



CONNOR, CLARK & LUNN

CAPITAL MARKETS

8

0

0

2

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

Annual Report

December 31, 2008

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

March 13, 2009

Dear Investor,

We are pleased to provide you with the annual report of the Connor, Clark & Lunn Real Return Income Fund (the "Fund") for the year ended December 31, 2008.

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 -2.80% in 2008 and its net asset value was \$7.69 at year end. The period ending December 31, 2008 was a very difficult period for U.S. Treasury Inflation Protected Securities (U.S. TIPS), as the rise in real yields along with a switch in CPI accretion from positive to negative combined to produce the largest underperformance since U.S. TIPS were first introduced in 1997. During the year ended December 31, 2008, the Fund paid monthly distributions of \$0.03125 per unit totalling \$0.375 per unit. These distributions are characterized as return of capital distributions. At its closing price of \$6.93 on December 31st, 2008 this represented a yield of 5.4 % and a pre-tax interest equivalent of 7.7%.

The credit markets continued to be very difficult throughout 2008. It is difficult to forecast when the current state of disequilibrium will end or when liquidity will return to the marketplace, but policy-makers seem determined to avoid erring on the side of doing too little. While the economy has become less responsive to traditional policy measures, the Fed has successfully provided stimulus through non-traditional measures including a variety of new lending facilities. On the inflation front, inflation expectations have shifted dramatically in recent months as economic conditions have changed. As recently as August 2008 (inflation through July), trailing one-year inflation was 5.4% and fears of inflation were rising as rapidly and as strongly as oil prices. Since then, oil prices have staged an unprecedented decline, economic growth has shifted into reverse and inflation has been negative in every month. This is why TIPS so dramatically underperformed nominal treasuries in the second half of the year.

Western Asset believes that real yields on TIPS today are very attractive relative to nominal Treasury securities across the entire yield curve. One-year TIPS have a real yield of 5.4% versus one-year Treasury Bills at 0.39%. The incremental yields that these TIPS are currently offering suggests that a TIPS investor could withstand 5.0% deflation over the next year and still get the same return as a treasury investor. While there is some uncertainty about the Fed's ability to prevent deflation in the short-term, there is little uncertainty about their ability to prevent it longer term. Currently, five-year TIPS offer a real yield of 2.5% versus nominal Treasuries at 1.5% implying 1% deflation per year or 5% deflation in year 1 and 0% inflation in the following four years. We believe that the market is fairly to modestly over-estimating deflation for the next twelve months and that the market is under-estimating inflation over the next five to ten years.

The Fund's Management Report of Fund Performance section of the report provides more information on what impacted the performance of the Fund during the fiscal period and Western Asset Management's views on the overall market environment. For the most up-to-date information on your investment, please visit our website at www.cclcapitalmarkets.com. We appreciate your investment and look forward to serving your investment needs in the future

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.**

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

Investment Objectives and Strategy

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 (“Transactional 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. Leverage was increased from zero during the period to approximately 0.06:1. 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 increased from zero during the period to approximately 0.06:1 in response to the Investment Advisor's belief in the attractive value of U.S. TIPS and to low 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 overnight 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 156% of Transactional NAV having been hedged to the Canadian dollar on December 31, 2008. 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 and 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

2008 marked a year in which the Federal Reserve intensified its campaign against downside risks to growth in response to the deepening financial crisis. The TED spread surged beyond previous extreme levels, and without the provision of credit, investors began to question the durability of the underlying economy. The funds rate was reduced a cumulative 425 bps (525 bps for the cycle) to near 0% by year end; this essentially moved the Fed beyond its traditional form of stimulus. A number of new lending facilities, designed to meet the liquidity demands of financial intermediaries across the full banking spectrum, were implemented. The Fed and the Treasury recently announced plans to channel up to \$600 billion directly to the mortgage market, and up to \$200 billion directly to consumer and small business finance, including credit card, auto and student loans. Details emerged that much of this funding would be unsterilized and result in a major increase in the money supply. Yields on 30-year fixed-rate conventional mortgages declined roughly 1% as a result, to the lowest level on record. The Treasury allocated the first \$250 billion of funds authorized under TARP by taking direct equity stakes in the

U.S. banking system. Economic data was negative and third-quarter GDP contracted 0.5% on falling consumption expenditures. Consumer confidence fell as labor market conditions deteriorated and equity prices plunged. The unemployment rate increased 1.7% to 6.7%, though the U.S. dollar gained close to 6% against a trade-weighted basket of currencies. The dollar's negative correlation with oil held strong as the price per barrel fell 54% after temporarily spiking in the summer. All in all, the period was the worst year for risk-taking in a quarter century. Spreads widened over 350 bps on investment-grade issues and more than 1,100 bps on high-yield issues. Mortgage-backed securities performed better, though even these government-backed securities underperformed Treasuries by 2.32% over the period. The S&P 500 lost 37% as volatility soared, marking 2008 as the worst year for equities since 1931.

On the inflation front, headline inflation in the U.S., as measured by the Consumer Price Index for All Urban Consumers (CPI-U), decreased significantly from 4.1% at the end of December 2007 to 0.1% at the end of December 2008 year over year. Core CPI (which excludes the effects of food and energy) decreased from 2.4% to 1.8% during the same period. Personal Consumption Expenditures (PCE) core deflator, which we believe is the Federal Reserve's favorite inflation measure, was 1.9% for the end of November 2008, down from 2.3% in December 2007.

