

Management Report of Fund Performance



COVINGTON STRATEGIC CAPITAL FUND INC.

For The Year Ended August 31, 2008

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This annual management report of fund performance contains financial highlights but does not contain the complete annual financial statements of the investment Fund. You can get a copy of the annual financial statements at your request, and at no cost, by calling 1-866-244-4714, by writing to us at Covington Capital Corporation, 200 Front St. West, Suite 3003, Toronto, Ontario M5V 3K2 or by visiting our website at www.covingtonfunds.com or on SEDAR at www.sedar.com.

Shareholders may also contact us using one of these methods to request a copy of the Fund's proxy voting polices and procedures or proxy voting disclosure record.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

(in \$000's except for per share amounts, number of shares and percentages)

INVESTMENT OBJECTIVE AND STRATEGIES

The Fund combines the benefits of a Labour Sponsored Investment Fund ("LSIF") while giving investors access to the Ontario venture capital market. The Fund's objective is to realize capital appreciation on its venture investments while investing primarily in Canadian independent software vendors that develop software applications that may run on one or more software operating systems and grow these businesses by fostering strategic relationships with key industry partners. It is this collaborative approach that helps to develop the channels necessary to grow these businesses.

RISK FACTORS

The Fund is suitable for investors with a longer-term investment focus and higher risk tolerance.

Venture capital investing carries the risk of having illiquid investments in the portfolio along with the risk of finding suitable investments meeting the Fund's investment criteria. The process of valuing venture investments for which no published market exists is subject to inherent uncertainties and the resulting values may differ from values which would have been used had a ready market existed for those investments.

Investors who purchase LSIF's are required to hold their investment for eight years in order to retain the tax credit offered by the provincial and federal governments. If all shareholders were to redeem their shares at the same time, the Fund may need to liquidate investments at lower values than currently ascribed and shareholders may not receive the posted Net Asset Value.

In any financial year, the Fund is not obligated to redeem greater than 20% of the net asset value of the Fund.

In 2005, the Ontario government announced that the LSIF credit would be eliminated at the end of the 2011 taxation year. The LSIF tax credit on purchases of the Fund's units remains at 15% for the 2008 and 2009 RSP seasons but will be reduced to 10% for the 2010 taxation year and 5% for the 2011 taxation year. The federal tax credit remains at 15%. The Ontario government does not currently intend to offer any provincial tax credits to investors beyond the 2012 RRSP season. This may impair the Fund's ability to fulfill its investment objectives and support the existing portfolio if the Fund cannot continue to raise sufficient capital.

The Fund is regulated by the Income Tax Act (Canada) (the "Act") and the Community Small Business Investments Funds's Act (Ontario) (the "Ontario Act") and is restricted to making investments in eligible small and medium sized Canadian businesses. The investments of the Fund must follow restrictions that include the size, nature, and timing of the investments. Companies generally of this size are privately owned and are characterized as having less than \$50 million in assets and less than 500 employees. There is no assurance that suitable investments meeting the restrictions will be found and if not met, the Fund could be levied with penalty taxes and ultimately have its LSIF status revoked. As at December 31, 2007, the Fund was in compliance with all of these restrictions as it relates to the Act and the Ontario Act.

The Fund is limited to sourcing investments in Canadian companies operating out of Ontario. Therefore, the Fund is highly sensitive to political, economic, and social conditions within the Canadian environment. However, as many of these companies sell products and services into the U.S. market, some of the investments are also exposed to foreign exchange fluctuations and U.S. economic conditions.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

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RESULTS OF OPERATIONS

Operations

The net assets of the Fund for the year ended August 31, 2008 were \$20,231. This represents an increase of 45.4% over \$13,916 at August 31, 2007. The overall increase in net assets is due primarily to the disposition of the Fund's investment in PlateSpin Ltd. The Fund had net realized gains of \$8,765 and raised a net amount of \$1,775 in new asset this fiscal year.

In addition, the Fund made \$1,687 in new and follow-on investments. New to the portfolio is Powerband Canada Inc., a company which has developed an automobile finance portal for the Canadian market related to on-demand credit application processing for the retail automotive sector.

The Fund's expenses before for the year were \$2,681 compared to \$970 for 2007. From the Fund's inception in January 2004 until August 31, 2007, the Manager, Sponsor and directors each waived their fees. This was done in order to allow the Fund to reach a critical mass whereby the ongoing Fund overheads could be self-sustained. In that time, one of the Fund's key holdings was exited and a win realized in the Fund.

