



CONNOR, CLARK & LUNN

CAPITAL MARKETS

0

1

0

2

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

Annual Report

March 31, 2010

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

May 18, 2010

### Dear Investor,

I am pleased to provide you with the annual financial statements for the twelve-month period ended March 31, 2010. The Fund delivered strong performance during the period, with a total return of 51.1% calculated by net asset value and 56.7% using the TSX price. The benchmark used by the Investment Manager was up by 51.6%.

While we provide the usual portfolio manager commentary on the portfolio and the markets in the body of the report, I want to use this letter to discuss the merger proposal that is being put to a unitholder vote on May 27<sup>th</sup>. An information circular was mailed to unitholders in late April and a copy of the circular, along with a list of questions and answers is posted on our website.

The proposal would result in the merger of the Fund and Prints (the "Merger Proposal"). Connor, Clark & Lunn Prints Trust ("Prints") will be the continuing fund and as a result unitholders of the Fund would become unitholders of Prints which will be renamed Connor, Clark & Lunn Conservative Income & Growth Fund ("Income & Growth Fund"). The board also announced a proposal to reposition Prints to amend the investment objectives, investment strategy and investment restrictions of Prints in order to provide an attractive yield through an actively managed portfolio of high income investments across a broad range of income-oriented securities.

There are two primary reasons why we have made this proposal. The new taxation regime for income trusts that was announced by the government in 2006 will go into effect next year which will considerably narrow the universe of available investments for the Fund. Since its launch in 2005, given the turmoil in the markets and the government changes in income trust taxation, the Fund has also had a significant portion of its units redeemed. This is a situation that many closed-end funds with similar income trust portfolio investment exposure have experienced. As a result, its assets are lower and the management expense ratio of the Fund is increasing.

We believe that the proposal provides a number of benefits for the Fund's unitholders. The change in mandate will provide an opportunity for capital growth and income over a broader range of investments. The new mandate will be similar to an existing CC&L mandate, the High Income Fund, which made the proposed shift in December 2006. It has had strong investment performance which we provide in the circular. The merger should also provide increased liquidity for unitholders as there will be a greater number of units outstanding. In May 2012 the Fund will convert to an open ended mutual fund that will provide daily liquidity at net asset value and is expected to provide a lower discount to net asset value in the interim. Prints has accumulated significant tax losses which are available to be applied against future gains and income with the result that distributions may be paid to unitholders as return of capital.

The board of directors of Connor, Clark & Lunn Capital Markets has determined that the Merger Proposal is in the best interests of the Fund and its unitholders and recommends that unitholders vote in favour of the extraordinary resolution. The meeting date is May 27 at 8:30 am and we would be pleased if you could attend. If you are not able to, then you may vote by proxy either on-line or by delivering it to your investment advisor. The proxy must be deposited with Computershare, our transfer agent, by 5:00 pm on May 25<sup>th</sup>. If you have any questions please do not hesitate to call me or one of my colleagues.

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.**

You can obtain a copy of the annual financial statements at no cost by writing to Connor, Clark & Lunn Capital Markets Inc. (the “Manager”) to the following address: Connor, Clark & Lunn Capital Markets Inc., Suite 300, 181 University Avenue, Toronto, Ontario M5H 3M7, or calling (416) 862-2020 or visiting the Manager’s website at [www.cclcapitalmarkets.com](http://www.cclcapitalmarkets.com) or by visiting [www.sedar.com](http://www.sedar.com).

Securityholders 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.

Note that any reference to “Net Assets” or “Net Assets per Unit” or “GAAP Net Assets” means that the value was determined in accordance with the Canadian Generally Accepted Accounting Principles “GAAP” for financial statements purposes. Also any reference to “Net Asset Value” or “Net Asset Value per Unit” or “Transactional NAV” means that the value was determined for valuation and transactional purposes. An explanation of the difference between both values can be found in note 3 to the financial statements.

## 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 the 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 the CIF II on its investment in the Portfolio.

Connor, Clark & Lunn Investment Management Ltd. (the “Investment Manager” or “CC&L”), 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 short term investments. As part of its strategy, the Investment Manager may employ 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 Derivatives***

The Fund has employed derivatives for the purpose of hedging interest rate exposure. Such exposure 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.

The Fund has also actively hedged foreign currency exposure, in particular the market value exposure associated with the positions in US dollar-denominated bonds.

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.

## **Recent Developments**

### ***Future accounting changes***

In February 2008, the Canadian Accounting Standards Board confirmed that the International Financial Reporting Standards ("IFRS") will replace current Canadian standards and interpretations as Canadian GAAP for publicly accountable enterprises effective January 1, 2011, which includes investment funds. The Fund will adopt IFRS on April 1, 2011. Management has commenced activities to identify key issues and the likely impacts resulting from the adoption of IFRS and is in the process of developing a changeover plan, which will include identifying differences between the Fund's current accounting policies and those it expects to apply under IFRS, as well as any accounting policy and implementation decisions and their resulting impact, if any, on NAV of the Funds. Management has presently determined that there will be no significant impact to NAV per Unit as a result of the changeover to IFRS but will continue to assess based on any changes to existing IFRS.

### ***Adoption of New Accounting Standards***

*CICA Section 3862, "Financial Instruments – Disclosures"*: In March 2009, the Canadian Accounting Standards Board announced it has agreed to adopt recent amendments to IFRS 7, "Financial Instruments: Disclosures", into Section 3862, "Financial Instruments – Disclosures". The amendments require that an entity disclose the classification, for each class of financial instrument, of fair value measurements within a fair value hierarchy. The hierarchy includes three levels: Level 1 – quoted prices in active markets, Level 2 – measurements determined using valuation models that employ observable inputs and Level 3 – measurements determined using valuation models that employ unobservable inputs. The Fund adopted the amendments to Section 3862 as of April 1, 2009. This standard impacted the Fund's disclosure provided but did not affect the Fund's results or financial position.

*EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities"*: On January 20, 2009, the CICA Emerging Issues Committee issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". The abstract requires the entity's own credit risk and the risk of the counterparty to be taken into consideration in assessing the fair value of financial assets and financial liabilities. The Fund adopted the abstract as of April 1, 2009. This did not significantly impact the Fund's results or financial position.

## **Results of Operations**

### ***Investment Manager Commentary***

The economic recovery continued into the first quarter as the capital markets once again produced positive returns for investors. The markets focus on yield has intensified, and we expect this theme to continue over the balance of the year. Performance in the Fund's portfolio was solid across all of its asset classes, with REITs and income trusts standing out the most.

It is our view that the REIT and real estate market in Canada is poised to become a large very public market due to a scarcity of yield-oriented securities, made more acute by the upcoming taxation of income trusts and energy trusts. While it has taken some time, we are encouraged by what appears to be a broadening and deepening of the REIT and real estate market in Canada. First, existing REITs, such as Allied Properties, RioCan, Primaris and Dundee, have begun to make significant acquisitions funded in part by equity and this, combined with rising share prices, has greatly increased the market capitalization of the REIT sector. Secondly, a pipeline of REIT and real estate IPOs is beginning to develop.

