

Connor, Clark & Lunn

CAPITAL MARKETS INC.

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**Connor, Clark & Lunn**  
**Real Return Income Fund**  
Semi-Annual Report  
June 30, 2006

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

June 30<sup>th</sup>, 2006

Dear Investor,

We thank you for your investment in Connor, Clark & Lunn Real Return Income Fund (the "Fund"). As Manager for the Fund, we are pleased to submit the semi-annual unitholders' report for the six-month period ended June 30, 2006.

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 affects of inflation. The Fund may also invest up to 20% of its total managed assets in other income producing securities and may utilize hedging strategies to help limit risk and to preserve capital. There can be no assurance, however, that the Fund will achieve its investment objectives.

Western Asset Management Company, a subsidiary of Legg Mason, Inc., is the Fund's Investment Adviser and manages the portfolio of securities on a day-to-day basis. The firm was founded in 1971 and has offices in Pasadena, London and Singapore. Western Asset managed \$511 billion in assets under management as of June 30, 2006.

During the period, the Fund paid distributions at an annual rate of 5.50% in the first quarter and 5.75% in the second quarter, for total distributions per Unit of \$0.28. These distributions were paid out as a return of capital. Net asset value went from \$9.33 at inception to \$8.22 at the end of the period. It was negatively affected by an increase in real yields of approximately 0.45% and by an increase in borrowing costs in line with the move up in the U.S. Fed Funds Rate as well as by relatively low inflation accrual to U.S. TIPS, of 1.16% cumulatively over the first six months of 2006.

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

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

Sincerely,

Yours truly,



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

# Management Report of Fund Performance

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

## Investment Objectives and Strategy

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

The Fund has the following investment objectives:

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

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

In order to enhance returns, the Trust employs leverage in the portfolio, with a debt-to-equity ratio that was approximately 1.7:1 at June 30, 2006. It is 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 Trust is entitled to employ leverage at a debt-to-equity ratio of up to 2:1. As at June 30, 2006, the Trust’s debt-to-equity ratio was approximately 1.7:1. The Trust’s borrowing is short-term and is effected by way of repurchase agreements. The effective rate of interest on such borrowing is highly correlated with the U.S. federal funds rate and has increased from approximately 3.2% at inception in July 2005 to approximately 5.25 % currently. Increased costs of borrowing that are not accompanied by an increase in inflation have a negative affect on the Trust’s, and therefore the Fund’s, overall cash flow and may affect the level of distributions.

### *Use of Derivatives:*

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

of short futures contracts and long put options with exposure up to 100% of the Fund's net asset value. The Trust has also hedged foreign currency exposure, with between 94% and 108% of NAV having been hedged to the Canadian dollar at any time. There is no guarantee that such hedging will be successful.

#### *Fluctuations in Net Asset Value:*

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

## **Results of Operations**

#### *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 Fund believes that the expectations reflected in those forward-looking statements and in the investment manager's analysis are reasonable but no assurance can be given that these expectations or the analysis will prove to be correct and accordingly they should not be unduly relied on. These statements speak only as of the date of this report. Actual events and outcomes may differ materially from those described in these forward-looking statements or the investment manager's analysis.**

Over the first six months of 2006, the U.S. economy was strong, growing by 5.6% in the first quarter and forecast have grown around 3% in the second quarter. Headline inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U), remained elevated at 4.2%, again due primarily to high energy costs. Core CPI (which excludes the effects of food and energy), increased to 2.4%, which led the Fed to question the extent to which higher energy prices were being passed on to consumers and whether their inflation expectations were rising as well. Jobs growth was moderate but relatively steady, averaging just over 140,000 new jobs created per month. The unemployment rate declined slightly from 4.9% to 4.6%.

As a result, the Fed increased short-term interest rates four more times (by 25 basis points each time) so that the official Fed Funds rate now stands at 5.25%, 100 basis points higher than the start of the year. Longer term interest rates also moved higher with the yield on 10-year U.S. Treasuries rising by roughly 80 bps and the 30-year U.S. Treasury bond yield rising by nearly 65 bps, continuing the flattening of the yield curve. The spread between the 2- and 10-year U.S. Treasury notes remained about unchanged at minus 1 basis point; however, as of June 30 both of their yields were below the current Fed Funds rate.

U.S. Treasury Inflation Protected Securities (U.S. TIPS) performed better than U.S. Treasuries although both had negative returns. The 10-year U.S. TIP lost 1.4% while the 10-year U.S. Treasury lost 3.9%. 30-year U.S. Treasuries were down 8.9%.

The credit markets produced a fairly marginal 15 basis point excess return (the duration adjusted return relative to similar duration U.S. Treasuries) during the first half of 2006, and a total negative return of -1.6% during the same period. The spread on the overall market relative to U.S. Treasury bonds widened by 5 basis points. Mortgage spreads were relatively stable as volatility remained low.

Emerging markets have returned negative 72 basis points through June 30, 2006. The primary driver of the negative performance was an increase in spread volatility in the first quarter and a general aversion to risk that increased in the second quarter. Poor performance was in contrast to positive political, fundamental and technical developments.

Throughout the 1<sup>st</sup> quarter, the Fed talked about simply raising rates to a “neutral” level. However, in the 2<sup>nd</sup> quarter the Fed changed its stance and started talking instead about the need to raise rates to combat rising inflation expectations. We believe that this change has created greater uncertainty about the path of rates. The near term economic picture is mixed, with some data showing that consumer spending has slowed while other data shows that core inflation remains above the Fed’s comfort zone. Today’s inverted yield curve is also the subject of debate – some see it as a reflection of the market’s confidence that inflation will remain contained by Fed policy – while others see it as a harbinger of recession or even a significant economic slowdown coming soon. We believe that recent statements from the Fed indicate that they would like to pause at 5.25% or 5.5%.

So far, 2006 has not been a good year for U.S. TIPS or most other fixed income products as returns are generally negative. U.S. TIPS’ yields continue to back up into a range where we believe more investors are finding them attractive, especially on a real yield basis. Current breakeven spreads are near their medium term averages at approximately 2.58%, suggesting that, all else being equal, U.S. TIPS should perform about the same as U.S. Treasuries unless inflation falls below the breakeven level.

