



CONNOR, CLARK & LUNN

CAPITAL MARKETS

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**Connor, Clark & Lunn  
Conservative Income Fund II**

Annual Report  
March 31, 2008

## Connor, Clark & Lunn Conservative Income Fund II Message to Unitholders

June 13, 2008

Dear Investor,

These annual financial statements are in respect of the twelve-month period ended March 31, 2007. We welcome the opportunity to provide you with an update.

The Fund's net asset value was \$10.17 on March 31, 2007 and had decreased to \$9.35 as at March 31, 2008. In total, the Fund declared distributions of \$0.65 for the year ended March 31, 2008 and totalling \$1.5949 per unit from inception to the end of March 31, 2008 for an annualized yield on the \$10.00 original issue price of 6.5 %. All distributions paid to date have been characterized as return of capital for tax purposes.

Connor, Clark & Lunn Investment Management Ltd. (the "Investment Manager") continues to focus on securities that can deliver stable distributions over an entire cycle – REITs, defensive Business and Utility Trusts and bonds – and deliver a solid yield while preserving capital for investors.

The US appears to be in the throes of a recession as US consumer purchasing power is being whittled away by lower asset prices and higher food and energy costs. However, the Investment Manager believes that the recession should be relatively mild because of the stimulus being provided by the US Federal Reserve (the "Fed"), tax rebates that are about reach US consumers and the ongoing strength in US exports. Canada, thanks to a stronger fiscal position, an ongoing boom in commodities and relatively upbeat consumers should avoid a recession in 2008.

Equity and income trust markets have been volatile for the past few months, but have stabilized from March as Fed intervention begins to take hold and markets began to reflect a fairly dire future. Continued de-leveraging by many investors may limit future upside, but the worst appears to be over.

Credit spreads are also starting to stabilize and corporate bonds are slowly moving higher, but it is still early days here as well. While credit markets, like equity markets, will be subject to some further selling as investors de-leverage and shore up their balance sheets, other buyers including insiders and sovereign wealth funds are stepping up as current valuations look appealing.

The investment manager expects that the economy will remain weak for another quarter or two, but equity markets typically begin to rebound three to six months ahead of the turn in real GDP, so we are establishing positions today with this in mind. Against this backdrop, volatility will remain elevated providing opportunities to build positions in high quality businesses.

Yours truly,



W. Neil Murdoch  
Chief Executive Officer  
Connor, Clark & Lunn Capital Markets

# Management Report of Fund Performance

This annual management report of fund performance for Connor, Clark & Lunn Conservative Income Fund II (the “Fund”) contains financial highlights but does not contain the complete annual financial statements of the Fund. **The annual financial statements and accompanying notes are attached to this report.**

## Investment Objectives and Strategy

The Fund is a closed-end investment Fund that is listed on the Toronto Stock Exchange under the symbol CCK.UN.

The Fund’s investment objectives are to:

- (i) provide holders of the Units (“Unitholders”) with a stable stream of tax-efficient monthly cash distributions targeted to be \$0.0542 per Unit (representing a yield of approximately 6.5% per annum on the issue price of \$10.00 per Unit); and
- (ii) preserve the net asset value per Unit in order to return at least the original issue price of Units (\$10.00 per Unit) to Unitholders on or about October 19, 2015 and provide to Unitholders an opportunity for capital appreciation above the original issue price.

In order to achieve the Fund’s investment objectives, the Fund obtained exposure to the performance of the Portfolio (the “Portfolio”) held by Conservative Income Fund II (the “CIF II”) by virtue of a forward purchase and sale agreement (the “Forward Agreement”) with Bank of Montreal (the “Counterparty”). The Fund does not invest directly in CIF II. The Fund invested the net proceeds of the Offering in a portfolio of common shares of Canadian public companies (the “Common Share Portfolio”). Under the Forward Agreement, the Fund is entitled to sell securities in the Common Share Portfolio from time to time to fund monthly distributions, redemptions and repurchases of Units and its operating expenses. As a result, Unitholders’ returns correlate with the net returns realized by CIF II on its investment in the Portfolio.

Connor, Clark & Lunn Investment Management Ltd. (the “Investment Manager”), the CIF II’s investment manager, actively manages the Portfolio. The Portfolio consists of income producing securities including Canadian business income trusts, real estate investment trusts, utility income trusts, corporate bonds and convertible bonds. In addition, from time to time, the Portfolio may include significant cash and cash equivalents. As part of its strategy, the Investment Manager employs leverage in the Portfolio to enhance returns when market conditions are considered appropriate.

## Risk

Changes in the risk exposure of the Fund occurred in the following areas:

### ▪ Use of leverage

CIF II is entitled to employ leverage of up to 15% of its total assets. CIF II did not employ any leverage during the year ended March 31, 2008.

### ▪ Use of Derivatives

CIF II has used derivatives for the purpose of hedging interest rate exposure. Such hedging has involved the use of short U.S. and Canadian 10-year Bond Futures and has been limited to less than 10% of the portfolio.

For full disclosure of risks associated with an investment in the Fund’s units, please refer to the Prospectus dated September 29, 2005 and to the Fund’s most recent Annual Information Form.

## Results of Operations

### *Portfolio Manager Commentary*

The US appears to be in the midst of a significant slowdown as US consumer purchasing power is being whittled away by lower asset prices and higher food and energy costs. However, the Investment Manager believes that the recession should be relatively mild because of the stimulus being provided by the US Federal Reserve (the “Fed”), tax rebates that are about to reach US consumers and the ongoing strength in US exports. Canada, thanks to a stronger fiscal position, an ongoing boom in commodities and relatively upbeat consumers should avoid a recession in 2008.

Equity and income trust markets have been volatile for the past few months, but have stabilized from March as Fed intervention begins to take hold and markets began to reflect a fairly dire future. Continued de-leveraging by many investors may limit future upside, but the worst appears to be over.

Credit spreads are also starting to stabilize and corporate bonds are slowly moving higher, but it is still early days here as well. While credit markets, like equity markets, will be subject to some further selling as investors de-leverage and shore up their balance sheets, other buyers including insiders and sovereign wealth funds are stepping up as current valuations look appealing.