During the year under review the Fund's exposure to Business and Utilities Trusts has remained within a relatively tight range. It increased towards the end of the calendar year as the Investment Manager took profits on the bond portfolio. The weighting subsequently dropped as the Investment Manager increased the portfolio's weighting in REITs while continuing to take profits in the bond portfolio.

We are encouraged by these developments and expect REITs and real estate corporations to become a much larger portion of the Fund's portfolio. This is of course subject to thorough senior management meetings, rigorous due diligence and appropriate valuations. One risk that we see to REIT performance is over-exuberance that pushes valuations too high and/or ignores major fundamental issues, examples of which would include RioCan REIT with its 120% payout ratio and Dundee REIT with its major exposure to the Calgary office market which is clearly the worst real estate market in Canada. We will continue to be selective and patient as we build our exposure.

The portfolio's REIT exposure has increased considerably in recent months, rising from 17% at the end of November 2009 to 29% at the end of March 2010. New positions were established in Crombie REIT, Northern Properties REIT and InnVest REIT.

Crombie REIT has a retail real estate portfolio focused in Atlantic Canada and is significantly cheaper than larger peers such as RioCan largely because not a household name. With an attractive 7.8% yield, we like the strategic relationship with Sobeys/Empire which should give the REIT an edge in acquiring grocery anchored shopping centers.

Northern Properties REIT has an apartment portfolio focused in northern Canada including northern points in BC, Alberta and Newfoundland as well as the Northwest Territories and Nunavut. With the exception of a few of Alberta markets, the REIT's portfolio has proved to be very resilient, and with the recovery in resource markets it is only matter of time before it attracts more attention from investors. While it offers a lower yield of approximately 6.8% at the time of writing, the payout ratio remains quite low.

InnVest REIT represents a recovery play given that its portfolio consists entirely of hotel properties. The REIT's balance sheet is solid after recent equity financings and the market is putting a low multiple on severely depressed cash flows. The yield at the time of writing exceeds 9%, but we believe the current distribution rate is sustainable. InnVest plans to reorganize using a stapled unit structure that would separate property and operations to allow it to qualify as a REIT.

During the quarter we eliminated the Fund's position in Boardwalk REIT. Although the REIT has one of the best management teams in the Canadian real estate market and a clean structure, we are concerned that the Alberta apartment recovery will be slow. The REIT has had a good run, and with yield of about 4%, it was time to take profits.

While the CIF II has had a considerable weighting in financial issuers, as spreads have improved in that sector, there has been a concerted effort by the team to pursue greater sector diversity by adding to names such as Loblaw and Canadian Tire.

We added Videotron and Corus bonds to the Fund's portfolio. Both present very attractive yields, exceeding 7% at the time of purchase, stable cash flows and good management. Bonds issued by financials continue to offer higher-than-average yields and benefit from increased regulation and lower leverage reducing credit risk.

### ***Net Assets***

The net assets 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, 2010, the value of the common share portfolio was \$18,387,783. 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, 2010 the value of the Forward Agreement was \$(30,366). Other liabilities net of other assets in the Fund totalled \$(179,165) leaving net assets of \$18,178,252 or \$9.05 per Unit. (On March 31, 2009, the fair value of the Common Share Portfolio was \$10,362,675. 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, 2009 the value of the Forward Agreement was \$6,361,046).

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

During the year ended March 31, 2010, the Fund had a net investment loss of \$419,618 (2009 – loss of 551,611) and realized \$743,083 in gains on investments sold during the same period (2009 – realized losses of 579,377). In addition, the portfolio had \$7,234,604 change in unrealized gains on investments as of March 31, 2010 (2009 – unrealized losses of \$6,221,877). The net investment loss, realized and unrealized gains combined for a total increase in net assets from operations of \$7,558,069, or \$3.24 per unit (the net investment loss, realized and unrealized losses combined for a total decrease in net assets from operations of \$7,352,865, or 2.38 per Unit during the year ended March 31, 2009). Distributions to unitholders totalled \$1,512,682, or \$0.65 per Unit (2009 - \$1,995,375, or \$0.65 per Unit).

### ***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, 2010, the Fund purchased 97,900 units for cancellation at a cost of \$758,171 (150,400 units at a cost of \$967,938 during the year ended March 31, 2009).

### ***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, 2010 were \$1,512,682 or \$0.65 per Unit (\$1,995,375 or \$0.65 per unit during the year ended March 31, 2009).

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

The Independent Review Committee tabled no special reports and made no material recommendations to management of the Fund during the year ended March 31, 2010.

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

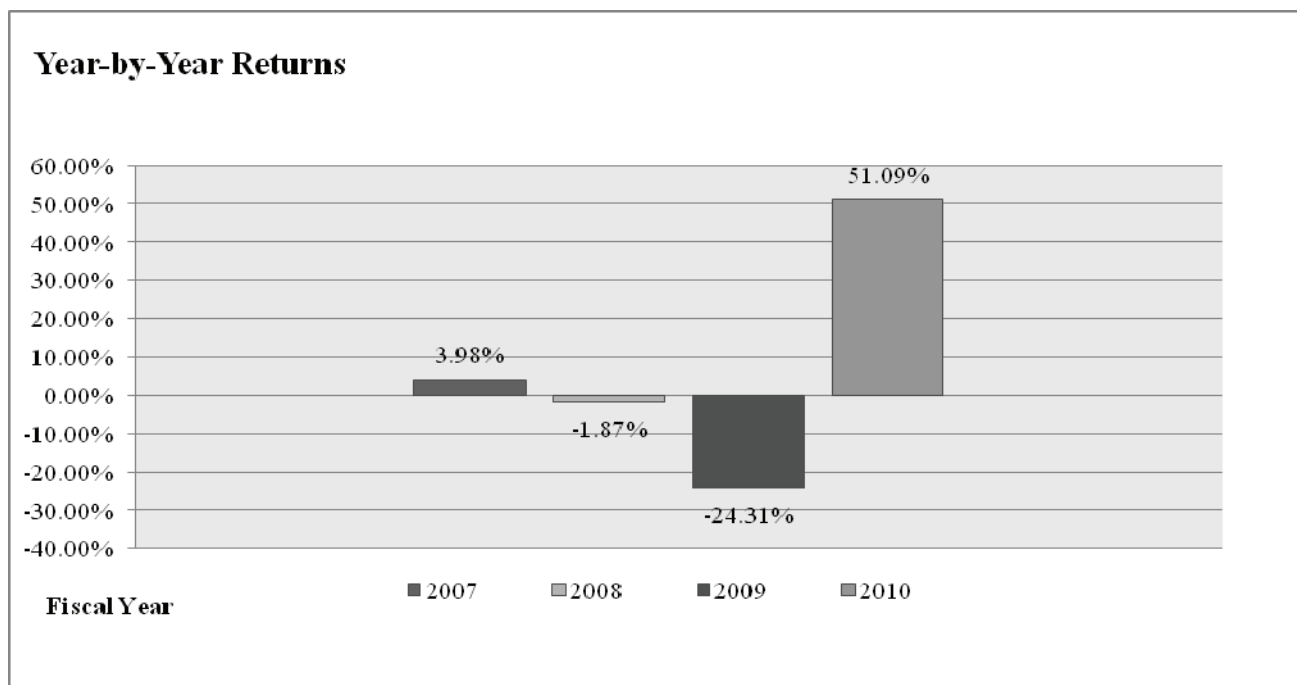
The management fees charged to the Fund and the CIF II on a combined basis during the year ended March 31, 2010 were \$213,488 (\$293,126 during the year ended March 31, 2009). The Manager is responsible for payment of the investment management fees of the Investment Manager out of the above management fees.

