

# **Palos Equity Income Fund**

Interim Financial Statements

**June 30, 2017 and 2016**

(expressed in Canadian dollars)

# **Palos Equity Income Fund**

## Notice

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The following Palos Equity Income Fund semi-annual Financial Statements have not been subject to a review by the Fund external auditors.

# Palos Equity Income Fund

## Statements of Financial Position

(expressed in Canadian dollars)

	As at June 30, 2017 \$	As at Dec.31, 2016 \$
<b>Assets</b>		
<b>Current assets</b>		
Investments	25,433,257	23,002,565
Cash	915,573	1,335,798
Subscriptions receivable	6,544	29,075
Receivable from investments sold	99,715	-
Accrued income receivable	69,582	88,654
	<u>26,524,671</u>	<u>24,456,092</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Payable for investments purchased	252,000	-
Redemptions payable	13,893	7,375
Distributions payable	74,481	71,264
Accrued liabilities	21,810	21,330
Management fees payable	-	850
Performance fees payable	23,041	70
	<u>385,225</u>	<u>100,889</u>
<b>Net assets attributable to holders of redeemable units</b>	<u>26,139,446</u>	<u>24,355,203</u>
<b>Net assets attributable to holders of redeemable units per series</b>		
Series A	17,347,058	18,648,521
Series F	8,792,388	5,706,682
<b>Net assets attributable to holders of redeemable units per series per unit</b>		
Series A	6.28	6.38
Series F	6.59	6.67

**Approved by the Manager, Palos Management Inc.**

(s) Charles Marleau

Director

(s) Robert Boisjoli

Director

The accompanying notes are an integral part of these financial statements.

**Palos Equity Income Fund**  
**Statements of Comprehensive Income**  
**For the periods ended June 30, 2017 and 2016**

(expressed in Canadian dollars)

	Note	2017 \$	2016 \$
<b>Income</b>			
Dividend income		273,172	245,350
Interest income for distribution purposes		72,945	66,823
Other changes in fair value of investments			
Net realized gain on sale of investments		383,064	665,343
Net change in unrealized appreciation (depreciation) of investments		(41,635)	467,802
<b>Total income, net</b>		<b>687,546</b>	<b>1,445,318</b>
<b>Expenses</b>			
Management fees	8	185,015	163,852
Performance fees	8	23,042	-
Administration and other professional fees		42,723	41,676
Trustee fees		8,408	6,842
Audit fees		25,688	20,675
Legal fees		138	7,666
Bank charges and interest		1,528	3,160
Independent review committee fees		5,951	5,951
Transaction cost		26,737	42,692
Withholding tax expense		268	1,962
<b>Total expenses, net</b>		<b>319,498</b>	<b>294,476</b>
<b>Increase in net assets attributable to holders of redeemable units</b>		<b>368,048</b>	<b>1,150,842</b>
<b>Increase in net assets attributable to holders of redeemable units per series</b>			
Series A		285,053	921,082
Series F		82,995	229,760
<b>Increase in net assets attributable to holders of redeemable units per series per unit</b>			
Series A	10	0.10	0.31
Series F	10	0.08	0.41

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

## Statements of Changes in Net Assets Attributable to Holders of Redeemable Units

For the periods ended June 30, 2017 and 2016

(expressed in Canadian dollars)

	Series A		Series F	
	2017 \$	2016 \$	2017 \$	2016 \$
<b>Net assets attributable to holders of redeemable units – Beginning of period</b>	18,648,521	17,441,588	5,706,682	2,638,160
Increase in net assets attributable to holders of redeemable units	285,053	921,082	82,995	229,759
<b>Distributions to holders of redeemable units</b>				
Net investment income	(26,150)	(36,578)	(25,199)	(21,995)
From net realized gains on investments and derivative:	(272,469)	(520,742)	(96,980)	(103,724)
Return of capital	(254,522)	(325,641)	(106,685)	(58,404)
<b>Total distributions to holders of redeemable units</b>	(553,141)	(882,961)	(228,864)	(184,123)
<b>Redeemable unit transactions</b>				
Proceeds from redeemable units issued	725,400	627,156	3,499,029	1,823,467
Reinvestments of distributions to holders of redeemable units	427,421	667,042	207,197	179,140
Redemption of redeemable units	(2,186,196)	(946,764)	(474,651)	(64,965)
<b>Net increase (decrease) from redeemable unit transactions</b>	(1,033,375)	347,434	3,231,575	1,937,642
<b>Net increase (decrease) in net assets attributable to holders of redeemable units:</b>	(1,301,463)	385,555	3,085,706	1,983,278
<b>Net assets attributable to holders of redeemable units – End of period</b>	17,347,058	17,827,143	8,792,388	4,621,438

The accompanying notes are an integral part of these financial statements.

