Financial instruments

Investments, at fair value, obligations from portfolio assets sold short at fair value and futures contracts, at fair value are classified as held for trading. Accounts receivable relating to shares issued, accounts receivable relating to portfolio assets sold, and amounts receivable relating to accrued income are classified as loans and receivables. Liabilities for portfolio assets purchased, distributions payable, accrued expenses and accounts payable relating to shares redeemed are classified as other financial liabilities.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

a) Financial instruments (continued...)

In June 2008, the Canadian Securities Administrators adopted changes to National Instrument 81-106 on Investment Fund Continuous Disclosure. These changes are essentially aimed at modifying the requirements pertaining to the calculation of the unit value due to the inclusion of Section 3855, Financial Instruments - Recognition and Measurement of the CICA Handbook. These changes allow the Fund to report two distinct net asset values: one for the financial statements, which is calculated in accordance with Canadian GAAP (called "net assets") and another for all other purposes, such as unit pricing (called "net asset value"). A reconciliation between the net assets per unit and the net asset value per unit is required (see note 8) as well as description of the differences between the valuation principles and practices used by the Manager to calculate the net asset value and those prescribed by Canadian GAAP. The changes are effective September 8, 2008 and have been reflected in these financial statements.

b) Valuation of investments

i) Investments listed on an exchange are valued at the last bid price reported by the principal securities exchange on which the issue is traded on the financial statement date. The difference between this amount and cost is shown as the change in the unrealized appreciation (depreciation) of the value of investments. For investments that are not traded in an active market, Section 3855 requires the use of specific valuation techniques to be used in the determination of fair value. When current market prices or quotations are not readily available, valuations are established using specific procedures in order to estimate what the fair value would be, in an arms length transaction, motivated by normal business considerations. Valuation techniques principally include the use of the last publicly traded price, the issuance price of securities at the date of the most recent financing of the entity or a price established by the Manager in accordance with its fair value policy.

ii) Investments which are restricted as to transferability are valued at the fair value of the unrestricted investment as provided in paragraph (i) above less a discount of 2% per month up to four months.

The process of valuing investments for which no published market exists is inevitably based on inherent uncertainties and the resulting values may differ from values that would have been established had a ready market existed for these investments.

iii) Trust units are valued at the last bid price reported by the principal securities exchange on which the issue is traded on the financial statement date. The cost of the trust units is reduced on an annual basis by distributions from the trust and increased by the annual income allocated to the units by the trust.

iv) Investments in mutual funds or pooled funds are valued based on the net asset value per unit at the close of trading on the financial statement date.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

b) Valuation of investments (continued...)

- v) The Fund values its investments in limited partnerships at the last bid price reported by the principal securities exchange on which the issue is traded on the financial statement date. The Fund calculates the cost value of its investment in limited partnerships using the equity method. Under this method, the limited partnership investments are recorded at cost plus the Fund's pro rata share in undistributed earnings since acquisition.
- vi) The Fund may make short sales whereby a security that it does not own is sold in anticipation of a decline in the fair value of the security. Securities which are sold short are valued at the last ask price reported by the principal securities exchange on which the issue is traded on the financial statement date. To enter a short sale, the Fund may need to borrow the security for delivery to the buyer.

While the transaction is open, the Fund will also incur a liability for any paid dividends or interest which are due to the lender of the security.

- vii) The Fund invests in derivatives which represent financial instruments which may require little or no initial investment and which are settled in the future. These investments are commonly referred to as options or futures contracts. Futures contracts listed upon a principal exchange are valued at their last bid price (for long contracts) and last ask price (for short contracts) at the financial statement date. Contracts with no available bid and ask prices are valued at the fair value as determined by the Manager.

c) Financial instruments disclosure and presentation and fair value measurements

The Fund has adopted CICA Handbook Sections 3862, Financial Instruments - Disclosures and 3863, Financial Instruments - Presentation, which have replaced Section 3861, Financial Instruments - Disclosure and Presentation. These new standards place increased emphasis on disclosures with respect to the nature and extent of risks arising from financial instruments and how the Fund has managed those risks. See note 9 for additional details.

The Fund adopted the amendments to CICA 3862, Financial Instruments – Disclosures on January 1, 2009. CICA 3862 establishes a three-tier hierarchy as a framework for disclosing fair value based on the inputs used to value the Fund's investments. The hierarchy of inputs is summarized below:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- 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) (Level 2); and
- Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

See note 12 for additional details.

