



CONNOR, CLARK & LUNN

CAPITAL MARKETS

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

Annual Report  
March 31, 2009

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

June 3, 2009

Dear Investor,

These annual financial statements are in respect of the twelve-month period ended March 31, 2009. We welcome the opportunity to provide you with an update. The past year has been a very challenging one, perhaps the toughest in our lifetimes. While the performance of the Fund has not been immune to these market conditions, its conservative approach has resulted in strong relative performance in comparison to the S&P/TSX Income Trust Index (the "Index"). Over the past year the Fund's total return was -24.3% compared to -41.4% for the Index. Since inception in October 2005, the Fund has had an annualised return of -3.6% versus -14.7% for the Index. Distributions have totalled \$2.25. All distributions have been characterised as return of capital which means that they are only taxed at maturity or disposition of the units and are considered to be capital transactions (and taxed at the capital gains rate).

Connor, Clark & Lunn Investment Management Ltd's (the "Investment Manager") prime objective is to deliver a yield to investors that is both attractive and sustainable. Therefore the prime focus of their team is to find solid companies that have demonstrated the ability and commitment to return a predictable level of capital to shareholders and bondholders in all market conditions, whether it is a business trust, REIT or corporate bond. They have done a good job in this regard. Since July 2008, 104 out of 185 income trusts have cut their distributions versus only four of the trusts held in the Fund.

During the year the mix of assets in the Fund changed slightly. The weighting of business trust was up 1% to 45.5%. Bonds were up to 32.9% from 29.1% and REITs were down by 4.2% to 20.1%. The Fund has retained a lower-than-normal weighting in REITs since mid-year as the impact of credit spreads has had a severe negative impact on valuations. The conservatism of the Canadian REIT structure (max 50-60% debt-gross book value) is serving them well, but market valuations have compressed a fair deal. We have continued to focus on REITs with access to CMHC-insured debt (apartments, seniors housing) and believe this will be a relative advantage for quite some time.

As we move further into 2009 the equity markets have been responding favourably to signs that the economy may be bottoming. It may be early to call an end to the recession but the Fund continues to focus on strong companies that can produce predictable cash flows and deliver stable distributions and a solid yield to clients. The current yield on the portfolio is very attractive, particularly in relation to other current investment alternatives.

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.**

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 leverage

The CIF II is entitled to employ leverage of up to 15% of its total assets. The CIF II did not employ any leverage during the year ended March 31, 2009.

### ▪ Use of Derivatives

The CIF II has used derivatives for the purpose of hedging interest rate exposure. Such exposure has involved the use

of short United States treasury notes 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**

### *Investment Manager Commentary*

We continue to meet the Fund's objective of delivering stable income. While losses have been unavoidable in the unprecedented market sell-off of recent months, the Fund continues to try to mitigate these headwinds with its defensive asset mix and focus on non-cyclical sectors. The Fund's strong cash flow serves as a significant cushion in difficult markets.

### *Income Trusts*

Income trusts have been cutting distributions fairly dramatically in recent months across the income trust universe, particularly in the Energy Trust space. In contrast, the Fund has had very few distribution cuts outside of conversions (such as CI Financial), speaking to the conservatism of the investment process.

Our prime objective is to deliver a yield to investors that is both attractive and sustainable. Therefore the prime focus of our team is to find solid companies that have demonstrated the ability and commitment to return a predictable level of capital to shareholders and bondholders in all market conditions, whether it is a business trust, REIT or corporate bond. Since July 2008, 104 out of 185 income trusts have cut their distributions versus only four of the trusts held in the Fund.

