

2010

**Connor, Clark & Lunn  
Conservative Income Fund**  
Annual Report  
October 31, 2010

**Connor, Clark & Lunn Conservative Income Fund Message to Unitholders**

**January 12, 2011**

**Dear Investor,**

These annual financial statements are in respect of the twelve-month period ended October 31, 2010. We welcome the opportunity to provide you with an update.

The Fund's net assets per unit were \$10.14 on October 31, 2010, up from \$8.28 as at October 31, 2009. In total, the Fund has declared distributions totalling \$4.11 per unit from inception to the end of October 31, 2010 for an annualized yield of 7.0% on the \$10.00 original issue price. The Fund delivered strong performance during the year, with a total return of 32.17%. Its benchmark, S&P/TSX Income Trust Index, was up 30.82%.

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.

While the economic recovery has continued to unfold through the period, the pace of the recovery has been disappointing. In particular, US housing and unemployment have remained weak. The silver lining is that interest rates have remained low and in fact fell through the period, particularly upon the announcement of a second quantitative easing program from the US Fed. As a result of persistently low interest rates, the demand for income-oriented securities was strong throughout the period to the benefit of the Fund.

Towards the beginning of the period, the weighting in REITs was increased significantly. REITs offer compelling valuation, stable fundamentals which have improved over the course of the year and superior yields and are a cornerstone of the Connor, Clark & Lunn Conservative Income Fund.

Income Trusts continued to outperform through the year with the demand for income. Despite distribution cuts from many income trusts, the cuts were well-telegraphed and became essentially a non-event. As income trusts converted to Corporations, many performed well due to the attention from a greater proportion of investors including those with the TSX Equity-only Index as their benchmark. We expect the remaining Income Trusts to convert by January.

The Fund continues to have a significant weighting in fixed income, although it has reduced over the course of the year. The bond market has continued to perform well as government rates have fallen and credit spreads have continued to compress.

As anticipated in my last letter to you, Connor, Clark & Lunn Capital Markets Inc. ("the Manager") has put forth a unitholder proposal to merge the Fund with the Connor, Clark & Lunn Conservative Income Fund. We expect the merger to be beneficial to the Fund's unitholders as it will broaden the investment mandate, provide additional liquidity and lower administrative expenses. The board of directors of the Manager recommended that you accept the proposal. Additional information is contained in the Notice of Special Meetings of Unitholders and Joint management Information Circular that is available on our website at [www.cclcapitalmarkets.com](http://www.cclcapitalmarkets.com) or on [www.sedar.com](http://www.sedar.com).

Yours truly,



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

# Management Report of Fund Performance

This annual management report of fund performance for Connor, Clark & Lunn Conservative Income Fund (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 the Manager at 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).

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 transactional purposes only. 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 CCQ.UN.

The Fund’s investment objectives are to:

- (i) provide a stable stream of monthly cash distributions targeted to yield approximately 7.0% per annum on the issue price of \$10.00 per Unit; preserve the net asset value per Unit in order to return at least \$10.00 per Unit on or about December 15, 2014; and
- (ii) provide an opportunity for capital appreciation above the original issue price.

In order to achieve the Fund’s investment objectives, Connor, Clark & Lunn Investment Management Ltd. (the “Investment Manager”), the Fund’s investment manager, invests the net proceeds of the Offering, together with any borrowings under the Fund’s loan facility or other leverage transactions, in a portfolio (the “Portfolio”) consisting of income producing securities including Canadian business income trusts, real estate investment trusts, utility income trusts, corporate bonds and convertible bonds. In addition, from time to time, the Portfolio may include significant cash and cash equivalents.

## 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 November 29, 2004 and to the Fund’s most recent Annual Information Form.

## Recent Developments

### *Future accounting changes*

The Canadian Accounting Standards Board (“CASB”) previously confirmed that effective January 1, 2011, International Financial Reporting Standards (“IFRS”) will replace Canadian GAAP for publicly accountable enterprises, which includes investment funds. In June 2010, the CASB issued an exposure draft “Adoption of IFRSs by Investment Companies”, proposing that investment companies currently applying Accounting Guideline 18 (“AcG 18”) “Investment Companies” issued by the Canadian Institute of Chartered Accountants (“CICA”), defer the adoption of IFRS by one year to fiscal years beginning on or after January 1, 2012. In September 2010, the CASB approved the optional one year deferral from IFRS adoption for investment companies applying AcG 18.

The Fund will adopt IFRS on January 1, 2012. 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.

### Results of Operations (*November 2010*)

While the economic recovery has continued to unfold through the period, the pace of the recovery has been disappointing. In particular, US housing and unemployment has remained weak. The silver lining is that interest rates have remained low and in fact fell through the period, particularly upon the announcement of a second quantitative easing program from the US Fed. As a result of persistently low interest rates, the demand for income-oriented securities was strong throughout the period to the benefit of the Fund.

#### *Income Trusts*

Income trusts continued to outperform through the year with the demand for income. Despite distribution cuts from many income trusts, the cuts were well-telegraphed and became essentially a non-event. As income trusts converted to Corporations, many performed well due to the attention from a greater proportion of investors including those with the TSX Equity-only Index as their benchmark. We expect most of the remaining Income Trusts to convert by January.

#### *Recent New Additions*

*Brookfield Infrastructure Partners (BIP.UN)*: The partnership was spun out in early-2008 as the infrastructure platform of Brookfield Asset Management (BAM). While the company lacked scale with its initial asset base, it has recently undergone a transformational acquisition and capital raise which now gives it the scale to compete on a global basis. We believe this acquisition was done on very attractive terms as the vendor, Babcock and Brown Infrastructure in Australia, was over-levered and facing near-term debt maturities. In terms of assets, the deal adds one of the world's largest coal terminals, the largest port operator in the UK and several other transportation and utility assets to its existing mix of timberlands and transmission assets. At purchase, the stock yielded 7.3% and has raised the distribution twice over the past year.

#### *REITs*

Towards the beginning of the period, the weighting in REITs was increased significantly. REITs offer compelling valuation, stable fundamentals which have improved over the course of the year and superior yields and are a cornerstone of the Fund.

The Investment Manager has been particularly positive on apartments. Historically the most defensive property class in the market, apartments are also benefitting from low utility costs, rising rents and most importantly exceptionally low borrowing costs. This is because apartments can issue Canadian Housing and Mortgage Corp (CMHC) insured mortgages at exceptionally low interest costs, a huge advantage vs. other commercial property types. Despite these factors, Canadian apartment companies have traded in-line with the Canadian REIT market and at a significant discount to US apartment REITs.