These changes have no impact on the net assets, results of operations or changes in net assets of the Fund.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

d) Transaction costs

Portfolio transaction costs are expensed and are included in "Transaction costs" in the Statements of Operations. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an investment, which include fees and commissions paid to agents, advisors, brokers and dealers, levies by regulatory agencies and securities exchanges. The individual security's cost shown on the Statement of Investment Portfolio includes only those transaction costs incurred on the acquisition of portfolio investments.

e) Cash and cash equivalents

Cash and cash equivalents consist of cash balances with banks and highly liquid short-term investments with original terms to maturity of less than three months.

f) Investment transactions and income recognition

Investment transactions are accounted for on a trade date basis. Gains and losses from such transactions are calculated using the weighted average cost of the securities on disposition.

Interest income is recorded on an accrual basis. Dividend income is recorded on the ex dividend date.

g) Foreign currency translation

Income, expenses and investment transactions in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the dates of such transactions. Assets and liabilities in foreign currencies are translated into Canadian dollars at the closing exchange rates on each valuation day.

h) Net increase (decrease) in net assets from operations per share

Net increase (decrease) in net assets from operations per share are based on the increase (decrease) in net assets from operations attributable to each series of shares divided by the average number of shares outstanding of that series during the year.

i) Net assets per share

The net assets per share is calculated by dividing the net assets of a series of shares by the total number of shares of the series outstanding at the end of the year.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

j) Capital disclosures

The Fund has adopted CICA Handbook Section 1535, Capital Disclosures, which requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. See note 11 for additional details.

k) General standards on financial statement presentation

CICA Handbook Section 1400, General Standards on Financial Statement Presentation, has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The Manager of the Fund has made this assessment and concluded that there are currently no material uncertainties that cast doubt on the Fund's ability to continue as a going concern.

l) Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Manager to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of financial statements, and the reported amounts of revenues and expenses during the reporting year. Significant estimates include the fair value of the Fund's investment in private companies and the fair value of the Fund's investment in corporate warrants which are not traded in active markets. Actual results may differ from those estimates.

m) Future accounting pronouncements

Recent accounting pronouncements that have been issued but are not yet effective, which have a potential implication for the Fund, are as follows:

International financial reporting standards ("IFRS")

Effective for its fiscal year commencing November 1, 2012, the Fund must adopt IFRS. In preparation thereof, the Manager continues to monitor and implement the Fund's changeover plan and will continue to assess the impact of the implementation as new IFRS guidance become available from the International Accounting Standards Board.

The Manager has reviewed the current IFRS against the Fund's current accounting policies and financial statement presentation under Canadian generally accepted accounting principles ("Canadian GAAP"), and does not expect the adoption of IFRS will have a material effect on the Fund's net asset value per share for all series of shares. The primary impact of IFRS on accounting policies and implementation decisions will be on the financial statement presentation and note disclosures in the Fund's financial statements. In particular, the Fund will be required to present a statement of shareholders' equity and a statement of cash flows, and will be required to include certain additional and enhanced disclosures.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

m) Future accounting pronouncements (continued...)

International financial reporting standards ("IFRS") (continued...)

The Fund's changeover plan includes key activities in (a) preparation of financial statements, (b) information processing and record-keeping, (c) business policy assessment and (d) systems and controls. Based on the Manager's preliminary analysis, the Manager believes the changeover to IFRS will not materially affect the Fund's existing business arrangements.

3. SHARES ISSUED AND OUTSTANDING

The authorized capital of the Fund consists of an unlimited number of mutual fund shares, available in four series. Redemption and commission fees vary according to each series of shares as follows:

Series A shares

Redemption fees payable to the Manager may be applicable upon the sale of shares of this series based on the original cost amount and the time to disposition. A redemption fee of 3% applies to shares of this series sold within the first 18 months following acquisition. A redemption fee of 2% applies to shares of this series sold after the first 18 months and prior to 36 months following acquisition. No redemption fee applies to shares of this series sold after the first 36 months following acquisition.

Series B shares

Commission fees payable to brokers, dealers or advisors may be applicable upon the purchase of shares of this series up to 5% of the gross purchase amount, at the discretion of the broker, dealer or advisor.

Series F shares

No redemption or commission fees are applicable to shares of this series.