There were a number of factors that enabled our team to avoid the vast sea of companies that were forced to cut their distributions and guide our portfolio towards trusts with sustainable yields, namely:

1. **Avoiding Energy/Commodity-Based Securities** – Essentially every energy and commodity trust has cut distributions; many more than once and in several cases distributions have been suspended completely. Many energy trusts operated with unsustainably high payout levels and inferior business fundamentals which were masked by a high and rising commodity price. Though we missed out on the performance when oil was rising, we were able to avoid the fallout when it plummeted in the latter half of 2008.
2. **Staying Close to Management** – We meet regularly with the management teams of all of our holdings to keep on top of trends in their businesses. This enables us to identify potential catalysts for future distribution cuts well in advance. It is also essential to determine the company's plan to deal with taxation beginning in 2011. Poorly planned or communicated strategies in this regard leads to underperformance in the market.
3. **Focus on Fundamentals** – It is imperative, particularly in this economic environment, that companies have strong balance sheets. Many recent cuts have been related to concerns about the ability of a company to withstand the current climate.
4. **Focus on Payout Ratio** – We certainly want to avoid companies with unsustainable payout ratios. This means not simply investing in the highest yielding securities in the market, which has been a sign in many cases that a distribution cut is coming.

The Federal Government's introduction of the Tax Fairness Plan in October 2006 significantly altered the course of the income trust universe, with all non-REIT trusts facing full taxation in 2011. Following that announcement, many institutional and retail investors put aside the asset class. We have, however, continued to selectively find attractive businesses in the trust sector that provide stable and mature cash flows and a commitment to return capital to shareholders in a consistent manner. As 2011 approaches, we expect many of these trusts to convert to corporations where they will likely continue business in the normal course, though operating as high dividend-paying equities. We will continue to evaluate each of these trusts to ensure we are comfortable holding the company, regardless of which structure it operates under. In the meantime, we remain comfortable with our trust holdings and like the flexibility to take advantage of some very compelling opportunities.

Recent activity in the portfolio holdings during the period included:

IBI Income Fund: We are bullish on infrastructure and IBI is another asset light engineering company that stands to benefit from government stimulus packages;

CI Financial: Converted to Corporation and slashed payout. Rather than speculate on a potential takeover by Bank of Nova Scotia, we decided to move on to higher yielding alternatives;

Liquor Stores Income Fund: We believe that this fund is fundamentally fine, but we are concerned about re-financing risk later in 2009 and a management team that seems to want to pursue an acquisition roll-up strategy even in a difficult credit environment.

### *REITs*

We have retained a lower-than-normal weighting in REITs since mid-year as the impact of credit spreads has had a severe negative impact on cap rates (valuations). The conservatism of the Canadian REIT structure (max 50-60% debt-gross book value) is serving them well, but market valuations have compressed a fair deal. We have continued to focus on REITs with access to CMHC-insured debt (apartments, seniors housing) and we believe this will be a relative advantage for quite some time.

### *Bonds*

From the beginning of the year, we had seen a good improvement in the credit markets other than early March, where the market was beginning to retest wide spreads in credit seen at the end of 2008. However, recently, consistent with the equity markets, we've again seen a substantial improvement, particularly in the financial names.

Recent sales in the portfolio holdings were primarily due to increased valuations.

New additions during the period included: Sally Holdings which is a company that produces and supply hair care products to hair care professionals which has proven very resilient in the current environment; Loblaw which has strong asset coverage, and looks to be seeing some signs of improvement in the operating model; Citigroup where we believe bondholders will ultimately benefit from government support even under a nationalization scenario and therefore purchased the bonds at a steep discount to par value.

Global growth is still declining, but the rate of descent appears to have moderated. Equity markets around the world have had powerful rallies: North American markets are up 35% to 40% off their March lows as investors are starting to look past the current recession to better times and focusing on positives, what Fed Chairman Bernanke has dubbed "green shoots" (economic indicators whose rate of deterioration is slowing). Three of the most important and reliable indicators now signalling that the US economy has seen its worst and that the cyclical bear market in stocks is over. Signs of increased economic activity have also surfaced in China as new orders and industrial production numbers have recently firmed up.