#### *Recent New Additions*

*Northern Property REIT (NPR.UN)*: Apartment REIT focused on more remote northern communities (BC, NWT, Nunavut, Nfld, AB) has proven to be very resilient over time with some upside driven by its exposure to resource-oriented markets. The REIT has a 6% yield with one of the lowest payout ratios in the group and raised their distributions last month.

*Transglobe Apartment REIT (TGA.UN)*: Transglobe is a recent IPO that began trading on May 14. They possess a quality apartment portfolio and a good pipeline of acquisitions, which sets it apart from its peers as private apartment deals are impossible to source right now. Given it was priced in a weak market, we believe the terms were attractive and it benefits from the attributes listed above for apartment REITs and has an attractive 7.8% yield.

### ***Bonds***

The Fund continues to have a significant weighting in fixed income, although it has reduced over the course of the year. The bond market has continued to perform well as government rates have fallen and credit spreads have continued to compress.

### ***Recent New Additions***

*RTL-Westcan*: a private company is one of the largest niche bulk commodity haulers in western Canada. We purchased the company's new issue of 9.5% senior secured notes, as we believe they have significant barriers to entry, a substantial market share, good assets and a strong management team.

### ***Leverage***

The Investment Manager employs leverage in the Portfolio to enhance returns when it considers market conditions appropriate. The Fund has entered into a Revolving Term Credit Facility Agreement with Bank of Montreal ("BMO"). The aggregate amount of borrowings under the loan facility and other leverage transactions may not exceed 15% of the gross asset value of the Fund.

Leverage has not been used since early October 2006.

### ***Capital transactions***

On December 15, 2004, the Fund completed an initial public offering pursuant to the prospectus dated November 29, 2004. \$140,000,000 was raised through the issue of 14 million Units at \$10.00 per Unit. On December 23, 2004, the Agents exercised an over-allotment option in respect of 0.375 million Units, raising a further \$3,750,000. Total proceeds from these two transactions after Agents' fees and issue expense were \$135,573,135.

In January 2010, on the Fund's annual Redemption Date, unitholders exercised their right to redeem 704,042 units at January 31, 2010 NAV per unit price totalling \$6,308,282 less the costs of funding the redemption including all brokerage fees, commissions and other costs incurred in liquidating the securities held in the portfolio (the amount \$8,336,484 was paid to redeem 1,183,995 units at January 31, 2009).

### ***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 Units closing price 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.

During the year ended October 31 2010 the Fund purchased 14,580 Units for cancellation at a total cost of \$125,790 (114,200 units at a cost of \$759,683 during the year ended October 31, 2009). All units purchased by the Fund were subsequently cancelled.

### ***Distributions***

The Fund has made all its scheduled distributions during the year ended October 31, 2010 paying regular monthly distributions of \$0.0583 to holders of record on the last business day of each month totalling \$0.6996 per unit (\$0.6996 per unit during the year ended October 31, 2009).

## **Related Party Transactions**

### ***Management Fees***

Pursuant to a trust agreement (“the Trust Agreement”) the Fund retained Connor, Clark & Lunn Capital Markets Inc. (“the Manager”) to act as manager. As compensation for coordinating the organization of and managing the ongoing business and administrative affairs of the Fund, the Manager is entitled to an annual management fee in an amount equal to 1.10% per annum of the net asset value of the Fund to be calculated and payable monthly in arrears, plus applicable taxes.

The total management fees charged to the Fund during the year ended October 31, 2010 were \$530,240 (2009 - \$472,641). The Manager pays the Investment Manager out of the above management fees.

### ***Service Fees***

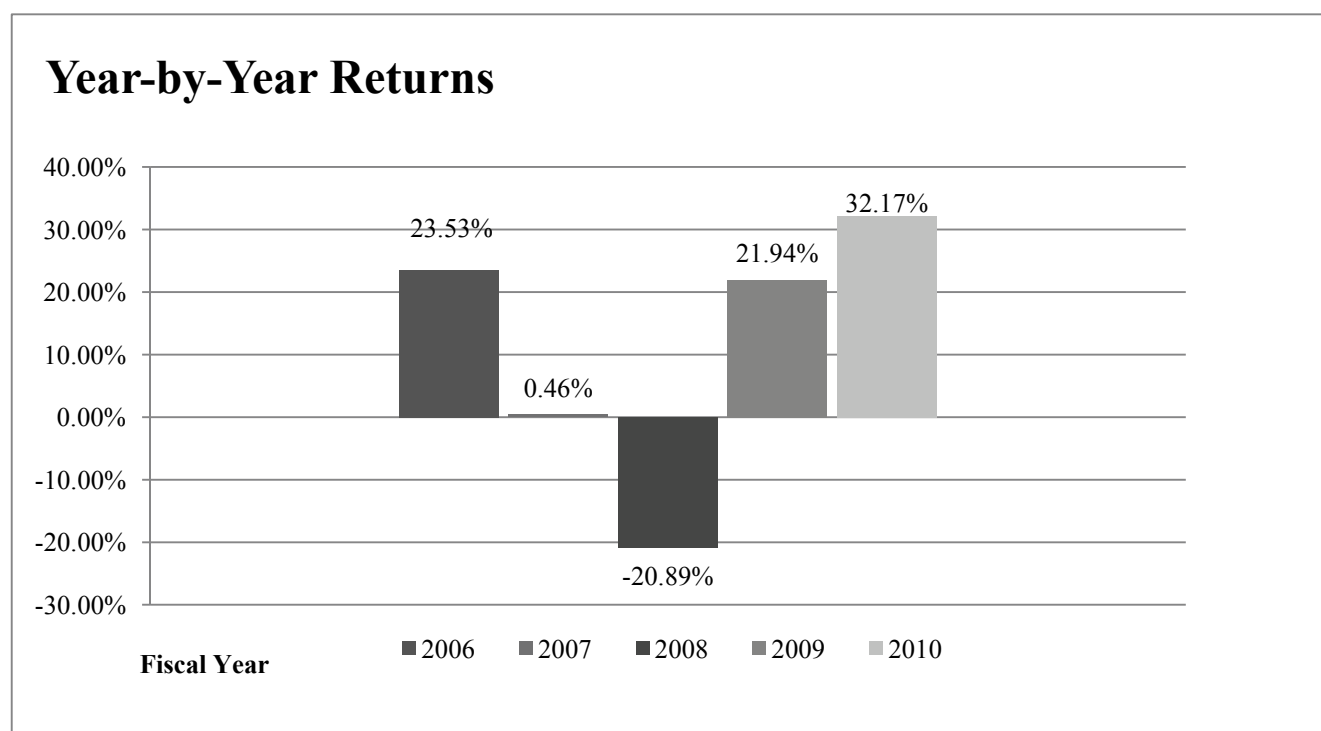
The Fund also pays a service fee to dealers whose clients hold Units in the Fund. The service fee is calculated and payable each calendar quarter in arrears and is equal to 0.40% annually of the net asset value of the Units held by clients of the dealers. The Fund is also responsible for all expenses incurred in connection with its operation and administration. The total service fees charged to the Fund during the year ended October 31, 2010 were \$178,449 (2009 - \$161,972).

