

CC&L Real Return Income Fund

Update: Q2 2006

Portfolio Update

The Fund's objective is to provide tax-efficient income that is linked to the rate of US inflation as well as capital preservation. To achieve that objective, the Fund currently has 82% of its total managed assets invested in US TIPS. US TIPS provide income-oriented investors the opportunity for attractive current income that is protected from the adverse effects of inflation. Other investments include allocations to bank loans (6.2%) and US high yield securities (6.0%). The weighted average credit rating of the portfolio remains at its target level of AA+.

The investment approach the Fund has taken is to concentrate on medium-duration securities, which generally experience less price volatility than longer duration bonds. Rather than taking risk in the form of long-duration securities, the portfolio is leveraged, with a debt/equity target of 1.6 times. The portfolio's core holding, at 78% of assets, is the US TIPS maturing in July 2015. As such, the core holding is term-matched to the Fund's Units.

Net Asset Value ("NAV")

The principal drivers of NAV can be isolated to four sources:

1. **Real Interest Rates** – The price of real return bonds is affected by changes in real interest rates. Real rates are less volatile than nominal rates, which include inflation expectations, and as such, real return bonds generally experience less price volatility in response to rate changes than nominal bonds. The Fund's stance of taking a leveraged core position in term-matched US TIPS means that fluctuations in value from time to time due to changing real interest rates should not significantly affect an investor who holds the fund to maturity, since there is minimal risk of mismatching.

In general, one would expect shorter-term rates to move less than long-term rates. However, as successive increases in the Fed Funds rate have pushed the US yield curve to inversion, medium term rates have risen while long rates have fallen. The approximately 20 bps rise in 10-year US real rates since inception has had an impact of approximately -1.7% on the value of the Fund's TIPS exposure, or about -4% impact on NAV.

The move up in US real rates has been significantly correlated with increases in the Fed Funds rate and the stock market. If the Fed stops raising rates at 4.75% or 5.00%, real rates should respond positively. One of the beneficial features of inflation-linked investments is their low correlation with other asset classes, including stocks.

2. **Inflation Accrual** – Inflation accrual is the primary source of portfolio revenue. Monthly inflation, on which the accrual is based, can be volatile and will affect NAV as the principal value and coupon of the inflation-linked bonds adjusts as a result of changes in inflation. For instance, during the first two months of 2006, the US TIPS experienced -0.8% of inflation accrual, due to a combination of seasonal factors and declining energy prices. The impact on NAV of this decline was close to \$4 million including its cash flow effects, or about \$0.32 per unit. We expect the decline to reverse over the upcoming months.
3. **Cost of Leverage** – There are two principal variable components to cash flow: inflation accretion to the inflation-linked bond holdings and the cost of borrowing. The Fund's cost of borrowing is the overnight repo rate, which has increased by 1.4% since inception. At a projected 4.75% (currently 4.60%), cash flow and inflation accretion from portfolio investments is expected to fund distributions at a 5.50% annualized rate along with expenses for an annual inflation rate of approximately 3.30% (currently 3.60%).
4. **Investment Basket** – The Fund is allowed to invest up to 20% in other types of securities that currently include bank loans, US high yield securities, corporate bonds, and emerging market debt. The returns of the basket are driven by interest rate movements and credit conditions as well as sector- and security-level investment decisions. This basket of securities is well diversified and we expect it will continue to add value to the portfolio over time.

Western Asset Management's Inflation Update and Interest Rate Outlook

Western Asset Management Company ("Western"), a subsidiary of Legg Mason, Inc., is the Fund's investment advisor 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 managed \$249.2 billion in assets as of December 31, 2005 and approximately \$24.3 billion in inflation-linked securities.

Inflation Update

With the stabilization of energy prices and the decline in other commodity prices, inflation fears have subsided for the time being. Headline inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U) is now 3.6% year-over-year and is expected to decline while core inflation measures (excluding the effects of food and energy) remain stable.

CC&L Real Return Income Fund

Update: Q2 2006

While Western agrees that inflation does look to be contained, the breakeven spread of nominal US Treasury yields less US TIPS real yields is now back to around 2.5%, which mirrors the average annual rate of inflation over the last 10 years. Unless one expects inflation to be lower for the next 10 years than it was for the past 10 years, US TIPS look to be reasonably valued versus US Treasuries.

Interest Rate Outlook

Inflation is one factor that affects the performance of US TIPS. US TIPS performance is also affected by real yields, which exert the same influence on US TIPS as nominal yields have on the prices of nominal bonds. Real rates have backed up significantly in the past few months and are now nearly the highest they have been in two years. Western continues to expect real yields to remain at or below 2.50%, consistent with real GDP growth.

With first quarter data looking strong, Western believes that the Fed will raise the Fed Funds rate to 4.75% at the end of March 2006, and another increase to 5.00% in May of 2006 cannot be ruled out. However, there is a lot of data to be released between now and the May 10 FOMC meeting, but with some anecdotal evidence of a slowdown in the housing market Western does not anticipate that the Fed will need to tighten beyond 5.00%.

Distribution Update

The annualized yield on the units for the second calendar quarter of 2006 is targeted at 5.50%. We have lowered the distribution rate by 25 bps from the previous quarter. In setting this quarter's distribution, we assumed year-over-year inflation of 3.00% to 3.50% (currently 3.60%), leverage at a debt-to-equity ratio of 1.62:1 and a borrowing cost of 4.75% to 5.00% (currently 4.60%). All of the distributions are expected to be characterized as ROC (Return of Capital). Based on the TSX closing price March 21, 2006 of \$8.47 and the 5.50% distribution rate, the current yield for the Fund is 6.49%, which works out to be a Pre-Tax Interest Equivalent of 9.43%.

The Fund intends to provide Unitholders with monthly cash distributions. Cash distributions from the Fund are not fixed and are intended to float with US inflation. The Manager will determine and announce at the beginning of each calendar quarter an anticipated monthly distribution amount for each month in that quarter based on prevailing market conditions and the Fund's estimate of distributable cash flow for the following quarter.

Connor, Clark & Lunn Real Return Income Fund ("the Fund") is an investment trust that has been created to invest on a levered basis in real return bonds issued by governments with AAA credit ratings, primarily US Treasury Inflation Protection Securities ("TIPS"). In

order to provide diversification, improve net asset value stability and increase expected returns, up to 20% of the portfolio may be invested in a mix of other assets. Western Asset Management Company ("Western Asset") is the Fund's investment advisor and is responsible for actively managing and making investment decisions with respect to the portfolio.

Connor, Clark & Lunn Capital Markets Inc. is the Manager of the Fund and is part of the Connor, Clark & Lunn Financial Group of companies which manages over \$30 billion in financial assets.

Disclaimer: The above information should be considered as background information only and should not be construed as an offer or solicitation to buy or sell. Investors should read fund documents available at www.cclcapitalmarkets.com or www.sedar.com, which further describe the risks and fees and expenses associated with an investment in the units, and should consult with professional advisors before investing. The units value may change frequently and past performance may not be repeated. The above analysis includes forward-looking statements. Such statements reflect the opinion of the manager and/or investment manager regarding factors that might be reasonably expected to affect the performance of the Fund, and are based on information available at the time of writing. Actual events and outcomes may differ materially from those described in the investment manager's analysis.