



CONNOR, CLARK & LUNN

CAPITAL MARKETS

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

Annual Report

December 31, 2007

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

March 14, 2008

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 the period ended December 31, 2007.

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 Inflation-linked securities issued by governments with AAA ratings, with at least 70% comprised of 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 effects 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 ("Western Asset") is the Fund's Investment Adviser and is responsible for actively managing and making investment decisions with respect to the Fund's portfolio. Western Asset is one of the world's premier fixed income managers with offices in Pasadena, New York, London, Tokyo, Singapore, Hong Kong, Melbourne and Sao Paulo.

The Fund generated a total return of approximately 5.1% in 2007. During the year, the Fund paid distributions totalling \$0.3937 per Unit. These distributions are expected to be characterized as returns of capital. Monthly distributions were reduced from \$0.3333 per Unit to \$0.3125 per Unit in October as a result of persistent low inflation.

2007 has continued the difficult bond market that characterized 2006. The Fund was negatively affected by continued low inflation in the U.S. as well as by an increase in real yields in the first half of 2007 which peaked at 2.8% for U.S. TIPS maturing on July 15, 2015. In the latter half of the year, the combination of weaker economic data, a weak U.S. dollar and soaring commodity prices proved to be a great environment for U.S. TIPS. The yield on U.S. TIPS maturing on July 15, 2015 experienced a significant decline, falling to 1.59% at the end of 2007 compared to 2.41% at the end of 2006. Inflation also rose in the last quarter of the year mainly as a result of rising crude oil prices and currently stands at 4.1% year over year. At the end of November, the Fund took advantage of declining real yields and reduced leverage to zero as treasury securities rallied strongly but borrowing costs remained high and the overall tone of the credit markets became highly negative in the second half.

While the Funds allocation to TIPs performed well during 2007, the Fund's other components lagged. Spreads on investment grade corporate bonds widened dramatically in the second half of the year as subprime fears spread through the financial system. Spreads on bank loans and high yield bonds widened dramatically during the second half of the year as well. The Fund's exposure to residential mortgage backed securities contributed negatively to performance as spreads widened. 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,



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 the Fund. **The annual financial statements and accompanying notes are attached to this report.**

Investment Objectives and Strategy

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 trust 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.

The Fund 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 U.S. 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 meet its investment objectives, the Fund has obtained exposure to the performance of a portfolio held by Real Return Trust (the “Real Return Trust”), an investment trust, by entering into a forward purchase and sale agreement (“Forward Agreement”) with the Bank of Montreal (“BMO”). 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. 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.

In order to enhance returns, the Real Return Trust may employ leverage in the portfolio, with a debt-to-equity ratio of up to 2:1. The Real Return Trust held no leverage at December 31, 2007. It is also intended that at least 90% of foreign currency exposure be hedged back to Canadian dollars at all times.

Risk

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

Use of leverage:

The Real Return Trust is entitled to employ leverage at a debt-to-equity ratio of up to 2:1. The Real Return Trust’s borrowing is short-term and is effected by way of repurchase agreements. Leverage was reduced from approximately 1.8:1 during the period to zero in response to borrowing costs and overall market conditions. The effective rate of interest on

such borrowing is highly correlated with the U.S. federal funds rate but in recent months had become more correlated with LIBOR rates as fundamentals in the credit market deteriorated. Increased costs of borrowing that are not accompanied by an increase in inflation have a negative effect on the Real Return Trust's performance, and therefore the Fund's overall cash flow and may affect the level of distributions.

Use of Derivatives:

The Real Return 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 Real Return Trust has also hedged foreign currency exposure, with 111% of NAV having been hedged to the Canadian dollar on December 31, 2007. 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

The Investment Advisor's 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 advisor 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 Manager believes that the expectations reflected in those forward-looking statements and in the investment advisor'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 advisor's analysis.