## Past Performance

The following bar chart and table indicate the performance of the 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 periods 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	Five Years	Since Inception <sup>(1)</sup>
Based on NAV	32.17%	8.43%	9.61%	9.23%
Based on share price	29.61%	8.00%	9.91%	7.61%
Index <sup>(3)</sup>	30.82%	7.52 %	8.21%	10.31 %

<sup>(1)</sup> Annualized for the period December 15, 2004 (Commencement of operations) to October 31, 2010.

<sup>(2)</sup> Annualized for the three year period November 1, 2007 to October 31, 2010.

<sup>(3)</sup> Index of 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 <sup>(1)</sup>:

	October 31, 2010	October 31, 2009	October 31, 2008	October 31, 2007	October 31, 2006
<b>Net Assets, beginning of period</b>	<b>8.28</b>	<b>7.45</b>	<b>10.17</b>	<b>10.89</b>	<b>9.43</b>
<b>Increase (decrease) from operations:</b>					
Total revenues	0.59	0.61	0.61	0.57	0.69
Total expenses	(0.20)	(0.16)	(0.19)	(0.22)	(0.20)
Realized gains (losses) for the period	0.43	(1.69)	(0.17)	0.28	0.52
Unrealized gains (losses) for the period	1.76	2.62	(2.24)	(0.81)	1.23
<b>Total increase (decrease) from operations <sup>(2)</sup></b>	<b>2.58</b>	<b>1.38</b>	<b>(1.99)</b>	<b>(0.18)</b>	<b>2.24</b>
<b>Distributions:</b>					
From income (excluding dividends)	(0.07)	(0.15)	(0.32)	(0.41)	(0.34)
From dividends	(0.02)	(0.01)	(0.01)	(0.04)	(0.06)
From capital gains	—	—	(0.11)	(0.25)	(0.28)
Return of capital	(0.61)	(0.54)	(0.26)	—	(0.02)
<b>Total Distributions <sup>(3)</sup></b>	<b>(0.70)</b>	<b>(0.70)</b>	<b>(0.70)</b>	<b>(0.70)</b>	<b>(0.70)</b>
<b>Net Assets, end of period <sup>(4)</sup></b>	<b>10.14</b>	<b>8.28</b>	<b>7.45</b>	<b>10.17</b>	<b>10.89</b>

<sup>(1)</sup> This information is derived from the Fund's audited annual financial statements. The net assets per unit presented in the financial statements differs from the net asset value per unit calculated for transactional purposes. The difference between the net asset value per unit and the net assets per unit as shown on the Statement of Net Assets is due to the different pricing methodology discussed in note 3 to the financial statements.

<sup>(2)</sup> 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.

<sup>(3)</sup> Distributions were paid in cash.

<sup>(4)</sup> This is not a reconciliation between the opening and the closing net assets per unit.

### Ratios and Supplemental Data:

	October 31, 2010	October 31, 2009	October 31, 2008	October 31, 2007	October 31, 2006
Net asset value (\$000's)	\$48,057	\$45,196	\$50,514	\$89,524	\$128,239
Number of units outstanding	4,719,817	5,438,439	6,736,634	8,764,853	11,779,213
Base Management expense ratio <sup>(1)(2)</sup>	1.97%	1.96%	1.80%	1.74%	1.75%
Interest expense ratio (annualized) <sup>(1)(2)</sup>	—	—	—	—	0.18%
Management expense ratio (annualized) <sup>(2)</sup>	1.97%	1.96%	1.80%	1.74%	1.93%
Management expense ratio before waivers or absorptions (annualized) <sup>(2)</sup>	1.97%	1.96%	1.80%	1.74%	1.93%
Portfolio turnover rate <sup>(3)</sup>	48.56%	50.42%	68.14%	117.87%	80.30%
Trading expense ratio <sup>(4)</sup>	0.18%	0.26%	0.20%	0.44%	0.30%
Net asset value per unit	\$10.18	\$8.31	\$7.50	\$10.21	\$10.89
Closing market price (TSX)	\$9.66	\$8.07	\$7.05	\$9.95	\$10.61

<sup>(1)</sup> A separate base management expense ratio has been presented to include the normal operating expenses and exclude (i) Issue expense ratio: representing all agents fees and unit issue expenses; (ii) Interest expense ratio: representing interest expense on bank indebtedness.

<sup>(2)</sup> Management expense ratio is based on total expenses (including interest expense on bank indebtedness) 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.

<sup>(3)</sup> 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.

<sup>(4)</sup> 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 October 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).

	Rate %	Maturity Date	Fair Value \$	% of NAV
<b>Portfolio by Category</b>				
Financials			15,628,101	32.7%
Corporate Bonds			9,221,596	19.2%
Industrials			5,711,552	12.0%
Utilities			5,571,118	11.6%
Consumer Discretionary			4,725,982	9.8%
Energy			3,076,799	6.4%
Cash & Cash Equivalents			2,885,796	6.0%
Materials			1,389,240	2.9%
Foreign currency forward contracts			43,214	0.1%
<b>Top 25 Holdings</b>				
Cash & Cash Equivalents			2,885,796	6.0%
Chartwell Seniors Housing Real Estate Investment Trust			2,613,325	5.4%
Canadian Apartment Properties Real Estate Investment Trust			2,436,714	5.1%
Brookfield Infrastructure Partners LP			2,334,948	4.9%
Inn Vest Real Estate Investment Trust			2,250,225	4.7%
Transglobe Apartment Real Estate Investment Trust			2,032,610	4.2%
Northland Power Inc. Fund			2,027,200	4.2%
IBI Income Fund			2,002,313	4.2%
Cominar Real Estate Investment Trust			1,917,396	4.0%
Wajax Income Fund			1,912,689	4.0%
Fort Chicago Energy Partners LP			1,832,613	3.8%
Cineplex Galaxy Income Fund			1,792,674	3.7%
Altus Group Income Fund			1,558,905	3.2%
CML Healthcare Income Fund			1,472,835	3.1%
Yellow Pages Income Fund			1,460,473	3.0%
Labrador Iron Ore Royalty Inc.			1,389,240	2.9%
Northern Property Real Estate Investment Trust			1,249,710	2.6%
Valener Inc.			1,208,970	2.5%
Genivar Income Fund			1,185,810	2.5%
Crombie Real Estate Investment Trust			946,460	2.0%
Morgan Stanley	4.90%	2/23/2017	780,495	1.6%
Keyera Facilities Inc.			719,626	1.5%
Tesoro Corp (U.S. Dollars)	6.50%	6/1/2017	717,411	1.5%
Corus Entertainment Inc.	7.25%	2/10/2017	704,550	1.5%
Great West Life Co. (U.S. Dollars)	7.15%	5/16/2016	698,077	1.5%
<b>Net asset value</b>			<b>48,056,617</b>	

## Management's Responsibility for Financial Reporting

The accompanying financial statements of **Connor, Clark & Lunn Conservative Income Fund** (the "Fund") and all of 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 of 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  
Chief Financial Officer  
Connor, Clark & Lunn Capital Markets Inc.