Series X shares

Redemption fees payable to the Manager may be applicable upon the sale of shares of this series based on the original cost amount and the time to disposition. A redemption fee of 5% applies to shares of this series sold within the first year following acquisition. A redemption fee of 3% applies to shares of this series sold within the second year following acquisition. A redemption fee of 1.5% applies to shares of this series sold within the third year following acquisition. No redemption fee applies to shares of this series sold after the third year following acquisition.

The Fund allocates income and expenses, and realized and unrealized capital gains and losses to each class of shares outstanding based on the average class allocation for the year.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

3. **SHARES ISSUED AND OUTSTANDING** (Continued...)

The following share transactions took place during the year:

	2010	2009
Shares outstanding, beginning of the year:		
Series A	3,713,765	1,502,966
Series B	5,738,289	530,657
Series F	368,349	45,603
Series X	-	-
Shares issued during the year:		
Series A	9,276,966	2,224,087
Series B	6,065,853	5,945,575
Series F	1,618,193	348,754
Series X	466,617	-
Share distributions reinvested during the year:		
Series A	397,925	133,977
Series B	439,832	300,818
Series F	43,859	11,801
Series X	12,633	-
Shares redeemed during the year:		
Series A	533,961	147,265
Series B	1,708,046	1,038,761
Series F	114,422	37,809
Series X	206,570	-
Shares outstanding, end of the year:		
Series A	12,854,695	3,713,765
Series B	10,535,928	5,738,289
Series F	1,915,979	368,349
Series X	272,680	-

4. **FEES AND EXPENSES**

The Fund pays a monthly management fee equal to 1/12 of 1.25% of the net asset value of the Series A shares and Series X shares and 1/12 of 1% of the net asset value of the Series B and Series F shares calculated and paid at the end of each month in arrears.

The Fund pays a monthly service fee of 1/12 of 0.75% of the net asset value of the Series A shares and 1/12 of 1% of the net asset value of Series B shares calculated and paid at the end of each month. The Fund pays a monthly service fee of 1/12 of 0.50% of the net asset value of Series X shares calculated and paid at the end of each month.

The Fund is responsible for payment of all operating and administrative expenses of the Fund. The main components of these expenses are legal and accounting fees, printing expenses, reporting issuer filing and sustaining fees, custodial fees, fees payable to, and expenses incurred by, the Fund's Independent Review Committee and expenses of making distributions to shareholders. As the Fund has more than one series of shares, the shareholders of each series bear their pro rata share of those expenses which are common to the operation of all series, as well as those expenses which are attributable solely to that series.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

4. FEES AND EXPENSES (Continued...)

The Manager may, at its discretion, add a service charge of up to 15% of the costs incurred for any operating and administrative costs charged to the Fund other than management services which are already included in the management fee rate which the Manager receives from the Fund.

The Fund pays a performance fee if the percentage gain in the net asset value of a series of the Fund (as adjusted for any prior return deficiencies) over the preceding fiscal quarter or quarters since a performance fee was last payable exceeds the percentage gain or loss of the benchmark (the "Benchmark") over the same year. The Benchmark for the Fund is calculated as follows: 50% of the percentage gain or loss in the S&P/TSX Composite Index and 50% of the percentage gain or loss in the DEX Universe All Corporate Bond Index over the same year. The fee is equal to this excess return per share multiplied by the number of shares outstanding at the end of the quarter multiplied by 20%, provided that the net asset value per share of the Fund (including distributions) is greater than all previous values at the end of each previous fiscal quarter. The starting reference point for the next fiscal quarter's calculation is based on the higher of either the Benchmark performance adjusted net asset value per share or the adjusted actual net asset value per share, both with respect to the previous quarter in which a performance fee was payable.

5. INCOME TAX AND DISTRIBUTION

The Fund qualifies as a mutual fund corporation under the Income Tax Act (Canada). The Corporation will earn three types of income, Canadian dividends, taxable capital gains and other net taxable income. The income of the Fund, including taxable capital gains, will be subject to income tax at applicable corporate tax rates, after claiming allowable deductions for expenses and applicable credits for foreign taxes paid on foreign source income. Income tax on capital gains is refundable to the Fund to the extent that such gains are distributed to shareholders as capital gains dividends or the Fund's share are redeemed. Gains and losses realized by the Fund in relation to certain derivative transactions and short sale transactions may be taxed on account of income as opposed to on account of capital. Other income is subject to tax at normal corporate rates and is not subject to refundable tax treatment.