Much of this has come about as a result of the massive amount of monetary and fiscal stimulus that is being deployed to fight the worst recession since the Great Depression. Normally this would signal a more bullish outlook for equities. However, before getting too enthusiastic, with equities now close to fair value there are still a number of milestones that need to be reached. The rate of decline in housing, employment, earnings and credit spreads still remains on our watch list for some signs of meaningful improvement.

In the meantime, we remain mindful that most asset prices have been discounting a severe recession accompanied by debt deflation, and therefore any improvement in the economic landscape should lead to a further lift in equity values and improvement to corporate spreads. Consequently, we continue to focus on strong companies that can produce predictable cash flows and deliver stable dividends and a solid yield to clients. The yield on the Fund's portfolio is currently 9.9%, which we think is extremely attractive, particularly in relation to other current investment alternatives.

### *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, 2009, the 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. Other liabilities net of other assets in the Fund totalled \$(256,485) leaving net assets of \$16,467,236 or \$6.49 per Unit.

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

The Fund had a net investment loss of \$(551,611) during the year ended March 31, 2009 and realized \$579,377 in losses on investments sold during the same period. In addition, the portfolio had \$(6,221,877) change in unrealized gains and losses on investments as of March 31, 2009. 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. Distributions to unitholders totalled \$1,995,375, or \$0.65 per Unit.

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

As at March 31, 2009, both the Fund and the CIF II held cash and short-term investments of \$303,884 on a consolidated basis. Both the Fund and CIF II had \$565,702 in Current Assets excluding investments, and had Current Liabilities, including distributions accrued but not yet paid, of \$493,713 on a consolidated basis.

### ***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, 2009, the Fund purchased 150,400 units for cancellation at a cost of \$967,938 (56,100 units at a cost of \$535,269 during the year ended March 31, 2008).

### ***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, 2009 were \$1,995,375 or \$0.65 per Unit (\$2,889,099 or \$0.65 per unit during the year ended March 31, 2008).

## **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, 2009.

## **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.

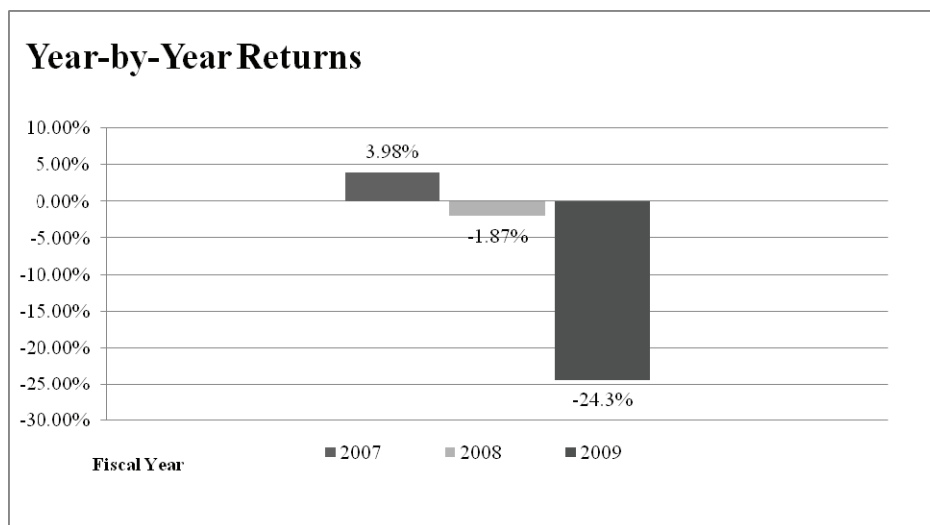
The management fees charged to the Fund and the CIF II on a consolidation basis during the year ended March 31, 2009 were \$293,126 (\$522,475 during the year ended March 31, 2008). The Manager is responsible for payment of the investment management fees of the Investment Manager out of the above management 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	-24.30%	-4.16%	-3.63%
Based on share price	-26.30%	-8.44%	-7.38%
Benchmark Index <sup>(2)</sup>	-41.43%	-20.67%	-14.69%

<sup>(1)</sup> Annualized for the period October 18, 2005 (Commencement of operations) to March 31, 2009.