The Barclays U.S. Government Inflation-Linked All Maturities Index returned -1.71% for the year, underperforming its nominal equivalent by 18.35%. CPI accretion was moderately positive early in the year but gradually became negative as inflation decreased sharply beginning in September.

Fund Performance

The Fund generated a total return of -2.80% in 2008. The period ending December 31, 2008 was a very difficult period for U.S. Treasury Inflation Protected Securities (U.S. TIPS), as the rise in real yields along with a switch in CPI accretion from positive to negative combined to produce the largest underperformance since U.S. TIPS were first introduced in 1997. The Barclays U.S. Government Inflation-Linked All Maturities Index generated a total return of -1.71%, while the U.S. Government Breakeven Index (composed of nominal U.S. Treasuries corresponding to the maturity of each U.S. TIPS issue) returned 16.65%. Although the Federal Reserve (Fed) cut short term interest rates from 4.25% to 0%, 10-year U.S. TIPS real yields rose from approximately 1.70% at the end of 2007 to approximately 2.09% at the end December 2008. At the same time, inflation in the U.S., as measured by the Consumer Price Index for All Urban Consumers (CPI-U), slowed sharply from 4.1% at the end of December 2007 to 0.1% as of December 2008, mainly as result of the collapse in commodity prices in the second half of the year. This combination of increasing real yields and falling inflation accretion resulted in significant underperformance for U.S. TIPS.

Agency mortgage-backed securities ("MBS") suffered for a majority of the period until the U.S. Treasury took the government-sponsored enterprises ("GSEs") into conservatorship in September 2008. A major rally was set off in the beginning weeks of September 2008 as spreads began to compress. Overall, for the 12 months ended December 31, 2008, our exposure to agency MBS contributed to performance. A series of bankruptcies, government conservatorships and mergers stemming from the credit crisis affected our investment grade positions. In September 2008, the federal government placed Fannie Mae and Freddie Mac, the GSEs, into conservatorship, purchased \$1 billion in senior preferred stock in each GSE, and indefinitely suspended the dividend on the existing preferred shares, thereby subordinating the interests of the existing preferred shareholders to the Treasury's. The Fund's exposure to Fannie Mae and Freddie Mac preferreds significantly detracted from performance. The Fund's exposure to financial issues and bank loans detracted from performance as spreads widened through the financial crisis.

Outlook and Strategy

It is difficult to forecast when the current state of disequilibrium will end or when liquidity will return to the marketplace, but policy-makers seem determined to avoid erring on the side of doing too little. While the economy has become less responsive to traditional policy measures, the Fed has successfully provided stimulus through nontraditional measures. Mortgage-yields have fallen to the lowest level on record as the market prepares for up to \$500 billion of direct purchases of fixed-rate agency mortgage-backed securities. This is a non-sterilized injection that looks quite similar to the helicopter money drop that Chairman Bernanke discussed in 2002 as a way to eradicate deflation. The Fed is essentially printing money and channelling it directly to the housing market to help arrest the decline in home prices. Therefore, we are currently assigning a high probability to policy-makers' success, not in restoring growth, but simply in ending the vicious cycle and restoring some semblance of equilibrium. Once liquidity returns to the marketplace, pricing in the fixed-income market should improve. We would also emphasize, however, that any new equilibrium will not necessarily be rosy. Policy-makers may be empowered to end the vicious cycle of debt-deflation but they cannot provide a sustainable engine of growth to replace the overspent U.S. consumer. Credit spreads will likely not enjoy as sharp a reversal as they have when

past financial crises came to an end. Nevertheless, we believe there is a profitable opportunity for investors with time on their side. The market has priced in a debt-deflationary vicious cycle for years to come, and anything less catastrophic would be positive for investors with a bias away from risk-free government debt.

Inflation expectations have shifted dramatically in recent months as economic conditions have changed. As recently as August 2008 (inflation through July), trailing one-year inflation was 5.4% and fears of inflation were rising as rapidly and as strongly as oil prices. Since then, oil prices have staged an unprecedented decline, economic growth has shifted into reverse and inflation has been negative in every month. This is why TIPS so dramatically underperformed nominal treasuries in the second half of the year.

However, the Fed has reminded us on numerous occasions that they are committed to preventing deflation. They have many tools at their disposal to prevent deflation and they have not been shy about using them. The Fed Funds rate has been reduced to near zero, monetary aggregates have been increased significantly, and they are now going to embark on an asset purchase plan that will include \$500 billion in agency MBS and \$100 billion in agency debentures. Collectively these programs will expand the Fed's balance sheet by an additional \$600 billion on top of the \$1.2 trillion expansion they have engineered so far. If inflation is indeed a monetary phenomenon, as we believe that it is, then these efforts will serve to: a) forestall deflation and b) ultimately create inflation.

Real yields on TIPS today are very attractive relative to nominal Treasury securities across the entire yield curve. One-year TIPS have a real yield of 5.4% versus one-year Treasury Bills at 0.39%. The incremental yields that these TIPS are currently offering suggests that a TIPS investor could withstand 5.0% deflation over the next year and still get the same return as a treasury investor. While there is some uncertainty about the Fed's ability to prevent deflation in the short-term, there is little uncertainty about their ability to prevent it longer term. Currently, five-year TIPS offer a real yield of 2.5% versus nominal Treasuries at 1.5% implying 1% deflation per year or 5% deflation in year 1 and 0% inflation in the following four years. Ten-year TIPS offer a real yield of 1.8% versus a nominal yield of 2.35%. This suggests that expectations are for inflation to average 55 basis points per year over the next ten years. We believe that the market is fairly to modestly over-estimating deflation for the next twelve months and that the market is under-estimating inflation over the next five to ten years.