Expenses have also increased due to the increase in net assets of the Fund. In August 2007, the Fund acquired \$4,819 in assets through acquisition of the Financial Industry Opportunity Fund Inc. ("FIOF"), another Fund managed by the Manager. 2008 represented the first full year of operations post-merger.

Investment performance

In March, 2008, one of the Fund's key portfolio investments, PlateSpin Ltd. was acquired by Novell Inc. in a transaction worth \$205 Million US. This transaction represented a key win for the Fund and helped to bolster the Fund's one year returns at August 31, 2008 to 31% for Series I and II respectively which is well ahead of the returns for the same period for the BMO Nesbitt Burns Canadian Small Cap Index of -10.8% and the LSIF group average of -5.05% as posted on the Globe and Mail.

The NAV per Class A Share ("NAVPS") has increased by \$4.25 and \$4.27 in Series I and II shares respectively.

Series I and II are identical to each other in that they share a common pool of assets. The differences between the series relate only to how commissions and trailer fees are charged. Series I pays dealers a 10% commission at time of issue but does not pay any service fees before the eighth anniversary of date of issue while Series II pays dealers a 6% commission at time of issue and a service fee of 0.5% of net asset value on an annual basis. As such, the results of operations of \$4.24/share for Series I and \$4.27/share for Series II relate only to the impact of the different dealer compensation structures on the Series.

The Manager is entitled to an incentive participation amount ("IPA") based on the performance of the Fund's investments since inception as disclosed in the Fund's annual prospectus. During the year-ended August 31, 2008, an IPA of \$1,711 was paid relating to the PlateSpin exit. There remains a contingent liability of \$274 for IPA based on what would be payable to the Manager if the venture portfolio were disposed of at its year-end carrying value. As of August 31, 2008, the conditions to pay the contingent IPA have not been met.

Before payment of the IPA, the MER would have been 7.7% and 7.5% for Series I and II respectively. After the payment, which is included in the MER calculation, the MER for 2008 is 15.8% and 15.6% for Series I and II respectively.

CLASS A SHARES, SERIES I, II

(in \$000's except for per share amounts, number of shares and percentages)

RECENT DEVELOPMENTS

Adoption of New Accounting Standards

The Canadian Institute of Chartered Accountants ("CICA") has issued Section 3855, Financial Instruments: Recognition and Measurement, effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The adoption of this section impacts the valuation and disclosure of the net asset value ("NAV") of the Fund and requires that the fair value of financial instruments which are traded in active markets be measured based on the bid price for long securities and the ask price for securities sold short.

National Instrument 81-106 ("NI 81-106"), which governs continuous disclosure requirements for investment funds, requires the Fund's financial statements to be prepared in accordance with Canadian GAAP. While Section 3855 defines specific measurement parameters for fair valuation of financial instruments which are traded in active markets, NI 81-106 allows daily net asset values of investment funds to be calculated using the fair value of the Fund's assets and liabilities. The valuation rules and techniques used by Fund are in accordance with the Fund's prospectus but are not necessarily in accordance with Section 3855. NI 81-106 has been amended to allow the daily Net Asset Value ("NAV") of an investment fund to be calculated in a manner that is not in accordance with Canadian GAAP for other than financial statement reporting purposes. The adoption of Section 3855 therefore, results in a different valuation method for determining the Fund's net assets as described in the Fund's valuation methodologies in Note 2 of the Fund's financial statements. Consequently, the Fund has applied section 3855 for financial statement reporting purposes only. A reconciliation between the net asset value calculated in accordance with GAAP (referred to as "Net Assets" or "net assets for GAAP purposes") and the price used for subscriptions and redemptions (referred to as "Net Asset Value" or "net assets for pricing purposes") is provided in the supplementary schedules to the financial statements.