Looking out over the horizon, risks do remain, and we think that U.S. TIPS continue to play an important role in managing these risks. Once again we would like to remind investors about the unique nature of U.S. TIPS; unlike other bonds, U.S. TIPS can perform well when either inflation rises or real yields fall.

Although energy prices are high, some forecasters are calling for even higher prices. If this happens, CPI-U could exceed the market’s current expectations (as embedded in U.S. TIPS breakeven rates noted above) which have energy prices remaining relatively stable. Also, if the market loses confidence in the inflation fighting ability of the Fed (thinking that they may have paused too soon to stop inflation pressure from spreading through the economy), then one could well see breakeven spreads widen out further.

Another risk is that economic growth slows dramatically. As mentioned above, some forecasters are already pointing to the weakness in housing and consumer spending as evidence that the economy may slow very quickly in the 2nd half of the year. If GDP stalls, the Fed will definitely be forced to the pause and then usually shifts to a rate reduction policy fairly quickly whereby real interest rates begin to fall.

With respect to the corporate debt component of the Fund, we continue to be somewhat cautious on spreads, much as we were at the beginning of the year. While the technicals remain in decent shape resulting from good corporate earnings, continued strong foreign demand for corporate bonds, and continued interest in the synthetic credit markets, spreads remain reasonably tight by historical standards. Share repurchase activity remains robust, and the recent announcement that HCA will be taken private in a leveraged buyout demonstrates the risks facing holders of investment grade bonds.

On balance, the global environment for emerging market debt remains supportive but more cautious. We expect growth to be moderate and inflation to remain low. We also believe the Fed is close to the end of its cycle of raising rates although further hikes are expected from the European Central Bank and the Bank of Japan is ending its quantitative easing cycle. However, market uncertainty has increased about inflation and whether the Fed continues to hike rates. Global liquidity is still strong but has declined from historically high levels. Emerging market macro fundamentals and technicals remain strong. Even with the sell-off in the sector since May 1st (spreads are 28% wider) we are concerned that valuations are too tight. Therefore we have reduced exposure to emerging market debt.

In general, there’s no easy pickings left in the world’s bond markets today, so investment strategies need to be more tactical than strategic. Caution is certainly warranted, but that need not preclude prudent and diversified exposure to risk, since current conditions are unlikely to unravel rapidly. For the time being, we think it is best to let duration increase as interest rates rise, and decrease as rates fall, thus taking advantage of relatively low volatility. The safest part of the curve still appears to be in the front end, since the Fed appears to be close to, if not finished raising rates.

In summary, we recognize that 2006 has been difficult so far, but believe that U.S. TIPS will remain attractive as a diversifying asset and could benefit substantially if either inflation rises or real yields fall.

### *Investment Income and Capital Gains*

Interest income, inflation accrual and dividends from foreign funds combined to earn \$7,785,166 for the portfolio and expenses, including interest, were \$5,193,551, leaving investment income of \$2,591,630. Distributions paid to Unitholders totalled \$3,452,132, or \$0.28 per Unit. Realized and unrealized losses combined for a total loss of \$12,714,760.

### *Leverage*

As at June 30, 2006, the Trust had a liability of \$171,931,991 (including accrued interest) under a master repurchase agreement with the Bank of Montreal, pursuant to which the Trust had agreed to repurchase certain U.S. TIPS from the Bank of Montreal with a market value on June 30, 2006 of \$174,666,365. The value of the Trust's portfolio on June 30, 2006 was \$260,859,528 and the net assets value was \$100,753,411. As such, the Trusts debt-to-equity ratio was approximately 1.7: 1.

### *Currency Hedging*

As at June 30, 2006, the Trust was approximately 107% hedged against moves in Canadian/U.S. exchange rates by way of a currency forward entitling the Trust to sell US \$91,076,068 in exchange for CA \$107,600,000 on July 17, 2015.

### *Market repurchases*

As set out in the Prospectus, the Fund is obligated, under certain conditions, to purchase Units in the market for cancellation. Subject to certain conditions described in the prospectus dated June 29, 2005, the Fund will be obligated to purchase any Units offered in the market if, at any, time, the price at which Units are offered for sale and the most recent closing price of the Units on the TSX are each less than 95% of the latest determined NAV per Unit. Pursuant to this obligation, the Fund purchased during the six-month period ended on June 30, 2006 56,300 units for cancellation at a cost of \$462,196 (77,000 units at a cost of \$666,035 during the period from July 18, 2005 (commencement of operations) to December 31, 2005).

## **Distributions**

The Fund has made all its scheduled distributions to date. The following schedule shows all the historical distributions per unit up to June 30 2006.

<b>Historical Distributions:</b>			
<b>2005</b>		<b>2006</b>	
August	\$0.0654	January	\$0.0479
September	\$0.0458	February	\$0.0479
October	\$0.0458	March	\$0.0479
November	\$0.0458	April	\$0.0458
December	\$0.0458	May	\$0.0458
		June	\$0.0458
<b>Total</b>	<b>\$0.2486</b>	<b>Total</b>	<b>\$0.2811</b>
<b>Total Distributions Since Inception:</b>			<b>\$0.5297</b>

## **Recommendations or Reports by the Independent Committee**

The Independent Committee of the Board of Advisors tabled no reports and made no reportable material recommendations to management of the Fund in the six month period ended June 30, 2006.