We believe that TIPS currently offer attractive real yield levels and protection from long-term inflation. While the current economic environment suggests that deflation is a potential problem, the Fed is actively engaged in preventing this. They have significant power to win the battle against deflation and in unleashing the full capabilities that they possess, it is possible, even likely that they force the pendulum in the opposite direction creating inflation. This suggests that TIPS are a good long-term investment today.

TIPS are designed to offer inflation protection, but they also offer deflation protection. They are guaranteed to mature at a minimum of par or at par plus the accretion of inflation over their lifetime. Therefore, if we do experience a significant period of deflation, the investor will receive less interest than anticipated, but the principal of the investment will be preserved. This assumes that investments are made in new issue TIPS with no accrued inflation. Seasoned TIPS with accrued inflation are subject to additional risk as the accreted value is not guaranteed at maturity.

We are viewing the current investment grade corporate market as two markets, essentially: financials, and everything else. The cataclysm in the financial market this year was extraordinary. The myriad programs devised by the Fed and the Treasury to support the banking system give us hope that we are nearing the end of financial spread widening. TARP was converted to a bank recapitalization scheme from an asset purchase scheme. The FDIC's Temporary Liquidity Guaranty Program has removed the near term refinancing risk that bank holding companies and their banking subsidiaries faced. The Commercial Paper Funding facility is accomplishing that for the rolling over of commercial paper by A1/P1 issuers. We know that the credit quality cycle commercial banks face will continue to deteriorate, and therefore downgrades will continue, but the near nationalization of the banking system should provide a backstop to bank spreads, and we feel that bank debt will be among the first sectors to recover in the corporate market. The pain of the current credit crunch was felt first in the banking system, and as the economic malaise moves from Wall Street to Main Street, the effects should move from the financial sector to the industrial sector. We believe that issuer credit metrics will generally deteriorate. At the same time, we are coming off a protracted period of underperformance in the corporate market and spread levels that have not been seen since the Great Depression. That puts investors in the difficult position of having to evaluate credits in light of a pessimistic view of credit quality over the medium term, with pricing that has rarely been seen. Given the year end price and spread of the Barclay's Corporate Bond Index, we can calculate the break-even default rate under varying recovery assumptions. Looking at the swap curve, presuming 30% recoveries (below the historical 38% recovery), the swaps-neutral cumulative default rate over five years is 27.6%. The worst five-year rate ever experienced was 4.7%, which

means that a default rate of 27.6% seems remote.

We believe that current valuations in today's high-yield market offer investors a very attractive risk/reward profile. Both yields and spreads have far surpassed anything ever witnessed in past markets, including the Great Depression. That having been said, we recognize that the credit cycle has certainly taken a turn for the worse and we expect to see a dramatic rise in defaults over the next 12 months. These defaults should take the form of both traditional restructurings as well as selective defaults generated by proactive bond exchanges. This rise in defaults should be somewhat tempered by the fact that refinancing risk does not become elevated until the year 2011 and beyond. Furthermore, current valuations suggest that such a default trend is widely anticipated by the market; as evidence, consider the fact that the average dollar price of a high-yield bond now stands at just \$61.50. With a yield-to-worst of 19.5%, the market should be able to absorb a combination of elevated defaults and depressed recoveries while still generating strong overall returns. Generous coupon income combined with marginal spread tightening should partially offset the impairment caused by an inevitable rise in default activity.

With respect to bank loans, we expect significantly better returns for the loan market in 2009 relative to the beating that was experienced in 2008. From a fundamental point of view, we remain concerned about the stressed economic environment and the frozen credit markets. We also recognize that for at least the next six months, corporate earnings will continue to suffer, that access to liquidity will remain tight, and that default rates will rise. Offsetting these valid and significant concerns is our belief that most issuers are well prepared to ride out the storm and that defaults will not exceed levels experienced during previous recessionary periods. Our default rate view, in particular, is in sharp contrast to what the market and many participants are expecting. At current spreads exceeding Libor +1700, the market is implying that defaults will exceed 15% per year for the next 5 years, or stated alternatively, that a static basket of loans held over the next five years will experience in excess of a 75% cumulative default rate.

Given the excessive spreads currently in the marketplace, we see many opportunities to fund investments that will perform well in a stagnant economic environment, yet will do extremely well in an improving economic environment. We continue to focus on large liquid loans, as those loans seemed to have been disproportionately priced down from the technical unwind trade that occurred in the second half of 2008. We will also continue with our overweight in the defensive sectors as a hedge against any further economic deterioration and against future volatility which we expect to remain elevated. But as the year progresses and we hopefully move closer to an economic rebound, we will more actively search for higher reward opportunities in both the cyclical space and off the run names as the spread within these 2 sub-categories has gotten to the point where the risk/reward is extremely compelling. Throughout the year, avoiding defaults will be the most important variable in leading to out-performance and we will continue to focus on companies with positive free-cash-flow, manageable balance sheets, and strong management.

Our other large sector exposure remains in mortgage-backed securities, particularly agency pass-throughs, since they are immune to default risk and have traditionally performed well during times of slowing growth. Agency mortgage yields have fallen to the lowest level on record as the market prepares for the Fed's direct purchase of up to \$500 billion of fixed-rate agency mortgage-backed securities. Fed purchases totaled \$10 billion in the first three days of buying in 2009. The US Treasury and Fed are expected to purchase more agency mortgages than produced so spreads should trade near current levels. Relative to Treasuries, we believe yields are still attractive and agency mortgages should achieve their yield advantage in excess spread.