## 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 years shown. This bar chart shows, 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	Three Years	Since Inception <sup>(1)</sup>
Based on Transactional NAV	51.09%	3.91%	6.61%
Based on share price	56.69%	3.99%	4.22%
Benchmark Index <sup>(2)</sup>	51.62%	6.62%	7.99%

<sup>(1)</sup> Annualized for the period October 18, 2005 (Commencement of operations) to March 31, 2010.

<sup>(2)</sup> Benchmark is 80% Scotia Income Trust Ex-Energy, 25% DEX Corporate, -5% DEX 91 T-bills.

## 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 Assets per unit:

	March 31, 2010	March 31, 2009	March 31, 2008	March 31, 2007	March 31, 2006 <sup>(1)</sup>
<b>Net Assets, beginning of period</b>	6.49	9.32	10.17	10.43	10.00
<b>Increase (decrease) from operations:</b>					
Total revenues	—	—	—	—	—
Total expenses	(0.18)	(0.18)	(0.20)	(0.20)	(0.09)
Unit issue expense <sup>(2)</sup>	—	—	—	(0.02)	(0.59)
Realized gains (losses) for the period	0.32	(0.19)	1.17	0.51	0.03
Unrealized gains (losses) for the period	3.10	(2.01)	(1.06)	(0.06)	1.36
<b>Total increase (decrease) from operations<sup>(3)</sup></b>	<b>3.24</b>	<b>(2.38)</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)	(0.65)	(0.65)	(0.29)
<b>Total Annual Distributions<sup>(4)</sup></b>	<b>(0.65)</b>	<b>(0.65)</b>	<b>(0.65)</b>	<b>(0.65)</b>	<b>(0.29)</b>
<b>Net Assets, end of period<sup>(5)</sup></b>	<b>9.05</b>	<b>6.49</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 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.

(4) Distributions were paid in cash.

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

Ratios and Supplemental Data:

Fund	March 31, 2010	March 31, 2009	March 31, 2008	March 31, 2007	March 31, 2006 <sup>(1)</sup>
Total net asset value (000's)	18,215	16,531	31,147	51,090	68,120
Number of units outstanding	2,007,642	2,538,336	3,331,824	5,023,014	6,533,600
Base Management expense ratio <sup>(2)(3)</sup>	2.28%	2.19%	1.96%	1.94%	1.97%
Issue expenses ratio <sup>(2)(3)</sup>	0.00%	0.00%	0.00%	0.18%	6.00%
Management expense ratio <sup>(3)</sup>	2.28%	2.19%	1.96%	2.12%	7.97%
Management expense ratio before waivers or absorptions <sup>(3)</sup>	2.28%	2.19%	1.96%	2.12%	7.97%
Portfolio turnover rate <sup>(4)</sup>	17.89%	66.78%	18.96%	8.03%	13.24%
Trading expense ratio <sup>(5)</sup>	0.00%	0.00%	0.00%	0.00%	0.00%
Net asset value per unit	9.07	6.51	9.35	10.17	10.43
Closing market price (TSX)	8.52	5.93	8.81	9.70	9.88

### Consolidated for the Fund and the CIF II

Base Management expense ratio <sup>(2)(3)</sup>	3.09%	2.89%	2.47%	2.42%	2.45%
---	-------	-------	-------	-------	-------

(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 asset value 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 asset value during the period.

## Summary of Investment Portfolio as of March 31, 2010

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).

### *Investment portfolio of the Connor Clark & Lunn Conservative Income Fund II*

	Fair value \$	% of NAV
<b>Portfolio by Category</b>		
Materials	11,848,853	65.1%
Information Technology	3,098,114	17.1%
Consumer Discretionary	2,912,086	15.9%
Consumer Staples	550,782	3.0%
Cash	25,497	0.1%
Equity Derivatives	(15,527)	-0.1%
<b>Top 25 Holdings</b>		
Teck Cominco Ltd.	4,907,856	26.9%
FNX Mining Company Inc.	4,338,220	23.9%
Gildan Activewear Class A	1,975,303	10.8%
Celestica Inc.	1,639,093	9.0%
Sino-Forest Corporation - Class A	1,509,037	8.3%
Pan American Silver Corp.	1,093,740	6.0%
Rona Inc.	936,783	5.1%
Research In Motion	847,616	4.7%
CGI Group Class A	611,405	3.4%
Viterra Inc	550,782	3.0%
Cash	25,497	0.1%
Equity Derivatives	(15,527)	-0.1%
<b>Net asset value</b>	<b>18,215,143</b>	

---

**Investment portfolio of the Conservative Income Fund II**

	<b>% Rate</b>	<b>Maturity date</b>	<b>Market value \$</b>	<b>% of NAV</b>
<b>Portfolio by Category</b>				
Financials			5,359,975	29.2%
Corporate Bonds			4,324,077	23.3%
Industrials			2,381,867	13.1%
Utilities			1,925,068	10.5%
Consumer Discretionary			1,339,865	7.3%
Energy			1,218,494	6.6%
Cash & Cash Equivalents			843,819	4.6%
Materials			766,194	4.2%
Health Care			733,014	4.0%
Derivative Contracts			(9,016)	-0.1%
<b>Top 25 Holdings</b>				
Cash & Cash Equivalents			843,819	4.6%
IBI Income Fund			804,285	4.4%
Northland Power Inc. Fund			801,444	4.4%
Cominar Real Estate Investment Trust			786,098	4.3%
Brookfield Infrastructure Partners LP			776,516	4.2%
Chartwell Seniors Housing Real Estate Investment Trust			767,050	4.2%
Labrador Iron Ore Royalty Inc.			766,194	4.2%
Inn Vest Real Estate Investment Trust			754,974	4.1%
Yellow Pages Income Fund			734,925	4.0%
CML Healthcare Income Fund			733,014	4.0%
Genivar Income Fund			732,452	4.0%
Allied Properties Real Estate Investment Trust			706,440	3.9%
Canadian Apartment Properties Real Estate Investment Trust			645,750	3.5%
Cineplex Galaxy Income Fund			604,940	3.3%
Altus Group Income Fund			600,660	3.3%
Westshore Terminals Income Fund			585,825	3.2%
Keyera Facilities Inc.			516,449	2.8%
Morgan Stanley	4.9%	2/23/2017	421,284	2.3%
CIBC Capital Trust	10.0%	6/30/2019	399,315	2.2%
Crombie Real Estate Investment Trust			394,800	2.1%
Fort Chicago Energy Partners LP			384,110	2.1%
Extencicare Real Estate Investment Trust			365,403	2.0%
Gaz Metro LP			347,108	1.9%
Northern Property Real Estate Investment Trust			338,800	1.8%
Merrill Lynch Fin. Co.	5.3%	5/30/2017	332,234	1.8%
<b>Net asset value</b>			<b>18,394,311</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.



Michael W. Freund  
Director  
Connor, Clark & Lunn Capital Markets Inc.

