

Connor, Clark & Lunn

CAPITAL MARKETS INC.

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**Connor, Clark & Lunn
Real Return Income Fund**

Annual Report
December 31, 2005

Connor, Clark & Lunn Real Return Income Fund Message to Unitholders

March 16th, 2006

Dear Investor,

We thank you for your investment in Connor, Clark & Lunn Real Return Income Fund (the "Fund"). As Manager for the Fund, we are pleased to submit the annual unitholders' report for period ended December 31, 2005.

The Fund's investment objective is to provide current income and to preserve and enhance net asset value. To achieve that objective, the Fund invests to obtain exposure of at least 80% of its managed assets to U.S. Treasury Inflation Protected Securities ("U.S. TIPS"). U.S. TIPS provide income-oriented investors the potential for attractive current income that is protected from the adverse affects of inflation. The Fund may also invest up to 20% of its total managed assets in other income producing securities and may utilize hedging strategies to help limit risk and to preserve capital. There can be no assurance, however, that the Fund will achieve its investment objectives.

Western Asset Management Company, a subsidiary of Legg Mason, Inc., is the Fund's Investment Adviser and manages the portfolio of securities on a day-to-day basis. The firm was founded in 1971 and has offices in Pasadena, London and Singapore. Western Asset managed \$249 billion in assets as of December 31, 2005.

During the period, the Fund paid distributions at an annual rate of 5.50%, for total distributions per Unit of \$0.25. These distributions were paid out as a return of capital. Net asset value went from \$9.44 at inception to \$9.33 at year's end. It was negatively affected by an increase in real yields of approximately 0.10% and by an increase in borrowing costs in line with the move up in the U.S. Fed Funds Rate and helped by high, energy driven inflation late in the year, which had largely re-traced its steps by the time of writing.

The Fund's Units are currently trading at a discount to the NAV. This discount may be caused by numerous factors, and is typical for closed-end funds in the Canadian market. However, we feel that this discount represents an opportunity, as Units of the Fund are now available in the market at prices below the value of the securities in the underlying portfolio.

To learn more about the Fund's performance over this fiscal period, we encourage you to read the Fund's Management Report of Fund Performance section of the report. You will find information on what impacted the performance of the Fund during the fiscal period and Western Asset Management's views on the overall market environment. We appreciate your investment and look forward to serving your investment needs in the future. For the most up-to-date information on your investment, please visit the Fund's website at www.cclcapitalmarkets.com.

Sincerely,

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 Real Return Income Fund (the “Fund”) contains financial highlights but does not contain the complete annual financial statements of Fund. **The annual financial statements and accompanying notes are attached to this report.**

Investment Objectives and Strategy

The Connor, Clark & Lunn Real Return Income Fund (the “Fund”) is an investment trust that was created to obtain exposure to an actively managed portfolio (the “Portfolio”) of which at least 80% will consist of AAA-rated real return bonds. The majority of the real return bonds held in the Portfolio are US Treasury Inflation Protected Securities (“U.S. TIPS”). In order to diversify the Portfolio and improve expected returns, up to 20% of the assets are invested in a mix of other fixed income assets to bring the overall dollar weighted average credit rating of the Portfolio to AA+.

The Fund has the following investment objectives:

- (i) to provide holders of Units with tax efficient monthly distributions of cash that will be linked to the rate of inflation; and
- (ii) to preserve and enhance the net asset value (“NAV”) of the Fund.

In order to enhance returns, the Trust employs leverage in the portfolio, with a debt-to-equity ratio that was approximately 1.5:1 at December 31, 2005. It is intended that at least 90% of foreign currency exposure be hedged back to Canadian dollars at all times.

In order to meet its investment objectives, the Fund has obtained exposure to the performance of a portfolio held by Real Return Trust (the “Trust”), an investment trust, by entering into a forward purchase and sale agreement (“Forward Agreement”) with the Bank of Montreal (“BMO”). The Fund holds a portfolio of Canadian common shares (the “Common Share Portfolio”) and, under the Forward Agreement, is entitled to deliver the Common Share Portfolio or the cash value of that portfolio to BMO in exchange for the value of the Real Return Trust. The Fund is also entitled to sell securities in the Common Share Portfolio from time to time to fund monthly distributions, redemptions, repurchases of Units and its operating expenses.

Risk

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

Use of leverage:

The Trust is entitled to employ leverage at a debt-to-equity ratio of up to 2:1. As at December 31, 2005, the Trust’s debt-to-equity ratio was approximately 1.5:1. The Trust’s borrowing is short-term and is effected by way of repurchase agreements. The effective rate of interest on such borrowing is highly correlated with the U.S. federal funds rate and has increased from approximately 3.2% at inception in July 2005 to approximately 4.5% currently. Increased costs of borrowing that are not accompanied by an increase in inflation have a negative affect on the Trust’s, and therefore the Fund’s, overall cash flow and may affect the level of distributions.

Use of Derivatives:

The Trust has employed derivatives for the purpose of hedging interest rate exposure. Such exposure has involved the use

of short futures contracts and long put options with exposure up to 100% of the Fund's net asset value. The Trust has also hedged foreign currency exposure, with between 90% and 100% of NAV having been hedged to the Canadian dollar at any time. There is no guarantee that such hedging will be successful.

Fluctuations in Net Asset Value:

Because of the Fund's leveraged exposure to U.S. TIPS, net asset value is sensitive to fluctuations in the month-over-month U.S. Consumer Price Index for All Urban Consumers ("CPI-U"), which accrue to the principal value of U.S. TIPS in the second month following their release. The month over month CPI-U can be much more volatile than annual inflation and is affected by seasonal factors. Leverage also makes net asset value sensitive to changes in U.S. real interest rates.