The Fund may elect in the prescribed manner and form in order to have the dividends it distributes treated as capital gains dividends to the extent that the dividends do not exceed the Fund's capital gains dividend account. The capital gains dividend account will be represented by the amount by which capital gains realized by the Fund while it was a mutual fund corporation exceed the aggregate of:

- (a) capital losses realized by the Fund while it was a mutual fund corporation;
- (b) certain capital gains dividends previously paid by it; and
- (c) amounts in respect of which the Fund received capital gains tax refunds.

The Fund anticipates that gains and losses realized on the disposition of investments will normally give rise to capital gains not ordinary income. The Fund intends to declare sufficient capital gains dividends so that it is entitled to a refund of the full amount of tax paid or payable on their capital gains. The suspended loss rules in the Income Tax Act (Canada) may prevent the Fund from recognizing capital losses on the disposition of securities in certain circumstances, which may increase the amount of capital gains dividends that the Fund must pay to Fund shareholders.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

5. INCOME TAX AND DISTRIBUTION (Continued...)

If allowable capital losses exceed taxable capital gains of the Fund in any taxation year, the excess cannot be allocated to shareholders, but may be carried back three years and carried forward indefinitely and be applied against taxable capital gains in such previous or subsequent years.

The Fund will allocate taxes payable and recoverable of the Fund to each of the classes. The Fund can pay ordinary taxable dividends or capital gains dividends to shareholders of any class in order to receive a refund of taxes on Canadian dividends or capital gains taxes. The Fund intends to pay out such dividends so as to maximize tax refunds and minimize taxes payable at the corporate level.

The Fund may be subject to provincial capital taxes.

The corporation's shares are qualified investments for registered plans.

6. TRANSACTION COSTS

The total brokerage commissions paid by the Fund with respect to securities transactions for the year ended October 31, 2010 was \$473,439 (2009 - \$319,236).

7. RELATED PARTY TRANSACTIONS

Management fees of \$1,724,605 (2009 - \$741,770) were paid to the Manager during the year (see note 4). Servicing fees of \$1,211,781 (2009 - \$446,426) were paid to the Manager during the year (see note 4). Operating costs of \$38,214 (2009 - \$Nil) were paid to the Manager during the year (see note 4). Performance fees of \$Nil (2009 - \$19,119) were incurred with the Manager during the year (see note 4). Included in accrued expenses are \$202,959 (2009 - \$114,226) of management fees payable to the Manager. Included in accrued expenses are \$111,468 (2009 - \$37,392) of accrued servicing fees payable to the Manager. Included in accrued expenses are \$3,412 (2009 - \$Nil) of accrued operating costs payable to the Manager. Accrued expenses includes performance fees of \$Nil (2009 - \$19,119) payable to the Manager.

708,207.530 (2009 - 654,661.390) of series B shares outstanding at year end representing 6.72% (2009 - 11.41%) of the total series B shares of the Fund are held by the Partners of the Manager.

36,016.200 (2009 - Nil) of series F shares outstanding at year end representing 1.88% (2009 - Nil%) of the total series F shares of the Fund are held by the Partners of the Manager.

The Fund may place a portion of its portfolio transactions with brokerage firms which are affiliates of the Manager 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. During the year ended October 31, 2010, Tuscarora Capital Inc, a company under common control to the Manager, received \$24,738 (2009 - \$10,119) in commissions on portfolio transactions for the Fund.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

7. RELATED PARTY TRANSACTIONS (Continued...)

Management fees, servicing fees, operating costs and performance fees are measured at the exchange amount of consideration prescribed by the offering documents of the Fund. When related parties enter shareholder transactions with the Fund, the exchange amount of consideration is the transactional NAV available to all other shareholders on the trade date. In the case of brokerage commissions, the exchange amount of consideration is that which is negotiated by the related parties.

8. RECONCILIATION OF NET ASSET VALUE TO NET ASSETS FOR FINANCIAL STATEMENTS

In accordance with the decision made by the Canadian securities regulatory authorities, a reconciliation between the transactional net asset value ("NAV") and net assets calculated using generally accepted accounting policies ("GAAP NA") of an investment fund is required for financial reporting years ending on or after October 31, 2007. For investments that are traded in an active market where quoted prices are readily and regularly available, Section 3855 requires bid prices (for investments held) and ask prices (for investments sold) to be used in the fair valuation of investments, rather than the use of closing trade prices currently used for the purpose of determining transactional NAV. For investments that are not traded in an active market, Section 3855 requires the use of specific valuation techniques (see note 2) rather than the use of valuation techniques in of general practice in the investment funds industry.