Leverage

As at December 31, 2008, the Fund had a liability of \$2,469,014 under a master repurchase agreement with the Bank of Montreal, pursuant to which the Fund had agreed to repurchase certain U.S. TIPS from the Bank of Montreal with a market value on December 31, 2008 of \$2,597,666. The value of the Fund's net assets value was \$39,925,638. As such, the Fund's debt-to-equity ratio (on a consolidation basis) was approximately 0.06: 1.

Currency Hedging

As at December 31, 2008, the Real Return Trust was approximately 156% 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 Transactional NAV per Unit. Pursuant to this obligation, during the year ended on December 31, 2008 the Fund purchased 10,900 units for cancellation at a cost of \$85,055 (94,500 units at a cost of \$729,475 during the year ended on December 31, 2007).

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 2008.

Historical Distributions:							
2005		2006		2007		2008	
		January	\$0.04790	January	\$0.03333	January	\$0.03125
		February	\$0.04790	February	\$0.03333	February	\$0.03125
		March	\$0.04790	March	\$0.03333	March	\$0.03125
		April	\$0.04580	April	\$0.03333	April	\$0.03125
		May	\$0.04580	May	\$0.03333	May	\$0.03125
		June	\$0.04580	June	\$0.03333	June	\$0.03125
		July	\$0.04375	July	\$0.03333	July	\$0.03125
August	\$0.06540	August	\$0.04375	August	\$0.03333	August	\$0.03125
September	\$0.04580	September	\$0.04375	September	\$0.03333	September	\$0.03125
October	\$0.04580	October	\$0.04167	October	\$0.03125	October	\$0.03125
November	\$0.04580	November	\$0.04167	November	\$0.03125	November	\$0.03125
December	\$0.04580	December	\$0.04167	December	\$0.03125	December	\$0.03125
Total	\$0.24860	Total	\$0.53736	Total	\$0.39372	Total	\$0.37500
Total Distributions Since Inception:				\$1.55468			

Recommendations or Reports by the Independent Review Committee

The Independent Review Committee tabled no special reports and made no reportable material recommendations to management of the Company during the six month period ended December 31, 2008.

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 Transactional 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.

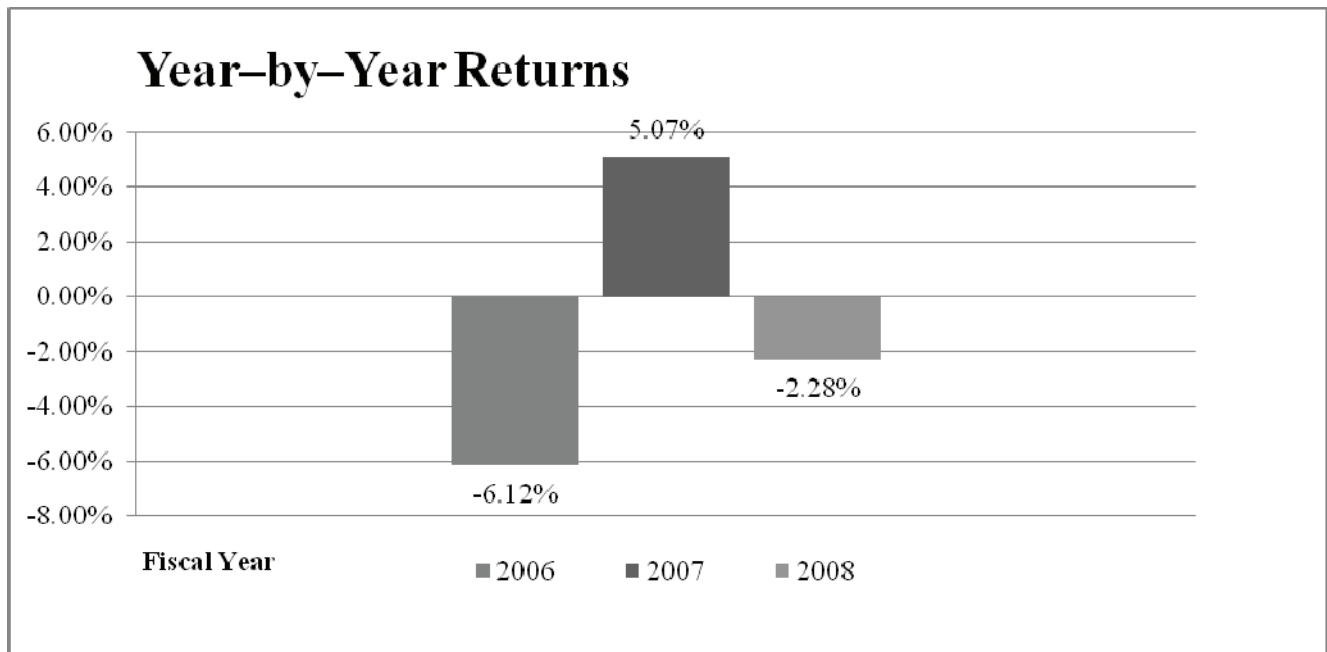
The Manager, in its capacity as manager of Fund and the Real Return Trust pays the Investment Advisor out of the above management fees.

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	Three Years	Since Inception ⁽¹⁾
Based on Transactional NAV	-2.28%	-1.21%	-0.64%
Based on share price	-5.04%	-2.53%	-4.92%
Barclays Capital U.S. Government Inflation-Linked All Maturities Index	-1.71%	3.36%	2.88%

⁽¹⁾ Annualized for the period July 18, 2005 (Commencement of operations) to December 31, 2008.