<sup>(2)</sup> Benchmark is S&P/TSX Income Trust Index.

## 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, 2009	March 31, 2008	March 31, 2007	March 31, 2006 <sup>(1)</sup>
<b>Net Assets, beginning of period</b>	9.32	10.17	10.43	10.00
<b>Increase (decrease) from operations:</b>				
Total revenues	—	—	—	—
Total expenses	(0.18)	(0.20)	(0.20)	(0.09)
Unit issue expense <sup>(2)</sup>	—	—	(0.02)	(0.59)
Realized gains (losses) for the period	(0.19)	1.17	0.51	0.03
Unrealized gains (losses) for the period	(2.01)	(1.06)	(0.06)	1.36
<b>Total increase (decrease) from operations<sup>(3)</sup></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)	(0.29)
<b>Total Annual Distributions<sup>(4)</sup></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>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, 2009	March 31, 2008	March 31, 2007	March 31, 2006 <sup>(1)</sup>
Total net asset value (000's)	16,531	31,147	51,090	68,120
Number of units outstanding	2,538,336	3,331,824	5,023,014	6,533,600
Base Management expense ratio <sup>(2)(3)</sup>	2.19%	1.96%	1.94%	1.97%
Issue expenses ratio <sup>(2)(3)</sup>	0.00%	0.00%	0.18%	6.00%
Management expense ratio <sup>(3)</sup>	2.19%	1.96%	2.12%	7.97%
Management expense ratio before waivers or absorptions <sup>(3)</sup>	2.19%	1.96%	2.12%	7.97%
Portfolio turnover rate <sup>(4)</sup>	66.78%	18.96%	8.03%	13.24%
Trading expense ratio <sup>(5)</sup>	0.00%	0.00%	0.00%	0.00%
Net asset value per unit	6.51	9.35	10.17	10.43
Closing market price (TSX)	5.93	8.81	9.70	9.88

### Consolidated for the Fund and the CIF II

Base Management expense ratio <sup>(2)(3)</sup>	2.89%	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 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, 2009

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).

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

	Market value \$	% of NAV
<b>Portfolio by Category</b>		
Equity Derivatives	6,347,957	38.6%
Materials	4,208,759	25.4%
Information Technology	3,016,865	18.2%
Consumer Discretionary	2,468,548	14.9%
Consumer Staples	583,141	3.5%
Energy	168,037	1.0%
Cash	32,300	0.2%
<b>Top 25 Holdings</b>		
Equity Derivatives	6,347,957	38.6%
FNX Mining Company Inc.	1,776,340	10.7%
Research In Motion	1,486,215	9.0%
Pan American Silver Corp.	1,474,564	8.9%
Gildan Activewear Class A	1,274,497	7.7%
Rona Inc.	1,194,051	7.2%
Sino-Forest Corporation - Class A	957,855	5.8%
Celestica Inc.	883,721	5.3%
CGI Group Class A	646,929	3.9%
Viterra Inc	583,141	3.5%
OPTI Canada Inc.	168,037	1.0%
Cash	32,300	0.2%
<b>Net asset value</b>	<b>16,531,408</b>	