These changes account for the difference between transactional NAV and GAAP NA. The impact of the adoption of Section 3855 on the net asset value of the Fund is as follows:

As at October 31, 2010

	<u>Net Asset Value</u>			<u>Net Asset Value per Share</u>	
	Transactional NAV	Section 3855 Adjustment	GAAP NA	Transactional NAV	GAAP NA
Series A	\$ 113,374,156	\$ (110,598)	\$ 113,263,558	\$ 8.82	\$ 8.81
Series B	93,517,439	(91,532)	93,425,906	8.88	8.87
Series F	17,007,273	(16,564)	16,990,709	8.88	8.87
Series X	2,407,550	(2,349)	2,405,202	8.83	8.82
Total	\$ 226,306,418	\$ (221,043)	\$ 226,085,375		

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

9. FINANCIAL INSTRUMENTS

The Fund's assets and liabilities classified in accordance with CICA Handbook Section 3855 are as follows:

As at October 31,

	2010	2009
Assets		
Held for trading	\$138,903,738	\$ 58,561,733
Cash and cash equivalents	102,423,701	28,353,015
Loans and receivables	<u>4,801,760</u>	<u>4,342,592</u>
Total Assets	<u>246,129,199</u>	<u>91,257,340</u>
Liabilities		
Held for trading	14,373,537	3,132,261
Other financial liabilities at amortized cost	<u>5,670,287</u>	<u>5,826,131</u>
Total liabilities	<u>20,043,824</u>	<u>8,958,392</u>
Net Assets	<u>\$226,085,375</u>	<u>\$ 82,298,948</u>

The Fund's financial instruments consist of investments at fair value, cash and cash equivalents, accounts receivable relating to shares issued, accounts receivable relating to portfolio assets sold, amounts receivable relating to accrued income, obligations from portfolio assets sold short, at fair value, liabilities for portfolio assets purchased, distributions payable, accrued expenses, accounts payable relating to shares redeemed and forward contracts, at fair value. It is the Manager's opinion that due to the short term nature of these financial instruments, the Fund is not exposed to significant market price, currency, interest rate, liquidity, cash flow and credit risks arising from these financial instruments except as described below. The fair value of these financial instruments approximate their carrying values, unless otherwise noted.

Risk management

The Investment Advisor seeks to minimize potential adverse effects of these risks on the Fund's performance by employing professional, experienced portfolio advisors, by daily monitoring of the Fund's positions and market events, and by diversifying the investment portfolio within the constraints of the investment objective. To assist in managing risk, the Manager also maintains a governance structure that oversees the Fund's investment activities and monitors compliance with the Fund's stated investment strategy and securities regulations.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

9. FINANCIAL INSTRUMENTS (Continued...)

Risk management (continued...)

The Fund's investment activities expose it to various types of risk that are associated with the financial instruments and markets in which it invests. The Statement of Investment Portfolio presents the securities held by the Fund as at October 31, 2010, and groups the securities by asset type, sector and/or market segment. Significant risks that are relevant to the Fund are discussed below.

i) Market price risk

Market price risk, is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting similar financial instruments traded in the market.

The Fund is exposed to market price risk arising from its investments in securities. The Investment Advisor manages the Fund's market price risk on a daily basis in accordance with the Fund's investment objective and policies.

ii) Currency risk

The Fund may invest in financial instruments denominated in currencies other than its measurement currency. Consequently, the Fund is exposed to risks that the exchange rate of its currency relative to other currencies may change in a manner that has an adverse effect on the value of the portion of the Fund's assets or liabilities denominated in currencies other than Canadian dollars, absent any changes in market prices or investment specific events.