Results of Operations

Portfolio Manager Commentary

The following analysis includes forward-looking statements. The use of any of the words "anticipate", "may", "will", "expect", "estimate", "should", "believe" and similar expressions are intended to identify forward-looking statements. Such statements reflect the opinion of the investment manager regarding factors that might be reasonably expected to affect the performance and the distributions on units of the Fund, and are based on information available at the time of writing. The Fund believes that the expectations reflected in those forward-looking statements and in the investment manager's analysis are reasonable but no assurance can be given that these expectations or the analysis will prove to be correct and accordingly they should not be unduly relied on. These statements speak only as of the date of this report. Actual events and outcomes may differ materially from those described in these forward-looking statements or the investment manager's analysis.

Over the past twelve months the U.S. economy grew by approximately 3.7%, a full 0.6% above its long-term potential growth rate and a bit more than most analysts had expected. Headline inflation, as measured by the CPI-U was somewhat elevated, however, due primarily to soaring energy costs. Core measures of inflation (i.e. inflation measures excluding the effects of food and energy) remained relatively subdued, but were near the upper end of the Federal Reserve's ("Fed") 1% to 2% comfort zone. Short-term interest rates moved steadily higher, and by more than expected, led by the Fed's eight 25 basis points (bps) rate hikes, while the yield on 10-year U.S. Treasuries rose by roughly 25 bps and the 30-year U.S. Treasury bond yield fell by 15 bps, resulting in a dramatic flattening of the yield curve. The spread between the 2- and 10-year U.S. Treasury notes narrowed by over 100 bps to close the year at less than 10 bps. Jobs growth was moderate but relatively steady, and the negative impact of the Katrina crisis in the South was relatively short-lived. The unemployment rate declined from 5.4% to 5.0%. Thanks to very strong growth in corporate profits, personal income, and capital gains realizations, tax receipts at the federal and state levels were substantially higher than expected, resulting in a 15% decline in the federal budget deficit.

Significant changes to the economic landscape over the near term are unlikely, since the fundamentals favour an economy that is not too strong, nor too weak, while core inflation remains within the Fed's comfort zone. Recent statements from the Fed indicate that they are likely to finish raising rates between 4.75% and 5.00%. Today's flat yield curve is best seen as a reflection of the market's confidence that Fed policy will not pose a threat to the economy—not as a harbinger of recession or even a significant economic slowdown.

If this view is correct, 2006 will be a modest year for U.S. TIPS – assuming real rates on the 10-year U.S. TIPS remain unchanged, which should produce an approximate 2% real return plus 2% to 3% inflation for a 4% to 5% total return. Not great, but not terrible given that the 10-year U.S. Treasury currently yields approximately 4.5%. Current breakeven spreads (the difference between 10-year U.S. Treasury yields and 10-year U.S. TIPS yields) are at approximately 2.5%, suggesting that, all else being equal, U.S. TIPS should perform slightly better than U.S. Treasuries this year unless CPI-U drops by more than 1% from December 2005 levels.

Looking out over the horizon, risks do remain, and we think that U.S. TIPS play an important role in managing these risks.

Once again we would like to remind investors about the unique nature of U.S. TIPS; unlike other bonds, U.S. TIPS can perform well when either inflation rises or real yields fall.

Although energy prices have retreated from their post-hurricane peaks, inflation could still rise. We believe that CPI-U could exceed the market's current expectations (as embedded in U.S. TIPS breakeven rates noted above) in light of continued strength in gold and commodity prices, generally elevated tangible asset prices worldwide, and elevated readings on the Institute of Supply Management prices paid surveys. If the market's current optimism regarding future inflation is shaken, one could well see breakeven spreads widen out again as they did in 2003. This would be particularly true at the long end of the yield curve where there is very little inflation risk premium currently priced in.

Another risk is that economic growth slows dramatically. For example, a number of forecasters are calling for a slowdown in the housing market this year. According to these forecasters, if housing prices start to fall, homeowners will be unable to extract any more equity from the value of their homes, potentially reducing consumption and leading to a decline in Gross Domestic Product (GDP) growth. When GDP stalls, the Fed usually shifts to a rate reduction policy and real interest rates fall.

With respect to the corporate debt component of the Fund, credit fundamentals and sector technicals remain favourable for the credit market. However, event risk issues that would increase leverage and/or reduce liquidity appear to us to be on the rise. Activist shareholders are succeeding with increasing regularity in pressuring corporate management to enhance shareholder returns by using leverage and/or liquidity to make special dividends. In addition, private equity sponsors have become increasingly active in identifying and effecting leveraged buyouts. We do not see the risks to bondholders associated with these actions going away anytime soon. Accordingly, we will continue to avoid those credits which are most vulnerable to leveraging actions and in which valuations do not reflect the risks involved. Since we expect economic activity to remain stable, we continue to favour lower rated credits.

With respect to the emerging markets debt component of the Fund, we believe that the global environment continues to be positive and liquidity is expected to remain strong. Country fundamentals are positive, new issue supply is very manageable, and portfolio flows into emerging market funds should remain strong as investors are expected to continue reaching for yield in this continued low-yield environment. However, after last year's strong performance, emerging market spreads are at historically tight levels and we do not expect further significant tightening. This leaves us constructive on emerging markets debt from a fundamental view, but more cautious due to valuations.

With respect to the bank loan component of the Fund, our outlook for the bank loan market is for returns of approximately 7.00% based on a 3-month Libor rate of 4.50% plus an average loan spread of 2.50%. Fundamentals and technicals remain strong for the credit market in general and the bank loan market in particular. From a fundamental perspective economic activity remains supportive of corporate earnings growth and a low default rate. Moody's Investor Service estimates the 2006 loan default rate will increase to 2.6% from 1.8% recorded in 2005, but these default rates are still below the historical average. From the technical perspective, demand for bank loans continues to far exceed available supply as investors look to take advantage of the highest Libor rate in five years.