Market Review

While economic data, particularly housing data, continued to weaken in the fourth quarter, the larger issue was continued subprime lending losses and the associated write-downs being taken by banks. This, along with normal year end pressures, forced banks to continue shrinking their balance sheets, which in turn caused a flight to quality rally in the treasury markets. Headline inflation in the US, as measured by the Consumer Price Index for All Urban Consumers (CPI-U), jumped from 2.8% at the end of September 2007 to 4.1% at the end of December 2007. Core CPI (which excludes the effects of food and energy) also rose, but at a slower pace, from 2.1% to 2.3% during the same period. Personal Consumption Expenditures (PCE) core deflator, which we believe is the Federal Reserve's (the "Fed") favourite inflation measure, also increased from 1.9% at the end of September 2007 to 2.2% at the end of November 2007.

We believe the combination of weaker economic data, a weak US dollar, and soaring commodity prices was a great environment for US TIPS performance. The 10-year US TIPS real yield fell from approximately 2.27% at the end of September 2007 to approximately 1.70% at the end of December 2007, and, with near term inflation accretion remaining positive, generated a total return of 5.47% for the fourth quarter. The 10-year US Treasury, on the other hand, had a total return of 5.27% for the fourth quarter.

Lending markets remained severely strained and risk aversion failed to moderate meaningfully. Despite a clear hesitancy to use further monetary stimulus, the Fed was forced to further cut the funds rate by a cumulative 50 bps, bringing the target funds rate to 4.25%. Energy prices soared, pushing headline inflation to uncomfortable levels. A portion of this passed through to the core measure, which rose modestly above the Fed's target range. For these reasons the Fed refused to focus its statements exclusively on downside risks to growth, and its governors preferred to use alternative tools to satisfy their responsibility as lender of last resort. After discount lending failed to materialize, the Fed began to directly intervene in money markets via term auctions. This had the intended effect and LIBOR rates finally eased as banks were able to acquire

necessary funding from the only trustworthy counterparty, the nation's central bank. Led by the financial sector, credit spreads widened sharply as the market value of corporate debt fell. Earnings were impacted by large subprime-related write-downs. For instance, Citigroup announced it would bring \$49 billion of SIV assets back onto its balance sheet, further impacting its capital base. The US dollar continued to lose ground against most currencies, though it did regain ground against the pound as the Bank of England eased rates and struggled to contend with the run on Northern Rock, the first run on a UK bank in over a century.

Fund Performance

The Fund generated a total return of 5.1% in 2007 with after a strong showing in the second half of the year. The Federal Reserve (Fed) cut short term interest rates from 5.25% to 4.25%, which caused 10-year U.S TIPS real yields to fall from approximately 2.41% at the end of 2006 to approximately 1.71% at the end of 2007. At the same time, inflation in the U.S., as measured by the Consumer Price Index for All Urban Consumers (CPI-U), rose from 2.5% at the end of December 2006 to just 4.1% as of December 2007 mainly as result of oil prices increasing to nearly \$100 per barrel. This combination of declining real yields and rising inflation accretion resulted strong performance for U.S. TIPS.

Although TIPS performed well, the other components lagged. Spreads on investment grade corporate bonds widened dramatically in the second half of the year as subprime fears spread through the financial system. Spreads on bank loans and high yield bonds widened dramatically during the second half of the year as well. The Funds exposure to residential mortgage backed securities contributed negatively to performance as spreads widened.

Outlook and Strategy

US TIPS were one of the best performing US dollar fixed income securities. Fed easing caused real yields to fall while the sharp jump in commodity prices also created a spike in headline inflation numbers. At the outset of 2008, our forecast calls for real GDP to slow to around 1.5% and core inflation to drift back towards the Fed's defined "comfort zone" of 1.5% to 2.0%. We continue to feel that any risks would be skewed to weaker data as there is a real risk that housing troubles could spill over into other areas of the economy. Our outlook means that real rates will remain stable or move slightly lower, with the most focus at the front end of the yield curve as the Fed continues to lower rates. Given the current state of the financial system we think that even if things stabilize the Fed will not be in a hurry to increase rates. But we would caution that with 2 year treasury notes yielding less than 3% a good deal of additional Fed easing is already discounted by the market so we are unlikely to see the kinds of gains from a long duration position that we did last year.