Toronto, Canada

**May 18, 2010**

May 20, 2010

## 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, 2010, the statements of net assets as at March 31, 2010 and 2009 and the statements of operations, changes in net assets, surplus (deficit) and contributed surplus and cash flow for the years then ended. These financial statements are the responsibility of the Fund's Manager. 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 the Fund's 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 March 31, 2010 and 2009 and the results of its operations, the changes in its net assets, surplus (deficit) 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**

## Connor, Clark & Lunn Conservative Income Fund II

Statements of Net Assets

As at March 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Assets</b>		
Cash	25,497	32,300
Investments pledged to counterparty under forward agreement (cost - \$13,617,252; March 31, 2009 - \$19,218,178)	18,387,783	10,362,675
Unrealized gain on forward agreement (note 8)	-	6,361,046
Interest and dividends receivable	-	202
	<u>18,413,280</u>	<u>16,756,223</u>
<b>Liabilities</b>		
Distributions payable	108,814	138,141
Accounts payable and accrued liabilities	81,814	99,289
Payable on securities purchased	-	28,576
Management fees payable	14,034	22,981
Unrealized loss on forward agreement (note 8)	30,366	-
	<u>235,028</u>	<u>288,987</u>
Net assets representing unitholders' equity	<u>18,178,252</u>	<u>16,467,236</u>
Units outstanding (note 5)	<u>2,007,642</u>	<u>2,538,336</u>
Net assets per unit	<u>9.05</u>	<u>6.49</u>
<b>Unitholders' equity</b>		
Unit Capital	11,858,508	16,905,689
Contributed surplus	-	681,258
Surplus (deficit)	<u>6,319,744</u>	<u>(1,119,711)</u>
Unitholders' equity	<u>18,178,252</u>	<u>16,467,236</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 the years ended March 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Income</b>		
Interest income	1,107	653
<b>Expenses</b>		
Management fees (note 10)	145,517	199,411
Forward fees (note 8)	91,793	127,184
Service fees (note 11)	70,346	92,955
Audit fees	22,411	22,411
Custodial and other unitholder fees	20,281	21,954
Administration fees	22,755	21,334
Filing fees	4,538	15,096
Transfer agent fees	15,952	14,332
Advisory board fees	10,500	10,500
Sustaining fees	8,031	10,395
Legal fees	2,771	9,698
Printing and mailing fees	1,101	3,000
Interest expense	795	2,069
IRC fees	2,367	-
Other	1,568	1,925
	<u>420,726</u>	<u>552,264</u>
<b>Investment income (loss)</b>	(419,619)	(551,611)
<b>Unrealized gain (loss) on investments</b>		
Change in unrealized gain (loss) on investments	13,626,034	(2,292,074)
Change in unrealized gain (loss) on forward agreement (note 8)	(6,391,412)	(3,929,803)
Change in unrealized gain (loss) on foreign exchange	(17)	-
	<u>7,234,605</u>	<u>(6,221,877)</u>
<b>Realized gain (loss) on investments</b>		
Net realized gain (loss) on investments	743,083	(578,147)
Net realized gain (loss) on foreign exchange	-	(1,230)
	<u>743,083</u>	<u>(579,377)</u>
<b>Net gain (loss) on investments</b>	<u>7,977,688</u>	<u>(6,801,254)</u>
<b>Increase (decrease) in net assets from operations</b>	<u>7,558,069</u>	<u>(7,352,865)</u>
<b>Increase (decrease) in net assets from operations per unit *</b>	<u>3.24</u>	<u>(2.38)</u>

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

## Connor, Clark & Lunn Conservative Income Fund II

Statements of Changes in Net Assets, Surplus (Deficit) and Contributed Surplus

For the years ended March 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Increase (decrease) in net assets from operations</b>	<u>7,558,069</u>	<u>(7,352,865)</u>
<b>Distributions to unitholders from:</b> (note 9)		
Return on capital	<u>(1,512,682)</u>	<u>(1,995,375)</u>
<b>Unitholders' transactions</b>		
Payments on cancellation of units (note 7)	(758,171)	(967,938)
Payments on redemption	<u>(3,576,200)</u>	<u>(4,259,308)</u>
	<u>(4,334,371)</u>	<u>(5,227,246)</u>
<b>Change in net assets during the year</b>	1,711,016	(14,575,486)
<b>Net assets - Beginning of year</b>	<u>16,467,236</u>	<u>31,042,722</u>
<b>Net assets - End of year</b>	<u>18,178,252</u>	<u>16,467,236</u>
<b>Surplus (Deficit), beginning of year</b>	(1,119,711)	6,233,154
Increase (decrease) in net assets from operations	7,558,069	(7,352,865)
Cost of shares repurchased in excess of par value price	<u>(118,614)</u>	<u>-</u>
<b>Surplus (Deficit), end of year</b>	<u>6,319,744</u>	<u>(1,119,711)</u>
<b>Contributed surplus (deficit), beginning of year</b>	681,258	-
Cost of shares repurchased at less than par value price	<u>(681,258)</u>	<u>681,258</u>
<b>Contributed surplus (deficit), end of year</b>	<u>-</u>	<u>681,258</u>

# Connor, Clark & Lunn Conservative Income Fund II

## Statements of Cash Flow

For the years ended March 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Operating Activities</b>		
Increase (decrease) in net assets from operations	7,558,069	(7,352,865)
Items not affecting cash:		
Change in unrealized (gain) loss on investments	(13,626,034)	2,292,074
Change in unrealized (gain) loss on forward agreement (note 8)	6,391,412	3,929,803
Net realized (gain) loss on investments	(743,083)	578,147
Changes in non-cash working capital:		
(Increase) decrease in prepaid expenses	-	9,005
(Increase) decrease in interest and dividends receivable	202	(202)
Increase (decrease) in accounts payable and accrued liabilities	(17,475)	(19,214)
Increase (decrease) in management fees payable	(8,947)	2,406
Purchase of investment portfolio	(2,987,031)	(11,500,871)
Proceeds on disposition of investment portfolio	9,302,464	19,322,491
<b>Net cash flow provided by (used in) operating activities</b>	<u>5,869,577</u>	<u>7,260,774</u>
<b>Financing Activities</b>		
Payments on redemption (note 5)	(3,576,200)	(4,259,308)
Payments on cancellation of units (note 7)	(758,171)	(967,938)
Distributions to unitholders	(1,542,009)	(2,037,819)
Proceeds from bank indebtedness	145,000	393,900
Principal payments on bank overdraft	(145,000)	(393,900)
<b>Net cash flow provided by (used in) financing activities</b>	<u>(5,876,380)</u>	<u>(7,265,065)</u>
<b>Net increase (decrease) in cash</b>	(6,803)	(4,291)
<b>Cash - beginning of year</b>	<u>32,300</u>	<u>36,591</u>
<b>Cash - end of year</b>	<u>25,497</u>	<u>32,300</u>
<b>Supplementary Information</b>		
Interest paid	795	2,069