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**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>				
Corporate Bonds			5,417,557	32.3%
Financials			3,382,523	20.1%
Energy			2,535,600	15.1%
Industrials			2,445,900	14.5%
Consumer Discretionary			1,034,616	6.1%
Health Care			1,017,268	6.1%
Telecommunication Services			554,300	3.3%
Cash & Cash Equivalents			271,584	1.6%
Materials			71,120	0.4%
Derivative Contracts			5,949	0.1%
<b>Top 25 Holdings</b>				
CML Healthcare Income Fund			1,017,268	6.1%
Boardwalk Real Estate Investment Trust			993,200	6.0%
New Flyer Limited Income Deposit Securities			622,502	3.7%
Chartwell Seniors Housing Real Estate Investment Trust			594,800	3.5%
Yellow Pages Income Fund			594,776	3.5%
Enerflex Systems Income Fund			594,207	3.5%
Calloway Real Estate Investment Trust			557,442	3.3%
Bell Aliant Regional Comm. Income Fund			554,300	3.3%
Keyera Facilities Inc.			549,762	3.3%
Dundee Real Estate Investment Trust			477,668	2.8%
Altagas Income Trust			451,725	2.7%
Westshore Terminals Income Fund			450,688	2.7%
Jazz Air Income Fund			418,170	2.5%
Mullen Group Income Fund			404,928	2.4%
Groupe Aeroplan Inc.			403,760	2.4%
Armtec Infrastructure Income Fund			357,545	2.1%
Genivar Income Fund			338,200	2.0%
Athabasca Oil Sands Corp.	13.0%	7/30/2011	336,600	2.0%
H&R Real Estate Investment Trust			331,100	2.0%
Bank of Nova Scotia	6.7%	1/22/2016	326,546	1.9%
Reliance LP	7.3%	4/3/2013	310,876	1.9%
Morgan Stanley	4.9%	2/23/2017	308,656	1.8%
GE Capital Canada Funding	5.2%	6/6/2013	308,651	1.8%
General Motors Acceptance Corp.	5.2%	5/21/2009	292,456	1.7%
Pembina Pipeline Income Trust Units			280,998	1.7%
<b>Net asset value</b>			<b>16,793,307</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

**June 12, 2009**

June 12, 2009

**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, 2009, the statements of net assets as at March 31, 2009 and 2008 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, 2009 and 2008 and the results of its operations, the changes in its net assets, its 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**

"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, 2009 and 2008

	March 31, 2009	March 31, 2008
	\$	\$
<b>Assets</b>		
Cash	32,300	36,591
Investments pledged to counterparty under forward agreement (cost - \$19,218,178; March 31, 2008 - \$27,589,369)	10,362,675	21,025,940
Unrealized gain on forward agreement (note 7)	6,361,046	10,290,849
Interest and dividends receivable	202	-
Prepaid expenses	-	9,005
	<u>16,756,223</u>	<u>31,362,385</u>
<b>Liabilities</b>		
Distributions payable	138,141	180,585
Accounts payable and accrued liabilities	99,289	118,503
Payable on securities purchased	28,576	-
Management fees payable	22,981	20,575
	<u>288,987</u>	<u>319,663</u>
<b>Net assets and unitholders' equity</b>	<u>16,467,236</u>	<u>31,042,722</u>
<b>Units outstanding</b> (note 5)	<u>2,538,336</u>	<u>3,331,824</u>
<b>Net assets per unit</b>	<u>6.49</u>	<u>9.32</u>
<b>Unitholders' equity</b>		
Unit Capital (note 5)	16,195,744	23,877,693
Contributed surplus	459,328	-
Surplus (deficit)	<u>(187,836)</u>	<u>7,165,029</u>
<b>Unitholders' equity - end of year</b>	<u>16,467,236</u>	<u>31,042,722</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 year ended March 31, 2009 and 2008

	2009	2008
	\$	\$
<b>Income</b>		
Interest income	653	2,069
<b>Expenses</b>		
Management fees (note 9)	199,411	355,496
Forward fees (note 7)	127,184	225,933
Service fees (note 10)	92,955	163,380
Audit Fees	22,411	26,388
Custodial and other unitholder fees	21,954	26,846
Administration fees	21,334	22,457
Filing fees	15,096	8,242
Transfer agent fees	14,332	13,047
Advisory board fees	10,500	10,487
Sustaining fees	10,395	11,316
Legal fees	9,698	6,951
Printing and mailing fees	3,000	2,951
Interest expense	2,069	1,109
Other	1,925	522
	<u>552,264</u>	<u>875,125</u>
<b>Investment income (loss)</b>	(551,611)	(873,056)
<b>Unrealized gain (loss) on investments</b>		
Change in unrealized gain (loss) on investments	(2,292,074)	(11,903,686)
Change in unrealized gain (loss) on forward agreement (note 7)	(3,929,803)	7,158,282
	(6,221,877)	(4,745,404)
<b>Realized gain (loss) on investments</b>		
Net realized gain (loss) on investments	(578,147)	5,239,335
Net realized gain (loss) on foreign exchange	(1,230)	-
	<u>(579,377)</u>	<u>5,239,335</u>
<b>Net gain (loss) on investments</b>	(6,801,254)	493,931
<b>Increase (decrease) in net assets from operations</b>	<u>(7,352,865)</u>	<u>(379,125)</u>
<b>Increase (decrease) in net assets from operations per unit *</b>	<u>(2.38)</u>	<u>(0.09)</u>
<b>Distributions per unit</b>	<u>0.65</u>	<u>0.65</u>