**Palos Equity Income Fund**  
**Statements of Cash Flows**  
**For the periods ended June 30, 2017 and 2016**

(expressed in Canadian dollars)

	<b>2017</b>	<b>2016</b>
	<b>\$</b>	<b>\$</b>
<b>Cash flows from operating activities</b>		
Increase in net assets attributable to holders of redeemable units	368,048	1,150,841
Adjustments for		
Foreign exchange gain	(15,142)	(195,095)
Net realized gain on sale of investments	(383,064)	(665,343)
Net change in unrealized depreciation (appreciation) of investments	41,635	(467,802)
Proceeds from sale and maturity of investments	7,051,221	11,635,828
Purchases of investments	(8,988,199)	(12,072,034)
Prepaid	-	(13,799)
Accrued income receivable	19,072	6,529
Accrued liabilities	480	2,862
Management fees payable	(850)	(274)
Performance fees payable	22,971	(110,290)
<b>Net cash from operating activities</b>	<u>(1,883,828)</u>	<u>(728,577)</u>
<b>Cash flows from financing activities</b>		
Distributions paid to holders of redeemable units, net of reinvested distributions	(144,170)	(296,879)
Proceeds from issuance of redeemable units	4,246,960	2,048,348
Amount paid on redemption of redeemable units	(2,654,329)	(1,011,729)
<b>Net cash from financing activities</b>	<u>1,448,461</u>	<u>739,741</u>
<b>Foreign exchange gain on cash</b>	<u>15,142</u>	<u>195,095</u>
<b>Net change in cash during the period</b>	(420,225)	206,259
<b>Cash – Beginning of period</b>	<u>1,335,798</u>	<u>154,653</u>
<b>Cash – End of period</b>	<u>915,573</u>	<u>360,912</u>
<b>Supplementary information on cash flows from operating activities</b>		
Interest received	34,882	68,685
Dividends received, net of withholding taxes	292,142	249,997

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

## Schedule of Investment Portfolio

As at June 30, 2017

(expressed in Canadian dollars)

	Maturity date	Coupon or dividend rate	Number of shares or par value	Average cost \$	Fair value \$
<b>Bonds</b>					
<b>Convertible bonds</b>					
Boralex Inc.	June 30, 2020	4.500%	300,000	300,000	361,860
Chemtrade Logistics Income Fund	June 30, 2021	5.250%	240,000	240,000	245,280
Element Fleet Management Corp.	June 30, 2019	5.125%	250,000	259,525	252,120
Northland Power Inc.	June 30, 2020	4.750%	400,000	426,004	458,872
<b>Total convertible bonds</b>				<u>1,225,529</u>	<u>1,318,132</u>
<b>Corporate bonds</b>					
Canadian Energy Service & Technology Corp.	April 17, 2020	7.375%	250,000	264,375	261,563
DHX Media Ltd.	Dec. 2, 2021	5.875%	500,000	500,000	531,565
Parkland Fuel Corp.	May 28, 2021	5.500%	200,000	200,000	205,376
<b>Total corporate bonds</b>				<u>964,375</u>	<u>998,504</u>
<b>Total bonds</b>				<u>2,189,904</u>	<u>2,316,636</u>
<b>Common stocks</b>					
<b>Consumer discretionary</b>					
Cineplex Inc.			4,000	176,999	211,440
Dollarama Inc.			3,000	236,004	371,730
Enercare Inc.			19,500	337,048	384,540
Invescor Restaurant Group Inc.			100,000	306,989	367,000
Park Lawn Corp.			7,000	133,000	131,740
Spin Master Corp.			9,000	247,515	348,300
Stingray Digital Group Inc.			40,120	306,601	316,146
<b>Total consumer discretionary</b>				<u>1,744,156</u>	<u>2,130,896</u>
<b>Consumer staples</b>					
Alimentation Couche Tard Inc. - Class B			4,500	263,478	279,720
Goodfood Market Corp.			35,330	88,325	62,534
Jamieson Wellness Inc.			16,000	252,000	252,000
Maple Leaf Foods Inc.			8,000	172,504	261,920
<b>Total consumer staples</b>				<u>776,307</u>	<u>856,174</u>

The accompanying notes are an integral part of these financial statements.