## Connor, Clark & Lunn Conservative Income Fund II

Statement of Investment Portfolio

As at March 31, 2010

	% Rate	Maturity date	Number of shares / par value \$	Average cost \$	Fair value \$	2010 % of net assets	2009 % of net assets
<b>Investments</b>							
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>							
<b>Energy</b>						0.0%	1.0%
<b>Materials</b>							
FNX Mining Company Inc.			319,692	3,716,188	4,335,024	23.9%	
Pan American Silver Corp.			46,781	1,543,773	1,093,740	6.0%	
Sino-Forest Corporation - Class A			75,831	1,467,330	1,505,245	8.3%	
Teck Cominco Ltd.			110,912	2,096,237	4,904,529	27.1%	
				8,823,528	11,838,538	65.3%	25.2%
<b>Consumer Discretionary</b>							
Gildan Activewear Class A			73,926	786,367	1,970,867	10.8%	
Rona Inc.			61,068	706,381	936,172	5.1%	
				1,492,748	2,907,039	15.9%	14.9%
<b>Consumer Staples</b>							
Viterra Inc			57,433	677,709	548,485	3.0%	3.5%
<b>Information Technology</b>							
CGI Group Class A			40,224	316,965	608,589	3.3%	
Celestica Inc.			147,666	1,859,517	1,639,093	9.0%	
Research In Motion			11,264	446,785	846,039	4.7%	
				2,623,267	3,093,721	17.0%	18.3%
<b>Total Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>				13,617,252	18,387,783	101.2%	62.9%
<b>Unrealized gain (loss) on forward agreement:</b>							
<b>Investments held in Conservative Income Fund II under the Forward Agreement</b>							
<b>Short-term investments</b>							
<b>Bankers acceptances</b>							
Bank of Nova Scotia		4/16/2010	400,000	399,909	399,909	2.2%	
First Bank		4/20/2010	100,000	99,976	99,976	0.5%	
Canadian Imperial Bank of Commerce		4/23/2010	150,000	149,965	149,965	0.8%	
				649,850	649,850	3.5%	1.5%
<b>Fixed Income</b>							
<b>Corporate Bonds</b>							
Reliance LP	7.30%	4/3/2013	302,000	302,000	307,473	1.7%	
Corus Entertainment Inc.	7.25%	2/10/2017	240,000	240,000	243,370	1.3%	
TD Bank (CGR III)	5.76%	12/18/2017	149,000	131,188	158,303	0.9%	
Brookfield Renewable Power Inc.	5.25%	11/5/2018	100,000	89,190	96,469	0.5%	
CIBC Capital Trust	9.98%	6/30/2019	300,000	361,980	398,190	2.2%	
Videotron LTEE	7.13%	1/15/2020	155,000	155,375	158,425	0.9%	
Bell Canada	7.00%	9/24/2027	125,000	117,021	134,781	0.7%	
Loblaw Co. Ltd	6.54%	2/17/2033	47,000	35,654	48,868	0.3%	
Brookfield Asset Management	5.95%	6/14/2035	168,000	175,657	137,846	0.8%	
Canadian Tire Corporation	5.61%	9/4/2035	115,000	109,969	105,335	0.6%	
Loblaw Co. Ltd	5.90%	1/18/2036	214,000	159,721	205,914	1.1%	
Morgan Stanley	4.90%	2/23/2017	425,000	381,419	420,221	2.3%	
Merrill Lynch Fin. Co.	5.29%	5/30/2017	353,000	302,415	331,352	1.8%	
Citigroup Financial Inc.	5.37%	3/6/2036	322,000	252,825	240,182	1.3%	
Goldman Sachs Capital II (U.S. Dollars)	5.79%	6/1/2012	80,000	65,396	68,786	0.4%	
Russel Metals Inc. (U.S. Dollars)	6.38%	3/1/2014	95,000	93,696	90,238	0.5%	
Sally Holdings LLC (U.S. Dollars)	9.25%	11/15/2014	125,000	121,977	134,428	0.7%	

## Connor, Clark & Lunn Conservative Income Fund II

Statement of Investment Portfolio .... Continued

As at March 31, 2010

	% Rate	Maturity date	Number of shares / par value \$	Average cost \$	Fair value \$	2010 % of net assets	2009 % of net assets
<b>Fixed Income.....Continued</b>							
Great West Life Co. (U.S. Dollars)	7.15%	5/16/2016	300,000	267,435	295,234	1.6%	
Freeport McMoran Copper & Gold (U.S. Dollars)	8.38%	4/1/2017	100,000	114,363	112,869	0.6%	
Tesoro Corp. (U.S. Dollars)	6.50%	6/1/2017	247,000	223,935	230,546	1.3%	
TD Northgroup (U.S. Dollars)	6.38%	10/15/2017	100,000	88,547	93,190	0.5%	
GE Capital Trust I (U.S. Dollars)	6.38%	11/15/2017	100,000	83,381	94,733	0.5%	
US Steel Corp. (U.S. Dollars)	7.00%	2/1/2018	200,000	207,632	199,866	1.1%	
<b>Total Fixed Income</b>				<u>4,080,776</u>	<u>4,306,619</u>	<u>23.6%</u>	<u>32.3%</u>
<b>Canadian Equity</b>							
<b>Telecommunication Services</b>							
						<u>0.0%</u>	<u>3.3%</u>
<b>Energy</b>							
Altgas Income Trust			7,200	162,606	132,480	0.7%	
Enbridge Income Fund			14,500	151,362	185,310	1.0%	
Fort Chicago Energy Partners LP			35,500	280,027	382,690	2.1%	
Keyera Facilities Inc.			19,149	329,505	514,917	2.8%	
				<u>923,500</u>	<u>1,215,397</u>	<u>6.6%</u>	<u>15.1%</u>
<b>Materials</b>							
Labrador Iron Ore Royalty Inc.			14,300	423,905	765,050	4.2%	0.4%
<b>Industrials</b>							
Armtec Infrastructure Income Fund			6,450	106,223	138,353	0.8%	
Genivar Income Fund			25,900	579,810	732,452	4.0%	
New Flyer Limited Income Deposit Securities			10,950	120,094	120,888	0.7%	
IBI Income Fund			54,900	739,669	798,795	4.4%	
Westshore Terminals Income Fund			36,500	629,738	585,825	3.2%	
				<u>2,175,534</u>	<u>2,376,313</u>	<u>13.1%</u>	<u>14.5%</u>
<b>Consumer Discretionary</b>							
Cineplex Galaxy Income Fund			29,800	460,342	604,940	3.3%	
Yellow Pages Income Fund			119,500	1,003,773	734,925	4.0%	
				<u>1,464,115</u>	<u>1,339,865</u>	<u>7.3%</u>	<u>6.1%</u>
<b>Health Care</b>							
CML Healthcare Income Fund			57,900	898,982	733,014	4.0%	6.1%
<b>Financials</b>							
Allied Properties Real Estate Investment Trust			34,800	571,739	706,440	3.9%	
Altus Group Income Fund			42,600	323,153	598,530	3.3%	
Canadian Apartment Properties Real Estate Investment Trust			45,000	565,343	645,750	3.6%	
Chartwell Seniors Housing Real Estate Investment Trust			105,800	575,141	767,050	4.2%	
Cominar Real Estate Investment Trust			40,900	782,424	785,280	4.3%	
Crombie Real Estate Investment Trust			32,900	367,798	392,168	2.2%	
Extencicare Real Estate Investment Trust			34,900	211,152	365,403	2.0%	
Inn Vest Real Estate Investment Trust			127,100	710,203	753,703	4.1%	
Northern Property Real Estate Investment Trust			14,000	312,273	338,800	1.9%	
				<u>4,419,226</u>	<u>5,353,124</u>	<u>29.5%</u>	<u>20.1%</u>
<b>Utilities</b>							
Brookfield Infrastructure Partners LP			43,600	665,360	776,080	4.3%	
Gaz Metro LP			21,400	348,058	344,754	1.9%	
Northland Power Inc. Fund			60,900	688,176	801,444	4.4%	
				<u>1,701,594</u>	<u>1,922,278</u>	<u>10.6%</u>	<u>0.0%</u>