\* (based on average 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 year ended March 31, 2009 and 2008

	2009	2008
	\$	\$
<b>Increase (decrease) in net assets from operations</b>	<u>(7,352,865)</u>	<u>(379,125)</u>
<b>Distributions to unitholders from:</b> (note 8)		
Return on capital	<u>(1,995,375)</u>	<u>(2,889,099)</u>
<b>Unitholders' transactions</b>		
Payments on cancellation of units (note 5 and 6)	(967,938)	(535,269)
Payments on redemption (note 6)	<u>(4,259,308)</u>	<u>(16,077,213)</u>
	<u>(5,227,246)</u>	<u>(16,612,482)</u>
<b>Change in net assets during the year</b>	<u>(14,575,486)</u>	<u>(19,880,706)</u>
<b>Net assets - Beginning of year (Transactional NAV)</b>	31,042,722	51,090,394
Section 3855 adjustment (note 3)	<u>-</u>	<u>(166,966)</u>
<b>Net assets - Beginning of year (GAAP Net Assets)</b>	<u>31,042,722</u>	<u>50,923,428</u>
<b>Net assets - End of year</b>	<u>16,467,236</u>	<u>31,042,722</u>
<b>Surplus (Deficit), beginning of year</b>	7,165,029	10,180,955
Section 3855 adjustment (note 3)	-	(166,966)
Increase (decrease) in net assets from operations	(7,352,865)	(379,125)
Cost of shares repurchased in excess of par value price	<u>-</u>	<u>(2,469,835)</u>
<b>Surplus (Deficit), end of year</b>	<u>(187,836)</u>	<u>7,165,029</u>
<b>Contributed surplus (deficit), beginning of year</b>	-	556,176
Cost of shares repurchased at less than par value price	<u>459,328</u>	<u>(556,176)</u>
<b>Contributed surplus (deficit), end of year</b>	<u>459,328</u>	<u>-</u>

# Connor, Clark & Lunn Conservative Income Fund II

## Statements of Cash Flow

For the year ended March 31, 2009 and 2008

	2009	2008
	\$	\$
<b>Operating Activities</b>		
Increase (decrease) in net assets from operations	(7,352,865)	(379,125)
Items not affecting cash:		
Change in unrealized (gain) loss on investments	2,292,074	11,903,686
Change in unrealized (gain) loss on forward agreement (note 7)	3,929,803	(7,158,282)
Net realized (gain) loss on investments	578,147	(5,239,335)
Changes in non-cash working capital:		
(Increase) decrease in prepaid expenses	9,005	892
(Increase) decrease in interest and dividends receivable	(202)	-
Increase (decrease) in accounts payable and accrued liabilities	(19,214)	(8,548)
Increase (decrease) in payable on securities purchased	28,576	-
Increase (decrease) in management fees payable	2,406	(13,875)
Purchase of investment portfolio	(11,529,447)	(8,672,072)
Proceeds on disposition of investment portfolio	19,322,491	29,255,089
<b>Net cash flow provided by (used in) operating activities</b>	<u>7,260,774</u>	<u>19,688,430</u>
<b>Financing Activities</b>		
Payments on redemption (note 5)	(4,259,308)	(16,077,213)
Payments on cancellation of units (note 6)	(967,938)	(535,269)
Distributions to unitholders	(2,037,819)	(2,980,761)
Proceeds from bank indebtedness	393,900	417,300
Principal payments on bank overdraft	(393,900)	(486,600)
Accrued interest on bank overdraft	-	(635)
<b>Net cash flow provided by (used in) financing activities</b>	<u>(7,265,065)</u>	<u>(19,663,178)</u>
<b>Net increase (decrease) in cash</b>	(4,291)	25,252
<b>Cash - beginning of year</b>	<u>36,591</u>	<u>11,339</u>
<b>Cash - end of year</b>	<u>32,300</u>	<u>36,591</u>
<b>Supplementary Information</b>		
Interest paid	10,500	1,744