Toronto, Canada

**January 12, 2011**

January 12, 2011

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**Auditor's Report**

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

We have audited the statement of investment portfolio of Connor, Clark & Lunn Conservative Income Fund (the Fund) as at October 31, 2010, the statements of net assets as at October 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 Manager of the Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at October 31, 2010 and 2009 and the results of its operations, 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

Statements of Net Assets

As at October 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Assets</b>		
Cash	390,769	54,914
Short-term investments	2,495,027	1,399,041
Investments at fair value (cost - \$37,530,482; 2009 - \$46,468,431)	45,139,930	45,503,366
Interest and dividends receivable	356,913	539,428
Unrealized gain on forward currency contracts	43,214	-
Receivable from investment sales	647,267	369,644
Prepaid expenses	4,358	2,840
Variation margin receivable	-	7,441
	<u>49,077,478</u>	<u>47,876,674</u>
<b>Liabilities</b>		
Payable for investment purchases	746,472	2,334,160
Distributions payable	275,165	317,061
Accounts payable and accrued liabilities	100,107	100,003
Management fees payable	47,467	42,877
Unrealized loss on forward currency contracts	-	12,186
Unrealized loss on future contracts	-	18,730
Variation margin payable	36,107	-
	<u>1,205,318</u>	<u>2,825,017</u>
<b>Net Assets and Unitholders' Equity</b>	<u>47,872,160</u>	<u>45,051,657</u>
<b>Units issued and outstanding</b> (note 5)	<u>4,719,817</u>	<u>5,438,439</u>
<b>Net assets per unit</b>	<u>10.14</u>	<u>8.28</u>
<b>Unitholders' Equity</b>		
Unit capital	37,115,266	46,218,409
Contributed surplus	2,354,121	2,681,005
Surplus (deficit)	8,402,773	(3,847,757)
<b>Total Unitholders' Equity</b>	<u>47,872,160</u>	<u>45,051,657</u>

Approved by the Manager



Director



Director

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Conservative Income Fund

## Statements of Operations

For the years ended October 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Income</b>		
Distributions received from income trusts	2,105,705	2,503,164
Interest	790,442	1,031,164
	<u>2,896,147</u>	<u>3,534,328</u>
<b>Expenses (note 8)</b>		
Management fees	530,240	472,641
Service fees (note 9)	178,449	161,972
Transaction costs (note 11)	81,319	111,373
Custodial and other unitholders' fees	45,289	47,232
Administration fees	20,372	18,410
Audit Fees	23,583	27,508
Advisory board fees	21,167	21,149
Transfer agent fees	15,825	16,660
Listing fees	10,259	11,764
Interest expenses	8,347	8,470
Loan fee expense	5,000	-
Printing fees	4,926	8,908
Legal fees	2,945	1,830
Other	14,344	5,534
IRC fees	1,512	1,152
Filing fees	1,175	24,107
	<u>964,752</u>	<u>938,710</u>
<b>Investment income (loss) for the period</b>	<u>1,931,395</u>	<u>2,595,618</u>
<b>Net realized gain (loss) on investments</b>		
Net realized gain (loss) on investments	1,947,305	(9,474,029)
Net realized gain (loss) on foreign exchange	3,738	(9,205)
Net realized gain (loss) on future contracts	(43,548)	(82,749)
Net realized gain (loss) on foreign exchange contracts	197,119	(249,078)
	<u>2,104,614</u>	<u>(9,815,061)</u>
<b>Net unrealized gain (loss) on investments</b>		
Change in unrealized gain (loss) on investments	8,574,513	14,683,608
Change in unrealized gain (loss) on future contracts	18,730	(41,528)
Change in unrealized gain (loss) on foreign exchange	216	(651)
Change in unrealized gain (loss) on foreign exchange contracts	55,400	606,764
	<u>8,648,859</u>	<u>15,248,193</u>
<b>Net gain on investments</b>	<u>10,753,473</u>	<u>5,433,132</u>
<b>Increase in net assets from operations</b>	<u>12,684,868</u>	<u>8,028,750</u>
<b>Increase in net assets from operations per unit *</b>	<u>2.58</u>	<u>1.38</u>
<b>Distributions per unit</b>	<u>0.70</u>	<u>0.70</u>

\* based on weighted average number of units of 4,912,527 units outstanding as of October 31, 2010 (2009 - 5,813,710).

(See accompanying notes to financial statements)

## Connor, Clark & Lunn Conservative Income Fund

Statements of Changes in Net Assets, Surplus (Deficit) and Contributed Surplus  
For the years ended October 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Increase in net assets from operations</b>	<u>12,684,868</u>	<u>8,028,750</u>
<b>Distributions to unitholders from:</b>		
Net investment income	(434,338)	(931,591)
Return on capital	<u>(2,995,955)</u>	<u>(3,118,886)</u>
	<u>(3,430,293)</u>	<u>(4,050,477)</u>
<b>Unitholders' transactions:</b>		
Payments on redemption/cancellation of units (notes 4 and 5)	<u>(6,434,072)</u>	<u>(9,096,167)</u>
<b>Change in net assets during the year</b>	2,820,503	(5,117,894)
<b>Net assets - Beginning of year</b>	<u>45,051,657</u>	<u>50,169,551</u>
<b>Net assets - End of year</b>	<u>47,872,160</u>	<u>45,051,657</u>
<b>Surplus (deficit), beginning of year</b>	(3,847,757)	(10,944,916)
Increase (decrease) in net assets from operations	12,684,868	8,028,750
Distributions to unitholders	<u>(434,338)</u>	<u>(931,591)</u>
<b>Surplus (deficit), end of year</b>	<u>8,402,773</u>	<u>(3,847,757)</u>
<b>Contributed surplus , beginning of year</b>	2,681,005	-
Cost of shares repurchased / redeemed at less than original issue price	<u>(326,884)</u>	<u>2,681,005</u>
<b>Contributed surplus , end of year</b>	<u>2,354,121</u>	<u>2,681,005</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Conservative Income Fund