On the inflation front, although core inflation moderated, the market focused more on the potential for higher inflation in the future. We believe these inflation fears are largely driven by increases in commodity prices. Retail gasoline, for example, increased by approximately 30% last year according to AAA, and oil prices have increased for 6 of the past 7 years. The bullish inflation argument for 2008 is that these trends will continue as global demand for resources continues to exceed global supply and that these cost increases are slowly finding their way into other parts of the economy. While we recognize this argument, we remain unconvinced that a slowing US economy with a weakened consumer will result in strong enough demand to maintain this trend and note that inflation tends to be a lagging indicator of economic activity. Therefore, we are not in the "stagflation" camp.

Leverage

During the second half of 2007, the Real Return Trust reduced its obligation under the repurchase agreement with the Bank of Montreal to zero.

Currency Hedging

As at December 31, 2007, the Real Return Trust was approximately 111% hedged against moves in Canadian/U.S. exchange rates by way of a currency forward entitling the Fund to sell US \$52,824,181 in exchange for CA \$62,408,000 on July 17, 2015. The degree of currency hedging employed is partly determined by the par value of the bonds in the portfolio, which mature at a minimum of par value and is also influenced by the term to maturity of the hedge.

Market repurchases

Subject to certain conditions described in the Annual Information Form, the Fund is obligated to purchase 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, during the year ended on December 31, 2007 the Fund purchased 94,500 units for cancellation at a cost of \$729,475 (252,600 units at a cost of \$2,062,968 during the year ended on December 31, 2006).

Distributions

The Fund has made all its scheduled distributions to date. The following schedule shows all the historical distributions per unit up to December 31 2007.

Historical Distributions:					
2005		2006		2007	
August	\$0.065	January	\$0.048	January	\$0.033
September	\$0.046	February	\$0.048	February	\$0.033
October	\$0.046	March	\$0.048	March	\$0.033
November	\$0.046	April	\$0.046	April	\$0.033
December	\$0.046	May	\$0.046	May	\$0.033
		June	\$0.046	June	\$0.033
		July	\$0.044	July	\$0.033
		August	\$0.044	August	\$0.033
		September	\$0.044	September	\$0.033
		October	\$0.042	October	\$0.031
		November	\$0.042	November	\$0.031
		December	\$0.042	December	\$0.031
Total	\$0.25	Total	\$0.54	Total	\$0.39
Distributions Since Inception:					\$1.18

Recommendations or Reports by the Board of Advisors

The Board of Advisors tabled no reports and made no reportable material recommendations to management of the Fund during the year ended December 31, 2007.

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 Fund and the Real Return Trust pays the Investment Advisor out of the above management fees.

Deconsolidation of the Real Return Trust

As the Fund is exposed to the future gains or losses arising on the portfolio securities held by Real Return Trust, Accounting Guideline “AcG 15 - Consolidation of Variable Interest Entities” required that the Fund’s financial statements be presented on a consolidated basis by including the results of Real Return Trust. The 2006 financial statements were prepared on this basis.

Effective February 2007, AcG 15 has been amended and now specifically excludes investment funds from its application. These changes were applicable for periods beginning on or after September 30, 2007, with early adoption encouraged.

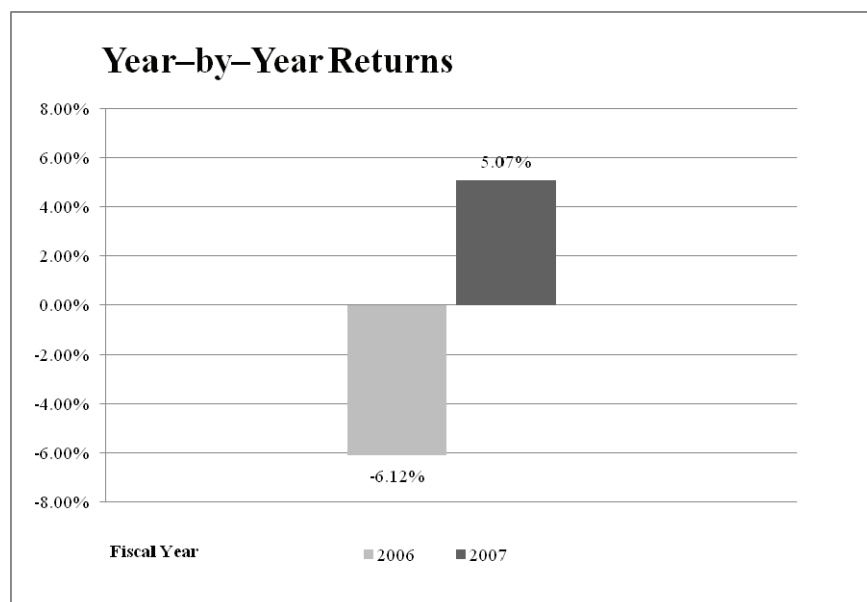
The Fund has adopted the amended AcG for the December 31, 2007 year-end and reclassified the December 31, 2006 comparative financial statements and financial highlights to conform to the new presentation.