In general, there is not much low-hanging fruit left in the world's bond markets today, so investment strategies need to be more tactical than strategic. Caution is certainly warranted, but that need not preclude prudent and diversified exposure to risk, since current conditions are unlikely to unravel rapidly. For the time being we think it is best to let duration increase as interest rates rise, and decrease as rates fall, thus taking advantage of relatively low volatility. The safest part of the curve appears to be in the front end, since the Fed is unlikely to raise rates dramatically, and could conceivably cut rates if the economy weakens unexpectedly.

In summary, we believe that 2006 will be a modest year for fixed income assets and that U.S. TIPS will remain attractive as a diversifying asset and could benefit substantially if either inflation rises or real yields fall.

The Market

In calendar 2005, U.S. TIPS performed similarly to U.S. Treasuries except for the long maturity securities. The Barclays U.S. Government Inflation-Linked All Maturities Index generated a total return of 2.72%, while the U.S. Government

Breakeven Index (composed of nominal U.S. Treasuries corresponding to the maturity of each U.S. TIPS issue) returned 3.75%. Almost all of the nominal outperformance occurred in the 30-year area of the curve. Shorter term U.S. TIPS issues generally performed better than shorter term nominal issues because of higher than expected inflation accretion, but longer-term nominal issues outperformed U.S. TIPS issues because long maturity nominal rates fell while real rates rose slightly.

Headline inflation, as expressed by the CPI-U, rose from 3.3% (year-over-year) in December 2004 to 3.4% (year-over-year) in December 2005, despite a spike in September 2005 to a peak rate of 4.7%. The big story was the rise in energy prices, particularly oil, gasoline, and natural gas, following the hurricanes. However, once the hurricanes passed, these were seen as mostly temporary increases resulting in little change to core inflation measures. Core CPI (i.e. excluding the effects of food and energy) remained unchanged at 2.2% from December 2004 to December 2005, while core Personal Consumption Expenditures (PCE), the Fed's favourite inflation measure, actually fell in 2005, down from 2.3% in 2004 to only 1.9% in 2005. We believe this reinforced the notion that higher productivity and overseas competitors continued to limit long-term inflation. For the first time in three years, the U.S. dollar appreciated, gaining approximately 10% against major foreign currencies, and this reduced fears of "imported inflation." Since long-term inflation expectations remained stable, breakeven spreads (the difference between 10-year U.S. Treasury yields and 10-year U.S. TIPS yields) narrowed and 10-year U.S. TIPS performed similarly to 10-year U.S. Treasuries.

The Fed continued raising rates, taking them from 2.25% to 4.25% by the end of December. During this process the Fed kept up its rhetoric of maintaining "vigilance" against inflation and inflation expectations. We believe market participants remained confident about the Fed's credibility and, therefore, no significant inflation scare occurred. As a result, the U.S. Treasury yield curve flattened dramatically, with 10-year and under 10-year maturity U.S. Treasury yields rising while longer bond yields actually declined.

Performance

U.S. TIPS performed similarly to U.S. Treasuries except for the long maturity securities as reduced inflation anxiety caused breakeven spreads to decline despite higher than expected inflation. Long maturity U.S. Treasuries outperformed all other government issues as long rates fell and the yield curve flattened significantly.

For the period ended December 31, 2005, the Fund paid distributions of \$0.2486 per Unit and generated a total return of 1.44% on a net asset value (NAV) basis. The Fund increased distributions from an annualized 5.50% to 5.75% for the first quarter of 2006 primarily because CPI-U spiked unexpectedly in the fourth quarter of 2005 due to the effects of the hurricanes. Investments in U.S. TIPS, non-U.S. inflation-linked bonds, high yield debt, bank loans and emerging market debt made a positive contribution to returns while investment grade corporate bond exposure detracted slightly.

Investment Income and Capital Gains

Interest income and inflation accrual combined to earn \$8,503,559 for the portfolio and expenses, including interest, were \$4,353,086, leaving investment income of \$4,150,473. Distributions paid to Unitholders totalled \$3,074,440, or \$0.25 per Unit. Realized and unrealized losses combined for a total gain of \$2,541,005.

Leverage

As at December 31, 2005, the Trust had a liability of \$176,476,197 under a master repurchase agreement with the Bank of Montreal, pursuant to which the Trust had agreed to repurchase certain U.S. TIPS from the Bank of Montreal with a market value on December 31, 2005 of \$177,470,834. The value of the Trust's portfolio on December 31, 2005 was \$284,911,568 and the net assets value was \$114,790,869. As such, the Trust's debt-to-equity ratio was approximately 1.5: 1.

Currency Hedging

As at December 31, 2005, the Trust was approximately 94% hedged against moves in Canadian/U.S. exchange rates by way of a currency forward entitling the Trust to sell US \$91,076,068 in exchange for CN \$107,600,000 on July 17, 2015.

Capital transactions

On July 18, 2005, the Fund completed an initial public offering pursuant to the prospectus dated June 29, 2005. \$120,000,000 was raised through the issue of 12 million Units at \$10.00 per Unit. On August 2, 2005, the Agents in the offering exercised an over-allotment option in respect of 384,408 Units, raising a further \$3,844,080. Total proceeds from these two transactions after Agents' fees and issue expense were \$116,921,876.

Market repurchases

As set out in the Prospectus, the Fund is obligated, under certain conditions, to purchase Units in the market for cancellation. Subject to certain conditions described in the prospectus dated June 29, 2005, the Fund will be obligated to purchase any Units offered in the market if, at any, time, the price at which Units are offered for sale and the most recent closing price of the Units on the TSX are each less than 95% of the latest determined NAV per Unit. Pursuant to this obligation, the Fund purchased 77,000 Units during the period for a total cost of \$666,035.