## Connor, Clark & Lunn Conservative Income Fund II

Statement of Investment Portfolio .... Continued

As at March 31, 2010

	Number of shares / par value \$	Average cost \$	Fair value \$	2010 % of net assets	2009 % of net assets		
<b>Total Canadian Equity</b>		12,006,856	13,705,041	75.3%	65.6%		
<b>Transaction costs - Section 3855 adjustment (note 3)</b>		(33,398)	-	0.0%	0.0%		
<b>Total Investments</b>		16,054,234	18,011,660	98.9%	97.9%		
	<b>Number of contracts</b>	<b>Maturity date</b>	<b>Contract price / rate \$</b>	<b>Fair value \$</b>	<b>Unrealized gain (loss) \$</b>	<b>2010 % of net assets</b>	<b>2009 % of net assets</b>
<b>Foreign currency forward contracts</b>							
Bought CAD 1,326,049, sold USD 1,316,700	1	6/18/2010	1.0071	1,335,986	(9,937)	-0.1%	0.1%
	<b>Number of contracts</b>	<b>Maturity date</b>	<b>Average cost \$</b>	<b>Fair value \$</b>	<b>Unrealized gain (loss) \$</b>	<b>2010 % of net assets</b>	
<b>Futures contracts</b>							
<b>Foreign futures</b>							
10 Year United States Treasury Note Futures	(4)	6/21/2010	475,287	471,766	3,521	0.0%	
<b>Domestic futures</b>							
10 Year Canadian Bond Futures	5	6/21/2010	590,050	587,450	(2,600)	0.0%	
					921	0.0%	
<b>Other assets net of other liabilities of the Conservative Income Fund II</b>					(295,077)	-1.6%	
<b>Net assets of the Conservative Income Fund II</b>					18,357,417	100.7%	
<b>Unrealized gain (loss) on forward agreement (note 8)</b>					(30,366)	-0.2%	
<b>Other liabilities net of other assets of the Fund</b>					(179,165)	-1.0%	
<b>Net assets of the Fund</b>					18,178,252	100.0%	

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2010

---

### 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") entered into by Connor, Clark & Lunn Capital Markets Inc. (the "Manager") and RBC Dexia Investor Services Trust ("RBC Dexia") (formerly "The Royal Trust Company") as trustee of the 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 (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 in the CIF II. The Fund invested the net proceeds of the offering in 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 the CIF II on its investment in the Portfolio. Connor, Clark & Lunn Investment Management Ltd. (the "Investment Manager") is the Investment Manager of the CIF II.

### 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 the Manager 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.

#### Future accounting changes

In February 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards ("IFRS") will replace current Canadian standards and interpretations as Canadian GAAP for publicly accountable enterprises effective January 1, 2011, which includes investment funds. The Fund will adopt IFRS on April 1, 2011. Management has commenced activities to identify key issues and the likely impacts resulting from the adoption of IFRS and is in the process of developing a changeover plan, which will include identifying differences between the Fund's current accounting policies and those it expects to apply under IFRS, as well as any accounting policy and implementation decisions and their resulting impact, if any, on NAV of the Fund. Management has presently determined that there will be no significant impact to NAV per Unit as a result of the changeover to IFRS but will continue to assess based on any changes to existing IFRS.

#### Adoption of New Accounting Standards

*CICA Section 3862, "Financial Instruments – Disclosures"*: In March 2009, the Canadian Accounting Standards Board announced it has agreed to adopt recent amendments to IFRS 7, "Financial Instruments: Disclosures", into Section 3862, "Financial Instruments – Disclosures". The amendments require that an entity disclose the classification, for each class of financial instrument, of fair value measurements within a fair value hierarchy. The hierarchy includes three levels: Level 1 – quoted prices in active markets, Level 2 – measurements determined using valuation models that employ observable inputs and Level 3 – measurements determined using valuation models that employ unobservable inputs. The Fund adopted the amendments to Section 3862 as of April 1, 2009. This standard impacted the Fund's disclosure provided but did not affect the Fund's results or financial position.

*EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities"*: On January 20, 2009, the CICA Emerging Issues Committee issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". The abstract requires the entity's own credit risk and the risk of the counterparty to be taken into consideration in assessing the fair value of financial assets and financial liabilities. The Fund adopted the abstract as of April 1, 2009. This did not significantly impact 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 ("GAAP Net Assets"). Should the quoted value for a security, in the opinion of the Manager, 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 Manager 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. The Fund calculates its daily Net Asset Value for the purchase and redemption of units ("Transactional NAV") based on the fair value of the investment fund's assets and liabilities (being the last traded price for the day). The Fund did not change its methodology in this respect.

The reconciliation between the Transactional NAV and the GAAP Net Assets 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, 2010

	<b>Transactional</b>	<b>GAAP</b>
	<u>NAV</u>	<u>Net Assets</u>
<b>Unit pricing</b>		
March 31, 2009	6.51	6.49
March 31, 2010	9.07	9.05

### Cash & Short Term Investments

Cash includes cash and cash equivalents with maturities of less than 90 days from the date of acquisition.

### 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. Distributions received from income trusts are recorded as income, capital gains or a return on capital based on the best information available to the trustee. Due to the nature of these investments, actual allocations could vary from this information. Distributions from income trusts that are treated as return of capital for income tax purposes reduce the average cost of the underlying trust. Realized gains and losses on investments and unrealized appreciation and depreciation in value calculated using average cost. All income, realized and unrealized net gains (losses) and transaction costs (apart from an insignificant amount of income arising from cash) 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 year. 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.

### Future contracts

The futures contracts are Exchange-traded futures contracts. Futures contracts are valued at their settlement price at the close of business on each Valuation Date. Any difference between the settlement value at the close of business on the current Valuation Date and that of the previous Valuation Date is recorded in the Statements of Operations and in the Statements of Net Assets as Unrealized gain (loss). Amounts receivable (payable) from future contracts are reflected in the Statements of Net Assets as unrealized gain or loss on future contracts and variation margin receivable (payable).

## 4 Custodian

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.

## 5 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, 2010 and 2009 are summarized as follows:

	<b>Number of units</b>	
	<b>Year Ended</b>	<b>Year Ended</b>
	<b>March 31,</b>	<b>March 31,</b>
	<b>2010</b>	<b>2009</b>
Opening balance	2,538,336	3,331,824
Units issued	—	—
Units redeemed	(432,794)	(643,088)
Units cancelled (note 6)	<u>(97,900)</u>	<u>(150,400)</u>
Ending balance	<u>2,007,642</u>	<u>2,538,336</u>

The Fund considers capital to include all units issued and outstanding. The Fund manages its capital in accordance with the objectives outlined in Note (2).