# Connor, Clark & Lunn Conservative Income Fund II

Statement of Investment Portfolio

As at March 31, 2009

	Number of shares / par value \$	Average cost \$	Fair value \$	% of net assets
<b>Investments</b>				
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>				
<b>Energy</b>				
OPTI Canada Inc.	169,734	2,958,464	168,030	1.0%
<b>Materials</b>				
FNX Mining Company Inc.	393,867	4,578,419	1,760,586	10.7%
Pan American Silver Corp.	66,213	2,185,029	1,449,404	8.8%
Sino-Forest Corporation - Class A	108,971	2,108,589	939,331	5.7%
		<u>8,872,037</u>	<u>4,149,321</u>	<u>25.2%</u>
<b>Consumer Discretionary</b>				
Gildan Activewear Class A	124,220	1,321,354	1,268,287	7.7%
Rona Inc.	100,594	1,163,583	1,186,004	7.2%
		<u>2,484,937</u>	<u>2,454,291</u>	<u>14.9%</u>
<b>Consumer Staples</b>				
Viterra Inc.	66,417	783,721	583,142	3.5%
<b>Information Technology</b>				
CGI Group Class A	63,549	500,766	639,939	3.9%
Celestica Inc.	198,589	2,500,776	881,736	5.4%
Research In Motion	27,275	1,117,477	1,486,216	9.0%
		<u>4,119,019</u>	<u>3,007,891</u>	<u>18.3%</u>
<b>Total investments</b>		<u>19,218,178</u>	<u>10,362,675</u>	<u>62.9%</u>
<b>Unrealized gain (loss) on forward agreement</b>			<u>6,361,046</u>	<u>38.7%</u>
<b>Other liabilities net of other assets</b>			<u>(256,485)</u>	<u>-1.6%</u>
<b>Net assets</b>			<u>16,467,236</u>	<u>100.0%</u>

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2009

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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") 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 agreements (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

The Canadian Accounting Standards Board ("AcSB") confirmed that effective January 1, 2011, International Financial Reporting Standards ("IFRS") will replace Canadian GAAP for publicly accountable enterprises, which includes investment funds. IFRS will apply to fiscal years beginning on or after January 1, 2011. As of March 31, 2009 the Manager has not developed a changeover plan to IFRS nor has it assessed the impact of the move to IFRS on business arrangements, GAAP net assets per unit and accounting policies. The Manager will develop a plan prior to the January 1, 2011 deadline and will disclose this plan in either the Fund's March 31, 2010 or March 31, 2011 annual reports.

#### Recent accounting pronouncements

On April 1, 2008, the Fund adopted the new CICA Section 1535, Capital Disclosures, which 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. This standard impacted the Fund's disclosures provided but it did not affect the Fund's results or financial position.

On April 1, 2008, the Fund adopted the new CICA Sections 3862, Financial Instruments – Disclosures ("Section 3862"), and 3863, Financial Instruments – Presentation (Section 3863"), which replaced CICA 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. These standards impacted the Fund's disclosures provided but they did 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 Section 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 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 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 Net Assets"). 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 March 31, 2007, 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 March 31, 2007, the Fund's policy has been to add these expenses to the cost of the securities purchased or deduct from the proceeds of sale.