Included in the undernoted accounts are the following foreign currency balances:

	Investment, at fair value	Cash	Foreign exchange contract	Total	Percentage of GAAP NA
United States Dollar	<u>\$ 37,287,686</u>	<u>\$ (30,290)</u>	<u>\$ (13,796)</u>	<u>\$ 37,243,600</u>	<u>16.47%</u>

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

9. FINANCIAL INSTRUMENTS (Continued...)

iii) Interest rate risk

The Fund may invest in fixed and floating rate securities. The income of the Fund may be affected by changes to interest rates relevant to particular securities or as a result of management being unable to secure similar returns on the expiry of contracts or sale of securities. The value of fixed interest securities may be affected by interest rate movements or the expectation of such movement in the future. Interest payable on bank overdraft or broker margin account positions will be affected by fluctuations in interest rates. As at October 31, 2010, there were 22.5% (2009 – 34.4%) of investments owned which are held in bonds. There were investments in short-term investments representing 5.4% (2009 – 4.0%) of the net asset value, all maturing in less than 60 days. The remaining portion of the Fund's investments are substantially non-interest bearing equity investments and its exposure to interest rate changes is minimal.

Financial assets	Floating Rate Financial Assets	Fixed Rate Financial Assets	Non-interest bearing	Total
Held for trading	\$ 5,168,341	\$ 46,423,452	\$ 87,311,945	\$ 138,903,738
Other receivables	-	-	4,801,760	4,801,760
Cash	<u>102,423,701</u>	<u>-</u>	<u>-</u>	<u>102,423,701</u>
Total	<u>\$ 107,592,042</u>	<u>\$ 46,423,452</u>	<u>\$ 92,113,705</u>	<u>\$ 246,129,199</u>
Financial liabilities				
Held for trading	\$ -	\$ 1,050,300	\$ 13,323,237	\$ 14,373,537
Other financial liabilities	<u>-</u>	<u>-</u>	<u>5,670,287</u>	<u>5,670,287</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 18,993,524</u>	<u>\$ 20,043,824</u>
GAAP NA				<u>\$ 226,085,375</u>

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

9. FINANCIAL INSTRUMENTS (Continued...)

iv) Liquidity risk

Liquidity risk is the risk the Fund will encounter difficulty in meeting obligations associated with financial liabilities. Shareholder redemption requests are the main liquidity risk for the Fund.

The Fund maintains sufficient cash and marketable securities, and manages liquidity risk through its ability to close out market positions.

	0-12 months	1-3 years	3-5 years	Beyond 5 years	Indefinite Maturity	Total
Financial assets						
Held for trading	\$ 7,709,321	\$ 17,481,636	\$ 14,772,889	\$ 11,627,947	\$ 87,311,945	\$ 138,903,738
Other receivables	4,801,760	-	-	-	-	4,801,760
Cash and cash equivalents	<u>102,423,701</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>102,423,701</u>
Total	<u>\$ 114,934,782</u>	<u>\$ 17,481,636</u>	<u>\$ 14,772,889</u>	<u>\$ 11,627,947</u>	<u>\$ 87,311,945</u>	<u>\$ 246,129,199</u>
Financial liabilities						
Held for trading	\$ 32,782	\$ 1,050,300	\$ -	\$ -	\$ 13,290,455	\$ 14,373,537
Other financial liabilities	<u>5,670,287</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,670,287</u>
Total	<u>\$ 5,703,069</u>	<u>\$ 1,050,300</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,290,455</u>	<u>\$ 20,043,824</u>
GAAP NA						<u>\$ 226,085,375</u>

Certain of the Fund's investments are in private securities which are thinly traded. As at October 31, 2010, the fair value of such assets was 6.1% (2009 - 10.4%) of the total net assets.

v) Cash flow risk

The risk that future cash flows associated with a monetary financial instrument will fluctuate in amount. In the case of a floating rate debt instrument, for example, such fluctuations could result from a change in the effective interest rate of the financial instrument, usually without a corresponding change in its fair value.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

9. FINANCIAL INSTRUMENTS (Continued...)

vi) Credit risk

The Fund is exposed to credit risk arising from its transactions with its counterparties and brokers, related to securities purchases and sales. Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Financial assets which potentially expose the Fund to credit risk consist principally of investments in bonds and amounts due from brokers. The Fund seeks to mitigate its exposure to credit risk by placing its cash, and transacting its securities activity with large financial institutions. The Fund may also invest in corporate bonds. Until the bonds are sold or mature, the Fund is exposed to credit risk relating to whether the bond issuer will meet its obligations when they come due. The extent of the Fund's exposure to credit risk in respect of these financial assets is reflected in their carrying value as recorded in the Fund's Statement of Net Assets.

