Annual Management Report of Fund Performance

December 31, 2006

Galileo Small/Mid Cap Fund

Management Discussion of Fund Performance

INVESTMENT OBJECTIVE AND STRATEGIES

The Fund invests primarily in shares of smaller and medium North American companies that are expected to profit from future economic growth, and may also invest in income and royalty trusts.

The portfolio manager uses a bottom-up, growth investment style. It seeks to invest in companies at an early stage of their development and hold them until they achieve success through rising sales, earnings and cash flow.

As part of its strategy, the Fund may engage in short selling as a result of special relief it obtained from the Canadian securities regulators and engage in securities lending as permitted by securities regulators.

RISK

The Fund became a reporting issuer by issuing a prospectus on November 14, 2006. The portfolio and the risks of the Fund did not change significantly in the period beginning November 14, 2006 to December 31, 2006.

Investors in the Fund should have a long-term investment horizon. As this Fund invests in smaller and medium sized companies, there are general risks such as stock market and smaller company risks, among other risks, which are associated with such investments.

The Fund did not perform any short selling or securities lending in 2006.

RESULTS OF OPERATIONS

As the Fund became a reporting issuer on November 14th, 2006, only the performance for the period from November 14th to December 31st are disclosed in this report except as disclosed in the Financial Highlights section. The Class A and F units had a return of 8.13% and 8.00% for the period. Both classes outperformed the S&P/TSX Small Cap Index and the S&P/TSX Mid Cap Index, which had performance of 7.71% and 6.15% respectively.

The portfolio did not have any significant changes over the period. The Fund held no foreign equities at the end of the year.

RECENT DEVELOPMENTS

On November 14th, 2006, the 13 provincial and territorial securities commissions of Canada gave final receipt of the Prospectus for the Galileo Funds. Prior to this, Galileo Small/Mid Cap Fund was only open to accredited investors.

With the receipt of the prospectus, a number of changes were made to the Fund:
- the name of the Fund was changed from the Galileo Special Equity Fund;
- the Trustee and Fund Manager changed from Galileo Equity Management Inc. to Galileo Funds Inc.;
- the Fund launched a 2nd class of units. All previous units of the Fund became known as Class F units and the new class available for purchase became Class A units.
- the Fund was permitted to engage in short-selling transactions (within certain limits and restrictions) as a result of special relief it obtained from the Canadian securities regulators. The Fund did not engage in short selling during 2006.

RELATED PARTY TRANSACTIONS

Galileo Funds Inc., the Fund's Manager and Trustee, is a wholly owned subsidiary of Galileo Equity Management Inc., which is the Fund's Portfolio Advisor. Galileo Funds Inc. receives management fees based on the average net assets of the Fund. The management fees are used to pay for sales and commissions, the investment management of the Fund and other general administration. For the year ended December 31, 2006, the Fund accrued management expenses of $8,616 to Galileo Funds Inc.

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

Net Asset Value (NAV) per Unit – Class A

Class A	**2006**
Net asset value, beginning of year(1)	**$ 11.53**
Increase (decrease) from operations:	
Total revenue	0.05
Total expenses	(0.02)
Realized gains (losses) for the period	0.11
Unrealized gains (losses) for the period	0.30
Total increase (decrease) from operations(2)	**0.44**
Distributions:	
From income (excluding dividends)	-
From dividends	-
From capital gains	-
Return of capital	-
Total annual distributions(3)	**-**
Net asset value at December 31	**$ 12.47**

Net Asset Value (NAV) per Unit – Class F

Class F	**2006**
Net asset value, beginning of year(1)	**$ 11.12**
Increase (decrease) from operations:	
Total revenue	0.36
Total expenses	(0.06)
Realized gains (losses) for the period	1.99
Unrealized gains (losses) for the period	(0.93)
Total increase (decrease) from operations(2)	**1.36**
Distributions:	
From income (excluding dividends)	0.31
From dividends	-
From capital gains	-
Return of capital	-
Total annual distributions(3)	**0.31**
Net asset value at December 31	**$ 12.15**

(1) The Fund was launched in September 2000 with 1 class of units. It was sold via an offering memorandum and was therefore open only to accredited investors. In November 2006, the various provincial securities commissions approved the prospectus of the Fund. At this time, the original class of units became Class F and a 2nd class of units, Class A, was launched. As such, the beginning of year for Class A is November 14th, 2006 and for class F is January 1st, 2006.

(2) Net asset value 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. For Class A the figures are for the period November 14th, 2006 until the end of the year and for Class F the figures are for the period January 1st, 2006 until the end of the year.

(3) Distributions were reinvested in additional units of the Fund.

Ratios and Supplemental Data

Class A	**2006**
Net assets[(1)]	$ 12
Number of units outstanding[(1)]	1
Management expense ratio[(2)]	1.27%
Management expense ratio before waivers/absorptions	1.68%
Portfolio turnover rate[(3)]	132.02%
Trading expense ratio[(4)]	0.63%

Class F	**2006**
Net assets[(1)]	$ 6,994,664
Number of units outstanding[(1)]	575,693
Management expense ratio[(2)]	0.54%
Management expense ratio before waivers/absorptions	1.23%
Portfolio turnover rate[(3)]	132.02%
Trading expense ratio[(4)]	0.63%

(1) This information is provided as at December 31, 2006

(2) Management expense ratio for each class of units is based on the total expenses of the Fund, incurred by or allocated to that class of units for the period shown, expressed as an annualized percentage of daily average net assets of that class during the period.

(3) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio advisor 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 necessarily a relationship between a high turnover rate and the performance of a Fund.