Past Performance

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

Year – by –Year Returns

The following bar chart shows the Fund's annual performance for the year shown. This bar chart 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 assuming all distributions were re-invested.



Annual Compound Returns

	Past Year	Since Inception ⁽¹⁾
Based on NAV	5.07%	0.03%
Based on share price	0.25%	-4.88%
Barclays Capital U.S. Government Inflation-Linked All Maturities Index	11.78%	6.05%

⁽¹⁾ Annualized for the period July 18, 2005 (Commencement of operations) to December 31, 2007.

Financial Highlights

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

The Fund's Net Asset Value per unit:

	December 31, 2007	December 31, 2006	December 31, 2005 ⁽¹⁾
Net Asset Value, beginning of period	8.23	9.33	10.00
Increase (decrease) from operations:			
Total revenues	–	–	–
Total expenses	(0.11)	(0.11)	(0.05)
Unit issue expense ⁽²⁾	–	(0.01)	(0.56)
Realized gains (losses) for the period	(0.09)	(0.01)	0.01
Unrealized gains (losses) for the period	0.48	(0.43)	0.17
Total increase (decrease) from operations ⁽³⁾	0.28	(0.56)	(0.43)
Distributions:			
From income (excluding dividends)	–	–	–
From dividends	–	–	–
From capital gains	–	–	–
Return of capital	(0.39)	(0.54)	(0.25)
Total Annual Distributions ⁽³⁾	(0.39)	(0.54)	(0.25)
Net Asset Value, end of period ⁽³⁾⁽⁴⁾	8.23	8.23	9.33

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

⁽²⁾ Issue expense 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⁾ This is not a reconciliation between the opening and the closing net asset values per unit.

Ratios and Supplemental Data:

Fund	December 31, 2007	December 31, 2006	December 31, 2005 ⁽¹⁾
Net assets (000's)	56,316	92,636	114,791
Number of units outstanding	6,839,067	11,260,603	12,307,408
Base Management expense ratio ⁽²⁾	1.30%	1.25%	1.25%
Issue expenses ratio ⁽²⁾	0.00%	0.08%	5.98%
Management expense ratio ⁽²⁾	1.30%	1.33%	7.23%
Management expense ratio before waivers or absorptions ⁽²⁾	1.30%	1.33%	7.23%
Portfolio turnover rate ⁽⁴⁾	0.00%	4.74%	10.91%
Trading expense ratio ⁽⁵⁾	0.00%	0.00%	0.00%
Closing market price (TSX)	7.67	8.05	8.87
Consolidated for the Fund and Real Return Trust			
Base Management expense ratio ⁽²⁾⁽³⁾	2.32%	2.24%	2.26%

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

⁽²⁾ Management expense ratio is based on total expenses for the stated period and is expressed as an annualized percentage of daily average net assets during the period. Unit issue expenses, representing all Agents' fees and other offering expenses which are one-time expenses are not annualized.

⁽³⁾ A separate management expense ratio has been presented above to include expenses of both the Fund and the Real Return Trust excluding interest expense on the reverse repurchase agreement.

⁽⁴⁾ The Fund's turnover rate indicates how actively the Fund's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund's buying and selling all of the securities in its portfolio once in the course of the year. There is not necessarily a relationship between turnover rate and the performance of the Fund.