Distributions

The Fund has made all its scheduled distributions to date, including an initial distribution of \$0.0654 per Unit in respect of the period from July 18, 2005 (commencement of operations) to September 30, 2005, monthly distributions of \$0.0458 per Unit for each of October 2005, November 2005 and December 2005 totalling \$0.2486 per Unit.

Recommendations or Reports by the Independent Committee

The Independent Committee of the Board of Advisors tabled no reports and made no material recommendations to management of the Fund in the year ending December 31, 2005.

Related Party Transactions

Management Fees

As compensation for management services rendered to the Fund, the Manager is entitled to receive an annual management fee in an amount equal to 0.30% per annum of the NAV of the Fund, to be calculated and payable monthly in arrears, plus applicable taxes. As compensation for management services rendered to Real Return Trust, the Manager is entitled to receive an annual management fee in an amount equal to 0.90% of the net asset value of Real Return Trust calculated and payable monthly in arrears, plus applicable taxes. The Manager, in its capacity as manager of Real Return Trust, is responsible for payment of the investment management fees of the Investment Advisor. The management fees charged to the Fund on consolidation basis for the period from July 18, 2005 (commencement of operations) to December 31, 2005 were \$658,590. The Manager pays Western Asset Management Company (the "Investment Advisor") out of the above management fees.

Financial Highlights

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

The Fund's Net Asset Value per unit:

	December 31, 2005 ⁽¹⁾
Net Asset Value, beginning of period	10.00
Increase (decrease) from operations:	
Total revenues	0.69
Total expenses	(0.35)
Unit issue expense ⁽²⁾	(0.56)
Realized gains (losses) for the period	(0.11)
Unrealized gains (losses) for the period	(0.10)
Total increase (decrease) from operations ⁽³⁾	(0.43)
Distributions:	
From income (excluding dividends)	—
From dividends	—
From capital gains	—
Return of capital	(0.25)
Total Annual Distributions ⁽⁴⁾	(0.25)
Net Asset Value, end of period ⁽⁵⁾	9.33

⁽¹⁾ Results for the period July 18, 2005 (commencement of operations) to December 31, 2005.

⁽²⁾ Issue expense of \$6,922,204 incurred in connection with the unit issuance, which has been treated as a reduction of capital.

⁽³⁾ Net asset value and distributions are based on the actual number of units outstanding at the relevant time. The increase / decrease from operations is based on the weighted average number of units outstanding over the financial period.

⁽⁴⁾ Distributions were paid in cash.

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

Ratios and Supplemental Data:

	December 31, 2005 ⁽¹⁾
Net assets (000's) ⁽²⁾	114,791
Number of units outstanding ⁽²⁾	12,307,408
Management expense ratio ⁽³⁾	14.26%
Management expense ratio before waivers or absorptions ⁽³⁾	14.26%
Issue expenses ratio ^{(3) (4)}	5.99%
Interest expense ratio ^{(3) (4)}	6.01%
Management expense ratio excluding unit issue and interest expenses ^{(3) (4)}	2.26%
Portfolio turnover rate ⁽⁵⁾	9.66%
Trading expense ratio ⁽⁶⁾	0.04%
Closing market price (TSX) ⁽²⁾	8.87

⁽¹⁾ Results for the period July 18, 2005 (commencement of operations) to December 31, 2005.

⁽²⁾ This information is provided as at December 31, 2005.

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

⁽⁴⁾ The management expense ratio has three components:

a. Issue expense ratio: based on total agents fees and unit issue expenses of \$6,922,204. This ratio is 5.59% when expressed as a percentage of the original proceeds from issue of units of \$123,844,080.

b. Interest expense ratio: based on a total interest expense on reverse repurchase agreements of \$3,164,459.

c. Other ongoing expenses: based on total expenses of \$1,188,627.

⁽⁵⁾ 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.

⁽⁶⁾ The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the period.

Summary of Investment Portfolio as of December 31, 2005

The summary of investment portfolio may change due to ongoing portfolio transactions of the investment Fund and a quarterly update is available.

	%	Maturity	Number	Average	Market	% of
	Rate	date	of shares / par value	cost	value	Net
			US\$	CNS\$	CNS\$	assets
Investments						
Foreign bonds						
US Treasury Inflation-Protected Securities	1.875%	7/15/15	194,370,000	241,042,173	228,777,057	199.3%
US Treasury Inflation-Protected Securities	3.875%	1/15/09	3,595,000	5,628,126	5,361,095	4.7%
Ford Motor Credit Corp.	7.875%	6/15/10	2,400,000	2,913,189	2,702,641	2.4%
General Motors Acceptance Corp.	7.750%	1/19/10	2,400,000	2,916,844	2,854,004	2.5%
United Mexican States Note	7.500%	4/8/33	2,050,000	2,862,357	2,841,335	2.5%
Russian Federation	5.000%	3/31/33	90,000	118,067	118,775	0.1%
Total foreign bonds				<u>255,480,756</u>	<u>242,654,907</u>	<u>211.5%</u>
Foreign funds						
Western Asset Opportunistic Emerging Markets Portfolio LLC			252,951	7,449,379	7,627,090	6.6%
Western Asset Floating Rate High Income Fund LLC			1,320,885	17,669,205	17,312,462	15.1%
Western Asset Non-US Inflation Linked Securities LLC			421,558	5,889,735	5,866,497	5.1%
Western Asset Opportunistic US\$ High Yield			678,266	11,779,470	11,450,612	10.0%
Total foreign mutual funds				<u>42,787,789</u>	<u>42,256,661</u>	<u>36.8%</u>
Total Real Return Trust portfolio				<u>298,268,545</u>	<u>284,911,568</u>	<u>248.3%</u>
Canadian common stocks (pledged to the Counterparty under the Forward Agreement)						
Energy						
Western Oil Sands Inc.			335,453	9,067,295	9,328,948	8.1%
Materials						
Kinross Gold Corp.			1,428,323	10,519,210	15,340,189	13.4%
Industrials						
Bombardier Inc. Class B			3,279,630	10,628,032	9,051,779	7.9%
Consumer Discretionary						
Gildan Activewear Class A			269,714	9,372,986	13,485,700	11.7%
Consumer Staples						
Cott Corp.			378,236	10,293,748	6,517,006	5.7%
Health Care						
Angiotech Pharmaceuticals Inc.			625,800	10,586,926	9,599,772	8.4%