The investment manager expects that the economy will remain weak for another quarter or two, but equity markets typically begin to rebound three to six months ahead of the turn in real GDP, so we are establishing positions today with this in mind. Against this backdrop, volatility will remain elevated providing opportunities to build positions in high quality businesses.

### *Asset Mix*

We continue to believe that the aggressive actions taken by the Fed will lead to a re-inflation cycle that will be more favourable to equity markets than bonds. As such we have moderately increased exposure to business trusts at the expense of bonds and REITs with overall current positioning 24% REITs, 37% Business/Utility trusts, 29% Bonds, and 2% Cash.

### *REITs*

The REIT weighting in the portfolio was as high as 40% in March 2007 and benefited from a strong run in REITs early in the year on lower rates. Since then we have reduced the weight to 24%, some of which occurred naturally following the takeover of Legacy Hotels and partial takeover of Dundee REIT. We are comfortable running below what we would see as long-term run-rate on REITs of around 33% weight due to concern about the impact the current credit crunch will have on valuations in the real estate market. However, in the medium term we continue to believe that the REIT market is attractive and will benefit from solid fundamentals, conservative leverage and that the likelihood that it will become the sole tax exempt asset class beyond 2011.

### *Business/Utility Trusts*

In the Business & Utility trusts segment, the weighting has been increased to 37% from the 30% range most of the year after valuations corrected following a big M&A-driven run in the first half. In fact, since the October 31, 2006 Tax Fairness Plan, approximately 39 Income Trusts and 6 REITs have been taken over. Takeovers in 2007 included several held by the CIF II: CCS, Movie Distribution, CanWest MediaWorks, Liquor Barn, Gateway Casinos, Dundee REIT and Legacy REIT.

### *Bonds*

The bond weighting has remained relatively consistent through the year in the 30% range. As a general comment, bond spreads are finally beginning to provide some opportunity to be rewarded for the credit risks inherent in specific issuers or in high yield credits after years of narrow spreads and limited differentiation. We are overweight financial credits as valuations are extremely compelling and are pricing in a worst-case outcome.

### ***Net Asset Value***

The net asset value per unit is calculated as the value of the common share portfolio and any other investments held by the Fund, plus the value of any gain or loss on the Forward Agreement, less any net liabilities of the Fund, divided by the number of units outstanding.

On March 31, 2008, the value of the common share portfolio was \$21.02 million. Since the Fund can deliver the value of the common share portfolio to the Counterparty in exchange for the value of the CIF II, the value of the Forward Agreement to the Fund is equal to the value of the CIF II less the value of the common share portfolio. On March 31, 2007 value of the Forward Agreement was \$10.29 million. Other net assets in the Fund totalled \$(0.27) million leaving a net asset value of \$31.04 million or \$9.32 per Unit.

### ***Investment Income and Capital Gains***

The Fund had a net investment gain of \$(0.87) million during the year ended March 31, 2008, and realized \$5.24 million in gains on investments sold during the same period. In addition, the portfolio had \$(4.75) million change in unrealized gains and losses on investments as of March 31, 2008. Losses, realized gains and unrealized losses combined for a total decrease in net assets from operations of \$(0.38) million, or \$(0.09) per Unit. Distributions to unitholders totalled \$2.89 million, or \$0.65 per Unit.

### ***Liquidity and Capital Resources***

As at March 31, 2008, both the Fund and the CIF II held cash and short-term investments of \$547,125 on a consolidated basis. The Fund had \$45,596 in Current Assets excluding investments, and had Current Liabilities, including distributions accrued but not yet paid, totalled \$319,663.

### ***Market repurchases***

As set out in the Prospectus, the Fund is obligated, under certain conditions, to purchase Units in the market for cancellation. If, on any day, the weighted average price of the Units is less than 95% of the net asset value per unit determined on the most recent valuation date, the Fund must purchase any units offered in the market the following day at 95% of net asset value per unit or less. The maximum number of Units purchased in any three-month period will be 1.25% of the number of Units outstanding at the beginning of that period.

During the year ended March 31, 2008, the Fund purchased 56,100 units for cancellation at a cost of \$ 535,269 (138,500 units at a cost of \$1,293,542 during the year ended March 31, 2007).

### ***Distributions***

The Fund has made all its scheduled distributions to date, including an initial distribution of \$0.0773 per Unit in respect of the period from October 18, 2005 (commencement of operations) to November 30, 2005 and monthly distributions of \$0.0542 per Unit from December 2005 thereafter.

Distributions paid during the year ended March 31, 2008 were \$2,889,099 or \$0.65 per Unit (\$3,916,397 or \$0.65 per unit during the year ended March 31, 2007).

### ***Redemptions***

1,635,090 units were surrendered for redemption during the year ended March 31, 2008 for total redemption cost of \$16,077,213 (1,372,086 units for total redemption cost of \$13,296,499 during the year ended March 31, 2007).

## **Recommendations or Reports by the Independent Committee**

The Independent Committee of the Board of Advisors tabled no special reports and made no extraordinary material recommendations to management of the Fund during the year ended March 31, 2008.

## **Related Party Transactions**

### ***Management Fees***

Pursuant to a management agreement (the "Management Agreement") the Fund has retained Connor, Clark & Lunn Capital Markets Inc. (the "Manager") to act as manager.

As compensation for management services rendered to the Fund, the Manager is entitled to receive an annual management fee in an amount equal to 0.75% per annum of the NAV of the Fund, to be calculated daily and payable monthly in arrears, plus applicable taxes.

As compensation for management services rendered to CIF II, the Manager will receive an annual management fee in an amount equal 0.35% of the CIF II's NAV, to be calculated daily and payable monthly in arrears, plus applicable taxes.

The management fees charged to the Fund and CIF II on consolidation basis during the year ended March 31, 2008 were \$522,475 (\$720,774 during the year ended March 31, 2007). The Manager is responsible for payment of the investment management fees of the Investment Manager out of the above management fees.