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

Summary of Investment Portfolio as of December 31, 2007

The summary of investment portfolio may change due to ongoing portfolio transactions of the Fund. A quarterly update is available at www.cclcapitalmarkets.com and at www.sedar.com.

Investment portfolio of the Connor Clark & Lunn Real Return Income Fund

	Market Value \$	% of NAV
Portfolio by Category		
Equity Derivatives	26,869,990	47.7%
Information Technology	16,885,889	30.0%
Technology Hardware & Equipment	8,360,304	14.8%
Consumer Staples	2,477,446	4.4%
Health Care	2,121,462	3.8%
Cash and Cash Equivalents	81,098	0.1%
Top 25 Holdings		
Equity Derivatives	26,869,990	47.7%
Cognos Inc.	12,924,714	23.1%
Nortel Networks Corp.	4,745,394	8.4%
CGI Group Class A	3,961,175	7.0%
Celestica Inc.	3,614,910	6.4%
Cott Corp.	2,477,446	4.4%
Angiotech Pharmaceuticals Inc.	2,121,462	3.8%
Cash and Cash Equivalents	81,098	0.1%
Net asset value (NAV)	56,315,971	

Investment portfolio of the Real Return Trust

	% Rate	Maturity date	Market Value \$	% of NAV
Portfolio by Category				
Foreign Bonds			41,983,355	74.0%
Foreign Currency Forward Contracts			6,779,840	12.0%
Foreign Funds			4,893,232	8.6%
Cash & Cash Equivalents			2,829,443	5.0%
Futures Contracts			44,807	0.1%
Option Contracts			(22,114)	0.0%
Top 25 Holdings				
US Treasury Inflation-Protected Securities	1.875%	Jul-15	41,288,522	72.7%
Foreign Currency Forward Contracts			6,779,840	12.0%
Western Asset Mgmt MBS Portfolio Fund LLC			2,874,282	5.1%
Cash & Cash Equivalents			2,829,443	5.0%
Western Asset Floating Rate High Income Fund LLC			2,018,950	3.5%
SLM Corp.	4.035%	Feb-10	435,246	0.8%
Vale Overseas	6.875%	Nov-36	259,587	0.5%
3 Month Eurodollar Futures		Mar-08	39,712	0.1%
5 Year United States Treasury Note Futures		Mar-08	9,322	0.0%
3 Month Sterling Futures		Mar-08	3,978	0.0%
3 Month Sterling Futures		Sep-08	2,898	0.0%
10 Year United States T-Note Put Option on Futures		Feb-08	(4,626)	0.0%
10 Year United States T-Note Call Option on Futures		Feb-08	(6,662)	0.0%
5 Year United States T-Note Put Option on Futures		Mar-08	(10,826)	0.0%
20 Year United States Treasury Note Futures		Mar-08	(11,103)	0.0%
Net asset value (NAV)			56,715,089	100.0%

Management's Responsibility for Financial Reporting

The accompanying financial statements of **Connor, Clark & Lunn Real Return Income Fund** (the "Fund") and all of the information have been prepared by Connor, Clark & Lunn Capital Markets in its capacity as Manager of the Fund and has 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.



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

Toronto, Canada
March 14, 2008

March 14, 2008

Auditors' Report

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

We have audited the statement of investments of **Connor, Clark & Lunn Real Return Income Fund** as at December 31, 2007, the statements of net assets as at December 31, 2007 and 2006 and the statements of operations, changes in net assets, surplus (deficit) and contributed surplus and cash flow for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and 2006 and the results of its operations, the changes in its net assets 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 Real Return Income Fund