## Related Party Transactions

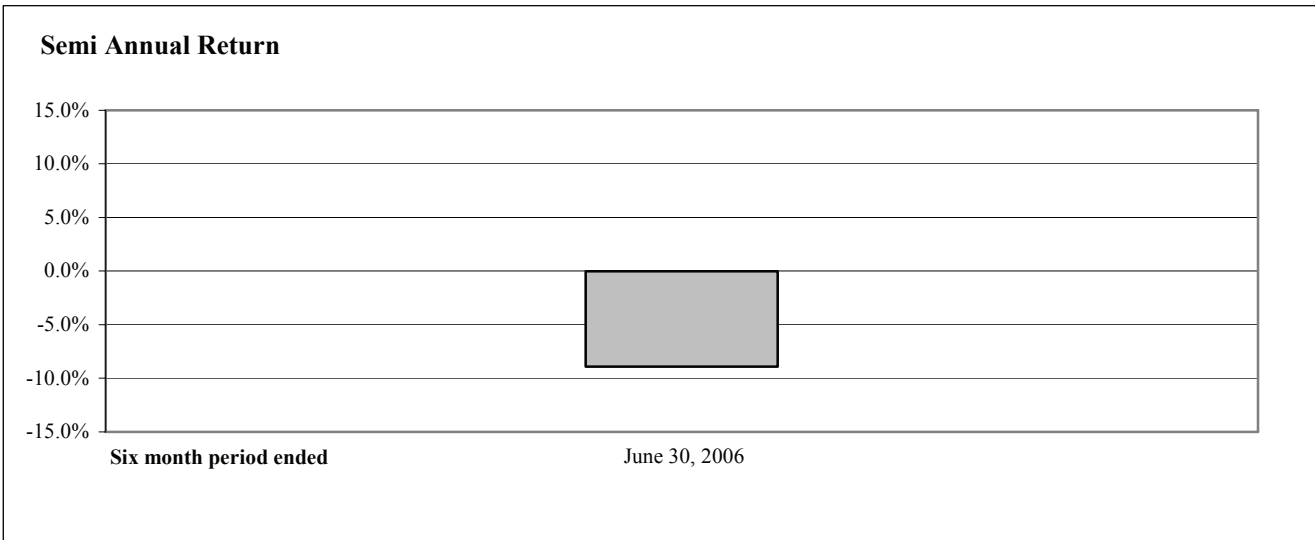
### *Management Fees*

As compensation for management services rendered to the Fund, the Manager is entitled to receive an annual management fee in an amount equal to 0.30% per annum of the NAV of the Fund, to be calculated and payable monthly in arrears, plus applicable taxes. As compensation for management services rendered to Real Return Trust, the Manager is entitled to receive an annual management fee in an amount equal to 0.90% of the net asset value of Real Return Trust calculated and payable monthly in arrears, plus applicable taxes. The Manager, in its capacity as manager of Real Return Trust, is responsible for payment of the investment management fees of the Investment Advisor. The management fees charged to the Fund on consolidation basis for during the six-month period ended on June 30, 2006 were \$669,935 (\$658,590 for the period from July 18, 2005 (commencement of operations) to December 31, 2005). The Manager pays Western Asset Management Company (the "Investment Advisor") out of the above management fees.

## Past Performance

The following bar chart indicates the performance of the units by showing the semi annual returns assuming all the distributions made by the Fund during the period shown were reinvested. The chart shows, in percentage terms, how much an investment made on the first day of the period would have grown or decrease by the last day of the period.

Past performance is not necessarily indicative of future performance.



## Financial Highlights

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

### The Fund's Net Asset Value per unit:

	June 30, 2006 (2)	December 31, 2005 (1)
<b>Net Asset Value, beginning of period</b>	9.33	10.00
<b>Increase (decrease) from operations:</b>		
Total revenues	0.63	0.69
Total expenses	(0.42)	(0.35)
Unit issue expense (3)	—	(0.56)
Realized gains (losses) for the period	(0.21)	(0.11)
Unrealized gains (losses) for the period	(0.83)	(0.10)
<b>Total increase (decrease) from operations (4)</b>	<b>(0.83)</b>	<b>(0.43)</b>
<b>Distributions:</b>		
From income (excluding dividends)	—	—
From dividends	—	—
From capital gains	—	—
Return of capital	(0.28)	(0.25)
<b>Total Annual Distributions (5)</b>	<b>(0.28)</b>	<b>(0.25)</b>
<b>Net Asset Value, end of period (6)</b>	<b>8.22</b>	<b>9.33</b>

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

(2) Results for the six-month period ended June 30, 2006.

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

(4) 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.

(5) Distributions were paid in cash.

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

### Ratios and Supplemental Data:

	June 30, 2006 (2)	December 31, 2005 (1)
Net assets (000's) (3)	100,753	114,791
Number of units outstanding (3)	12,251,108	12,307,408
Base Management expense ratio (4) (5)	2.27%	2.26%
Issue expenses ratio (4) (5)	—	5.99%
Interest expense ratio (4) (5)	7.55%	6.01%
Management expense ratio (4)	9.82%	14.26%
Management expense ratio before waivers or absorptions (4)	9.82%	14.26%
Portfolio turnover rate (6)	6.94%	9.66%
Trading expense ratio (7)	0.03%	0.04%
Closing market price (TSX) (3)	7.97	8.87

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

(2) Results for the six-month period ended June 30, 2006.

(3) This information is provided as at June 30, 2006 and December 31, 2005.

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

(5) The management expense ratio has three components:

- Issue expense ratio: based on total agents fees and unit issue expenses of \$6,922,204. This ratio is 5.59% when expressed as a percentage of the original proceeds from issue of units of \$123,844,080.
- Interest expense ratio: based on a total interest expense on reverse repurchase agreements of \$3,994,848 during the six month period ended June 30, 2006 (\$3,164,459 for the period July 18, 2005 (commencement of operations) to December 31, 2005).
- Other ongoing expenses: based on total expenses of \$1,198,703 during the six month period ended June 30, 2006 (\$1,188,627 for the period July 18, 2005 (commencement of operations) to December 31, 2005).

(6) 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.

(7) 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 June 30, 2006

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

The Real Return Trust portfolio is the portfolio managed by Western Asset Management. The portfolio of Canadian common stocks is pledged to the counterparty under the Forward Agreement.