On September 8, 2008, the Canadian Securities Administration issued the amended National Instrument 81-106 ("NI 81-106"). Section 14.2 of this amended NI 81-106 requires an investment fund to calculate its daily Net Asset Value for the purchase and redemption of units ("Transactional NAV") based on the last traded price for the day.

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, 2009

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	<u>Transactional NAV</u>	<u>GAAP Net Assets</u>
<b>Unit pricing</b>		
March 31, 2008	9.35	9.32
March 31, 2009	6.51	6.49

### Cash

Cash is deemed to be held for trading and therefore is 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) 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.

## 4 Custodian

Pursuant to 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, including calculating the Transactional NAV, net income and net realized capital gains of the Fund and maintaining the books and records of the Fund. 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, 2009 and 2008 are summarized as follows:

	Number of units	
	Year Ended March 31, 2009	Year Ended March 31, 2008
Opening balance	3,331,824	5,023,014
Units issued	—	—
Units redeemed	(643,088)	(1,635,090)
Units cancelled (note 6)	<u>(150,400)</u>	<u>(56,100)</u>
Ending balance	<u>2,538,336</u>	<u>3,331,824</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).

## 6 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

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2009

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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, 2009, the Fund purchased 150,400 units for cancellation at a cost of \$967,938 (56,100 units at a cost of \$535,269 during the year ended March 31, 2008).

### 7 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, 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. Other liabilities net of other assets in the Fund totalled \$256,485 leaving net assets of \$16,467,236 or \$6.49 per Unit (on March 31, 2008, the value of the common share portfolio was \$21,025,940. 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, 2008 value of the Forward Agreement was \$10,290,849. Other liabilities net of other assets in the Fund totalled \$274,067 leaving a net asset value of \$31,042,722 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 the CIF II calculated and payable quarterly in arrears.

### 8 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, 2009 were \$1,995,375 or \$0.65 per Unit (\$2,889,099 or \$0.65 per unit during the year ended March 31, 2008).

### 9 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, 2009 were \$199,411 (\$355,496 during the year ended March 31, 2008). The Manager is responsible for payment of the investment management fees of the Investment Advisor out of the above management fees.

### 10 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, 2009 were \$92,955 (\$163,380 during the year ended March 31, 2008).

### 11 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

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2009

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.

### 12 Broker commission charges and soft dollar services

There were \$nil broker commissions paid during the year ended on March 31, 2009 (\$nil during the year ended March 31, 2008) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.

### 13 Financial instruments

The Fund obtained exposure to the performance of the portfolio held by the CIF II through the Forward Agreement and therefore the categorization in accordance with Section 3862 is best presented by consolidating the assets and liabilities of both; the Fund and the CIF II.

<u>Assets</u>	\$
Held for trading	16,756,021
Loans and receivables	202
<b>Total assets</b>	<b>16,756,223</b>
<u>Liabilities</u>	
Held for trading	–
Financial liabilities at amortized cost	288,987
<b>Total liabilities</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.

### 14 Financial instrument risk

The Fund obtained exposure to the performance of the portfolio held by the 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.

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. It includes the Fund's assets and trading liabilities at fair values, categorized by the earlier of contractual re-pricing or maturity dates.

	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, 2009, 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 \$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 CIF II'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, 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 and the approximate impact on net assets had the Canadian Dollar ("CAD") weakened by 5% in relation to

# Connor, Clark & Lunn Conservative Income Fund II

## Notes to Financial Statements

March 31, 2009

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.

	Monetary instruments \$	Non-monetary 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, 2009, all other variables held constant, the net assets of the Fund would have increased or decreased, respectively, by approximately \$1,639,000. In practice, 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, 2009.

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

Rating <sup>(1)</sup>	March 31, 2009 (% of Net Assets)	Rating <sup>(1)</sup>	March 31, 2009 (% of Net Assets)
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>

As at March 31, 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 6). 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.