Statements of Net Assets

As at December 31, 2007 and 2006

	2007	2006 ^(*)
	\$	\$
Assets		
Cash	81,098	-
Investments at market value (cost - \$55,094,722; 2006 - \$96,527,329)	29,845,101	100,484,846
Unrealized gain on forward agreement	26,869,988	-
	<u>56,796,187</u>	<u>100,484,846</u>
Liabilities		
Bank overdraft	-	131
Bank indebtedness (note 8)	-	113,000
Unrealized loss on forward agreement	-	7,047,416
Accounts payable and accrued liabilities	227,874	168,592
Distributions payable	213,846	469,971
Management fees payable	30,743	49,883
Market repurchases payable (note 6)	7,755	-
	<u>480,218</u>	<u>7,848,993</u>
Net Assets and Unitholders' Equity	<u>56,315,969</u>	<u>92,635,853</u>
Units outstanding (note 5)	<u>6,839,067</u>	<u>11,260,603</u>
Net asset value per unit	<u>8.23</u>	<u>8.23</u>
Unitholders' Equity		
Unit capital (note 5)	54,499,774	96,084,082
Contribution surplus	4,040,855	1,561,442
Surplus (Deficit)	<u>(2,224,660)</u>	<u>(5,009,671)</u>
Unitholders' equity - End of period	<u>56,315,969</u>	<u>92,635,853</u>

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



Director



Director

(*) Restated to reflect the change in accounting policy described in Note 3.
(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Statements of Operations

For the year ended December 31, 2007 and 2006

	2007	2006 ^(*)
	\$	\$
Income		
Interest income	1,276	-
Expenses		
Forward fees (note 7)	405,129	516,566
Management fees	257,472	328,775
Service fees	221,901	298,277
Audit fees	27,902	12,089
Custodial and other unitholder fees	34,310	29,919
Administration fees	23,357	20,856
Legal fees	16,367	15,903
Transfer agent fees	14,928	13,031
Sustaining fees	15,722	17,723
Advisory Board fees	10,758	13,450
Filing fees	8,405	9,500
Printing and mailing fees	3,033	5,531
Interest expense	1,144	3,895
Other	2,192	1,513
	<u>1,042,620</u>	<u>1,287,028</u>
Investment income (loss)	<u>(1,041,344)</u>	<u>(1,287,028)</u>
Unrealized gain (loss) on investments		
Change in unrealized gain (loss) on investments	(29,207,139)	2,885,141
Change in unrealized gain (loss) on forward agreement (note 7)	33,917,404	(8,123,724)
	4,710,265	(5,238,583)
Realized gain (loss) on investments		
Net realized gain (loss) on investments	(883,910)	(93,528)
Net gain (loss) on investments	<u>3,826,355</u>	<u>(5,332,111)</u>
Increase (decrease) in net assets from operations	<u>2,785,011</u>	<u>(6,619,139)</u>
Increase (decrease) in net assets from operations per unit^(**)	<u>0.28</u>	<u>(0.56)</u>
Distributions per unit	<u>0.39</u>	<u>0.54</u>

* (Restated to reflect the change in accounting policy described in Note 3.)

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

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

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

For the year ended December 31, 2007 and 2006

	2007	2006 ^(*)
	\$	\$
Increase (decrease) in net assets from operations	2,785,011	(6,619,139)
Distributions to unitholders from return on capital	(3,868,606)	(6,439,211)
Unitholders' transactions		
Payments on redemption (note 5)	(34,506,654)	(6,947,605)
Payments on cancellation of units (note 6)	(729,635)	(2,062,968)
Agents' fees and issue expenses	-	(86,093)
	<u>(35,236,289)</u>	<u>(9,096,666)</u>
Change in net assets during the year	(36,319,884)	(22,155,016)
Net assets - Beginning of period	<u>92,635,853</u>	<u>114,790,869</u>
Net assets - End of period	<u>56,315,969</u>	<u>92,635,853</u>
Surplus (Deficit), beginning of period	(5,009,671)	1,609,468
Increase (decrease) in net assets from operations	<u>2,785,011</u>	<u>(6,619,139)</u>
Surplus (Deficit), end of period	<u>(2,224,660)</u>	<u>(5,009,671)</u>
Contributed surplus, beginning of period	1,561,442	103,965
Cost of shares repurchased at less than stated value	<u>2,479,413</u>	<u>1,457,477</u>
Contributed surplus, end of period	<u>4,040,855</u>	<u>1,561,442</u>

* (Restated to reflect the change in accounting policy described in Note 3.)
(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Statements of Cash Flow