Summary of Investment Portfolio as of December 31, 2005 Continued

	% Rate	Maturity date	Number of shares / par value US\$	Average cost CNS	Market value CNS	% of Net assets	
Information Technology							
Cognos Inc.			233,290	10,632,540	9,459,909	8.2%	
ATI Technologies Inc.			678,940	10,647,883	13,443,012	11.7%	
Celestica Inc.			628,680	10,587,217	7,757,911	6.8%	
Nortel Networks Corp.			3,167,824	10,599,836	11,245,775	9.8%	
Research In Motion			123,260	10,682,158	9,460,205	8.2%	
				53,149,634	51,366,812	44.7%	
Total Canadian common stocks				113,617,831	114,690,206	99.9%	
Payable to the Counterparty under the Forward Agreement				(113,617,831)	(114,690,206)	-99.9%	
Total investments				298,268,545	284,911,568	248.3%	
	Maturity date	Number of contracts	Average cost CNS	Market value CNS	Unrealized gain (loss) CNS	% of Net assets	
Futures contracts							
3 Month Eurodollar Futures	12/15/06	159	44,344,435	44,207,454	(136,981)	-0.1%	
3 Month Eurodollar Futures	3/17/06	269	74,912,306	74,806,939	(105,367)	-0.1%	
10 Year United States Treasury Note Futures	3/17/06	(12)	(1,525,139)	(1,533,635)	(8,496)	0.0%	
Unrealized gain (loss) on futures contracts					(250,844)	-0.2%	
	Rate	Maturity date	Number of contracts	Bought CN \$	Sold US \$	Unrealized gain (loss) CNS	% of Net assets
Foreign currency forward contracts							
Bought CAD, sold USD	1.18143	7/17/15	1	107,600,000	91,076,068	4,505,727	3.9%
Reverse repurchase agreement						(173,610,260)	-151.3%
Liabilities, net of other assets						(765,322)	-0.7%
Net Assets						114,790,869	100.0%

Management's Responsibility for Financial Reporting

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

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

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



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



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

Toronto, Canada
February 24, 2006

February 24, 2006

Auditors' Report

To the Unitholders of Connor, Clark & Lunn Real Return Income Fund

We have audited the consolidated statements of investments and net assets of **Connor, Clark & Lunn Real Return Income Fund** as at December 31, 2005 and the consolidated statements of operations, changes in net assets, deficit and contributed surplus, cash flow and changes in investments for the period from July 18, 2005 (commencement of operations) to December 31, 2005. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2005 and the results of its operations, and the changes in its net assets, deficit and contributed surplus and cash flow for the period from July 18, 2005 (commencement of operations) to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Net Assets

As at December 31, 2005

	2005
	\$
Assets	
Cash	418,292
Investments at market value (cost - \$298,268,545)	284,911,568
Investments pledged to counterparty under forward agreement (note 8)	114,690,206
Interest and dividends receivable	2,256,722
Receivable from investment sales	850,985
Unrealized gain on foreign exchange contracts	4,505,727
	<u>407,633,500</u>
Liabilities	
Accounts payable and accrued liabilities	293,371
Distributions payable	563,968
Management fees payable	267,880
Market repurchases payable (note 7)	55,289
Payable to counterparty under forward agreement	114,690,206
Reverse repurchase agreement (note 4)	173,610,260
Interest payable	2,865,937
Variation margin payable (note 11)	244,876
Unrealized loss on futures contracts	250,844
	<u>292,842,631</u>
Net Assets and Unitholders' Equity	<u>114,790,869</u>
Units outstanding (note 6)	<u>12,307,408</u>
Net asset value per unit	<u>9.33</u>
Unitholder's Equity	
Share Capital (note 6)	123,074,080
Contribution surplus	103,965
Deficit	<u>(8,387,176)</u>
Unitholder's equity - End of year	<u>114,790,869</u>

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



Director



Director

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Operations

For the period from July 18, 2005 (commencement of operations) to December 31, 2005

	2005
	\$
Income	
Interest and dividend income	<u>8,503,559</u>
Expenses	
Interest expense (note 4)	3,164,459
Management fees	658,590
Forward fees	264,382
Service fees	157,352
Custodial and other unitholder fees	34,659
Audit Fees	28,159
Advisory fees	10,028
Legal fees	9,383
Transfer agent fees	9,251
Sustaining fees	8,718
Printing and mailing fees	6,808
Filing fees	<u>1,297</u>
	<u>4,353,086</u>
Investment income (loss)	4,150,473
Unrealized gain (loss) on investments	
Unrealized gain (loss) of investments	(13,356,977)
Unrealized gain (loss) of forward agreement (note 8)	19,045
Unrealized gain (loss) on foreign exchange contracts	4,505,727
Unrealized gain (loss) on foreign exchange	7,926,497
Unrealized gain (loss) on futures contracts	<u>(250,844)</u>
	<u>(1,156,552)</u>
Realized gain (loss) on investments	
Net realized gain (loss) on investments	(14,020)
Net realized gain (loss) on foreign exchange	(1,093,904)
Net realized gain (loss) on options	(28,640)
Net realized gain (loss) on futures contracts	<u>(247,889)</u>
	<u>(1,384,453)</u>
Net gain (loss) on investments	<u>(2,541,005)</u>
Increase (decrease) in net assets from operations	<u>1,609,468</u>
Increase (decrease) in net assets from operations per unit *	<u>0.13</u>
Distributions per unit*	<u>0.25</u>