Independent Review Committee

National Instrument 81-107 Independent Review Committee for Investment Funds ("NI 81-107"), came into force on November 1, 2006. NI 81-107 requires all publicly offered investment funds, such as the Fund, to establish an independent review committee (the "IRC" or the "Independent Review Committee"). The manager must refer certain conflict of interest matters between the Fund and its manager for review or approval to the IRC. NI 81-107 also imposes obligations upon the manager to establish written policies and procedures for dealing with conflict of interest matters, to maintain records, in respect of these matters and to provide the IRC with guidance and assistance in carrying out its functions and duties. According to NI 81-107, the IRC must be comprised of a minimum of three independent members, and is subject to requirements to conduct regular assessments of its members and to provide reports, at least annually, to the Fund and to its shareholders in respect of those functions. The Fund's IRC commenced operations October 11, 2007 and the report prepared by the Fund will be available, in November 2008, on the Fund's website www.covingtonfunds.com, or at a shareholders' request at no cost, by contacting the Fund at 200 Front Street W., Suite 3003, P.O. Box 10, Toronto, Ontario M5V 3K2 or at info@covingtonfunds.com.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

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RECENT DEVELOPMENTS *(Continued)*

Deemed Dividend

On October 7, 2008, the Board of Directors approved a resolution increasing the stated capital of the Class A Shares by \$2,060, resulting in a deemed dividend on the issued and outstanding Class A Shares of the Fund. Class A shareholders will be deemed to have received a capital gains dividend equal to the holder's proportionate share of such deemed dividend even though there will not be a cash distribution from the Fund. While this deemed dividend has no impact for shareholders who own their shares within an RRSP or RRIF, Class A shareholders who hold the shares outside of registered plans must include the amount of the dividend in their capital gains for their taxation year that includes October 7, 2008, even though no cash has been received from the Fund.

RELATED PARTY TRANSACTIONS

The Manager, Fund Advisor, Sponsor and Fund Administrator are deemed to be related parties. Please refer to the section titled "Management Fees" which outlines the fees paid to these related parties.

On January 1, 2007, the Manager of the Fund, Covington Capital Corporation, amalgamated with its affiliated company and the Fund Advisor, Covington Group of Funds Inc., to be continued as Covington Capital Corporation. As such, Covington Capital Corporation is both Manager and Fund Advisor to the Fund.

FINANCIAL HIGHLIGHTS

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance since its inception in January 2004.

All references to "net assets" or "net assets per share" are determined in accordance with Canadian GAAP as presented in the audited financial statements of the Fund. All references to "net asset value" or "net asset value per share" are determined in accordance with the net asset value calculated for pricing purposes.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

(in \$000's except for per share amounts, number of shares and percentages)

THE SERIES' NET ASSETS PER SHARE

	2008		2007		2006		2005		2004 (3)	
	Series I	Series II	Series I	Series II	Series I	Series II	Series I	Series II	Series I	Series II
Net assets, beginning of year (1)	\$ 13.78	\$ 13.85	\$ 12.45	\$ 12.52	\$ 11.49	\$ 11.54	\$ 11.93	\$ 11.96	\$ 12.00	\$ 12.00
Increase (decrease) from operations										
Total revenue	0.35	0.35	0.23	0.20	0.31	0.31	0.44	0.44	0.14	0.14
Total expenses	(2.51)	(2.49)	(1.59)	(1.34)	(0.56)	(0.53)	(0.87)	(0.84)	(0.22)	(0.20)
Realized gains (losses) for the period	8.20	8.20	-	-	-	-	-	-	-	-
Unrealized gains (losses) for the period	(1.79)	(1.79)	2.73	2.31	1.12	1.12	-	-	-	-
Total increase (decrease) from operations (2)	4.25	4.27	1.38	1.17	0.86	0.89	(0.43)	(0.40)	(0.08)	(0.05)
Net assets, end of year (1)	\$ 18.03	\$ 18.12	\$ 13.78	\$ 13.85	\$ 12.45	\$ 12.52	\$ 11.49	\$ 11.54	\$ 11.93	\$ 11.96

(1) This information is derived from the Fund's audited annual financial statements. The net assets per security presented in the financial statements differs from the asset value calculated for fund pricing purposes. On September 1, 2007, the Fund adopted CICA section 3855 on a retrospective basis without restatement of prior periods. As such, the beginning balance of net assets per share for the year ended August 31, 2008 may not equal the closing balance on August 31, 2007.

(2) Net assets are based on the actual number of shares outstanding as at the stated year-end. The increase/(decrease) from operations is based on the weighted average number of shares outstanding over the fiscal period.