For the year ended December 31, 2007 and 2006

	2007	2006 ^(*)
	\$	\$
Operating Activities		
Increase (decrease) in net assets from operations	2,785,011	(6,619,139)
Items not effecting cash:		
Change in unrealized (gain) loss on investments	29,207,139	(2,885,141)
Change in unrealized (gain) loss on forward agreement (note 7)	(33,917,404)	8,123,724
Net realized (gain) loss on investments	883,910	93,528
Changes in non-cash working capital		
(Increase) decrease in interest and dividends receivable	-	1,310
Increase (decrease) in accounts payable and accrued liabilities	59,282	(94,627)
Increase (decrease) in management fees payable	(19,140)	(43,326)
	<u>(1,001,202)</u>	<u>(1,423,671)</u>
Investing Activities		
Purchase of investments	-	(5,151,313)
Proceeds on disposition of investments	40,548,696	22,148,287
	<u>40,548,696</u>	<u>16,996,974</u>
Financing Activities		
Payments on redemption (note 5)	(34,506,654)	(6,947,605)
Payments on cancellation of units (note 6)	(729,635)	(2,062,968)
Distributions to unitholders	(4,124,731)	(6,533,208)
Unit issue costs	-	(86,093)
Increase (decrease) in market repurchases payable (note 6)	7,755	(55,289)
Proceeds from bank indebtedness	444,100	1,622,301
Principal payments on bank indebtedness	(557,100)	(1,509,301)
	<u>(39,466,265)</u>	<u>(15,572,163)</u>
Net cash flow provided by financing activities		
	<u>(39,466,265)</u>	<u>(15,572,163)</u>
Net increase in cash	81,229	1,140
Bank overdraft - beginning of period	<u>(131)</u>	<u>(1,271)</u>
Cash - end of period	<u>81,098</u>	<u>(131)</u>
Interest paid	1,144	3,895

* (Restated to reflect the change in accounting policy described in Note 3.)
(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Statement of Investments

As at December 31, 2007

	Number of shares	Average cost	Market value	% of Portfolio
Canadian common stocks (pledged to the Counterparty under the Forward Agreement)				
Consumer Staples				
Cott Corp.	378,236	10,293,748	2,477,446	8.3%
Health Care				
Angiotech Pharmaceuticals Inc.	625,800	10,586,926	2,121,462	7.1%
Information Technology				
CGI Group Class A	344,450	2,714,266	3,961,175	13.3%
Cognos Inc.	226,273	10,312,730	12,924,714	43.3%
		13,026,996	16,885,889	56.6%
Technology Hardware & Equipment				
Celestica Inc.	628,680	10,587,217	3,614,910	12.1%
Nortel Networks Corp.	316,782	10,599,835	4,745,394	15.9%
		21,187,052	8,360,304	28.0%
Total Canadian common stocks		55,094,722	29,845,101	100.0%

	Maturity date	Number of contracts	Market value \$
Derivative contracts			
Forward Agreement (note 7)	18-Jul-15	1	26,869,988

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2007

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 the Fund. The Fund is a mutual fund trust 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.

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 a 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, commodity index investments directly or indirectly throughout investments in underlying investment funds. 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. 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.

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 debt to equity ratio of up to 2:1.

3 Summary of significant accounting policies

Basis of presentation

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

Deconsolidation of the Real Return Trust

As the Fund is exposed to the future gains or losses arising on the portfolio securities held by Real Return Trust, Accounting Guideline "AcG 15 - Consolidation of Variable Interest Entities" required that the Fund's financial statements be presented on a consolidated basis by including the results of Real Return Trust. The 2006 financial statements were prepared on this basis.

Effective February 2007, AcG 15 has been amended and now specifically excludes investment funds from its application. These changes were applicable for periods beginning on or after September 30, 2007, with early adoption encouraged.

The Fund has adopted the amended AcG 15 for the December 31, 2007 year-end and reclassified the December 31, 2006 comparative financial statements to conform to the new presentation

Recent accounting pronouncements

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

The new Section 1535, Capital Disclosures, requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Fund.