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2010

---

### 6 Bank indebtedness

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, 2010, the outstanding bank overdraft account had a minimum balance of \$nil and a maximum balance of \$100,000 (a minimum balance of \$nil and maximum balance of \$200,000 during the year ended March 31, 2009).

### 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 Transactional 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 Transactional 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, 2010, the Fund purchased 97,900 units for cancellation at a cost of \$758,171 (150,400 units at a cost of \$967,938 during the year ended March 31, 2009).

### 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 the 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, 2010, the value of the common share portfolio was \$18,387,783. 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, 2010 the value of the Forward Agreement was \$(30,366). (On March 31, 2009, the fair value of the Common Share Portfolio was \$10,362,675. 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, 2009 the value of the Forward Agreement was \$6,361,046).

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

### 9 Distributions

The Fund pays monthly cash distributions plus any additional amounts as directed by the Manager. Distributions consist primarily of returns of capital but may include capital gains 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, 2010 were \$1,512,682 or \$0.65 per Unit (\$1,995,375 or \$0.65 per unit during the year ended March 31, 2009).

### 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 Transactional 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, 2010 were \$145,517 (\$199,411 during the year ended March 31, 2009). The Manager is responsible for payment of the investment management fees of the Investment Advisor out of the above management fees.

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2010

### 11 Service Fee

The Fund pays to registered dealers a servicing fee equal to 0.40% annually of the Transactional 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, 2010 were \$70,346 (\$92,955 during the year ended March 31, 2009).

### 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.

At the most recent tax year end, the Fund had net capital losses of \$47,998 (March 31, 2009 - \$47,998), which may be carried forward indefinitely to reduce future realized capital gains and non-capital losses of \$2,735,376 (March 31, 2009 - \$1,774,481), which expire within the next twenty years as shown in the following table.

Year of the realized non-capital tax loss	Amount of tax loss	Expiry date
2005	348,881	2025
2006	562,595	2026
2008	863,005	2028
2009	960,895	2029
<b>Total</b>	<b>2,735,376</b>	

### 13 Broker commission charges and soft dollar services

There were \$nil broker commissions paid during the year ended on March 31, 2010 (\$nil during the year ended March 31, 2009) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.

### 14 Financial instruments

<u>Assets</u>	<u>2010</u>	<u>2009</u>
	\$	\$
Held for trading	18,413,280	16,756,021
Loans and receivables	–	202
<b>Total assets</b>	<b>18,413,280</b>	<b>16,756,223</b>
<u>Liabilities</u>		
Held for trading	30,366	–
Financial liabilities at amortized cost	204,662	288,987
<b>Total liabilities</b>	<b>235,028</b>	<b>288,987</b>

For the purposes of categorization in accordance with Section 3862, interest and dividends receivable are deemed to be loans and receivables and recorded at cost or amortized cost. Similarly, distributions payable, management fees payable, accounts payable and accrued liabilities, and payable on securities purchased are deemed to be financial liabilities and reported at amortized cost.

During 2009, Section 3862 was amended to include enhanced disclosures about inputs to fair value measurement. As mentioned in note 7 above, the Fund is exposed to the performance of the portfolio held by CIF II through the Forward Agreement, and therefore, the following table illustrates the classification of the CIF II's financial instruments within the fair value hierarchy as at March 31, 2010. The Canadian common stocks held by the Fund and pledged to the Counterparty under the Forward Agreement have no actual risk exposure to the Fund, and therefore, were excluded:

Assets at fair value as at March 31, 2010 (\$)	Level 1	Level 2	Level 3	Total
Equities	13,705,041	–	–	13,705,041
Short-term notes	–	649,850	–	649,850
Bonds	–	4,306,619	–	4,306,619
Future contracts	921	–	–	921
<b>Total</b>	<b>13,705,962</b>	<b>4,956,469</b>	<b>–</b>	<b>18,662,431</b>
Liabilities at fair value as at March 31, 2010 (\$)	Level 1	Level 2	Level 3	Total
Foreign currency forward contracts	–	9,937	–	9,937
<b>Total</b>	<b>–</b>	<b>9,937</b>	<b>–</b>	<b>9,937</b>

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2010

Fair values are classified as Level 1 when the related security or derivative is actively traded and a quoted price is available. If an instrument classified as Level 1 subsequently ceases to be actively traded, it is transferred out of Level 1. In such cases, instruments are reclassified into Level 2, unless the measurement of its fair value requires the use of significant unobservable inputs, in which case it is classified as Level 3.

*Equities:* The Fund's long equity positions are classified as Level 1 as all these securities are actively traded and a reliable quote is observable.

*Foreign funds:* Foreign funds are classified as Level 2 as they are valued using observable inputs. These funds have audited financial statement and values that can be confirmed by the trustee who is responsible for their valuations.

*Bonds and short-term notes:* Bonds and short-term notes are classified as Level 2 as they are valued using observable inputs, including interest rate curves, credit spreads and volatilities.

*Future contracts:* The Fund holds future contracts which relate to the United States Treasury Note and Canada Bonds. These contracts are Exchange-traded and, therefore, are classified as Level 1 as the fair value is based on a quote in an active market.

*Foreign currency forward contracts:* Foreign currency forward contracts for which inputs, including interest rates, forward market rates and credit spreads are observable and reliable, or for which unobservable inputs are determined not to be significant to fair value, are classified as Level 2.

There were no transfers among the three levels during the year ended March 31, 2010.

### 15 Financial instrument risk

As mentioned in note 8 above, the Fund is exposed to the performance of the portfolio held by CIF II through the Forward Agreement, and therefore, the risks associated with an investment in the Fund's units are best defined by describing the financial risks associated with an investment in the CIF II's portfolio as at March 31, 2010. The Canadian common stocks held by the Fund and pledged to the Counterparty under the Forward Agreement have no actual risk exposure to the Fund, and therefore, were excluded.

The Investment Manager invests in derivatives for the purpose of hedging interest rate exposure; such exposure has involved the use of short United States and Canadian 10-year Bond Futures and has been limited to less than 10% of the portfolio. The Investment Manager also invests in foreign currency forward contracts to hedge the CIF II's foreign exchange risk exposure.

#### Interest rate risk

Interest rate risk arises on interest-bearing financial instruments held in the investment portfolio such as bonds and fixed income derivatives. The Fund is exposed to the risk that the value of interest-sensitive financial instruments will fluctuate due to changes in the prevailing levels of market interest rates. The table below summarizes the Fund's exposure to interest rate risks through its investment in CIF II. It includes the assets and trading liabilities at fair values for the Fund and CIF II, categorized by the earlier of contractual re-pricing or maturity dates.