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

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Changes in Net Assets, Deficit and contributed Surplus

For the period from July 18, 2005 (commencement of operations) to December 31, 2005

	2005
	\$
Increase (decrease) in net assets from operations	<u>1,609,468</u>
Distributions to unitholders	<u>(3,074,440)</u>
Unitholders' transactions	
Proceeds from issue of units (note 6)	123,844,080
Units purchased for cancellation (note 7)	(666,035)
Agents' fees and issue expenses	<u>(6,922,204)</u>
	<u>116,255,841</u>
Change in net assets during the year	<u>114,790,869</u>
Net assets - Beginning of year	<u>-</u>
Net assets - End of year	<u>114,790,869</u>
Deficit, beginning of period	-
Increase in net assets from operations	1,609,468
Distributions to unitholders	(3,074,440)
Agents' fees and issue expenses	<u>(6,922,204)</u>
Deficit, end of period	<u>(8,387,176)</u>
Contributed surplus, beginning of period	-
Cost of shares repurchased at less than stated value	<u>103,965</u>
Contributed surplus, end of period	<u>103,965</u>

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Cash Flow

For the period from July 18, 2005 (commencement of operations) to December 31, 2005

	2005
	\$
Operating Activities	
Increase (decrease) in net assets from operations	1,609,468
Distributions to unitholders	(3,074,440)
Items not affecting cash:	
Unrealized (gain) loss of investments	13,356,977
Unrealized (gain) loss of forward agreement (note 8)	(19,045)
Unrealized (gain) loss on foreign exchange contracts	(4,505,727)
Net realized (gain) loss on investments	14,020
Changes in non-cash working capital	
(Increase) decrease in interest and dividends receivable	(2,256,722)
(Increase) decrease in receivable from investment sales	(850,985)
Increase (decrease) in accounts payable and accrued liabilities	293,371
Increase (decrease) in distributions payable	563,968
Increase (decrease) in management fees payable	267,880
Increase (decrease) in redemption payable (note 7)	55,289
Increase (decrease) in interest payable	2,865,937
Increase (decrease) in variation margin payable (note 11)	244,876
Increase (decrease) in unrealized loss on futures contracts	250,844
Net cash flow provided by operating activities	<u>8,815,711</u>
Investing Activities	
Purchase of common stocks portfolio	(125,988,162)
Purchase of Real Return Trust portfolio	(324,979,577)
Proceeds on disposition of common stocks portfolio	9,192,021
Proceeds on disposition of Real Return Trust portfolio	26,590,322
Cash received from the Counterparty to fund the purchase of the Real Return Trust portfolio	<u>116,921,876</u>
Net cash used in investing activities	<u>(298,263,520)</u>
Financing Activities	
Proceeds from issuance of units	123,844,080
Units purchased for cancellation (note 7)	(666,035)
Unit issue costs	(6,922,204)
Proceeds from reverse repurchase agreement	186,807,058
Principal payments on reverse repurchase agreement	(5,313,260)
Unrealized (gain) loss on foreign exchange from reverse repurchase agreement	<u>(7,883,538)</u>
Net cash flow provided by financing activities	<u>289,866,101</u>
Net increase in cash and short-term investments	418,292
Cash and short-term investments - beginning of period	<u>-</u>
Cash and short-term investments - end of period	<u>418,292</u>

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Changes in Investments

For the period from July 18, 2005 (commencement of operations) to December 31, 2005

2005

\$

Investments at average cost - Beginning of period

-

Cost of investments purchased

450,967,739

Cost of investments sold

(39,081,363)

Cost of investments pledged to the Counterparty under the

Forward Agreement (note 8) (market value - \$114,690,206)

(113,617,831)

Investments at average cost - End of period

298,268,545

Unrealized appreciation (depreciation) of investments

(13,356,977)

Investments at market value

284,911,568

Proceeds from investments sold

39,067,343

Cost of investments sold

(39,081,363)

Net realized loss on investments

(14,020)

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Investments

As at December 31, 2005

	% Rate	Maturity date	Number of shares / par value US \$	Average cost CN \$	Market value CN \$	% of Portfolio
Investments						
Foreign bonds						
US Treasury Inflation-Protected Securities (note 4 and 11)	1.875%	7/15/15	194,370,000	241,042,173	228,777,057	80.3%
US Treasury Inflation-Protected Securities	3.875%	1/15/09	3,595,000	5,628,126	5,361,095	1.9%
Ford Motor Credit Corp.	7.875%	6/15/10	2,400,000	2,913,189	2,702,641	0.9%
General Motors Acceptance Corp.	7.750%	1/19/10	2,400,000	2,916,844	2,854,004	1.0%
United Mexican States Note	7.500%	4/8/33	2,050,000	2,862,357	2,841,335	1.0%
Russian Federation	5.000%	3/31/33	90,000	118,067	118,775	0.0%
Total foreign bonds				255,480,756	242,654,907	85.1%
Foreign funds						
Western Asset Opportunistic Emerging Markets Portfolio LLC			252,951	7,449,379	7,627,090	2.7%
Western Asset Floating Rate High Income Fund LLC			1,320,885	17,669,205	17,312,462	6.1%
Western Asset Non-US Inflation Linked Securities LLC			421,558	5,889,735	5,866,497	2.1%
Western Asset Opportunistic US\$ High Yield			678,266	11,779,470	11,450,612	4.0%
Total foreign mutual funds				42,787,789	42,256,661	14.9%
Total Real Return Trust portfolio				298,268,545	284,911,568	100.0%
Canadian common stocks (pledged to the Counterparty under the Forward Agreement)						
Energy						
Western Oil Sands Inc.			335,453	9,067,295	9,328,948	3.3%
Materials						
Kinross Gold Corp.			1,428,323	10,519,210	15,340,189	5.4%
Industrials						
Bombardier Inc. Class B			3,279,630	10,628,032	9,051,779	3.2%
Consumer Discretionary						
Gildan Activewear Class A			269,714	9,372,986	13,485,700	4.7%
Consumer Staples						
Cott Corp.			378,236	10,293,748	6,517,006	2.3%
Health Care						
Angiotech Pharmaceuticals Inc.			625,800	10,586,926	9,599,772	3.4%
Information Technology						
Cognos Inc.			233,290	10,632,540	9,459,909	3.3%
ATI Technologies Inc.			678,940	10,647,883	13,443,012	4.7%
Celestica Inc.			628,680	10,587,217	7,757,911	2.7%
Nortel Networks Corp.			3,167,824	10,599,836	11,245,775	3.9%
Research In Motion			123,260	10,682,158	9,460,205	3.3%
				53,149,634	51,366,812	17.9%
Total Canadian common stocks				113,617,831	114,690,206	40.2%
Payable to the Counterparty under the Forward Agreement				(113,617,831)	(114,690,206)	-40.2%
Total investments				298,268,545	284,911,568	100.0%