## Financial Highlights

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

The Fund's Net Asset Value per unit:

	March 31, 2008	March 31, 2007	March 31, 2006 <sup>(1)</sup>
<b>Net Asset Value, beginning of period</b>	10.17	10.43	10.00
<b>Increase (decrease) from operations:</b>			
Total revenues	—	—	—
Total expenses	(0.20)	(0.20)	(0.09)
Unit issue expense <sup>(2)</sup>	—	(0.02)	(0.59)
Realized gains (losses) for the period	1.17	0.51	0.03
Unrealized gains (losses) for the period	(1.06)	(0.06)	1.36
<b>Total increase (decrease) from operations<sup>(3)</sup></b>	<b>(0.09)</b>	<b>0.23</b>	<b>0.71</b>
<b>Distributions:</b>			
From income (excluding dividends)	—	—	—
From dividends	—	—	—
From capital gains	—	—	—
Return of capital	(0.65)	(0.65)	(0.29)
<b>Total Annual Distributions<sup>(4)</sup></b>	<b>(0.65)</b>	<b>(0.65)</b>	<b>(0.29)</b>
<b>Net Asset Value, end of period<sup>(5)</sup></b>	<b>9.32</b>	<b>10.17</b>	<b>10.43</b>

(1) Results for the period October 18, 2005 (commencement of operations) to March 31, 2006.

(2) Issue expense of \$4,016,331 incurred in connection with the unit issuance, which has been treated as a reduction of capital.

(3) 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.

(4) Distributions were paid in cash.

(5) This is not reconciliation between the opening and the closing net asset values per unit.

Ratios and Supplemental Data:

Fund	March 31, 2008	March 31, 2007	March 31, 2006 <sup>(1)</sup>
Net assets (000's)	31,147	51,090	68,120
Number of units outstanding	3,331,824	5,023,014	6,533,600
Base Management expense ratio <sup>(2)(3)</sup>	1.96%	1.94%	1.97%
Issue expenses ratio <sup>(2)(3)</sup>	0.00%	0.18%	6.00%
Management expense ratio <sup>(3)</sup>	1.96%	2.12%	7.97%
Management expense ratio before waivers or absorptions <sup>(3)</sup>	1.96%	2.12%	7.97%
Portfolio turnover rate <sup>(4)</sup>	18.96%	8.03%	13.24%
Trading expense ratio <sup>(5)</sup>	0.00%	0.00%	0.00%
Closing market price (TSX)	8.81	9.70	9.88

### Consolidated for the Fund and CIF II

Base Management expense ratio <sup>(2)(3)</sup>	2.47%	2.42%	2.45%
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(1) Results for the period October 18, 2005 (commencement of operations) to March 31, 2006.

(2) A separate base management expense ratio has been presented to include the normal operating expenses and exclude the Issue expense ratio, which is based on total agents fees and unit issue expenses of \$4,016,331.

(3) Management expense ratio is based on total expenses (including issue expenses) for the stated period and is expressed as an annualized percentage of daily average net assets during the period. Unit issue expenses, representing all Agents' fees and other offering expenses which are one-time expenses are not annualized.

(4) The Fund's 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's buying and selling all of the securities in its portfolio once in the course of the year. There is not necessarily a relationship between turnover rate and the performance of the Fund.

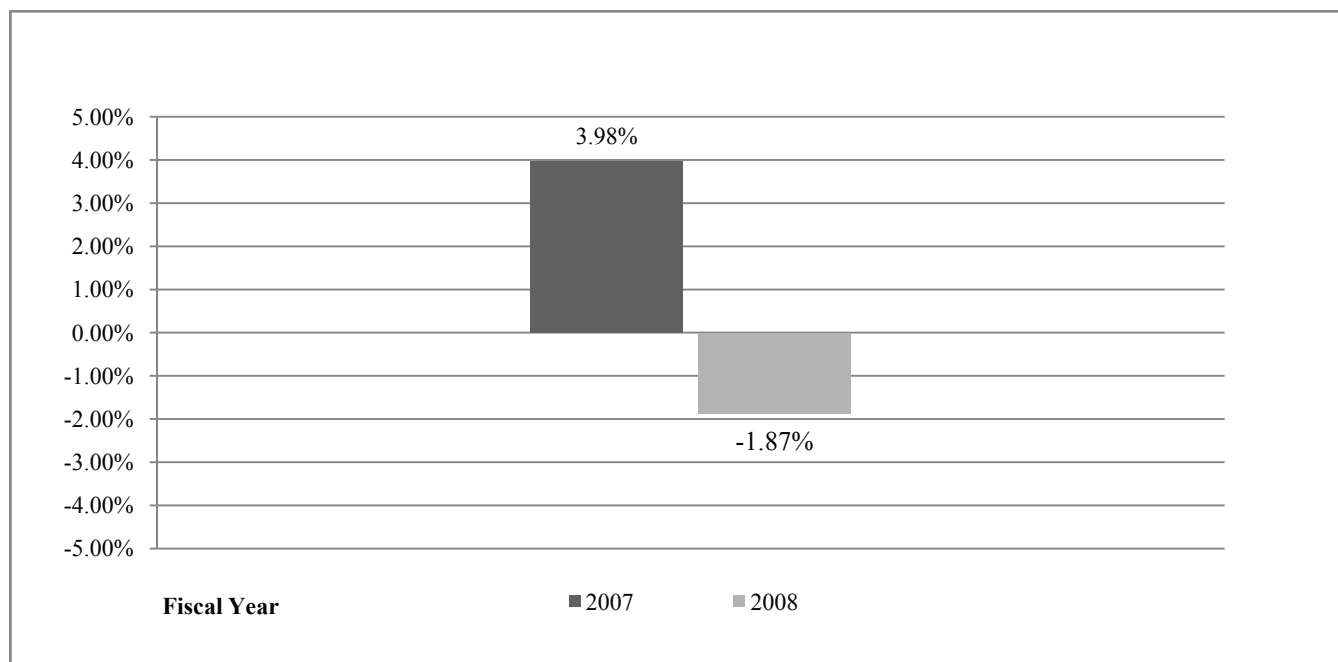
(5) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the period.

## Past Performance

The following bar chart and table indicate the performance of the Fund's units by showing both annual returns by fiscal year and annualized compound returns from inception assuming all the distributions made by the Fund in the year shown were reinvested. Past performance is not necessarily indicative of future performance.