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 Assets per unit:

	2008	2007	2006	2005 ⁽¹⁾
Net Assets, beginning of period	8.23	8.23	9.33	10.00
Increase (decrease) from operations:				
Total revenues	—	—	—	—
Total expenses	(0.11)	(0.11)	(0.11)	(0.05)
Unit issue expense ⁽²⁾	—	—	(0.01)	(0.56)
Realized gains (losses) for the period	0.56	(0.09)	(0.01)	0.01
Unrealized gains (losses) for the period	(0.45)	0.48	(0.43)	0.17
Total increase (decrease) from operations⁽³⁾	0.00	0.28	(0.56)	(0.43)
Distributions:				
From income (excluding dividends)	—	—	—	—
From dividends	—	—	—	—
From capital gains	—	—	—	—
Return of capital	(0.38)	(0.39)	(0.54)	(0.25)
Total Annual Distributions⁽³⁾	(0.38)	(0.39)	(0.54)	(0.25)
Net Assets, end of period⁽³⁾⁽⁴⁾	7.69	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 assets and distributions are based on the actual number of units outstanding at the relevant time. The increase / decrease from operations is based on the weighted average number of units outstanding over the financial period.

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

Ratios and Supplemental Data:

Fund	2008	2007	2006	2005 ⁽¹⁾
Net asset value (000's)	39,926	56,316	92,636	114,791
Number of units outstanding	5,193,552	6,839,067	11,260,603	12,307,408
Base management expense ratio ⁽²⁾	1.34%	1.30%	1.25%	1.25%
Issue expenses ratio ⁽²⁾	0.00%	0.00%	0.08%	5.98%
Management expense ratio ⁽²⁾	1.34%	1.30%	1.33%	7.23%
Management expense ratio before waivers or absorptions ⁽²⁾	1.34%	1.30%	1.33%	7.23%
Portfolio turnover rate ⁽⁴⁾	118.09%	0.00%	4.74%	10.91%
Trading expense ratio ⁽⁵⁾	0.00%	0.00%	0.00%	0.00%
Closing market price (TSX)	6.93	7.67	8.05	8.87
Net asset value per unit	7.69	8.23	8.23	9.33

Consolidated for the Fund and Real Return Trust

Base Management expense ratio ⁽²⁾⁽³⁾	2.49%	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, 2008

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

	Fair Value \$	% of Transactional NAV
Portfolio by Category		
Equity Derivatives	23,770,290	59.5%
Information Technology	9,831,881	24.6%
Consumer Staples	3,668,608	9.2%
Materials	2,923,169	7.3%
Cash and Cash Equivalents	19,850	0.0%
 Top 25 Holdings		
Equity Derivatives	23,770,290	59.4%
Sino-Forest Corporation - Class A	4,739,650	11.9%
Pan American Silver Corp.	4,437,492	11.1%
Viterra Inc	3,668,608	9.2%
Celestica Inc.	2,312,207	5.8%
FNX Mining Company Inc.	654,739	1.6%
CGI Group Class A	543,381	1.4%
Nortel Networks Corp.	67,581	0.2%
Cash and Cash Equivalents	19,850	0.0%
 Net asset value (Transactional NAV)	 39,925,638	

Investment portfolio of the Real Return Trust

	% Rate	Maturity date	Fair Value \$	% of Transactional NAV
Portfolio by Category				
Foreign bonds			36,794,062	91.5%
Foreign funds			4,568,237	11.4%
Foreign currency forward contracts			624,086	1.6%
Foreign preferred shares			397,699	1.0%
Cash & Cash Equivalents			17,400	0.0%
Futures contracts			(205,641)	-0.5%
Top 25 Holdings				
US Treasury Inflation-Protected Securities	1.875%	Jul-15	35,555,551	88.5%
Western Asset Mgmt MBS Portfolio Fund LLC			2,966,227	7.4%
Western Asset Floating Rate High Income Fund LLC			1,602,010	4.0%
Foreign currency forward contracts			624,086	1.6%
SLM Corp.	4.035%	Feb-10	483,488	1.2%
Citigroup Inc.			365,439	0.9%
Vale Overseas	6.875%	Nov-36	291,346	0.7%
JP Morgan Chase & Co.	7.900%	Apr-49	256,725	0.6%
Bank of America	8.000%	Jan-49	195,353	0.5%
Federal National Mortgage Association			21,415	0.1%
Cash & Cash Equivalents			17,400	0.0%
US Treasury Inflation-Protected Securities	1.375%	Jul-18	11,599	0.0%
Federal Home Loan Mortgage Corporation			10,845	0.0%
10 Year United States Treasury Note Futures		Mar-09	(55,360)	-0.1%
20 Year United States Treasury Note Futures		Mar-09	(150,281)	-0.4%
Net asset value (Transactional NAV)			40,193,948	

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.