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Investments Continued

As at December 31, 2005

	Maturity date	Number of contracts	Average cost CN \$	Market value CN \$	Unrealized gain (loss) CN \$	
Futures contracts						
3 Month Eurodollar Futures	12/15/06	159	44,344,435	44,207,454	(136,981)	
3 Month Eurodollar Futures	3/17/06	269	74,912,306	74,806,939	(105,367)	
				119,014,393	(242,348)	
10 Year United States Treasury Note Futures	3/17/06	(12)	(1,525,139)	(1,533,635)	(8,496)	
Unrealized gain (loss) on futures contracts					(250,844)	
	Rate	Maturity date	Number of contracts	Bought CN \$	Sold US \$	Unrealized gain (loss) CN \$
Foreign currency forward contracts						
Bought CAD , sold USD	1.18143	7/17/15	1	107,600,000	91,076,068	4,505,727
Unrealized gain (loss) on foreign exchange contracts						4,505,727

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Notes to Consolidated Financial Statements

December 31, 2005

1 Corporate activities

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

These consolidated financial statements include the accounts of Real Return Trust ("Real Return Trust"). Western Asset Management Company acts as the Real Return Trust's investment advisor (the "Investment Advisor") and is actively managing and making investment decisions with respect to Real Return Trust's assets.

2 Investment objectives

The Fund's investment objectives as set out in the Prospectus dated June 29, 2005 are (i) to provide its holders of units ("Unitholders") with tax efficient monthly cash distributions that will be linked to the rate of inflation; and (ii) to preserve and enhance the net asset value (the "NAV") of the Fund.

In order to meet its investment objectives, the Fund obtained exposure to the performance of the Portfolio held by Real Return Trust by entering into one or more forward purchase and sale agreements (collectively, the "Forward Agreement") with Bank of Montreal (the "Counterparty").

The Real Return Trust invests, on a leveraged basis, in a Portfolio with (i) at least 80% of this Portfolio invested in real return bonds issued by the governments with AAA credit ratings including the United States, the United Kingdom, Canada, France, Sweden and Australia. At least 70% of the portfolio is invested in U.S. Treasury Inflation Protected Securities ("TIPS"). In addition, up to 20% of the Portfolio may be invested in AAA-rated real return bonds issued by governments other than the United States; and (ii) in order to diversify the Portfolio, improve net asset value stability and increase expected returns, up to 20% of the Portfolio can be invested in a mix of assets which may include mortgage-backed and other asset-backed securities, corporate debt securities, bank loans, emerging markets debt securities, and commodity index investments. No more than 10% of the Portfolio may be invested in any one of these asset classes with the exception of mortgage-backed securities, in respect of which up to 20% of the Portfolio may be invested.

The combination of these investments is targeted to create a portfolio that has a dollar weighted average credit rating of AA+ on the Portfolio assets. In order to enhance returns the Manager employs leverage in the Portfolio with a targeted debt to equity ratio of 1.6:1.

3 Summary of significant accounting policies

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.

Principles of consolidation

These consolidated financial statements include the accounts of the Fund and of Real Return Trust (note 1). The financial statements of the Fund and Real Return Trust have been consolidated for financial reporting purposes by virtue of the fact that the activities of Real Return Trust are considered to be an extension of the operations of the Fund and as such, Real Return Trust forms an integral part of the Fund's business activities. Although not sharing common ownership, both the Fund and Real Return Trust are subject to common influence over the management of its individual operations.

Valuation of investments

Short-term investments are carried at cost, which together with interest receivable approximates market value. Other investments are recorded at their quoted market value, being the last sale price recorded by the securities exchanges on which such investments are principally traded. Debt instruments are recorded at the average of available bid and ask quotations.

Investment transactions, income and expenses

Investment transactions are accounted for on the trade date. Realized and unrealized gains and losses on investments are determined using the average cost basis. Interest income and expenses are recognized on an accrual basis.

Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the end of the period.

Purchases and sales of investments and income and expenses are translated into Canadian dollars at the exchange rate prevailing on the transaction dates.

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.

Forward contracts

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.

Connor, Clark & Lunn Real Return Income Fund

Notes to Consolidated Financial Statements

December 31, 2005

Future contracts

The futures contracts are Exchange-traded futures contracts and listed in the Statements of Investment Portfolio. 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 Investment 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 a Variation Margin Receivable (Payable).

Options

Option premiums paid or received by the Fund, as long as the options are outstanding, reflect an asset or liability, respectively in the Statement of Investment Portfolio and are valued at an amount equal to the current market value of an option that would have the effect of closing the position. Any difference resulting from revaluation is treated as an unrealized gain or loss on investments. Gains or losses realized upon exercise or expiration of options are included in net realized gain or loss on investments.