### Year – by –Year Returns

The following bar chart shows the Fund's annual performance for the year shown. This bar chart show, in percentage terms, how much an investment made on the first day of the financial year would have grown or decreased by the last day of the financial year.



### Annual Compound Returns

	Past Year	Annualized Since Inception <sup>(1)</sup>
Based on NAV <sup>(2)</sup>	-1.87%	6.34%
Based on share price <sup>(3)</sup>	-2.63%	1.65%
Benchmark Index <sup>(4)</sup>	1.13%	6.79%

<sup>(1)</sup> Annualized for the period October 18, 2005 (Commencement of operations) to March 31, 2007.

<sup>(2)</sup> Calculated from initial net asset value of \$9.41 and March 31, 2006 net asset value of \$10.43 assuming all distributions reinvested.

<sup>(3)</sup> Calculated from issue price of \$10.00 and March 31, 2006 market price of \$9.88 assuming all distributions reinvested.

<sup>(4)</sup> Benchmark is 80 % Scotia Income Trust Ex-Royalty Trusts, 25% SC Corporate Bond Index, -5% SC 91 Day T-Bills plus 65 bps

## Summary of Investment Portfolio as of March 31, 2008

The summary of investment portfolio may change due to ongoing portfolio transactions of the Fund. A quarterly update is available at [www.cclcapitalmarkets.com](http://www.cclcapitalmarkets.com) and at [www.sedar.com](http://www.sedar.com).

	Market value \$	% of NAV
<b>Portfolio by Category</b>		
Equity Derivatives	10,290,849	33.2%
Information Technology	7,561,584	24.3%
Consumer Discretionary	3,578,362	11.5%
Materials	2,969,167	9.6%
Energy	2,931,306	9.4%
Industrials	1,733,102	5.6%
Consumer Staples	1,759,304	5.7%
Health Care	493,115	1.6%
Cash & Cash Equivalents	36,591	0.1%
<b>Top 25 Holdings</b>		
Equity Derivatives	10,290,849	33.2%
Gildan Activewear Class A	3,578,362	11.5%
CGI Group Class A	3,029,621	9.7%
Sino-Forest Corporation - Class A	2,969,167	9.6%
OPTI Canada Inc.	2,931,306	9.4%
Research In Motion	1,985,283	6.4%
Celestica Inc.	1,949,551	6.3%
Bombardier Inc. Class B	1,733,102	5.6%
Viterra Inc.	1,083,958	3.5%
Cott Corp.	675,346	2.2%
Nortel Networks Corp.	597,129	1.9%
Angiotech Pharmaceuticals Inc.	493,115	1.6%
Cash & Cash Equivalents	36,591	0.1%
<b>Net asset value (NAV)</b>	<b>31,042,722</b>	

## Summary of Investment portfolio of the CIF II

	Market value \$	% of NAV
<b>Portfolio by Category</b>		
Corporate Bonds	9,014,784	28.7%
Financials	8,986,821	28.8%
Consumer Discretionary	3,689,456	11.8%
Industrials	2,303,839	7.3%
Energy	2,203,266	7.0%
Health Care	1,642,285	5.3%
Materials	870,046	2.8%
Telecommunication Services	784,428	2.5%
Cash & Cash Equivalents	510,534	1.6%
Consumer Staples	442,624	1.4%
Information Technology	334,080	1.1%
Utilities	298,964	1.0%
Derivatives	(97,365)	-0.4%
<b>Top 25 Holdings</b>		
Calloway Real Estate Investment Trust	1,467,477	4.8%
Aeroplan Units	1,394,120	4.5%
CI Financial Income Fund	1,394,068	4.5%
Canadian Apartment Properties Real Estate Investment Trust	1,392,861	4.4%
Jazz Air Income Fund	1,381,539	4.4%
Dundee Real Estate Investment Trust	1,351,666	4.4%
Yellow Pages Income Fund	1,319,616	4.2%
Boardwalk Real Estate Investment Trust	1,319,220	4.2%
CML Healthcare Income Fund	1,214,820	3.9%
Keyera Facilities Inc	1,104,065	3.5%
Canadian Real Estate Investment Trust	946,746	3.0%
Armtec Infrastructure Income Fund	922,300	2.9%
Residential Funding of Canada	784,680	2.5%
Bell Aliant Regional Communications Income Fund	784,428	2.5%
General Motors Acceptance Corp	726,099	2.3%
Reliance LP	721,000	2.3%
General Motors Acceptance Corp.	688,212	2.2%
New Flyer Limited Income Deposit Securities	684,780	2.2%
Morgan Stanley	665,543	2.1%
Countrywide Financial Corp. (USD)	631,881	2.0%
Western Oil Sands (USD)	567,132	1.8%
Enbridge Income Fund	560,805	1.8%
Domtar Inc (USD)	559,326	1.8%
Fording Canadian Coal Trust	540,451	1.7%
Spectra Energy Income Fund	538,396	1.7%
<b>Net asset value (NAV)</b>	<b>31,316,789</b>	

## Management's Responsibility for Financial Reporting

The accompanying financial statements of **Connor, Clark & Lunn Conservative Income Fund II** (the "Fund") and all the information have been prepared by Connor, Clark & Lunn Capital Markets Inc. in its capacity as Manager of the Fund and have been approved by the Board of Directors of the Manager. The Fund's Manager is responsible for all the information and representations contained in these financial statements and other sections of the Annual Report.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based on estimates and judgements. The Manager has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has ensured that the other financial information presented in this annual report is consistent with the financial statements.

The financial statements have been audited by PricewaterhouseCoopers LLP on behalf of the unitholders. They have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the financial statements.



W. Neil Murdoch  
President and Chief Executive Officer  
Connor, Clark & Lunn Capital Markets Inc.



Philip Gow  
Chief Financial Officer  
Connor, Clark & Lunn Capital Markets Inc.