	% Rate	Maturity date	Number of shares / par value US \$	Average cost CA \$	Market value CA \$	% of NAV
<b>Investments</b>						
<b>Foreign bonds</b>						
US Treasury Inflation-Protected Securities	1.875%	Jul-15	193,370,000	242,035,778	211,425,571	209.8%
US Treasury Inflation-Protected Securities	3.875%	Jan-09	3,095,000	4,804,969	4,383,015	4.4%
US Treasury Inflation-Protected Securities	2.000%	Jan-14	3,095,000	4,204,454	4,167,677	4.1%
Ford Motor Credit Corp.	7.875%	Jun-10	2,400,000	2,913,189	2,585,098	2.6%
General Motors Acceptance Corp.	7.750%	Jan-10	2,400,000	2,916,844	2,647,551	2.6%
United Mexican States Note	7.500%	Apr-33	1,025,000	1,431,179	1,213,996	1.2%
Kaupthing Bank	7.125%	May-16	1,280,000	1,421,423	1,426,413	1.4%
Glitnir banki HF	6.693%	Jun-16	780,000	865,987	863,369	0.9%
<b>Total foreign bonds</b>				<u>260,593,823</u>	<u>228,712,690</u>	<u>227.0%</u>
<b>Foreign funds</b>						
Western Asset Opportunistic Emerging Markets Portfolio LLC			176,567	4,606,363	3,091,094	3.1%
Western Asset Floating Rate High Income Fund LLC			1,320,885	17,669,205	16,998,760	16.9%
Western Asset Mgmt MBS Portfolio Fund LLC			484,958	5,912,872	5,590,073	5.5%
Western Asset US\$ High Yield Securities Portfolio LLC			221,775	3,851,571	3,653,166	3.6%
Western Asset Yankee Portfolio LLC			262,270	3,055,835	2,813,745	2.8%
<b>Total foreign mutual funds</b>				<u>35,095,846</u>	<u>32,146,838</u>	<u>31.9%</u>
<b>Total Real Return Trust portfolio</b>				<u>295,689,669</u>	<u>260,859,528</u>	<u>258.9%</u>
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>						
<b>Energy</b>						
Western Oil Sands Inc.			335,453	9,067,295	10,378,916	10.3%
<b>Materials</b>						
Kinross Gold Corp.			861,445	6,344,308	10,483,786	10.4%
<b>Industrials</b>						
Bombardier Inc. Class B			3,279,630	10,628,032	10,199,649	10.1%
<b>Consumer Discretionary</b>						
Gildan Activewear Class A			247,770	8,610,397	13,079,778	13.0%
<b>Consumer Staples</b>						
Cott Corp.			378,236	10,293,748	5,522,246	5.5%

**Summary of Investment Portfolio as of June 30, 2006 .... Continued**

	<b>% Rate</b>	<b>Maturity date</b>	<b>Number of shares / par value US \$</b>	<b>Average cost CA \$</b>	<b>Market value CA \$</b>	<b>% of NAV</b>
<b>Health Care</b>						
Angiotech Pharmaceuticals Inc.			625,800	10,586,926	8,147,916	8.1%
<b>Information Technology</b>						
Cognos Inc.			233,290	10,632,525	7,327,639	7.3%
ATI Technologies Inc.			678,940	10,647,883	11,012,407	10.9%
Celestica Inc.			628,680	10,587,217	6,645,148	6.6%
Nortel Networks Corp.			3,167,824	10,599,836	7,856,204	7.8%
Research In Motion			123,260	10,682,158	9,589,628	9.5%
				53,149,619	42,431,026	42.1%
<b>Total Canadian common stocks</b>				108,680,325	100,243,317	99.5%
<b>Payable to the Counterparty under the Forward Agreement</b>				(108,680,325)	(100,243,317)	-99.5%
<b>Total investments</b>				295,689,669	260,859,528	258.9%

	<b>Strike Price</b>	<b>Maturity date</b>	<b>Number of contracts</b>	<b>Average cost CA \$</b>	<b>Market value CA \$</b>	<b>% of NAV</b>
<b>Option contracts</b>						
10 Year United States T-Note Call Option on Futures	106.00	Aug-06	(64)	(27,803)	(5,561)	0.0%
5 Year United States T-Note Call Option on Futures	103.00	Aug-06	(70)	(26,760)	(41,356)	0.0%
Fed Funds Put Option on Futures	94.56	Jul-06	(392)	(9,083)	(4,541)	0.0%
Fed Funds Put Option on Futures	94.69	Jul-06	392	27,249	4,541	0.0%
<b>Options at market value</b>					(46,917)	0.0%

	<b>Maturity date</b>	<b>Number of contracts</b>	<b>Average cost CA \$</b>	<b>Market value CA \$</b>	<b>Unrealized gain (loss) CA \$</b>	<b>% of NAV</b>
<b>Futures contracts</b>						
3 Month Eurodollar Futures	Dec-06	125	32,972,028	32,808,688	(163,340)	-0.2%
10 Year United States Treasury Note Futures	Sep-06	40	4,708,119	4,664,564	(43,555)	0.0%
					(206,895)	-0.2%
20 Year United States Treasury Note Futures	Sep-06	(6)	(706,878)	(711,674)	(4,796)	0.0%
<b>Unrealized gain (loss) on futures contracts</b>					(211,691)	-0.2%

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**Summary of Investment Portfolio as of December 31, 2005** .... Continued

	<b>Maturity date</b>	<b>Number of contracts</b>	<b>Bought CA \$</b>	<b>Sold US \$</b>	<b>Unrealized gain (loss) CA \$</b>	<b>% of NAV</b>
<b>Foreign currency forward contracts</b>						
Bought CAD, sold USD at 1.18143	Jul-15	1	107,600,000	91,076,068	<u>7,162,185</u>	<u>7.1%</u>
<b>Unrealized gain (loss) on foreign exchange contracts</b>					<u>7,162,185</u>	<u>7.1%</u>
<b>Other liabilities net of other assets</b>					<u>(167,009,695)</u>	<u>-165.8%</u>
<b>Net assts value (NAV)</b>					<u>100,753,411</u>	<u>100.0%</u>

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

Financial Statements (Unaudited)

**June 30, 2006**

***Notice to Reader:***

*These interim financial statements and related notes for the six month period ended June 30, 2006 have been prepared by Management of Connor, Clark & Lunn Capital Markets Inc. The auditors of the Fund have not audited or reviewed these interim financial statements.*

# Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Net Assets (Unaudited)