Reverse Repurchase Agreements

A reverse repurchase agreement involves the transfer of securities to a buyer in return for cash, under the agreement the Fund will later pay the cash plus interest in exchange for the return (repurchase) of the same securities. A sale is not recorded in respect of securities transferred to a buyer on the inception of a reverse repurchase agreement, and such instruments continue to be recorded as a component of marketable securities. Obligations to repay cash received under reverse repurchase agreement, plus accrued interest, are recorded as a liability in the combined statements of net assets.

4 Reverse repurchase agreements

The Fund entered into a reverse repurchase agreement to finance the acquisition of its investments with Bank of Montreal whose credit rating is AA- as of December 31, 2005 by Standard & Poors. Reverse repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts. Accrued interest payable and the related expense are recorded as separate line items in the Statement of Net Assets, and the Statement of Operations respectively.

As of December 31, 2005, the outstanding reverse repurchase agreement is summarized as follows:

<u>Transaction Date</u>	<u>Expiry Date</u>	<u>Cash Received (US \$)</u>	<u>Cash Received (CN \$)</u>	<u>Portfolio Bought</u>	<u>Par (US \$)</u>	<u>Market value (CN \$)</u>
July 19, 2005	January 3, 2006	137,703,000	160,858,595	US TIPS 1.875% July 15, 2015	139,800,000	164,547,172
September 12, 2005	January 3, 2006	9,264,062	10,821,871	US TIPS 1.875% July 15, 2015	9,410,000	11,075,743
September 14, 2005	January 3, 2006	952,000	1,112,085	US TIPS 1.875% July 15, 2015	855,000	1,006,351
October 11, 2005	January 3, 2006	<u>700,000</u>	<u>817,709</u>	US TIPS 1.875% July 15, 2015	715,000	<u>841,568</u>
		<u>148,619,062</u>	<u>173,610,260</u>			<u>177,470,834</u>

5 Custodian

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

6 Unitholder's 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 July 18, 2005 and August 2, 2005, the Fund issued 12,000,000 and 384,408 units respectively, for net proceeds of \$113,270,000 and 3,651,876 respectively. Changes in outstanding units are summarized as follows:

	<u>Number of units</u>
Balance – beginning of period	–
Units issued	12,384,408
Units cancelled (note 7)	<u>(77,000)</u>
Balance – end of period	<u>12,307,408</u>

Connor, Clark & Lunn Real Return Income Fund

Notes to Consolidated Financial Statements

December 31, 2005

7 Market Purchase Program

In accordance with the Fund's prospectus, and to enhance liquidity and provide market support for the Units, the Fund has a mandatory market purchase program under which, subject to certain limitations and exceptions, and in compliance with any applicable regulatory requirements, the Fund is obligated to purchase Units for cancellation if, at any time, the price at which Units are offered in the market is less than 95% of the latest determined NAV per Unit, up to a maximum in any calendar quarter of 1.25% of the outstanding Units at the beginning of such calendar quarter. In addition, the Fund will have the right, but not the obligation, to purchase Units in the market at its sole discretion, subject to applicable regulatory requirements and limitations. During the period from July 18, 2005 (commencement of operations) to December 31, 2005, the Fund purchased 77,000 units for cancellation at a cost of \$666,035.

8 Forward Agreement and Common Share Portfolio

The Fund entered into a Forward Agreement with the Counterparty to obtain exposure to the performance of the Portfolio held by Real Return Trust. 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 Real Return Trust. The Common Share Portfolio securities is pledged to, and held by, the Counterparty as security for the obligations of the Fund under the Forward Agreement.

The following table splits the changes in the Common Share Portfolio between (i) shares delivered to the Counterparty as a partial settlement under the forward agreement, and (ii) substitutions in the Common Share Portfolio during the period from July 18, 2005 (commencement of operations) to December 31, 2005:

	2005
	\$
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	3,285,000
Cost of investments delivered through partial pre-settlement	<u>(3,251,902)</u>
Realized gain on partial pre-settlement	<u>33,098</u>
Proceeds on sale of investments (subsequently reinvested)	35,782,343
Cost of investments sold	<u>(35,829,461)</u>
Realized gain (loss) on sale of investments	<u>(47,118)</u>
Realized gain (loss) on investments	<u>(14,020)</u>
Liability to Counterparty under Forward Agreement - Beginning of period	-
Original liability to Counterparty under Forward Agreement	116,921,876
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	(3,285,000)
Liability to Counterparty under Forward Agreement at period end, at cost	<u>113,617,831</u>
Unrealized gain on Forward Agreement	<u>19,045</u>

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

9 Distributions

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

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

Connor, Clark & Lunn Real Return Income Fund

Notes to Consolidated Financial Statements

December 31, 2005

Cash distributions of \$3,074,440 (\$0.2486 per unit) were paid during the period from inception (July 18, 2005) to December 31, 2005.

10 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 is entitled to receive an annual management fee in an amount equal to 0.30% per annum of the NAV of the Fund, to be calculated and payable monthly in arrears, plus applicable taxes.

As compensation for management services rendered to the Real Return Trust, the Manager will receive an annual management fee in an amount equal 0.90% of the Real Return Trust's NAV, to be calculated and payable monthly in arrears, plus applicable taxes.

The Manager is responsible for payment of the investment management fees of the Investment Advisor.

11 Futures contracts

As of December 31, 2005, brokers held the following securities as a collateral against the open futures contracts:

<u>Security</u>	<u>Par (US \$)</u>	<u>Market value (US\$)</u>	<u>Market value (CN \$)</u>
US TIPS 1.875% July 15, 2015	1,149,000	1,157,717	1,352,394

12 Income taxes

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

13 Broker commission charges and soft dollar services

There were \$23,460 broker commissions paid during the period from July 18, 2005 (commencement of operations) to December 31, 2005 in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.