Toronto, Canada

**June 13, 2008**

June 13, 2008

## Auditors' Report

### To the Unitholders of Connor, Clark & Lunn Conservative Income Fund II

We have audited the statement of investment portfolio of **Connor, Clark & Lunn Conservative Income Fund II** (the Fund) as at March 31, 2008, the statements of net assets as at March 31, 2008 and 2007 and the statements of operations, changes in net assets, surplus and contributed surplus and cash flow for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 management, 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 March 31, 2008 and 2007 and the results of its operations, the changes in its net assets, its surplus and contributed surplus and its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

**Chartered Accountants, Licensed Public Accountants**

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

# Connor, Clark & Lunn Conservative Income Fund II

Statements of Net Assets

As at March 31, 2008 and 2007

	2008	2007
	\$	\$
<b>Assets</b>		
Cash	36,591	11,339
Investments pledged to counterparty under forward agreement (cost - \$27,017,157; March 31, 2007 - \$42,933,060)	21,025,940	48,340,649
Unrealized gain on forward agreement (note 8)	10,290,849	3,232,192
Prepaid expenses	9,005	9,897
	<u>31,362,385</u>	<u>51,594,077</u>
<b>Liabilities</b>		
Bank overdraft (note 4)	-	69,300
Accrued interest	-	635
Distributions payable	180,585	272,247
Accounts payable and accrued liabilities	118,503	127,051
Management fees payable	20,575	34,450
	<u>319,663</u>	<u>503,683</u>
<b>Net Assets and Unitholders' Equity</b>	<u>31,042,722</u>	<u>51,090,394</u>
<b>Units outstanding</b> (note 6)	<u>3,331,824</u>	<u>5,023,014</u>
<b>Net asset value per unit</b>	<u>9.32</u>	<u>10.17</u>
<b>Unitholders' Equity</b>		
Unit Capital (note 6)	23,877,693	40,353,263
Contributed surplus (note 7)	-	556,176
Surplus	7,165,029	10,180,955
<b>Unitholders' equity - End of period</b>	<u>31,042,722</u>	<u>51,090,394</u>

Approved on behalf of the Manager,  
Connor, Clark & Lunn Capital Markets Inc.



Director



Director

# Connor, Clark & Lunn Conservative Income Fund II

## Statements of Operations

For year ended March 31, 2008 and 2007

	2008	2007
	\$	\$
<b>Income</b>		
Interest income	2,069	1,167
<b>Expenses</b>		
Management fees (note 10)	355,496	490,452
Forward fees (note 8)	225,933	309,776
Service fees (note 11)	163,380	229,574
Custodial and other unitholder fees	26,846	31,046
Audit Fees	26,388	28,418
Administration fees	22,457	25,217
Filing fees	8,242	16,938
Legal fees	6,951	16,931
Transfer agent fees	13,047	13,413
Sustaining fees	11,316	10,816
Advisory fees	10,487	10,713
Printing and mailing fees	2,951	5,539
Other	522	3,734
Interest expense (note 4)	1,109	2,967
	<u>875,125</u>	<u>1,195,534</u>
<b>Investment income (loss)</b>	(873,056)	(1,194,367)
<b>Unrealized gain (loss) on investments</b>		
Change in unrealized gain (loss) on investments	(11,903,686)	(2,981,873)
Change in unrealized gain (loss) on forward agreement (note 8)	7,158,282	2,640,890
	(4,745,404)	(340,983)
<b>Realized gain (loss) on investments</b>		
Net realized gain (loss) on investments	5,239,335	3,123,969
<b>Net gain (loss) on investments</b>	493,931	2,782,986
<b>Increase (decrease) in net assets from operations</b>	(379,125)	1,588,619
<b>Increase (decrease) in net assets from operations per unit *</b>	(0.09)	0.25
<b>Distributions per unit</b>	0.65	0.65

\* (based on average number of units outstanding during the period)

## Connor, Clark & Lunn Conservative Income Fund II

Statements of Changes in Net Assets, Surplus and Contributed Surplus

For year ended March 31, 2008 and 2007

	2008	2007
	\$	\$
<b>Increase (decrease) in net assets from operations</b>	<u>(379,125)</u>	<u>1,588,619</u>
<b>Distributions to unitholders from:</b> (note 9)		
Return on capital	<u>(2,889,099)</u>	<u>(3,916,397)</u>
<b>Unitholders' transactions</b>		
Agents' fees and issue expenses	-	(111,351)
Payments on redemption (note 6)	(16,077,213)	(13,296,499)
Payments on cancellation of units (note 7)	<u>(535,269)</u>	<u>(1,293,542)</u>
	<u>(16,612,482)</u>	<u>(14,701,392)</u>
<b>Change in net assets during the year</b>	<u>(19,880,706)</u>	<u>(17,029,170)</u>
<b>Net assets - Beginning of period (Transactional NAV)</b> (note 3)	51,090,394	68,119,564
Section 3855 adjustment (note 3)	<u>(166,966)</u>	<u>-</u>
<b>Net assets - Beginning of period (GAAP NAV)</b> (note 3)	50,923,428	68,119,564
<b>Net assets - End of period</b>	<u>31,042,722</u>	<u>51,090,394</u>
<b>Surplus, beginning of period</b>	10,180,955	8,592,336
Section 3855 adjustment (note 3)	(166,966)	-
Increase (decrease) in net assets from operations	(379,125)	1,588,619
Cost of shares repurchased in excess of original issue price	<u>(2,469,835)</u>	<u>-</u>
<b>Surplus, end of period</b>	<u>7,165,029</u>	<u>10,180,955</u>
<b>Contributed surplus (deficit), beginning of period</b>	556,176	40,357
Cost of shares repurchased at less than (in excess of) original issue price	<u>(556,176)</u>	<u>515,819</u>
<b>Contributed surplus (deficit), end of period</b>	<u>-</u>	<u>556,176</u>