## Statements of Cash Flow

For the years ended October 31, 2010 and 2009

	2010	2009
	\$	\$
<b>Operating Activities</b>		
Increase in net assets from operations	12,684,868	8,028,750
Items not affecting cash:		
Net realized (gain) loss on investments	(1,947,305)	9,474,029
Change in unrealized (gain) loss on investments	(8,574,513)	(14,683,608)
Change in unrealized (gain) loss on future contracts	(18,730)	41,528
Change in unrealized (gain) loss on foreign exchange contracts	(55,400)	(606,764)
Changes in non-cash working capital		
(Increase) decrease in interest and dividends receivable	182,515	129,269
(Increase) decrease in variation margin receivable	43,548	(2,252)
(Increase) decrease in prepaid expenses	(1,518)	1,141
Increase (decrease) in accounts payable and accrued liabilities	104	4,990
Increase (decrease) in management fees payable	4,590	(19,542)
Cost of investments purchased	(23,205,649)	(19,735,232)
Proceeds from investments sold	32,225,592	30,777,856
	<u>11,338,102</u>	<u>13,410,165</u>
<b>Net cash flow provided by (used in) operating activities</b>		
	<u>11,338,102</u>	<u>13,410,165</u>
<b>Financing Activities</b>		
Payments on redemption/cancellation of units	(6,434,072)	(9,096,167)
Distributions to unitholders	(3,472,189)	(4,126,243)
	<u>(9,906,261)</u>	<u>(13,222,410)</u>
<b>Net cash flow provided by (used in) financing activities</b>		
	<u>(9,906,261)</u>	<u>(13,222,410)</u>
<b>Net increase in cash and short-term investments</b>	1,431,841	187,755
<b>Cash and short-term investments - beginning of year</b>	1,453,955	1,266,200
	<u>2,885,796</u>	<u>1,453,955</u>
<b>Cash and short-term investments - end of year</b>		
	<u>2,885,796</u>	<u>1,453,955</u>
<b>Supplementary Information</b>		
Interest paid	8,347	8,470

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Conservative Income Fund

Statement of Investment Portfolio

As at October 31, 2010

			Par Value / Quantity	Average Cost \$	Fair Value \$	% of Net Assets
<b>Short Term Investments</b>						
<b>Bankers acceptances</b>						
Bank of Nova Scotia	11/15/2010		250,000	249,536	249,536	0.5%
Bank of Nova Scotia	12/29/2010		900,000	898,380	898,380	1.9%
Bank of Nova Scotia	1/6/2011		100,000	99,711	99,711	0.2%
Canadian Imperial Bank of Commerce	1/24/2011		100,000	99,719	99,719	0.2%
<b>Bearer deposit notes</b>						
Bank of Nova Scotia	12/29/2010		1,000,000	998,098	998,098	2.1%
Royal Bank of Canada	1/19/2011		150,000	149,583	149,583	0.3%
				<u>2,495,027</u>	<u>2,495,027</u>	<u>5.2%</u>
<b>Investments</b>						
<b>Corporate bonds</b>						
Goldman Sachs Capital II (U.S. Dollars)	5.79%	6/1/2012	220,000	179,839	192,251	0.4%
Russel Metals Inc. (U.S. Dollars)	6.38%	3/1/2014	200,000	197,256	202,503	0.4%
Sally Holdings LLC (U.S. Dollars)	9.25%	11/15/2014	455,000	440,272	486,739	1.0%
Ford Credit Canada	7.50%	8/18/2015	540,000	540,000	579,912	1.2%
American Achievement (U.S. Dollars)	10.88%	4/15/2016	385,000	403,186	402,552	0.8%
Great West Life Co. (U.S. Dollars)	7.15%	5/16/2016	700,000	624,015	690,954	1.4%
Corus Entertainment Inc.	7.25%	2/10/2017	660,000	660,000	702,075	1.5%
Morgan Stanley	4.90%	2/23/2017	772,000	730,791	778,082	1.6%
Freeport McMoran Copper & Gold (U.S. Dollars)	8.38%	4/1/2017	500,000	571,816	575,583	1.2%
Westcan Limited Partnership	9.50%	4/7/2017	375,000	375,000	375,469	0.8%
Tesoro Corp (U.S. Dollars)	6.50%	6/1/2017	705,000	638,580	713,824	1.5%
Armtec Holdings Ltd	8.88%	9/22/2017	230,000	230,000	237,975	0.5%
Visant Corp (U.S. Dollars)	10.00%	10/1/2017	320,000	343,468	346,800	0.7%
TD Northgroup (U.S. Dollars)	6.38%	10/15/2017	200,000	177,094	193,105	0.4%
GE Capital Trust I (U.S. Dollars)	6.38%	11/15/2017	200,000	166,762	201,231	0.4%
US Steel Corp (U.S. Dollars)	7.00%	2/1/2018	450,000	467,170	468,225	1.0%
Spectrum Brands Holdings (U.S. Dollars)	9.50%	6/15/2018	150,000	166,936	169,527	0.4%
Videotron LTEE	7.13%	1/15/2020	475,000	476,250	501,924	1.0%
CHC Helicopter (U.S. Dollars)	9.25%	10/15/2020	220,000	222,583	233,947	0.5%
Bell Canada (Prydes)	8.88%	4/17/2026	300,000	352,710	369,028	0.8%
Brascan Corporation	5.95%	6/14/2035	286,000	301,255	269,594	0.6%
Citigroup Financial Inc.	5.37%	3/6/2036	639,000	485,754	494,332	1.0%
				<u>8,750,737</u>	<u>9,185,632</u>	<u>19.1%</u>
<b>Canadian common stock</b>						
<b>Energy</b>						
Enbridge Income Fund			31,600	449,984	521,400	1.1%
Fort Chicago Energy Partners LP			145,100	1,257,918	1,828,260	3.8%
Keyera Facilities Inc.			22,737	387,382	716,443	1.5%
				<u>2,095,284</u>	<u>3,066,103</u>	<u>6.4%</u>
<b>Materials</b>						
Labrador Iron Ore Royalty Inc.			22,700	674,970	1,384,700	2.9%
<b>Industrials</b>						
Genivar Income Fund			42,050	942,967	1,177,400	2.5%
Wajax Income Fund			58,979	1,546,073	1,906,201	4.0%
IBI Income Fund Unit Trust			135,750	1,914,133	1,995,525	4.2%
Westshore Terminals Income Fund			26,100	449,419	609,174	1.3%
				<u>4,852,592</u>	<u>5,688,300</u>	<u>12.0%</u>

(See accompanying notes to financial statements)