As at June 30, 2006 and December 31, 2005

	June30, 2006 (Unaudited)	December 31, 2005 (Audited)
	\$	\$
<b>Assets</b>		
Cash	4,128,150	418,292
Investments at market value (cost - \$295,689,669; December 31, 2005 - \$298,268,545 )	260,859,528	284,911,568
Investments pledged to counterparty under forward agreement (note 8)	100,243,315	114,690,206
Interest and dividends receivable	2,161,344	2,256,722
Receivable from investment sales	-	850,985
Unrealized gain on foreign exchange contracts	7,162,185	4,505,727
	<u>374,554,522</u>	<u>407,633,500</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	211,722	293,371
Distributions payable	561,101	563,968
Management fees payable	110,966	267,880
Market repurchases payable (note 7)	-	55,289
Payable to counterparty under forward agreement	100,243,315	114,690,206
Reverse repurchase agreement (note 4)	165,279,207	173,610,260
Interest payable	6,652,784	2,865,937
Options at market value	46,917	-
Variation margin payable (note 11)	483,409	244,876
Unrealized loss on futures contracts	211,690	250,844
	<u>273,801,111</u>	<u>292,842,631</u>
<b>Net Assets and Unitholders' Equity</b>	<u>100,753,411</u>	<u>114,790,869</u>
<b>Units outstanding</b> (note 6)	<u>12,251,108</u>	<u>12,307,408</u>
<b>Net asset value per unit</b>	<u>8.22</u>	<u>9.33</u>
<b>Unitholder's Equity</b>		
Unit Capital (note 6)	122,511,080	123,074,080
Contribution surplus	204,769	103,965
Deficit	(21,962,438)	(8,387,176)
<b>Unitholders' equity - End of period</b>	<u>100,753,411</u>	<u>114,790,869</u>

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



Director



Director

# Connor, Clark & Lunn Real Return Income Fund

## Consolidated Statement of Operations

For the six months ended June 30, 2006 and the period from July 18, 2005 (commencement of operations) to December 31, 2005

	<b>2006</b>	<b>2005</b>
	(Unaudited)	(Audited)
	\$	\$
<b>Income</b>		
Interest and dividend income	4,729,330	8,503,559
Dividends from foreign funds	3,055,836	-
	<u>7,785,166</u>	<u>8,503,559</u>
<b>Expenses</b>		
Interest expense (note 4)	3,994,848	3,164,459
Management fees	669,935	658,590
Forward fees	271,493	264,382
Service frees	160,808	157,352
Custodial and other unitholder fees	34,321	34,659
Audit Fees	18,636	28,159
Advisory fees	11,008	10,028
Legal fees	9,487	9,383
Sustaining fees	9,170	8,718
Transfer agent fees	7,734	9,251
Printing and mailing fees	5,594	6,808
Filing fees	517	1,297
	<u>5,193,551</u>	<u>4,353,086</u>
<b>Investment income (loss)</b>	<u>2,591,615</u>	<u>4,150,473</u>
<b>Unrealized gain (loss) on investments</b>		
Change in unrealized gain (loss) on investments	(21,473,164)	(13,356,977)
Change in unrealized gain (loss) on forward agreement (note 8)	122,506	19,045
Change in unrealized gain (loss) on foreign exchange contracts	2,656,458	4,505,727
Change in unrealized gain (loss) on foreign exchange	8,528,629	7,926,497
Change in unrealized gain (loss) on options	(10,520)	-
Change in unrealized gain (loss) on futures contracts	39,154	(250,844)
	<u>(10,136,937)</u>	<u>(1,156,552)</u>
<b>Realized gain (loss) on investments</b>		
Net realized gain (loss) on investments	(2,181,961)	(14,020)
Net realized gain (loss) on foreign exchange	(67,185)	(1,093,904)
Net realized gain (loss) on options	72,954	(28,640)
Net realized gain (loss) on futures contracts	(401,616)	(247,889)
	<u>(2,577,808)</u>	<u>(1,384,453)</u>
<b>Net gain (loss) on investments</b>	<u>(12,714,745)</u>	<u>(2,541,005)</u>
<b>Increase (decrease) in net assets from operations</b>	<u>(10,123,130)</u>	<u>1,609,468</u>
<b>Increase (decrease) in net assets from operations per unit *</b>	<u>(0.82)</u>	<u>0.13</u>
<b>Distributions per unit*</b>	<u>0.28</u>	<u>0.25</u>

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

# Connor, Clark & Lunn Real Return Income Fund

## Consolidated Statement of Changes in Net Assets, Deficit and Contributed Surplus

For the six months ended June 30, 2006 and the period from July 18, 2005 (commencement of operations) to December 31, 2005

	2006 (Unaudited)	2005 (Audited)
	\$	\$
<b>Increase (decrease) in net assets from operations</b>	<u>(10,123,130)</u>	<u>1,609,468</u>
<b>Distributions to unitholders</b>	<u>(3,452,132)</u>	<u>(3,074,440)</u>
<b>Unitholders' transactions</b>		
Proceeds from issue of units (note 6)	-	123,844,080
Units purchased for cancellation (note 7)	(462,196)	(666,035)
Agents' fees and issue expenses	<u>-</u>	<u>(6,922,204)</u>
	<u>(462,196)</u>	<u>116,255,841</u>
<b>Change in net assets during the year</b>	<u>(14,037,458)</u>	<u>114,790,869</u>
<b>Net assets - Beginning of period</b>	<u>114,790,869</u>	<u>-</u>
<b>Net assets - End of period</b>	<u>100,753,411</u>	<u>114,790,869</u>
<b>Deficit, beginning of period</b>	(8,387,176)	-
Increase (decrease) in net assets from operations	(10,123,130)	1,609,468
Distributions to unitholders	(3,452,132)	(3,074,440)
Agents' fees and issue expenses	<u>-</u>	<u>(6,922,204)</u>
<b>Deficit, end of period</b>	<u>(21,962,438)</u>	<u>(8,387,176)</u>
<b>Contributed surplus, beginning of period</b>	103,965	-
Cost of shares repurchased at less than stated value	<u>100,804</u>	<u>103,965</u>
<b>Contributed surplus, end of period</b>	<u>204,769</u>	<u>103,965</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Real Return Income Fund