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

Toronto, Canada
March 13, 2009

PricewaterhouseCoopers LLP
Chartered Accountants
PO Box 82
Royal Trust Tower, Suite 3000
Toronto Dominion Centre
Toronto, Ontario
Canada M5K 1G8
Telephone +1 416 863 1133
Facsimile +1 416 365 8215

March 17, 2009

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** (the Fund) as at December 31, 2008, the statements of net assets as at December 31, 2008 and 2007 and the statements of operations, changes in net assets, surplus (deficit) and contributed surplus and cash flow for the years then ended. These financial statements are the responsibility of the Fund's Manager. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2008 and 2007 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

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

Connor, Clark & Lunn Real Return Income Fund

Statements of Net Assets

As at December 31, 2008 and 2007

	2008	2007
	\$	\$
Assets		
Cash	19,850	81,098
Investments at fair value (cost - \$41,432,723; 2007 - \$55,094,722)	16,423,658	29,845,101
Unrealized gain on forward agreement	23,770,290	26,869,988
	<u>40,213,798</u>	<u>56,796,187</u>
Liabilities		
Accounts payable and accrued liabilities	98,622	227,874
Distributions payable	162,330	213,846
Management fees payable	20,252	30,743
Market repurchases payable (note 6)	6,956	7,755
	<u>288,160</u>	<u>480,218</u>
Net Assets and Unitholders' Equity	<u>39,925,638</u>	<u>56,315,969</u>
Units outstanding (note 5)	<u>5,193,552</u>	<u>6,839,067</u>
Net assets per unit	<u>7.69</u>	<u>8.23</u>
Unitholders' Equity		
Unit capital (note 5)	39,029,026	54,499,774
Contributed surplus	3,109,443	4,040,855
Surplus (Deficit)	<u>(2,212,831)</u>	<u>(2,224,660)</u>
Unitholders' equity - End of period	<u>39,925,638</u>	<u>56,315,969</u>

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



Director



Director

Connor, Clark & Lunn Real Return Income Fund

Statements of Operations

For the year ended December 31, 2008 and 2007

	2008	2007
	\$	\$
Income		
Interest income	479	1,276
Other income	25,881	-
	<u>26,360</u>	<u>1,276</u>
Expenses		
Forward fees (note 7)	265,649	405,129
Management fees	164,055	257,472
Service fees	144,205	221,901
Audit fees	32,131	27,902
Administration fees	20,492	23,357
Custodial and other unitholder fees	20,123	34,310
Transfer agent fees	13,939	14,928
Sustaining fees	10,094	15,722
Advisory Board fees	10,019	10,758
Filing fees	9,020	8,405
Printing and mailing fees	3,155	3,033
IRC fees	2,404	-
Interest expense	126	1,144
Legal fees	-	16,367
Other	4,147	2,192
	<u>699,559</u>	<u>1,042,620</u>
Investment income (loss)	<u>(673,199)</u>	<u>(1,041,344)</u>
Unrealized gain (loss) on investments		
Change in unrealized gain (loss) on investments	240,556	(29,207,139)
Change in unrealized gain (loss) on forward agreement (note 7)	(3,099,698)	33,917,404
	(2,859,142)	4,710,265
Realized gain (loss) on investments		
Net realized gain (loss) on investments	<u>3,544,170</u>	<u>(883,910)</u>
Net gain (loss) on investments	<u>685,028</u>	<u>3,826,355</u>
Increase (decrease) in net assets from operations	<u>11,829</u>	<u>2,785,011</u>
Increase (decrease) in net assets from operations per unit ^(*)	<u>-</u>	<u>0.28</u>
Distributions per unit	<u>0.38</u>	<u>0.39</u>

^(*) 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, 2008 and 2007

	2008	2007
	\$	\$
Increase (decrease) in net assets from operations	11,829	2,785,011
Distributions to unitholders from return on capital	(2,357,820)	(3,868,606)
Unitholders' transactions		
Payments on redemption (note 5)	(13,959,285)	(34,506,654)
Payments on cancellation of units (note 6)	<u>(85,055)</u>	<u>(729,635)</u>
	<u>(14,044,340)</u>	<u>(35,236,289)</u>
Change in net assets during the year	(16,390,331)	(36,319,884)
Net assets - Beginning of year	<u>56,315,969</u>	<u>92,635,853</u>
Net assets - End of year	<u>39,925,638</u>	<u>56,315,969</u>
Surplus (Deficit), beginning of year	(2,224,660)	(5,009,671)
Increase (decrease) in net assets from operations	<u>11,829</u>	<u>2,785,011</u>
Surplus (Deficit), end of year	<u>(2,212,831)</u>	<u>(2,224,660)</u>
Contributed surplus, beginning of year	4,040,855	1,561,442
Cost of shares repurchased at less than (more than) stated value	<u>(931,412)</u>	<u>2,479,413</u>
Contributed surplus, end of year	<u>3,109,443</u>	<u>4,040,855</u>

Connor, Clark & Lunn Real Return Income Fund

Statements of Cash Flow

For the year ended December 31, 2008 and 2007

	2008	2007
	\$	\$
Operating Activities		
Increase (decrease) in net assets from operations	11,829	2,785,011
Items not effecting cash:		
Change in unrealized (gain) loss on investments	(240,556)	29,207,139
Change in unrealized (gain) loss on forward agreement (note 7)	3,099,698	(33,917,404)
Net realized (gain) loss on investments	(3,544,170)	883,910
Changes in non-cash working capital		
Increase (decrease) in accounts payable and accrued liabilities	(129,252)	59,282
Increase (decrease) in management fees payable	(10,491)	(19,140)
Purchase of investments	(33,927,563)	-
Proceeds on disposition of investments	51,133,732	40,548,696
Net cash flow provided by operating activities	<u>16,393,227</u>	<u>39,547,494</u>
Financing Activities		
Payments on redemption (note 5)	(13,959,285)	(34,506,654)
Payments on cancellation of units (note 6)	(85,055)	(729,635)
Distributions to unitholders	(2,409,336)	(4,124,731)
Increase (decrease) in market repurchases payable (note 6)	(799)	7,755
Proceeds from bank indebtedness	22,500	444,100
Principal payments on bank indebtedness	(22,500)	(557,100)
Net cash flow provided by financing activities	<u>(16,454,475)</u>	<u>(39,466,265)</u>
Net increase (decrease) in cash	(61,248)	81,229
Cash (bank overdraft) - beginning of year	<u>81,098</u>	<u>(131)</u>
Cash - end of year	<u>19,850</u>	<u>81,098</u>
Interest paid	126	1,144