## Connor, Clark & Lunn Conservative Income Fund

Statement of Investment Portfolio .... Continued

As at October 31, 2010

	Par Value / Quantity	Average Cost \$	Fair Value \$	% of Net Assets		
<b>Consumer Discretionary</b>						
Cineplex Galaxy Income Fund	84,600	1,366,472	1,788,444	3.7%		
Yellow Pages Income Fund	238,250	1,961,965	1,434,265	3.0%		
CML Healthcare Income Fund	118,300	1,838,935	1,468,103	3.1%		
		<u>5,167,372</u>	<u>4,690,812</u>	<u>9.8%</u>		
<b>Financials</b>						
Allied Properties Real Estate Investment Trust	27,000	465,873	605,070	1.3%		
Altus Group Income Fund	100,900	773,412	1,550,833	3.2%		
Canadian Apartment Properties Real Estate Investment Trust	139,800	1,789,284	2,426,928	5.1%		
Chartwell Seniors Housing Real Estate Investment Trust	279,500	1,503,247	2,610,530	5.5%		
Cominar Real Estate Investment Trust	88,400	1,691,711	1,914,744	4.0%		
Crombie Real Estate Investment Trust	74,000	822,817	941,280	2.0%		
H&R Real Estate Investment Trust	800	15,856	16,312	0.0%		
Inn Vest Real Estate Investment Trust	328,500	1,843,228	2,243,655	4.7%		
Northern Property Real Estate Investment Trust	46,200	1,032,815	1,243,242	2.6%		
Transglobe Apartment Real Estate Investment Trust	192,300	1,916,184	2,032,612	4.2%		
		<u>11,854,427</u>	<u>15,585,206</u>	<u>32.6%</u>		
<b>Utilities</b>						
Brookfield Infrastructure Partners LP	107,800	1,628,203	2,309,076	4.8%		
Valener Inc.	70,700	1,155,355	1,205,435	2.5%		
Northland Power Inc. Fund	126,700	1,420,342	2,024,666	4.2%		
		<u>4,203,900</u>	<u>5,539,177</u>	<u>11.5%</u>		
<b>Total Canadian common stock</b>		<u>28,848,545</u>	<u>35,954,298</u>	<u>75.2%</u>		
<b>Total Investments (Transactional net asset value)</b>		<u>37,599,282</u>	<u>45,139,930</u>	<u>94.3%</u>		
Transaction costs - Section 3855 adjustment (note 3)		<u>(68,800)</u>	<u>-</u>	<u>0.0%</u>		
<b>Total Investments (GAAP net asset value)</b>		<u>37,530,482</u>	<u>45,139,930</u>	<u>94.3%</u>		
	<b>Maturity date</b>	<b>Number of contracts</b>	<b>Contract price / rate</b>	<b>Fair value</b>	<b>Unrealized gain (loss)</b>	<b>% of Net Assets</b>
			\$	\$	\$	
<b>Foreign currency forward contracts</b>						
Bought CAD 3,806,365 , sold USD 3,700,800	12/20/2010	1	1.0285	3,841,791	35,426	0.1%
Bought CAD 610,356 , sold USD 590,400	12/20/2010	1	1.0338	619,115	8,759	0.0%
Bought USD 170,000 , sold CAD 175,150	12/20/2010	1	1.0303	173,222	(1,928)	0.0%
Bought CAD 170,532 , sold USD 168,700	12/20/2010	1	1.0109	169,173	(1,359)	0.0%
Bought CAD 206,723 , sold USD 202,500	12/20/2010	1	1.0209	207,111	388	0.0%
Bought USD 37,500 , sold CAD 38,853	12/20/2010	1	1.0361	38,211	(642)	0.0%
Bought CAD 405,155 , sold USD 395,100	12/20/2010	1	1.0255	407,725	2,570	0.0%
					<u>43,214</u>	<u>0.1%</u>
<b>Other assets net of other liabilities</b>					<u>193,989</u>	<u>0.4%</u>
<b>Net assets</b>					<u>47,872,160</u>	<u>100.0%</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Conservative Income Fund

## Notes to Financial Statements

October 31, 2010

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### 1 Formation of Fund

Connor, Clark & Lunn Conservative Income Fund (the "Fund") is an investment fund established under the laws of the Province of Ontario pursuant to a trust agreement dated as of November 29, 2004 (the "Trust Agreement") between Connor, Clark & Lunn Capital Markets Inc. (the "Manager") in its capacity as manager and RBC Dexia Investor Services Trust ("RBC Dexia") (formerly "The Royal Trust Company") (the "Trustee") as trustee.

### 2 Investment objectives

The Fund's investment objectives as set out in the Prospectus dated November 29, 2004 are (i) to pay to holders of Units ("Unitholders") a monthly cash distributions of approximately \$0.0583 per Unit (\$0.70 per annum to yield 7.0% per annum on the issue price of \$10.00 per Unit) and (ii) preserve net asset value in order to return at least the issue price of the Units (\$10.00 per Unit) on or about December 15, 2014.

### 3 Summary of significant accounting policies

#### Terms and definitions

Any reference to "Net Assets" or "Net Assets per Unit" or "GAAP Net Assets" means that the value was determined in accordance with 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 below.

#### Basis of presentation

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

#### International Financial Reporting Standards ("IFRS")

The Canadian Accounting Standards Board ("CASB") previously confirmed that effective January 1, 2011, IFRS will replace Canadian GAAP for publicly accountable enterprises, which includes investment funds. In June 2010, the CASB issued an exposure draft "Adoption of IFRSs by Investment Companies", proposing that investment companies currently applying Accounting Guideline 18 ("AcG 18") "Investment Companies" issued by the Canadian Institute of Chartered Accountants ("CICA"), defer the adoption of IFRS by one year to fiscal years beginning on or after January 1, 2012. In September 2010, the CASB approved the optional one year deferral from IFRS adoption for investment companies applying AcG 18.

The Fund will adopt IFRS on January 1, 2012. 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.

#### 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 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.

As at October 31, 2010, the Fund's net asset value per unit was \$10.18. The difference between the net asset value per unit and the net assets per unit as shown on the Statement of Net Assets is due to the different pricing methodology discussed above. The reconciliation between the Transactional NAV and the GAAP Net Assets as a result of the adoption of Section 3855 is as follows:

	Transactional NAV	Section 3855 Adjustment	GAAP Net Assets
<b>Per Unit</b>			
Opening Value – November 1, 2009	8.31	(0.03)	8.28
Closing Value – October 31, 2010	10.18	(0.04)	10.14

#### Cash and short-term investments

Cash and short term investments include cash and cash equivalents with maturities of less than 90 days from the date of acquisition.

# Connor, Clark & Lunn Conservative Income Fund

## Notes to Financial Statements

October 31, 2010

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### Income recognition

Income from investments is recognized on an accrual basis. Dividend income is recognized 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 on investments are 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 and short-term investments) are attributable to investments and derivatives which are deemed held for trading.