(3) For the period from January 12, 2004 to August 31, 2004.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

(in \$000's except for per share amounts, number of shares and percentages)

FINANCIAL HIGHLIGHTS *(Continued)*

RATIOS AND SUPPLEMENTAL DATA ⁽¹⁾

	2008		2007		2006		2005		2004	
	Series I	Series II	Series I	Series II	Series I	Series II	Series I	Series II	Series I	Series II
Net asset value	\$14,644	\$ 5,587	\$10,130	\$ 3,786	\$ 5,281	\$ 2,224	\$3,999	\$ 1,696	\$ 3,455	\$ 1,422
Number of units outstanding	812,118	308,436	735,157	273,439	424,183	177,655	347,993	146,908	289,591	118,955
Management expense ratio ⁽²⁾ *	15.81%	15.56%	12.28%	10.72%	4.78%	4.49%	7.40%	7.12%	2.94%	2.60%
Portfolio turnover ratio ⁽³⁾	19.72	19.72	-	-	-	-	-	-	-	-
Closing market price or pricing NAV	\$ 18.03	\$ 18.12	\$ 13.78	\$ 13.85	\$ 12.45	\$ 12.52	\$ 11.49	\$ 11.54	\$ 11.93	\$ 11.96

* The management expense ratio before IPA or contingent IPA was 7.71% and 7.5% for Series I and II respectively for the year-ended August 31, 2008 and 4.60% and 4.01% respectively for the year ended August 31, 2007.

(1) This information shown is as at August 31 of the years shown.

(2) Management expense ratio includes all expenses of the Fund, capital taxes, Goods and Services Tax, the Manager's contingent and non-contingent Incentive Participation Amount ("IPA"), if any, and the change in contingent IPA during the year and is expressed as a percentage of average assets administered during the year. Contingent IPA is the determination of the bonus that would be payable to the Manager if the Fund were to dispose of its venture investment portfolio at its carrying value as at the dates shown. The Manager is entitled to this bonus only upon realization of certain conditions as outlined in the Fund's Prospectus.

(3) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio advisor manages portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities once during the year. The higher a Fund's portfolio turnover rate in a period, the greater the trading costs payable by the Fund in a period, and the greater the change of investors 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. This ratio has not been provided as the Fund has not engaged in active trading of its venture portfolio.

(5) Prior to September of 2007, the Manager, Fund Advisor, Sponsor and Directors had all agreed to waive all fees chargeable to the Fund. This waiver was in effect from the Fund's inception in 2004 to August 31, 2007.

Management Fees

The Fund's MER consists of all of its operating expenses, including distribution service fees, certain ongoing marketing costs, audit and legal expenses, custody fees and contingent incentive participation amount. With the exception of the incentive participation amount, the largest components of MER are fees that are calculated as a percentage of the NAV of the Fund. These fees are the Manager, Fund Advisor, Administrator and Sponsor fees.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

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The key components of the MER are as follows:

Description - % of NAV	Year ended August 31, 2008 \$	Year ended August 31, 2007 \$
Manager and Fund Advisor - annual rate of 3.0% *	514	-
Sponsor - annual rate of 0.3%*	51	-
Distribution Service Fees - annual rate of 1.92% and 1.152% of the original issue price of Class A Shares series I and II respectively	240	121
Fund Administration, annual rate of 0.6% of NAV	103	47

* The Manager, Fund Advisor, Sponsor and Directors had all waived the fees for the 2007 fiscal year.

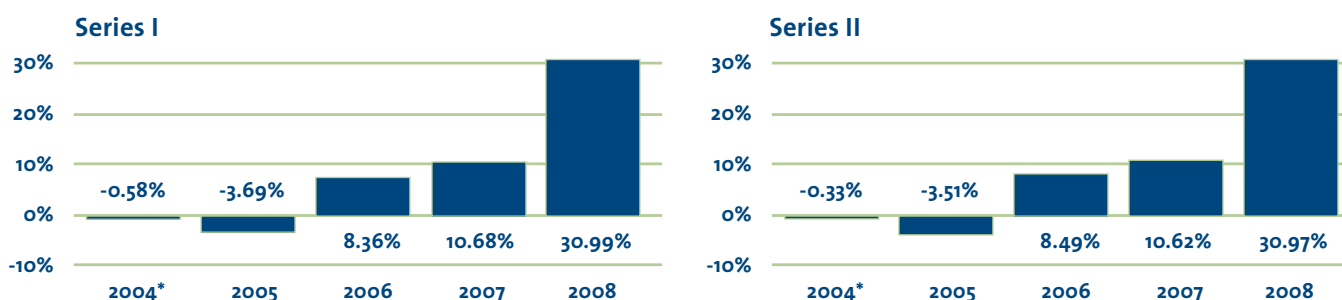
The Manager and Fund Advisor are responsible for the direction of the business, operations and affairs of the Fund as well as implementing the investment strategy and monitoring of the portfolio companies. Because the venture portfolio companies are generally small in size and in an earlier stage of development relative to conventional mutual funds, the Fund requires a greater level of management involvement in the analysis, monitoring support and development activities. The Manager and Fund Advisor uses the management fees it receives to finance its general and administrative expenses.