## Consolidated Statement of Cash Flow

For the six months ended June 30, 2006 and the period from July 18, 2005 (commencement of operations) to December 31, 2005

	2006 (Unaudited)	2005 (Audited)
	\$	\$
<b>Operating Activities</b>		
Increase (decrease) in net assets from operations	(10,123,130)	1,609,468
Distributions to unitholders	(3,452,132)	(3,074,440)
Items not affecting cash:		
Change in unrealized (gain) loss of investments	21,473,164	13,356,977
Change in unrealized (gain) loss of forward agreement (note 8)	(122,506)	(19,045)
Change in unrealized (gain) loss on foreign exchange contracts	(2,656,458)	(4,505,727)
Net realized (gain) loss on investments	2,181,961	14,020
Changes in non-cash working capital		
(Increase) decrease in interest and dividends receivable	95,378	(2,256,722)
(Increase) decrease in receivable from investment sales	850,985	(850,985)
Increase (decrease) in accounts payable and accrued liabilities	(81,649)	293,371
Increase (decrease) in distributions payable	(2,867)	563,968
Increase (decrease) in management fees payable	(156,914)	267,880
Increase (decrease) in market repurchases payable (note 7)	(55,289)	55,289
Increase (decrease) in interest payable	3,786,847	2,865,937
Increase (decrease) in variation margin payable (note 11)	238,533	244,876
Increase (decrease) in options at market value	46,917	-
Increase (decrease) in unrealized loss on futures contracts	(39,154)	250,844
<b>Net cash flow provided by operating activities</b>	<u>11,983,686</u>	<u>8,815,711</u>
<b>Investing Activities</b>		
Purchase of common stock portfolio	-	(125,988,162)
Purchase of Real Return Trust portfolio	(26,891,645)	(324,979,577)
Proceeds on disposition of common stock portfolio	4,815,000	12,477,021
Proceeds on disposition of Real Return Trust portfolio	27,411,066	26,590,322
Cash received from the Counterparty to fund the purchase of the Real Return Trust portfolio	-	116,921,876
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	<u>(4,815,000)</u>	<u>(3,285,000)</u>
<b>Net cash used in investing activities</b>	<u>519,421</u>	<u>(298,263,520)</u>
<b>Financing Activities</b>		
Proceeds from issuance of units	-	123,844,080
Units purchased for cancellation (note 7)	(462,196)	(666,035)
Unit issue costs	-	(6,922,204)
Proceeds from reverse repurchase agreement	-	186,807,058
Principal payments on reverse repurchase agreement	-	(5,313,260)
Unrealized (gain) loss on foreign exchange from reverse repurchase agreement	<u>(8,331,053)</u>	<u>(7,883,538)</u>
<b>Net cash flow provided by financing activities</b>	<u>(8,793,249)</u>	<u>289,866,101</u>
<b>Net increase in cash and short-term investments</b>	3,709,858	418,292
<b>Cash and short-term investments - beginning of period</b>	<u>418,292</u>	<u>-</u>
<b>Cash and short-term investments - end of period</b>	<u>4,128,150</u>	<u>418,292</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Real Return Income Fund

## Consolidated Statement of Changes in Investments

For the six months ended June 30, 2006 and the period from July 18, 2005 (commencement of operations) to December 31, 2005

	2006 (Unaudited)	2005 (Audited)
	\$	\$
<b>Investments at average cost - Beginning of period</b>	298,268,545	-
Cost of investments purchased	26,891,645	450,967,739
Cost of investments sold	(34,408,012)	(39,081,363)
Cost of investments released by (pledged to) the Counterparty under the Forward Agreement (notes 2 and 6)	<u>4,937,491</u>	<u>(113,617,831)</u>
<b>Investments at average cost - End of period</b>	295,689,669	298,268,545
Unrealized appreciation (depreciation) of investments	<u>(34,830,141)</u>	<u>(13,356,977)</u>
<b>Investments at market value</b>	<u>260,859,528</u>	<u>284,911,568</u>
Proceeds from investments sold	32,226,051	39,067,343
Cost of investments sold	<u>(34,408,012)</u>	<u>(39,081,363)</u>
<b>Net realized loss on investments</b>	<u>(2,181,961)</u>	<u>(14,020)</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Investments