# Connor, Clark & Lunn Conservative Income Fund II

## Statements of Cash Flow

For year ended March 31, 2008 and 2007

	2008	2007
	\$	\$
<b>Operating Activities</b>		
Increase (decrease) in net assets from operations	(379,125)	1,588,619
Items not affecting cash:		
Change in unrealized (gain) loss on investments	11,903,686	2,981,873
Change in unrealized (gain) loss on forward agreement (note 8)	(7,158,282)	(2,640,890)
Net realized (gain) loss on investments	(5,239,335)	(3,123,969)
Changes in non-cash working capital:		
(Increase) decrease in interest and dividends receivable	-	271
(Increase) decrease in prepaid expenses	892	(1,061)
Increase (decrease) in accounts payable and accrued liabilities	(8,548)	(209,218)
Increase (decrease) in management fees payable	(13,875)	(11,895)
<b>Net cash flow provided by (used in) operating activities</b>	<u>(894,587)</u>	<u>(1,416,270)</u>
<b>Investing Activities</b>		
Purchase of investment portfolio	(8,672,072)	(4,628,585)
Proceeds on disposition of investment portfolio	<u>29,255,089</u>	<u>24,928,321</u>
<b>Net cash provided by (used in) investing activities</b>	<u>20,583,017</u>	<u>20,299,736</u>
<b>Financing Activities</b>		
Payments on redemption (note 6)	(16,077,213)	(13,296,499)
Payments on cancellation of units (note 7)	(535,269)	(1,293,542)
Distributions to unitholders	(2,980,761)	(3,998,542)
Unit issue costs	-	(111,351)
Proceeds from bank overdraft	417,300	1,071,780
Principal payments on bank overdraft	(486,600)	(1,243,447)
Accrued interest on bank overdraft	<u>(635)</u>	<u>(507)</u>
<b>Net cash flow provided by (used in) financing activities</b>	<u>(19,663,178)</u>	<u>(18,872,108)</u>
<b>Net increase in cash</b>	25,252	11,358
<b>Cash (overdraft) - beginning of period</b>	<u>11,339</u>	<u>(19)</u>
<b>Cash (overdraft) - end of period</b>	<u>36,591</u>	<u>11,339</u>
<b>Supplementary Information</b>		
Interest paid	1,744	3,474

# Connor, Clark & Lunn Conservative Income Fund II

Statement of Investment Portfolio

As at March 31, 2008

	Number of shares / par value \$	Average cost \$	Market value \$	% of NAV
<b>Investments</b>				
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>				
<b>Energy</b>				
OPTI Canada Inc.	169,734	<u>2,958,464</u>	<u>2,931,306</u>	<u>9.4%</u>
<b>Materials</b>				
Sino-Forest Corporation - Class A	185,689	<u>3,593,082</u>	<u>2,969,167</u>	<u>9.6%</u>
<b>Industrials</b>				
Bombardier Inc. Class B	317,418	<u>829,402</u>	<u>1,733,102</u>	<u>5.6%</u>
<b>Consumer Discretionary</b>				
Gildan Activewear Class A	93,138	<u>1,991,377</u>	<u>3,578,362</u>	<u>11.5%</u>
<b>Consumer Staples</b>				
Cott Corp.	187,596	3,680,414	675,346	2.2%
Viterra Inc.	74,859	<u>883,336</u>	<u>1,083,958</u>	<u>3.5%</u>
		<u>4,563,750</u>	<u>1,759,304</u>	<u>5.7%</u>
<b>Health Care</b>				
Angiotech Pharmaceuticals Inc.	235,940	<u>3,830,497</u>	<u>493,115</u>	<u>1.6%</u>
<b>Information Technology</b>				
CGI Group Class A	280,261	2,208,456	3,029,621	9.7%
Celestica Inc.	284,606	3,583,964	1,949,551	6.3%
Nortel Networks Corp.	86,666	3,592,067	597,129	1.9%
Research In Motion	17,202	<u>438,310</u>	<u>1,985,283</u>	<u>6.4%</u>
		<u>9,822,797</u>	<u>7,561,584</u>	<u>24.3%</u>
<b>Total investments</b>		<u>27,589,369</u>	<u>21,025,940</u>	<u>67.7%</u>
<b>Unrealized gain on forward agreement</b>			<u>10,290,849</u>	<u>33.2%</u>
<b>Other liabilities net of other assets</b>			<u>(274,067)</u>	<u>-0.9%</u>
<b>Net asset value (NAV)</b>			<u>31,042,722</u>	<u>100.0%</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2008

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### 1 Corporate activities

Connor, Clark & Lunn Conservative Income Fund II (the "Fund") was established under the laws of Ontario as of September 29, 2005 by a Trust Agreement (the "Trust Agreement") made by Connor, Clark & Lunn Capital Markets Inc. (the "Manager") and RBC Dexia Investor Services Trust ("RBC Dexia") as trustee of Fund. The Fund is a mutual fund whose investment portfolio (the "Common Share Portfolio") consists of common shares of Canadian public companies that are Canadian securities for the purpose of the Income Tax Act (Canada) (the "Tax Act"). The Fund commenced operations on October 18, 2005 and will be terminated on or about October 19, 2015 (the "Termination Date") if not terminated earlier in accordance with its terms.

### 2 Investment objectives

The Fund's investment objectives as set out in the Prospectus dated September 29, 2005 are to:

- (i) provide holders of the Units ("Unitholders") with a stable stream of tax-efficient monthly cash distributions targeted to be \$0.0542 per Unit (representing a yield of approximately 6.5% per annum on the issue price of \$10.00 per Unit); and
- (ii) preserve the net asset value per Unit in order to return at least the original issue price of Units (\$10.00 per Unit) to Unitholders on or about October 19, 2015 (the "Termination Date") and provide to Unitholders an opportunity for capital appreciation above the original issue price.

In order to achieve the Fund's investment objectives, the Fund obtained exposure to the performance of the Portfolio held by Conservative Income Fund II ("CIF II") by virtue of a forward purchase and sale agreements (the "Forward Agreement") with Bank of Montreal (the "Counterparty"). The Fund does not invest in CIF II. The Fund invested the net proceeds of the Offering in a portfolio of common shares of Canadian public companies (the "Common Share Portfolio"). Under the Forward Agreement, the Fund is entitled to sell securities in the Common Share Portfolio from time to time to fund monthly distributions, redemptions and repurchases of Units and its operating expenses. As a result, Unitholders' returns correlate with the net returns realized by CIF II on its investment in the Portfolio.