As at October 31, 2010, the Fund had \$50,541,493 (2009 - \$28,297,143) in long term debt instruments with the following credit ratings obtained from Standard and Poor's, Moody's and DBRS.:

Debt instruments by credit rating	Percentage of GAAP NA
AAA	0.2%
A+	1.1%
BBB	0.7%
BBB-	1.2%
BB+	0.4%
BB	2.4%
BB-	1.3%
B	0.4%
Not available or not rated	14.7%

As at October 31, 2010, the Fund's investment portfolio included \$2,588,508 (face value of \$4,300,000) in investments in debt obligations where repayments of interest or principal were contractually in arrears. These investments are not considered to be impaired and the fair values have been discounted to reflect the extended period to ultimate collection.

10. FORWARD FOREIGN CURRENCY CONTRACTS

The Fund has entered into forward foreign currency contracts to protect against fluctuations in the U.S. dollar exchange rates. As at October 31, 2010, the Fund has contracted to sell U.S. dollar currency in aggregate amounting to Cdn \$30,572,937 at a forward rate of 1.019 and maturing on November 08, 2010.

The net unrealized loss from the contracts amounted to \$13,796 as at October 31, 2010.

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

11. CAPITAL MANAGEMENT

The Manager considers the Fund's capital to consist of the issued ordinary share capital and the net assets attributable to participating shareholders.

The Manager manages the capital of the Fund in accordance with the Fund's investment objectives, policies and restrictions, as outlined in the Fund's prospectus, while maintaining sufficient liquidity to meet participating shareholder redemptions. The Fund's overall strategy for managing capital remains unchanged from 2009.

The Fund does not have any externally imposed capital requirements.

12. FAIR VALUE HIERARCHY

The following is a summary of the inputs used as of October 31, 2010 in valuing the Fund's investments and derivatives carried at fair values as discussed in note 2(c):

Assets at fair value as at October 31, 2010	Quoted price in active market for identical assets	Significant other observable input	Significant unobservable inputs	Total
	Level 1	Level 2	Level 3	
Investments, at fair value	\$ 83,145,570	\$ 41,916,338	\$ 13,841,830	\$ 138,903,738
Short-term notes	-	12,287,410	-	12,287,410
	<u>\$ 83,145,570</u>	<u>\$ 54,203,748</u>	<u>\$ 13,841,830</u>	<u>\$ 151,191,148</u>
Liabilities at fair value as at October 31, 2010	Level 1	Level 2	Level 3	Total
Obligations from portfolio used, at fair value	\$ 13,276,659	\$ 1,083,082	\$ -	\$ 14,359,741
Forward contracts, at fair value	-	13,796	-	13,796
	<u>\$ 13,276,659</u>	<u>\$ 1,096,878</u>	<u>\$ -</u>	<u>\$ 14,373,537</u>

FRONT STREET DIVERSIFIED INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS OCTOBER 31, 2010 AND 2009

12. FAIR VALUE HIERARCHY (Continued...)

	Fair value measurement	Investments, at fair value
	Equities - long	Bonds
Beginning balance as at November 1, 2009	\$ 3,310,482	\$ 8,436,079
Purchases	3,644,779	2,755,467
Sales	(1,646,722)	(2,089,429)
Transfers in	-	705,709
Gain (losses)		
Realized	(605,377)	71,883
Unrealized	393,760	(1,134,801)
	<u>\$ 5,096,922</u>	<u>\$ 8,744,908</u>

The transfers in represents a bond that has moved from level two to level three as a result of no longer having observable market data on this bond.

13. SUBSEQUENT EVENTS

On December 23, 2010, Front Street Mutual Funds Limited (“FSMFL”) and Front Street Resource Performance Fund Ltd. (“FSRPFL”) issued a notice of special meeting of shareholders pertaining to the proposed amalgamation of Front Street Mutual Funds Limited and Front Street Resource Performance Fund Ltd. If the resolution is approved by the shareholders of the FSMFL and FSRPFL, the effective date of the amalgamation will be the close of business on February 28, 2011. The merger will be accomplished by the amalgamation of these two mutual fund corporations under the Canada Business Corporations Act (Canada).

Upon amalgamation, FSMFL is considered to be the continuing fund for securities regulatory purposes. A new class of shares of FSMFL will be created, namely Series L of Front Street Resource Fund. Existing shareholders of FSRPFL will receive one share of Series L shares of Front Street Resource Fund class of shares of FSMFC.