March 31, 2010:

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
<b>Investments</b>	921	68,786	532,139	3,705,694	13,705,041	<b>18,012,581</b>
<b>Cash and cash equivalents</b>	649,850	–	–	–	219,466	<b>869,316</b>
<b>Other assets</b>	–	–	–	–	319,657	<b>319,657</b>
<b>Liabilities</b>	–	–	–	–	(1,023,302)	<b>(1,023,302)</b>
<b>Net assets</b>						<b>18,178,252</b>

March 31, 2009:

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
<b>Investments</b>	626,849	534,711	910,852	3,320,007	11,002,828	<b>16,395,247</b>
<b>Cash</b>	249,799	–	–	–	54,085	<b>303,884</b>
<b>Other assets</b>	–	–	–	–	261,818	<b>261,818</b>
<b>Liabilities</b>	–	–	–	–	(493,713)	<b>(493,713)</b>
<b>Net assets</b>						<b>16,467,236</b>

As at March 31, 2010, had prevailing interest rates raised or lowered by 1.0%, with all other variables held constant, net assets would have decreased or increased, respectively, by approximately \$288,000 (2009 - \$259,000). In practise, actual results may differ from this sensitivity analysis and the difference could be material.

#### Currency risk

Currency risk arises from financial instruments that are denominated in a currency other than the Canadian dollar, which is the Fund's functional currency. The Fund is exposed to the risk that the value of securities denominated in other currencies will fluctuate due to changes in exchange rates. The Fund's Statement of Investments identifies all securities denominated in foreign currencies.

The table below summarizes the Fund's exposure to foreign currencies as at March 31, 2010 and 2009. Amounts shown are based on the carrying values of monetary and non-monetary assets as well as the underlying principal amounts of foreign currency derivatives such as futures and forward contracts. Other financial assets such as interest and variation margin receivable and liabilities such as accounts payable and accrued liabilities denominated in foreign currencies do not expose the Fund to significant currency risk. The table below summarizes the Fund's exposure to foreign currencies through its investment in CIF II and the approximate impact on net assets had the Canadian Dollar ("CAD") weakened by 5% in relation to these currencies. If the Canadian dollar were to strengthen relative to these currencies, the opposite would occur. In practice, actual results may differ from this sensitivity analysis and the difference could be material.

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2010

March 31, 2010:

	Monetary instruments \$	Non- monetary instruments \$	Derivative instruments \$	Total \$	% of Net Assets	Sensitivity (based on devaluation of CAD) \$
US Dollar	1,319,890	–	(1,332,465)	(12,175)	(0.1%)	(1,000)

March 31, 2009:

	Monetary instruments \$	Non- monetary instruments \$	Derivative instruments \$	Total \$	% of Net Assets	Sensitivity (based on devaluation of CAD) \$
US Dollar	1,301,482	–	(1,233,897)	67,585	0.4%	3,000

### Other market risk

Other market risk is the risk that the value of financial instruments will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or currency risk), whether caused by factors specific to an individual investment, its issuer, or all factors affecting all instruments traded in a market or market segment. All securities present a risk of loss of capital. The Investment Manager moderates this risk through a careful selection of securities and other financial instruments within the parameters of the investment strategy. Except for futures contracts, the maximum risk resulting from financial instruments is equivalent to their fair value. Possible losses from futures contracts can be unlimited. The Fund's equity instruments are susceptible to market price risk arising from uncertainties about future prices of the instruments.

If equity prices had increased or decreased by 10% on March 31, 2010, all other variables held constant, the net assets of the Fund would have increased or decreased, respectively, by approximately \$1,801,000 (2009 - \$1,639,000). In practise, actual results may differ from this sensitivity analysis and the difference could be material.

### Credit risk

The Fund is exposed to the risk that a security issuer or counterparty will be unable to pay amounts in full when due. The fair value of debt securities includes consideration of the credit worthiness of the debt issuer. The carrying amount of debt investments and unrealized gain on derivative instruments outstanding with counterparties represents the maximum credit risk exposure as at March 31, 2010.

The table below summarizes the Fund's exposure to credit risk as of March 31, 2010 and 2009. Amounts shown are based on the carrying value of debt investments and the unrealized gain on derivative instruments outstanding with counterparties.

March 31, 2010:

Rating <sup>(1)</sup>	(% of Net Assets)	Rating <sup>(1)</sup>	(% of Net Assets) <sup>(2)</sup>
AAA	0.0%	BBB-	2.2%
AA+	–	BB+	1.3%
AA	–	BB	2.8%
AA-	–	BB-	0.9%
A+	0.4%	B+	–
A	3.6%	B	0.7%
A-	7.7%	B-	–
BBB+	1.3%	A-1+	2.2%
BBB	2.3%	A-1	1.3%
		<b>Total</b>	<b>26.7%</b>

March 31, 2009:

Rating <sup>(1)</sup>	(% of Net Assets)	Rating <sup>(1)</sup>	(% of Net Assets) <sup>(2)</sup>
AAA	0.0%	BBB-	4.5%
AA+	1.8%	BB+	2.2%
AA-	1.6%	BB	0.6%
A+	3.2%	BB-	1.2%
A	4.8%	B+	1.2%
A-	4.4%	B	0.9%
BBB+	1.9%	CCC	2.5%
BBB	1.1%	Not Rated	2.0%
		<b>Total</b>	<b>33.9%</b>

<sup>(2)</sup> Amounts shown as a percentage of CIFII's Net Assets of \$18,357,417 (2009: \$16,723,721).

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2010

---

As at March 31, 2010 and 2009, no debt securities were contractually past due and no longer meeting interest payment obligations.

All transactions in listed securities are settled or paid for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation.

### **Liquidity risk**

The Fund is exposed to daily cash redemptions due to its market purchase program which are limited to certain conditions (see note 7). The Fund is also exposed to unlimited annual anniversary redemptions on November 30 of every year. Therefore, the Fund invests the majority of its assets in investments that are traded in an active market and can be readily disposed. In addition, the Fund retains sufficient cash positions to maintain liquidity. All liabilities are due within three months.

### **Concentration risk**

The investments of the Fund are concentrated in the Real Estate / Financials sector, and will be especially affected by factors particular to this sector. Factors influencing this sector may include changes in government policy, fluctuations in the capital markets and conditions of the overall economy. Changes that specifically affect the provision of financial services may cause the Net Assets of the Fund to be more volatile than the value of a more broadly diversified portfolio.

The Investment Manager believes that the real estate market in Canada is poised to become a large very public market due to a scarcity of yield-oriented securities, made more acute by the upcoming taxation of income trusts and energy trusts. While it has taken some time, the Investment Manager is encouraged by what appears to be a broadening and deepening of the Real Estate Investment Trust ("REIT") and real estate market in Canada.

The Statement of Investments summarizes the Fund's exposure to the concentration risk.

## **16 Subsequent event**

On April 21, 2010, the Fund announced that the board of directors of the Manager has approved a proposal that would result in the merger between the Fund and Connor, Clark & Lunn PRINTS Trust ("Prints"). This proposal is being put to a unitholder vote on May 27<sup>th</sup>. Prints will be the continuing fund and as a result unitholders of the Fund would become unitholders of Prints which will be renamed Connor, Clark & Lunn Conservative Income & Growth Fund. An information circular was mailed to unitholders in late April and a copy of the circular, along with a list of questions and answers is posted on the Manager's website.

The objectives of the proposals are to: (i) to lower the administrative costs and increase trading liquidity by establishing a larger fund; (ii) expand the investment mandate of the Fund to include a broader range of high yielding securities as required due to the pending change in taxation of income trusts; and (iii) change the investment mandate of Prints which should allow for a resumption of distributions, utilize its accumulated tax losses and provide greater potential for capital growth.