### 3 Summary of significant accounting policies

#### Basis of presentation

These financial statements, prepared in accordance with Canadian generally accepted accounting principles, include estimates and assumptions by management that affect the reported amounts of assets, liabilities, income and expenses during the reporting period. Actual results could differ from these estimates. The following is a summary of the significant accounting policies of the Fund.

#### Recent accounting pronouncements

On April 1, 2007, the Fund adopted Section 1506 of the CICA Handbook, Accounting Changes, which prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. This standard did not affect the Fund's financial position or results of operations.

The new Section 1535, Capital Disclosures, requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically April 1, 2008 for the Fund. This standard will impact the Fund's disclosures provided but will not affect the Fund's results or financial position.

The new CICA Sections 3862, Financial Instruments – Disclosures ("Section 3862"), and 3863, Financial Instruments – Presentation (Section 3863"), replaced Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The new standards apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically April 1, 2008 for the Fund. This standard will impact the Fund's disclosures provided but will not affect the Fund's results or financial position.

#### Valuation of investments

Investments are deemed to be categorized as "held for trading" in accordance with CICA 3855, Financial Instruments – Recognition and Measurement ("Section 3855") and therefore are recorded at fair value, established by the closing bid price for a security on the recognized exchange on which it is principally traded. Should the quoted value for a security, in the opinion of the Managers, be inaccurate, unreliable or not readily available, the fair value of the security is estimated based on valuation techniques. Fair value is determined by the Managers on the basis of the most recently reported information for the security, similar securities and the markets in which the security is active. Investment purchase and sale transactions are recorded as of the trade date and realized and unrealized gains and losses on investments are determined using average cost. Brokers' commissions and other transaction charges are immediately charged to net income in the period incurred.

On April 1, 2007, the Fund adopted Section 3855 on a prospective basis for financial reporting purposes ("GAAP NAV"). Section 3855 requires that the fair value of financial instruments which are actively traded be measured based on the bid price for the security. Until September 30, 2006, fair value for GAAP was based on the last traded price for the day, when available. In addition, Section 3855 requires that transaction costs, such as brokerage commissions, incurred in the purchase and sale of securities by the Fund be charged to net income in the period. Until September 30, 2006, the Fund's policy has been to add these expenses to the cost of the securities purchased or deduct from the proceeds of sale.

The Canadian Securities Administrators have granted temporary relief to investment funds from complying with Section 3855, for the purpose of calculating and reporting of NAV ("Transactional NAV") (other than for financial reporting purposes) until September 30, 2008, to permit review of the suitability of these financial reporting requirements for purposes other than the financial statements, such as the purchase and redemption price of an investment fund.

The reconciliation between the Transactional NAV and the GAAP NAV as a result of the adoption of Section 3855 is as follows:

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements March 31, 2008

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	<u>Transactional</u> NAV	<u>Section 3855</u> Adjustment	<u>GAAP</u> NAV
<b>Net Asset Value</b>			
Opening NAV – April 1, 2007	51,090,394	(166,966)	50,923,428
Closing NAV – March 31, 2008	31,146,709	(103,987)	31,042,722
<b>Net Asset Value Per Unit</b>			
Opening NAV – April 1, 2007	10.17	(0.03)	10.14
Closing NAV – March 31, 2008	9.35	(0.03)	9.32

### Cash and cash equivalents

Cash and cash equivalents are comprised of cash on deposit with terms to maturity of less than 90 days at acquisition. Cash and cash equivalents are deemed to be held for trading and therefore are carried at fair value.

### Income recognition

Income from investments is recognized on an accrual basis. Dividend income is recognized at the time a security trades on an ex-dividend basis. Interest income is based on the number of days the investment is held during the period. All income, realized and unrealized net gains (losses) and transaction costs (apart from an insignificant amount of income arising from cash and cash equivalents) are attributable to investments and derivatives which are deemed held for trading.

### Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the end of the period. Purchases and sales of investments and income and expenses are translated into Canadian dollars at the exchange rate prevailing on the transaction dates.

### Forward contract

Forward contracts entered into by the Fund are valued at an amount that is equal to the gain or loss that would be realized if the position were to be closed out, which is equivalent to the difference between the deliverable asset and the value of the asset to be received. Changes in the value of a forward contract or the assets deliverable under such a contract are included as unrealized gains or losses on investments (See notes "2" and "8").

## 4 Bank overdraft

The Fund maintains a Bank overdraft account with Bank of Montreal ("BMO") to finance its short term obligations such as trades executed under the Market Purchase Program (Note 7). During the year ended March 31, 2008, the outstanding bank overdraft account had a minimum balance of \$nil and a maximum balance of \$254,500 (a minimum balance of \$nil and maximum balance of \$680,000 during the year ended March 31, 2007). The related total interest expense was \$1,109 during the year ended March 31, 2008 (\$2,967 during the year ended March 31, 2007).

## 5 Custodian

In the Trust Agreement RBC Dexia ("the Custodian") acts as custodian of the assets of the Fund. The Custodian is also responsible for certain aspects of the Fund's day-to-day operations. In consideration for these services, the Fund pays a fee to the Custodian.

## 6 Unitholders' equity

The Fund is authorized to issue an unlimited number of redeemable, transferable units of one class, each of which represents an equal, undivided interest in the net assets of the Fund, subject to the terms and conditions of the Trust Agreement.

On October 18, 2005 and November 8, 2005, the Fund issued 6,400,000 and 250,000 units respectively, for net proceeds of \$60,220,000 and 2,375,000 respectively. Changes in outstanding units during the years ended March 31 are summarized as follows:

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements March 31, 2008

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	Number of units	
	2008	2007
Opening balance	5,023,014	6,533,600
Units issued	—	—
Units redeemed	(1,635,090)	(1,372,086)
Units cancelled (note 7)	<u>(56,100)</u>	<u>(138,500)</u>
Ending balance	<u>3,331,824</u>	<u>5,023,014</u>

### 7 Market Purchase Program

To enhance liquidity and to provide market support for the Units, the Fund has a mandatory market purchase program under which the Fund, subject to certain exceptions contained in the Trust Agreement and in compliance with any applicable regulatory requirements, is obligated to purchase Units for cancellation on and subject to the terms below. If, on the business day following any Valuation Date, the weighted average price of the Units is less than 95% of the net asset value of the Fund ("NAV") per Unit (the "NAV per Unit") determined as at the most recently published Valuation Date, the Fund will offer to purchase for cancellation any Units offered in the market at or below 95% of the NAV per Unit on the following business day. The maximum number of Units purchased in any three-month period is 1.25% of the number of Units outstanding at the beginning of the period (commencing with the three month period that begins on the first day of the month following October 18, 2005 (commencement of operations)). The Fund is not obligated to make such purchases if: (i) the Fund lacks the cash, debt capacity or other resources to make such purchases, or (ii) in the opinion of the Manager, such market purchases would adversely affect the ongoing activities of the Fund.