(See accompanying notes to financial statements)

Connor, Clark & Lunn Real Return Income Fund

Statement of Investments

As at December 31, 2008

	Number of shares	Average cost	Fair value	% of Portfolio
Canadian common stocks (pledged to the Counterparty under the Forward Agreement)				
Materials				
FNX Mining Company Inc.	216,801	5,146,855	654,739	4.0%
Pan American Silver Corp.	213,752	7,053,816	4,437,492	27.0%
Sino-Forest Corporation - Class A	491,665	9,513,718	4,739,650	28.9%
		<u>21,714,389</u>	<u>9,831,881</u>	<u>59.9%</u>
Consumer Staples				
Viterra Inc	386,984	5,146,887	3,668,608	22.3%
Information Technology				
CGI Group Class A	57,198	450,720	543,381	3.3%
Celestica Inc.	418,878	7,054,070	2,312,207	14.1%
Nortel Networks Corp.	211,191	7,066,657	67,581	0.4%
		<u>14,571,447</u>	<u>2,923,169</u>	<u>17.8%</u>
Total Canadian common stocks		<u>41,432,723</u>	<u>16,423,658</u>	<u>100.0%</u>
		Maturity date	Number of contracts	Fair value \$
Derivative contracts				
Forward Agreement (note 7)		18-Jul-15	1	23,770,290

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2008

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 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 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

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.

Future accounting changes

As of December 31, 2008 the Manager has not developed a changeover plan to the International Financial Reporting Standards ("IFRS") nor has it assessed the impact of IFRS on business arrangements, net asset value per unit and accounting policies. The Manager will develop a plan prior to the January 1, 2011 deadline and will disclose this plan in either the Fund's 2009 or 2010 annual reports.

Recent accounting pronouncements

On January 1, 2008, the Fund adopted the new Section 1535, Capital Disclosures, which requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. This standard impacted the Fund's disclosures provided but it did not affect the Fund's results or financial position.

On January 1, 2008, the Fund adopted the new CICA Sections 3862, Financial Instruments – Disclosures ("Section 3862), and 3863, Financial Instruments – Presentation (Section 3863"), which replaced 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. These standards impacted the Fund's disclosures provided but they did not affect the Fund's results or financial position.

Valuation of investments

Investments are deemed to be categorized as "held for trading" in accordance with CICA 3855, Financial Instruments – Recognition and Measurement ("Section 3855") and therefore are recorded at fair value, established by the closing bid price for a security on the recognized exchange on which it is principally traded. Should the quoted value for a security, in the opinion of the Managers, be inaccurate, unreliable or not readily available, the fair value of the security is estimated based on valuation techniques. Fair value is determined by the Managers on the basis of the most recently reported information for the security, similar securities and the markets in which the security is active. Investment purchase and sale transactions are recorded as of the trade date and realized and unrealized gains and losses on investments are determined using average cost. Brokers' commissions and other transaction charges are immediately charged to net income in the period incurred.

On January 1, 2007, the Fund adopted Section 3855 on a prospective basis for financial reporting purposes ("GAAP Net Assets"). Section 3855 requires that the fair value of financial instruments which are actively traded be measured based on the bid price for the security. Until December 31, 2006, fair value for GAAP was based on the last traded price for the day, when available. In addition, Section 3855 requires that transaction costs, such as brokerage commissions, incurred in the purchase and sale of securities by the Fund be charged to net income in the period. Until December 31, 2006, the Fund's policy has been to add these expenses to the cost of the securities purchased or deduct from the proceeds of sale.

On September 8, 2008, the Canadian Securities Administration issued the amended National Instrument 81-106 ("NI 81-106"), Section 14.2 of this amended NI 81-106 requires an investment fund to calculate its daily Net Asset Value for the purchase and redemption of units ("Transactional NAV") based on the fair value of the investment fund's assets and liabilities (being the last traded price for the day). The Fund did not change its methodology in this respect.

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2008

There were no differences between the Transactional NAV and the GAAP Net assets as a result of the adoption of Section 3855.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash on deposit with terms to maturity of less than 90 days at acquisition. Cash and cash equivalents are deemed to be held for trading and therefore are carried at fair value.

Income recognition

Income from investments is recognized on an accrual basis. Dividend income is recognized at the time a security trades on an ex-dividend basis. Interest income is based on the number of days the investment is held during the period. All income, realized and unrealized net gains (losses) and transaction costs (apart from an insignificant amount of income arising from cash and cash equivalents) are attributable to investments and derivatives which are deemed held for trading.

Unit valuation

Units of the Fund are valued at the net asset value per unit of the Fund. The net asset value per unit is determined by dividing the aggregate fair value of net assets of the Fund by the total number of units of the Fund.

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 Transactional NAV 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 2008 the fund had its annual Redemption Date and \$13,959,285 was paid to redeem 1,634,615 units at August 31, 2008 Transactional 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.

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, 2008.