### Foreign currency forward contracts

The Fund may enter into foreign currency forward contracts to hedge against exposure to foreign currency fluctuations. The carrying value of these contracts is the gain or loss that would be realized if the position were closed out on the valuation date, and is recorded as an unrealized gain or loss. Upon closing of a contract, the gain or loss is recorded as a net realized gain or loss on foreign currency forward contracts.

### 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 futures contracts are reflected in the Statements of Net Assets as unrealized gain or loss on future contracts and variation margin receivable (payable).

### Unit valuation

The net asset value per unit is determined by dividing the aggregate market value of net assets of the Fund by the total number of units of the Fund outstanding before giving effect to redemptions or subscriptions for units on that day.

## 4 Market Purchase Program

In accordance with the Fund's prospectus, and to enhance liquidity and to provide support to the units, the Fund has a mandatory market purchase program under which the Fund, subject to exceptions contained in the Trust Agreement and in compliance with any regulatory requirements, is obligated to purchase its own units for cancellation. If, on any business day, the closing price of the units is less than 95% of the net asset value per unit determined by the trustee as at the most recent valuation date, the Fund will offer to purchase for cancellation any units offered in the market at or below 95% of the net asset value per unit on the following business day. The maximum number of units to be purchased in any quarterly period will not be over 1.25% of the number of units outstanding at the beginning of such period.

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.

During the year ended October 31, 2010, the Fund purchased 14,580 Units for cancellation at a total cost of \$125,790 (114,200 units at a cost of \$759,683 during the year ended October 31, 2009). All units purchased by the Fund either were or will be cancelled.

## 5 Units of the Fund

Units of the Fund were offered to the public by way of prospectus. The Fund is authorized to issue 14,375,000 (representing the maximum amount stated in the prospectus plus a 15% over allotment) transferable, redeemable Fund units of one class, each of which represents an equal, undivided interest in the net assets of the Fund.

Units may be surrendered at any time for redemption by the Fund. Where Units are surrendered for redemption prior to the 10<sup>th</sup> business day of the month, Units will be redeemed on the last business day of that month (a "Redemption Date"); where Units are surrendered after the 10th day of the month, Units will be redeemed on the Redemption date of the following month. For redemptions occurring on a Redemption Date other than the January Redemption Date of each year, the redemption price per Unit is equal to the lesser of:

- (a) 95% of the weighted average trading price of the Units on the Toronto Stock Exchange for the ten trading days immediately preceding the applicable Redemption Date, and
- (b) 100% of the closing price of the Units on the Toronto Stock Exchange on the applicable Redemption Date, minus an amount equal to the aggregate of all brokerage fees, commissions and other costs incurred by the Fund in connection with the redemption including costs incurred in liquidating securities held in the portfolio.

For redemptions on the January Redemption Date in each year the redemption price will be equal to the net asset value per Unit determined as of the relevant Redemption Date, minus an amount equal to the aggregate of all brokerage fees, commissions and other costs incurred by the Fund in connection with the redemption including costs incurred in liquidating securities held in the portfolio. In January 2010, the Fund's annual Redemption Date, unitholders exercised their right to redeem 704,042 units at January 31, 2010 NAV per unit price totalling \$6,308,282 less the costs of funding the redemption including all brokerage fees, commissions and other costs incurred in liquidating the securities held in the portfolio (the amount \$8,336,484 was paid to redeem 1,183,995 units at January 31, 2009).

If the redemption price is lower than the original price, the difference is included in Contributed Surplus on the statements of net assets. If the price is greater than the original issue price, the difference is first charged to Contributed Surplus until the entire account is eliminated, and the remaining amount is charged to retained earnings (deficit).

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

# Connor, Clark & Lunn Conservative Income Fund

## Notes to Financial Statements

October 31, 2010

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Changes in outstanding units during year ended October 31, 2010 and 2009 are summarized as follows:

	2010	2009
Balance – beginning of year	5,438,439	6,736,634
Units redeemed under the Market Purchase Program (note 4)	(14,580)	(114,200)
Units redeemed	<u>(704,042)</u>	<u>(1,183,995)</u>
Balance – end of year	<u>4,719,817</u>	<u>5,438,439</u>

### 6 Custodian

Pursuant to a custodian agreement (“the Custodian Agreement”), the Fund has retained RBC Dexia to act 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.

### 7 Distributions

The targeted monthly distribution rate is \$0.0583 per Unit. During the year ended October 31, 2010, the Fund met its targeted monthly distribution and paid total distributions of \$3,430,293, or \$0.70 per Unit (\$4,050,477, or \$0.70 per Unit during the year ended October 31, 2009).

### 8 Management fees and other expenses

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 receives an annual management fee in an amount equal to 1.1% of the net asset value of the Fund, calculated and paid monthly in arrears, plus applicable taxes. The Fund is also responsible for all expenses incurred in connection with its operation and administration.

### 9 Service fees

The Fund pays a service fee to dealers whose clients hold Units in the Fund. The service fee is calculated and payable each calendar quarter in arrears and is equal to 0.40% annually of the net asset value of the Units held by clients of the dealers. The total service fees charged to the Fund during the year ended October 31, 2010 were \$178,449 (2009 - \$161,972).

### 10 Income taxes

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

As at December 31, 2009, the Fund had net capital losses of \$11,206,714 (2008 - \$1,199,369), which may be carried forward indefinitely to reduce future realized capital gains.

### 11 Broker commission charges and soft dollar services

There were \$81,319 broker commissions paid during the year ended October 31, 2010 (\$111,373 during the year ended October 31, 2009) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.

# Connor, Clark & Lunn Conservative Income Fund

## Notes to Financial Statements

October 31, 2010

### 12 Financial instruments

<u>Assets</u>	<u>2010</u>	<u>2009</u>
Cash	390,769	54,914
Held for trading	47,678,171	46,902,407
Loans and receivables	1,004,180	919,353
<b>Total assets</b>	<b>49,073,120</b>	<b>47,876,674</b>
<u>Liabilities</u>		
Held for trading	–	30,916
Financial liabilities at amortized cost	1,205,318	2,794,101
<b>Total liabilities</b>	<b>1,205,318</b>	<b>2,825,017</b>

For the purposes of categorization in accordance with section 3862, interest and dividends receivable, receivable from investment sales and variation margin receivable are deemed to be loans and receivables and recorded at cost or amortized cost. Similarly, payable for investment purchases, distributions payable, management fees payable and accounts payable and accrued liabilities 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. The following table illustrates the classification of the Fund's financial instruments within the fair value hierarchy as at October 31, 2010 and 2009:

<u>Assets at fair value as at October 31, 2010</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
<b>Equities</b>	35,954,298	–	35,954,298
<b>Bonds</b>	–	9,185,632	9,185,632
<b>Foreign currency forward contracts</b>	–	43,214	43,214
<b>Total</b>	<b>35,954,298</b>	<b>9,228,846</b>	<b>45,183,144</b>

<u>Assets at fair value as at October 31, 2009</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
<b>Equities</b>	31,390,612	–	31,390,612
<b>Bonds</b>	–	14,112,754	14,112,754
<b>Total</b>	<b>31,390,612</b>	<b>14,112,754</b>	<b>45,503,366</b>

<u>Liabilities at fair value as at October 31, 2009</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
<b>Foreign currency forward contracts</b>	–	12,186	12,186
<b>Future contracts</b>	18,730	–	18,730
<b>Total</b>	<b>18,730</b>	<b>12,186</b>	<b>30,916</b>

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.