As at June 30, 2006

	% Rate	Maturity date	Number of shares / par value US \$	Average cost CA \$	Market value CA \$	% of Portfolio
<b>Investments</b>						
<b>Foreign bonds</b>						
US Treasury Inflation-Protected Securities	1.875%	Jul-15	193,370,000	242,035,778	211,425,571	81.1%
US Treasury Inflation-Protected Securities	3.875%	Jan-09	3,095,000	4,804,969	4,383,015	1.7%
US Treasury Inflation-Protected Securities	2.000%	Jan-14	3,095,000	4,204,454	4,167,677	1.6%
Ford Motor Credit Corp.	7.875%	Jun-10	2,400,000	2,913,189	2,585,098	1.0%
General Motors Acceptance Corp.	7.750%	Jan-10	2,400,000	2,916,844	2,647,551	1.0%
United Mexican States Note	7.500%	Apr-33	1,025,000	1,431,179	1,213,996	0.5%
Kaupthing Bank	7.125%	May-16	1,280,000	1,421,423	1,426,413	0.5%
Glitnir banki HF	6.693%	Jun-16	780,000	865,987	863,369	0.3%
<b>Total foreign bonds</b>				<u>260,593,823</u>	<u>228,712,690</u>	<u>87.7%</u>
<b>Foreign funds</b>						
Western Asset Opportunistic Emerging Markets Portfolio LLC			176,567	4,606,363	3,091,094	1.2%
Western Asset Floating Rate High Income Fund LLC			1,320,885	17,669,205	16,998,760	6.5%
Western Asset Mgmt MBS Portfolio Fund LLC			484,958	5,912,872	5,590,073	2.1%
Western Asset US\$ High Yield Securities Portfolio LLC			221,775	3,851,571	3,653,166	1.4%
Western Asset Yankee Portfolio LLC			262,270	3,055,835	2,813,745	1.1%
<b>Total foreign mutual funds</b>				<u>35,095,846</u>	<u>32,146,838</u>	<u>12.3%</u>
<b>Total Real Return Trust portfolio</b>				<u>295,689,669</u>	<u>260,859,528</u>	<u>100.0%</u>
<b>Canadian common stocks (pledged to the Counterparty under the Forward Agreement)</b>						
<b>Energy</b>						
Western Oil Sands Inc.			335,453	9,067,295	10,378,916	4.0%
<b>Materials</b>						
Kinross Gold Corp.			861,445	6,344,308	10,483,786	4.0%
<b>Industrials</b>						
Bombardier Inc. Class B			3,279,630	10,628,032	10,199,649	3.9%
<b>Consumer Discretionary</b>						
Gildan Activewear Class A			247,770	8,610,397	13,079,778	5.0%
<b>Consumer Staples</b>						
Cott Corp.			378,236	10,293,748	5,522,246	2.1%
<b>Health Care</b>						
Angiotech Pharmaceuticals Inc.			625,800	10,586,926	8,147,916	3.1%
<b>Information Technology</b>						
Cognos Inc.			233,290	10,632,525	7,327,639	2.8%
ATI Technologies Inc.			678,940	10,647,883	11,012,407	4.2%
Celestica Inc.			628,680	10,587,217	6,645,148	2.5%
Nortel Networks Corp.			3,167,824	10,599,836	7,856,204	3.0%
Research In Motion			123,260	10,682,158	9,589,628	3.7%
				<u>53,149,619</u>	<u>42,431,026</u>	<u>16.2%</u>
<b>Total Canadian common stocks</b>				<u>108,680,325</u>	<u>100,243,317</u>	<u>38.3%</u>
<b>Payable to the Counterparty under the Forward Agreement</b>				<u>(108,680,325)</u>	<u>(100,243,317)</u>	<u>-38.3%</u>
<b>Total investments</b>				<u>295,689,669</u>	<u>260,859,528</u>	<u>100.0%</u>

(See accompanying notes to financial statements)

## Connor, Clark & Lunn Real Return Income Fund

Consolidated Statement of Investments ..... Continued

As at June 30, 2006

	Strike Price	Maturity date	Number of contracts	Average cost CA \$	Market value CA \$	
<b>Option contracts</b>						
10 Year United States T-Note Call Option on Futures	106.00	Aug-06	(64)	(27,803)	(5,561)	
5 Year United States T-Note Call Option on Futures	103.00	Aug-06	(70)	(26,760)	(41,356)	
Fed Funds Put Option on Futures	94.56	Jul-06	(392)	(9,083)	(4,541)	
Fed Funds Put Option on Futures	94.69	Jul-06	392	27,249	4,541	
<b>Options at market value</b>					<u>(46,917)</u>	
	Maturity date	Number of contracts	Average cost CA \$	Market value CA \$	Unrealized gain (loss) CA \$	
<b>Futures contracts</b>						
3 Month Eurodollar Futures	Dec-06	125	32,972,028	32,808,688	(163,340)	
10 Year United States Treasury Note Futures	Sep-06	40	4,708,119	4,664,564	(43,555)	
					<u>(206,895)</u>	
20 Year United States Treasury Note Futures	Sep-06	(6)	(706,878)	(711,674)	(4,796)	
<b>Unrealized gain (loss) on futures contracts</b>					<u>(211,691)</u>	
	Rate	Maturity date	Number of contracts	Bought CA \$	Sold US \$	Unrealized gain (loss) CA \$
<b>Foreign currency forward contracts</b>						
Bought CAD , sold USD	1.18143	Jul-15	1	107,600,000	91,076,068	7,162,185
<b>Unrealized gain (loss) on foreign exchange contracts</b>						<u>7,162,185</u>

(See accompanying notes to financial statements)

# Connor, Clark & Lunn Real Return Income Fund

## Notes to Consolidated Financial Statements (Unaudited)

June 30, 2006

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### 1 Corporate activities

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

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

### 2 Investment objectives

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

In order to meet its investment objectives, the Fund obtained exposure to the performance of the Portfolio held by Real Return Trust by entering into 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, and commodity index investments. No more than 10% of the Portfolio may be invested in any one of these asset classes with the exception of mortgage-backed securities, in respect of which up to 20% of the Portfolio may be invested.

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

### 3 Summary of significant accounting policies

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

#### Principles of consolidation

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

#### Valuation of investments

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

#### Investment transactions, income and expenses

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

#### Foreign currency translation

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

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

#### Foreign currency forward contracts

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

#### Forward contracts

Forward contracts entered into by the Fund are valued at an amount that is equal to the gain or loss that would be realized if the position were to be closed out, which is equivalent to the difference between the deliverable asset and the value of the asset to be received. Changes in the value of a forward contract or the assets deliverable under such a contract are included as unrealized gains or losses on investments.

# Connor, Clark & Lunn Real Return Income Fund

## Notes to Consolidated Financial Statements (Unaudited)

June 30, 2006

### Future contracts

The futures contracts are Exchange-traded futures contracts and listed in the Statements of Investment Portfolio. Futures contracts are valued at their settlement price at the close of business on each Valuation Date. Any difference between the settlement value at the close of business on the current Valuation Date and that of the previous Valuation Date is recorded in the Statements of Investment Operations and in the Statements of Net Assets as Unrealized gain (loss). Amounts receivable (payable) from futures contracts are reflected in the Statements of Net Assets as a Variation Margin Receivable (Payable).

### Options

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

### Reverse Repurchase Agreements

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

## 4 Reverse repurchase agreements

The Fund entered into a reverse repurchase agreement to finance the acquisition of its investments with Bank of Montreal whose credit rating is AA- as of June 30, 2006 by Standard & Poors. Reverse repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts. Accrued interest payable and the related expense are recorded as separate line items in the Statement of Net Assets, and the Statement of Operations respectively.