(4) 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.

MANAGEMENT FEES

The Fund pays an annual fee of 1.95% of the net asset value of Class A and 0.95% of the net asset value of Class F plus GST to the Fund Manager in consideration for the provision of management, distribution and Fund advisory services. This management fee is calculated as a percentage of the Fund’s net assets per class and is calculated and credited daily. The Fund is required to pay Goods and Services Tax (GST) on the management fee.

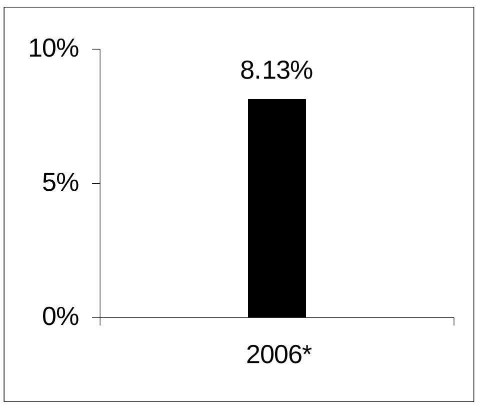
PAST PERFORMANCE

The performance information shown below assumes that all distributions made by the Fund in the period shown were reinvested in additional units of the Fund. The performance information does not take into account sales, redemptions, distributions or other optional charges that would have reduced returns or performance. It is important to note that the past performance of the Fund does not tell you how the Fund will perform in the future.

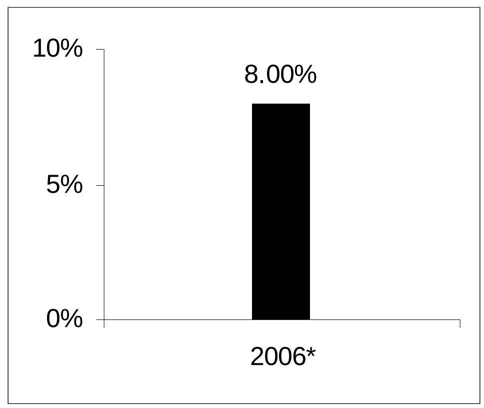
Year-by-year Returns

The following bar chart indicates the Fund's historical annual returns, which will vary from year to year. It shows the percentage change in value of an investment from November 14th, 2006 (the date the Fund first became eligible for purchase by retail clients).

Class A



Class F



* Return is for a partial year starting November 14th, 2006.

Annual Compound Returns

The following table shows the Fund's historical average annual compound returns compared with its benchmark the S&P/TSX Composite Index for the period November 14, 2006 to December 31, 2006.

Class A	8.13%
Class F	8.00%
S&P/TSX Small Cap Index	7.71%
S&P/TSX Mid Cap Index	6.15%

SUMMARY OF INVESTMENT PORTFOLIO
Portfolio breakdown as at December 31, 2006

Top 25 Positions	% of Net Assets*
Cash and Cash Equivalents	19.5%
CCS Income Trust	4.9%
Yamana Gold Inc.	4.4%
Shoppers Drug Mart Corporation	4.0%
Sino-Forest Corporation	3.9%
Agnico-Eagle Mines Limited	3.9%
Plutonic Power Corporation	3.6%
Bonavista Energy Trust	3.5%
Hudbay Minerals Inc.	3.3%
Denison Mines Corp.	3.3%
Shawcor Ltd.	3.2%
Westjet Airlines Ltd.	3.1%
Falcon Oil & Gas Ltd.	3.1%
CAE Inc.	3.0%
GMP Capital Trust	3.0%
Trinidad Energy Services Income Trust	3.0%
Yellow Pages Income Fund	2.7%
Inter Pipeline Fund	2.4%
SNC-Lavalin Group Inc.	2.3%
Systems Xcellence Inc.	2.2%
Western Oil Sands Inc., Class A	2.0%
Cyries Energy Inc.	2.0%
Garda World Security Corporation, Class A	2.0%
Progress Energy Trust	2.0%
Allen-Vanguard Corporation	1.9%

Sector	% of Net Assets*
Energy	24.2%
Industrials	19.5%
Cash & Cash Equivalents	19.4%
Materials	18.7%
Utilities	6.0%
Consumer Staples	4.0%
Financials	3.0%
Consumer Discretionary	2.7%
Information Technology	1.9%
Investment Funds	0.5%
Other net assets	0.1%

* calculated as a percent of the net assets of the Fund as at December 31, 2006.

The summary of investment portfolio may change due to ongoing portfolio transactions of the Fund and updates will be available on a quarterly basis.

The prospectus and other information on the Income & Equity Index Participation Fund are available on the internet at www.SEDAR.com.

A NOTE ON FORWARD-LOOKING STATEMENTS

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. Such statements are generally identifiable by the terminology used, such as “plan”, “anticipate”, “believe”, “intent”, “expect”, “estimate” or other similar wording.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. We do not undertake, and specifically disclaim, any obligation to update or revise any forward-looking information, whether as a result of new information, future developments or otherwise.

Galileo Funds

Galileo Absolute Return Fund
Galileo Canadian Active/Passive Fund
Galileo Fund
Galileo Global Active/Passive Fund
Galileo High Income Plus Fund
Galileo Money Market Fund
Galileo Small/Mid Cap Fund

Additional information about the Galileo Funds is available in the Funds' Prospectus, Annual Information Form and Financial Statements.

You can get a copy of any of these documents and other information about the Galileo Funds, such as information circulars and material contracts, are also available on our website at www.galileofunds.ca or at www.sedar.com. Some of this information is available on our website in English only.

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