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

Changes in outstanding units are summarized as follows:

	Number of units	
	December 31, 2008	December 31, 2007
Opening balance	6,839,067	11,260,603
Units issued	—	—
Units redeemed	(1,634,615)	(4,327,036)
Units cancelled (note 6)	<u>(10,900)</u>	<u>(94,500)</u>
Ending balance	<u>5,193,552</u>	<u>6,839,067</u>

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2008

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 Transactional NAV per Unit.

Pursuant to this obligation, during the year ended on December 31, 2008 the Fund purchased 10,900 units for cancellation at a cost of \$85,055 (94,500 units at a cost of \$729,475 during the year ended on December 31, 2007).

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, 2008, the Credit Facility had a minimum outstanding balance of \$nil and a maximum outstanding balance of \$22,500. The related total interest expense was \$126 for the year ended on December 31, 2008 (2007 - \$1,144).

As of December 31, 2008, the Credit Facility had \$nil outstanding balance (December 31, 2007 - \$nil).

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.

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 Transactional 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 Transactional 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.

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2008

12 Broker commission charges and soft dollar services

There were \$nil broker commissions paid during the year ended on December 31, 2008 (\$nil during the year ended on December 31, 2007) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.

13 Financial instruments

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

<u>Assets</u>	\$
Held for trading	40,213,798
Loans and receivables	–
Total assets	40,213,798
<u>Liabilities</u>	
Held for trading	–
Financial liabilities at amortized cost	288,160
Total liabilities	288,160

For the purposes of categorization in accordance with section 3862, interest receivable, variation margin receivable, and other assets are deemed to be loans and receivables and recorded at cost or amortized cost. Similarly, management fees payable, accounts payable and accrued liabilities, amount payable under the Reverse repurchase agreement, interest payable and other liabilities are deemed to be financial liabilities and reported at amortized cost.

14 Financial instrument risk

The Fund obtained exposure to the performance of the portfolio held by Real Return Trust through the Forward Agreement and therefore the risks associated with an investment in the Fund's units are best defined by describing the financial risks associated with an investment in the Real Return Trust's portfolio. The following is a description of these risks based on the financial statements of the Real Return Trust.

Interest rate risk

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

	Less than 1 year	1 - 3 years	3 - 5 years	> 5 years	Non-interest bearing	Total
Investments	(205,641)	483,488	–	36,310,574	5,590,022	42,178,443
Cash and cash equivalents	–	–	–	–	37,250	37,250
Other assets	–	–	–	–	646,535	646,535
Liabilities	–	–	–	–	(2,936,590)	(2,936,590)
Net assets value						39,925,638

As at December 31, 2008, had prevailing interest rates raised or lowered by 1.0%, with all other variables held constant, net assets would have decreased or increased, respectively, by approximately \$2,112,000. In practise, actual results may differ from this sensitivity analysis and the difference could be material. This Fund is also exposed to indirect interest rate risk to the extent the underlying mutual funds invest in interest-sensitive financial instruments.

Currency risk

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

The table below summarizes the Fund's exposure to foreign currencies as at December 31, 2008. Amounts shown are based on the carrying values of monetary and non-monetary assets as well as the underlying principal amounts of foreign currency derivatives such as futures and forward contracts. Other financial assets such as interest and variation margin receivable and liabilities such as accounts payable and accrued liabilities denominated in foreign currencies do not expose the Fund to significant currency risk. The table below summarizes the Fund's exposure to foreign currencies and the approximate impact on net assets had the Canadian Dollar ("CAD") weakened by 5% in relation to these currencies. If the Canadian dollar were to strengthen relative to these currencies, the opposite would occur. In practice, actual results may differ from this sensitivity analysis and the difference could be material.

Connor, Clark & Lunn Real Return Income Fund

Notes to Financial Statements

December 31, 2008

	Monetary instruments \$	Non- monetary instruments \$	Total \$	% of Net Assets	Sensitivity (based on devaluation of CAD) \$
US Dollar	(26,575,834)	397,699	(26,178,135)	(65.1%)	(1,309,000)

Other market risk

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

If equity prices had increased or decreased by 10% on December 31, 2008, all other variables held constant, the net assets of the Fund would have increased or decreased, respectively, by approximately \$40,000. In practise, actual results may differ from this sensitivity analysis and the difference could be material.

Credit risk

The Fund is exposed to the risk that a security issuer or counterparty will be unable to pay amounts in full when due. The fair value of debt securities includes consideration of the credit worthiness of the debt issuer. The carrying amount of debt investments and unrealized gain on derivative instruments outstanding with counterparties represents the maximum credit risk exposure as at December 31, 2008. This also applies to other assets, as they have a short-term to settlement.

The table below summarizes the Fund's exposure to credit risk as of December 31, 2008. Amounts shown are based on the carrying value of debt investments and the unrealized gain on derivative instruments outstanding with counterparties.

Rating	December 31, 2008 (% of net assets)
AAA	95.40%
A+	1.60%
A-	0.60%
BBB	1.20%
BBB-	1.20%
B+	4.00%
Total	104.0%

As at December 31, 2008, no debt securities were contractually past due and no longer meeting interest payment obligations.

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

Liquidity risk

The Fund is exposed to daily cash redemptions due to its market purchase program which are limited to certain conditions (see note 6). The Fund is also exposed to unlimited annual anniversary redemptions on August 31 of every year (see note 5). Therefore, the Fund invests the majority of its assets in investments that are traded in an active market and can be readily disposed. In addition, the Fund retains sufficient cash and cash equivalent positions to maintain liquidity