As of June 30, 2006, the outstanding reverse repurchase agreement is summarized as follows:

<u>Transaction Date</u>	<u>Expiry Date</u>	<u>Cash Received (US \$)</u>	<u>Cash Received (CA \$)</u>	<u>Portfolio Bought</u>	<u>Par (US \$)</u>	<u>Market value (CA \$)</u>
July 19, 2005	July 4, 2006	137,703,000	153,139,457	US TIPS 1.875% July 15, 2015	139,800,000	152,853,570
September 12, 2005	July 4, 2006	9,264,062	10,302,561	US TIPS 1.875% July 15, 2015	9,410,000	10,288,642
September 14, 2005	July 4, 2006	952,000	1,058,719	US TIPS 1.875% July 15, 2015	855,000	934,834
October 11, 2005	July 4, 2006	700,000	778,470	US TIPS 1.875% July 15, 2015	715,000	781,762
May 3, 2006	July 4, 2006	—	—	US TIPS 1.875% July 15, 2015	8,970,000	9,807,557
		<u>148,619,062</u>	<u>165,279,207</u>			<u>174,666,365</u>

## 5 Custodian

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

## 6 Unitholder's equity

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

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

	<u>Number of units</u>
Balance – beginning of period	12,307,408
Units issued	—
Units cancelled (note 7)	<u>(56,300)</u>
Balance – end of period	<u>12,251,108</u>

# Connor, Clark & Lunn Real Return Income Fund

## Notes to Consolidated Financial Statements (Unaudited)

June 30, 2006

### 7 Market Purchase Program

In accordance with the Fund's prospectus, and to enhance liquidity and provide market support for the Units, the Fund has a mandatory market purchase program under which, subject to certain limitations and exceptions, and in compliance with any applicable regulatory requirements, the Fund is obligated to purchase Units for cancellation if, at any time, the price at which Units are offered in the market is less than 95% of the latest determined NAV per Unit, up to a maximum in any calendar quarter of 1.25% of the outstanding Units at the beginning of such calendar quarter. In addition, the Fund will have the right, but not the obligation, to purchase Units in the market at its sole discretion, subject to applicable regulatory requirements and limitations. During the six-month period ended on June 30, 2006, the Fund purchased 56,300 units for cancellation at a cost of \$462,196 (77,000 units at a cost of \$666,035 during the period from July 18, 2005 (commencement of operations) to December 31, 2005).

### 8 Forward Agreement and Common Share Portfolio

The Fund entered into a Forward Agreement with the Counterparty to obtain exposure to the performance of the Portfolio held by Real Return Trust. Under the Forward Agreement, the Fund is entitled to sell securities in the Common Share Portfolio from time to time to fund monthly distributions, redemptions and repurchases of Units and its operating expenses. Under the terms of the Forward Agreement, the Fund and the Counterparty have agreed that their settlement obligations under the Forward Agreement with respect to the Common Share Portfolio securities will be discharged by physical delivery of the Common Share Portfolio securities by the Fund to the Counterparty against cash payment or, at the election of the Fund, by the making of cash payments between the parties. The amount payable by the Counterparty for physical delivery of the Common Share Portfolio may be more or less than the original aggregate subscription price of the Units. Unless the Fund elects cash settlement of the Forward Agreement, the Counterparty will pay to the Fund on or about the Termination Date, as the purchase price for the Common Share Portfolio, an amount equal to the Canadian dollar equivalent of the redemption proceeds of a corresponding number of units of the Real Return Trust. The Common Share Portfolio securities is pledged to, and held by, the Counterparty as security for the obligations of the Fund under the Forward Agreement.

The following table splits the changes in the Common Share Portfolio between (i) shares delivered to the Counterparty as a partial settlement under the forward agreement, and (ii) substitutions in the Common Share Portfolio during the six-month period ended on June 30, 2006 and the period from July 18, 2005 (commencement of operations) to December 31, 2005:

	June 30, 2006	December 31, 2005
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	4,815,000	3,285,000
Cost of investments delivered through partial pre-settlement	<u>(4,937,491)</u>	<u>(3,251,902)</u>
Realized gain on partial pre-settlement	<u>(122,491)</u>	<u>33,098</u>
Proceeds on sale of investments (subsequently reinvested)	27,411,051	35,782,343
Cost of investments sold	<u>(29,470,521)</u>	<u>(35,829,461)</u>
Realized gain (loss) on sale of investments	<u>(2,059,470)</u>	<u>(47,118)</u>
<b>Realized gain (loss) on investments</b>	<b><u>(2,181,961)</u></b>	<b><u>(14,020)</u></b>
Liability to Counterparty under Forward Agreement - Beginning of period	113,617,831	-
Original liability to Counterparty under Forward Agreement	-	116,921,876
Reduction in liability to the Counterparty under the Forward Agreement through partial pre-settlement	(4,815,000)	(3,285,000)
Liability to Counterparty under Forward Agreement at period end, at cost	<u>108,680,325</u>	<u>113,617,831</u>
<b>Unrealized gain on Forward Agreement</b>	<b><u>122,506</u></b>	<b><u>19,045</u></b>

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

### 9 Distributions

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

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

Cash distributions of \$3,452,132 (\$0.2811 per unit) were paid during the six-month period ended on June 30, 2006 (\$3,074,440 (\$0.2486 per unit) during the period from July 18, 2005 (commencement of operations) to December 31, 2005).

# Connor, Clark & Lunn Real Return Income Fund

Notes to Consolidated Financial Statements (Unaudited)

June 30, 2006

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## 10 Management fees and other expenses

Pursuant to a management agreement (the "Management Agreement") the Fund has retained Connor, Clark & Lunn Capital Markets Inc. (the "Manager") to act as manager.

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

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

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

## 11 Futures contracts

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

<u>Security</u>	<u>Par (US \$)</u>	<u>Market value (US\$)</u>	<u>Market value (CA \$)</u>
US TIPS 1.875% July 15, 2015	1,733,000	1,703,818	1,894,816

## 12 Income taxes

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

## 13 Broker commission charges and soft dollar services

There were \$16,330 broker commissions paid during the six-month period ended on June 30, 2006 (\$23,460 during the period from July 18, 2005 (commencement of operations) to December 31, 2005) in connection with portfolio transactions. No soft dollar services were included in the broker commission charges.