In addition, the Trust Agreement provides that the Fund has the right (but not the obligation), exercisable in its sole discretion, at any time, to purchase for cancellation Units in the market at prices not exceeding the NAV per Unit, subject to any applicable regulatory requirements and limitations. Such purchases, if made, are made as normal course issuer bids through the facilities and under the rules of the exchange or market on which the Units are listed, if applicable, as provided for in the Trust Agreement or as otherwise permitted by applicable securities laws.

During the year ended March 31, 2008, the Fund purchased 56,100 units for cancellation at a cost of \$ 535,269 (138,500 units at a cost of \$1,293,542 during the year ended March 31, 2007).

### 8 Forward Agreement and Common Share Portfolio

The Fund entered into a Forward Agreement with the Counterparty to obtain exposure to the performance of the Portfolio held by CIF II. Under the Forward Agreement, the Fund is entitled to sell securities in the Common Share Portfolio from time to time to fund monthly distributions, redemptions and repurchases of Units and its operating expenses. Under the terms of the Forward Agreement, the Fund and the Counterparty have agreed that their settlement obligations under the Forward Agreement with respect to the Common Share Portfolio securities will be discharged by physical delivery of the Common Share Portfolio securities by the Fund to the Counterparty against cash payment or, at the election of the Fund, by the making of cash payments between the parties. The amount payable by the Counterparty for physical delivery of the Common Share Portfolio may be more or less than the original aggregate subscription price of the Units. Unless the Fund elects cash settlement of the Forward Agreement, the Counterparty will pay to the Fund on or about the Termination Date, as the purchase price for the Common Share Portfolio, an amount equal to the Canadian dollar equivalent of the redemption proceeds of a corresponding number of units of the CIF II. The Common Share Portfolio securities are pledged to, and held by, the Counterparty as security for the obligations of the Fund under the Forward Agreement.

On March 31, 2008, the value of the common share portfolio was \$21.02 million. Since the Fund can deliver the value of the common share portfolio to the Counterparty in exchange for the value of the CIF II, the value of the Forward Agreement to the Fund is equal to the value of the CIF II less the value of the common share portfolio. On March 31, 2007 value of the Forward Agreement was \$10.29 million. Other net assets in the Fund totalled \$(0.27) million leaving a net asset value of \$31.04 million or \$9.32 per Unit.

The Fund pays to the Counterparty a fee under the Forward Agreement of approximately 0.50% per annum of the net asset value of CIF II calculated and payable quarterly in arrears.

### 9 Distributions

The Fund pays monthly cash distributions plus any additional amounts as directed by the Manager. Such distributions may consist of net income, net realized capital gains and return of capital and shall be paid no later than 10 days after the record date for Distribution.

The amount of distributions in any particular month shall be determined by the Manager, having regard to the investment objectives of the Fund, the net realized capital gains and net income of the Fund, if any, during the month and the year to date, the net realized capital gains and net income of the Fund anticipated in the balance of the year, and distributions made in previous months; provided, however, that the aggregate distributions of net income and net realized capital gains made in each year shall be such amount as is sufficient to ensure that the Fund is not liable for income tax thereon under the Act, except to the extent that any tax payable on net realized capital gains of the Fund for a year that are retained by the Fund would be recoverable by it in such year.

Distributions paid during the year ended March 31, 2008 were \$2,889,099 or \$0.65 per Unit (\$3,916,397 or \$0.65 per unit during the year ended March 31, 2007).

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2008

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### 10 Management fees

Pursuant to a management agreement (the "Management Agreement") the Fund has retained Connor, Clark & Lunn Capital Markets Inc. (the "Manager") to act as manager. As compensation for management services rendered to the Fund, the Manager is entitled to receive an annual management fee in an amount equal to 0.75% per annum of the NAV of the Fund, to be calculated daily and payable monthly in arrears, plus applicable taxes.

The management fees charged to the Fund during the year ended March 31, 2008 were \$355,496 (\$490,452 during the year ended March 31, 2007). The Manager is responsible for payment of the investment management fees of the Investment Advisor out of the above management fees.

### 11 Service Fee

The Fund pays to registered dealers a servicing fee equal to 0.40% annually of the NAV per Unit for each Unit held by clients of the registered dealer (accrued daily and paid at the end of each calendar quarter), plus any applicable taxes.

The service fees charged to the Fund during the year ended March 31, 2008 were \$163,380 (\$229,574 March 31, 2008 were \$355,496 (\$490,452 during the year ended March 31, 2007).

### 12 Income taxes

The Fund qualifies as a mutual fund trust under the provisions of the Income Tax Act (Canada) and, accordingly, is subject to tax on its investment income, including net realized capital gains, for any calendar year in which its net investment income or sufficient net realized capital gains are not paid or payable to its unitholders as at the end of the calendar year. It is the intention of the Manager that all annual net investment income and sufficient net taxable capital gains will be distributed to unitholders on a calendar year basis such that Canadian income taxes payable by the Fund under present legislation will be minimized. As a result thereof, and of the deduction of expenses in computing its taxable income, no provisions for income taxes are made in the financial statements.

As at December 31, 2007, the Fund had net capital losses of \$47,998 (December 31, 2006 - \$47,998), which may be carried forward indefinitely to reduce future realized capital gains and non-capital losses of \$911,476 (December 31, 2006 - \$911,476), which expire within the next twenty years.

### 13 Broker commission charges and soft dollar services

There were \$nil broker commissions paid during the year ended on March 31, 2008 (\$nil during the year ended on March 31, 2008) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.