PAST PERFORMANCE

The performance shown does not take into account sales, redemptions, distribution or other optional charges that would have reduced returns or performance. The Fund's past performance is no guarantee of how it will perform in the future.

Year-by-year Non-cumulative returns

The graph below indicates the Fund's annual performance for each of the years shown and how the Fund's performance has changed from year to year. It also shows, in percentage terms, how much an investment made on the first day of each financial year would have increased or decreased by the last day of each financial year.



* From inception January 12, 2004 to August 31, 2004

COVINGTON STRATEGIC CAPITAL FUND INC.

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ANNUAL COMPOUND RETURNS

The table below summarizes Covington Strategic Capital Fund's past performance for the five, three and one year periods ended August 31 of the periods indicated. As a basis of comparison, we have provided the Retail Venture Capital Group average compound returns as posted on www.globefund.com and the BMO Nesbitt Cdn Small Cap Index as at August 31, 2008.

The Retail Venture Capital Group average is the most representative broad-based securities market index as it includes all the Ontario based LSIF's.

Compound Returns	Series I	Series II	Retail Venture Capital Index*	BMO Nesbitt Burns Cdn Small Cap Index
1 Year	30.99%	30.97%	-5.05%	-10.80%
3 Years	16.25%	16.27%	-1.63%	5.74%
5 Years	N/A	N/A	-0.85%	11.77%
Since Inception	9.21%	9.33%	**	**

* The inclusion of the BMO Nesbitt Burns Cdn Small Cap Index is only intended to give perspective to general market activity.

** This has not been included because there is no comparable market index quotation for the same period.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

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SUMMARY OF INVESTMENT PORTFOLIO

Below is a summary of the Covington Strategic Capital Fund portfolio as at August 31, 2008. This is a summary only and may change due to ongoing portfolio activity. An update is available on the Fund's website at www.covingtonfunds.com.

	Debt, at cost	Equity, at cost	Total
1293551 Ontario Ltd.	250	495	745
Acorn Energy Inc.*+	-	27	27
Business Propulsion Systems Inc.	2,127	485	2,612
Cyence International Inc	1,560	-	1,560
Gatehouse Capital Inc.	-	190	190
NexGen Financial LP	500	-	500
Powerband Canada Inc.	-	850	850
RuggedCom Inc.*	-	496	496
	4,627	2,353	6,980

* Indicates a publicly traded security.

+ Indicates foreign property.

The venture portfolio of the Fund is invested solely in technology companies. The table below shows the portfolio distribution according to stage of development.

Stage of Development	Number of companies	Cost of investments \$	% Total venture investments at cost %	Fair value of investments \$	% Total venture investments at fair value %
Start up/Early*	4	4,153	59	4,107	56
Expansion	4	2,827	41	3,271	44
Later	-	-	-	-	-
	8	6,980	100.0	7,378	100.0

* On August 24, 2007, the Fund acquired the assets of Financial Industry Opportunities Fund Inc. As part of this, the Fund acquired two positions in financial services businesses both of which are in their early stage of development.

COVINGTON STRATEGIC CAPITAL FUND INC.

CLASS A SHARES, SERIES I, II

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SUMMARY OF INVESTMENT PORTFOLIO (Continued)

Composition of net assets	Fair Value of Investments \$	% of Net Asset Value %
Cash, marketable securities and other	12,853	64.5
Venture investments, at fair value	7,378	36.5
Net assets, at fair value	20,231	100.0

NOTES

NOTES

COVINGTON STRATEGIC CAPITAL FUND INC.

CORPORATE INFORMATION

Fund Symbols

Series I - CIG916
Series II - CIG917

Fund Manager and Fund Advisor

Covington Capital Corporation
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Toronto, ON M5V 3K2

Fund Administrator

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