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

*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.

*Future contracts:* The Fund held in the prior year 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.

There were no transfers among the three levels during the years ended October 31, 2010 and 2009.

### 13 Financial instrument risk

The Fund's activities expose it to a variety of financial risks. The following is a description of these risks.

#### 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.

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2010:

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
<b>Investments</b>	–	192,250	1,269,154	7,724,227	35,997,512	<b>45,183,143</b>
<b>Cash and Short term investments</b>	2,495,027	–	–	–	390,769	<b>2,885,796</b>
<b>Other assets</b>	–	–	–	–	1,008,539	<b>1,008,539</b>
<b>Liabilities</b>	–	–	–	–	(1,205,318)	<b>(1,205,318)</b>
<b>Net assets</b>	2,495,027	192,250	1,269,154	7,724,227	36,191,502	<b>47,872,160</b>

2009:

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
<b>Investments</b>	337,440	810,900	1,973,262	10,991,152	31,359,696	<b>45,472,450</b>
<b>Cash and Short term investments</b>	1,399,041	–	–	–	54,914	<b>1,453,955</b>
<b>Other assets</b>	–	–	–	–	919,353	<b>919,353</b>
<b>Liabilities</b>	–	–	–	–	(2,794,101)	<b>(2,794,101)</b>
<b>Net assets</b>	1,736,481	810,900	1,973,262	10,991,152	29,539,862	<b>45,051,657</b>

As at October 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 \$506,000 (2009 - \$895,000). 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 Statement of Investments identifies all bonds denominated in foreign currencies. Bonds from other countries are presumed to be denominated in that country's currency unless otherwise noted.

The table below summarizes the Fund's exposure to foreign currencies as at October 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 and the approximate impact on net assets had the Canadian Dollar ("CAD") weakened by 5% in relation to these currencies. If the CAD 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.

2010:

	Monetary instruments	Non-monetary instruments	Derivative instruments	Total	% of Net Assets	Sensitivity (based on devaluation of CAD)
	\$	\$	\$	\$		\$
US Dollar	4,507,961	–	(5,033,481)	(156,240)	0.3%	(8,000)

2009:

	Monetary instruments	Non-monetary instruments	Derivative instruments	Total	% of Net Assets	Sensitivity (based on devaluation of CAD)
	\$	\$	\$	\$		\$
US Dollar	4,507,961	–	(4,023,686)	484,275	1.1%	24,000

### 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 October 31, 2010, with all other variables held constant, the net assets of the Fund would have increased or decreased, respectively, by approximately \$3,595,000 (2009 - \$3,139,000). In practise, actual results may differ from this sensitivity analysis and the difference could be material.

### Credit risk

Credit risk is the risk that 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 October 31, 2010. This also applies to other assets, as they have a short-term to settlement.

The tables below summarize the Fund's exposure to credit risk as of October 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.

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2010:

Rating	(% of Net Assets)	Rating	(% of Net Assets)
A+	0.50%	BB-	2.00%
A	2.00%	B+	2.50%
A-	3.00%	B	1.70%
BBB	1.20%	B-	0.70%
BBB-	1.20%	A-1+	5.00%
BB+	1.50%	A-1	0.20%
BB	2.90%		
		<b>Total</b>	<b>24.40%</b>

2009:

Rating	(% of Net Assets)	Rating	(% of Net Assets)
AAA	-0.10%	BB+	1.50%
AA+	0.90%	BB	1.50%
A+	0.40%	B	1.10%
A	3.60%	B-	0.60%
A-	10.60%	CCC	0.70%
BBB+	1.40%	N/R	1.80%
BBB	2.10%	A-1+	2.00%
BBB-	5.10%	A-1	1.10%
		<b>Total</b>	<b>34.30%</b>

As at October 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. The Fund is also exposed to unlimited annual anniversary redemptions on January 31 of every year (see notes 4 and 5). Therefore, the Fund invests the majority of its assets in investments that are traded in an active market and can be readily disposed of. In addition, the Fund retains sufficient cash and cash equivalent positions to meet its daily cash requirements.

## 14 Loan agreement

As part of its strategy, the Investment Manager may employ leverage in the Portfolio to enhance returns when market conditions are considered appropriate. The Investment Manager may reduce or eliminate leverage and may increase the allocation to cash when the Investment Manager believes the outlook for market performance is unfavourable. The aggregate amount of borrowings and other leverage under the Leverage Transactions may not exceed 15% of the assets of the Fund. Such leverage may be used to purchase additional securities for the Portfolio.

On November 29, 2005, the Fund entered into an annually Revolving Term Credit Facility Agreement (the "Credit Facility") with the Bank of Montreal ("BMO"). Under the terms of this agreement, the maximum allowable borrowing limit is the lesser of (i) the amount \$16,000,000 or (ii) 15% of the gross asset value of the Fund.

Leverage has not been used since early October 2006.

## 15 Future contracts

As of October 31, 2010, there were no open future contracts held by the Fund. As of October 31, 2009, brokers held the following security as collateral against the open future contracts:

Security	Maturity	Par value	Market value
Ontario Treasury Bills	12/10/2009	100,000	99,897

## 16 Subsequent event

On December 16, 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 Conservative Income & Growth Fund ("CCP"). The objectives of the proposals are to: (i) broaden the investment mandate; (ii) provide additional liquidity; and (iii) lower administrative expenses. This proposal is being put to a unitholder vote on January 14, 2011. CCP will be the continuing fund and as a result unitholders of the Fund would become unitholders of CCP. The Notice of Special Meetings of Unitholders and Joint management Information Circular was mailed to unitholders in late December and a copy of the circular, along with a list of questions and answers is posted on the Manager's website at [www.cclcapitalmarkets.com](http://www.cclcapitalmarkets.com) or on [www.sedar.com](http://www.sedar.com).