This standard will impact the Fund's disclosures provided but will not affect the Fund's results or financial position.

The new Sections 3862 and 3863 replace Handbook Section 3861 Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The new standards apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Fund.

This standard will impact the Fund's disclosures provided but will not affect the Fund's results or financial position.

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2007

Section 3855

National Instrument 81-106 "Investment Fund Continuous Disclosure" requires the net asset value of the Fund be calculated in accordance with Canadian generally accepted accounting principles ("GAAP").

The Canadian Institute of Chartered Accountants ("CICA") has issued Section 3855, Financial Instruments: Recognition and Measurement, effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The adoption of this section will impact the valuation and disclosure of the net asset value ("NAV") of the Fund, and the way transaction costs are recorded for financial reporting purposes.

Section 3855 requires that the fair value of financial instruments which are traded in active markets be measured based on the bid price for long securities and the ask price for securities held short. Prior to this new section, the fair value was based on the last traded price for the day, when available. The impact of adopting the amended policy is not material to the financial statements.

Section 3855 also requires that transaction costs, such as brokerage commissions, incurred in the purchase and sale of securities be charged to net income in the period. Prior to this new section, these costs have been added to the cost of the securities purchased or deducted from the proceeds of sale.

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

On January 1, 2007, the Fund adopted Section 3855 on a prospective basis for financial reporting purposes ("GAAP NAV"). The provisions of Section 3855 have been also applied to the opening NAV on January 1, 2007 without restating prior period financial statements. There were no differences between the Trading NAV and the GAAP NAV as a result of the adoption of Section 3855.

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 bid price recorded by the securities exchanges on which such investments are principally traded. Foreign funds are recorded at the available net asset value per unit.

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. Distributions from foreign investment funds are recorded on the ex-dividend date.

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.

4 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.

5 Unitholders' equity

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

On 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.

For redemptions on the August Redemption Date in each year the redemption price is 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. During August 2007 the fund had its annual Redemption Date and \$34,506,654 was paid to redeem 4,327,036 units at August 31, 2007 NAV per unit price minus the costs of funding the redemption including all brokerage fees, commissions and other costs incurred in liquidating the securities held in the Portfolio.

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2007

The Unit Capital dollar amount represents the face value of the fund units minus any return on capital distributions and issue cost paid since July 18, 2005 (commencement of operations) to December 31, 2007.

Changes in outstanding units are summarized as follows:

	Number of units	
	December 31, 2007	December 31, 2006
Opening balance	11,260,603	12,307,408
Units issued	—	—
Units redeemed	(4,327,036)	(794,205)
Units cancelled (note 6)	<u>(94,500)</u>	<u>(252,600)</u>
Ending balance	<u>6,839,067</u>	<u>11,260,603</u>

6 Market Purchase Program

Subject to certain conditions described in the prospectus dated June 29, 2005, the Fund is 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, during the year ended on December 31, 2007 the Fund purchased 94,500 units for cancellation at a cost of \$729,635 (252,600 units at a cost of \$2,062,968 during the year ended on December 31, 2006).

7 Forward Agreement and Common Share Portfolio

The Fund entered into a Forward Agreement with the Counterparty to obtain exposure to the performance of the Portfolio held by 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 are pledged to, and held by, the Counterparty as security for the obligations of the Fund under the Forward Agreement.

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.

8 Bank indebtedness

The Fund has an overdraft agreement with the Bank of Montreal ("BMO") dated March 2, 2006. Under the terms of this agreement, the maximum allowable borrowing limit is \$500,000.

During the year ended December 31, 2007, the Credit Facility had a minimum outstanding balance of \$0 and a maximum outstanding balance of \$139,000. The related total interest expense was \$1,144 for the year ended on December 31, 2007 (2006 - \$3,895).

As of December 31, 2007, the Credit Facility had \$nil outstanding balance (December 31, 2006 - \$113,000).

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 Financial Statements

December 31, 2007

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 to 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 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.

12 Broker commission charges and soft dollar services

There were \$nil broker commissions paid during the year ended on December 31, 2007 (\$nil during the year ended on December 31, 2006) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.