**Palos Equity Income Fund**  
 Schedule of Investment Portfolio ... *continued*  
 As at June 30, 2017

(expressed in Canadian dollars)

	Number of shares or par value	Average cost \$	Fair value \$
<b>Energy</b>			
AltaGas Ltd	17,000	527,000	501,330
ARC Resources Ltd.	19,000	334,446	322,240
CES Energy Solutions Corp.	51,000	299,061	294,780
Keyera Corp.	15,200	518,285	620,464
Leucrotta Exploration Inc.	60,000	108,600	111,600
Parkland Fuel Corp.	4,000	110,800	110,800
Pembina Pipeline Corp	3,400	105,879	146,030
Secure Energy Services Inc.	38,900	409,677	344,265
Seven Generations Energy Ltd	5,000	131,147	111,050
Spartan Energy Corp.	28,333	171,392	174,248
Tamarack Valley Energy Ltd.	130,000	407,223	289,900
Tidewater Midstream and Infrastructure Ltd.	265,000	372,650	347,150
Tourmaline Oil Corp.	5,000	128,618	139,400
Trican Well Service Ltd	62,900	247,197	228,327
Veresen Inc.	34,000	506,718	623,560
Vermilion Energy Inc.	8,300	370,325	341,462
Whitecap Resources Inc.	39,000	474,352	361,140
<b>Total energy</b>		<u>5,223,370</u>	<u>5,067,746</u>
<b>Financials</b>			
Bank of Montreal	4,000	345,492	380,880
Bank of Nova Scotia	13,000	880,491	1,014,130
Canadian Imperial Bank of Commerce	2,500	262,564	263,475
ECN Capital Corp.	55,000	203,164	220,000
Intact Financial Corp.	4,200	385,324	407,460
Royal Bank of Canada	9,000	679,916	847,440
Sun Life Financial Inc.	10,000	389,472	463,600
Toronto - Dominion Bank	13,514	534,390	883,140
<b>Total financials</b>		<u>3,680,813</u>	<u>4,480,125</u>
<b>Health Care</b>			
Sienna Senior Living Inc.	10,000	172,600	179,700

The accompanying notes are an integral part of these financial statements.

**Palos Equity Income Fund**  
Schedule of Investment Portfolio ... *continued*  
As at June 30, 2017

(expressed in Canadian dollars)

	Number of shares or par value	Average cost \$	Fair value \$
<b>Industrials</b>			
Boyd Group Income Fund	3,000	259,465	288,450
Canadian Pacific Railway Ltd	1,500	293,635	312,975
CanWel Building Materials Group Ltd	50,000	305,000	328,000
Exchange Income Corp.	10,000	325,700	330,600
Hardwoods Distribution Inc.	15,000	251,593	278,850
Morneau Shepell Inc.	11,635	121,452	242,473
New Flyer Industries Inc.	4,000	161,940	216,960
People Corp.	30,000	114,441	164,400
Savaria Corp.	16,000	184,180	250,840
SNC – Lavalin Group Inc.	6,100	313,845	343,247
Waste Connections Inc.	4,650	260,881	388,415
WSP Global Inc.	8,000	320,910	430,480
<b>Total industrials</b>		<u>2,913,042</u>	<u>3,575,690</u>
<b>Information technology</b>			
Blackberry Ltd	17,000	233,390	220,320
CGI Group Inc. – Class A	5,500	322,842	364,430
Kinaxia Inc.	4,650	304,808	375,441
Pivot Technology Solutions Inc.	50,000	91,539	123,500
Shopify inc.	3,700	141,691	416,620
<b>Total information technology</b>		<u>1,094,270</u>	<u>1,500,311</u>
<b>Materials</b>			
Agnico Eagle Mines Ltd	6,000	242,274	350,880
Agrium Inc.	2,400	263,999	282,072
B2Gold Corp.	70,000	260,853	255,500
CCL Industries Inc. – Class B	8,000	235,007	524,880
First Quantum minerals Ltd	22,000	271,736	241,340
Franco-Nevada Corp.	5,000	360,363	467,850
Lundin Mining Corp.	75,000	348,867	552,750
Nemaska Lithium Inc.	60,000	63,000	58,800
Trevali Mining Corp.	240,000	285,536	292,200
<b>Total materials</b>		<u>2,331,635</u>	<u>3,026,272</u>
<b>Real estate</b>			
American Hotel Income Properties REIT LP	25,500	241,414	253,980
InterRent Real Estate Investment Trust	46,200	343,611	373,758
Tricon Capital Group Inc.	22,000	232,992	255,640
<b>Total real estate</b>		<u>818,017</u>	<u>883,378</u>

The accompanying notes are an integral part of these financial statements.

**Palos Equity Income Fund**  
 Schedule of Investment Portfolio ... *continued*  
 As at June 30, 2017

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(expressed in Canadian dollars)

	Number of shares or par value	Average cost \$	Fair value \$
<b>Utilities</b>			
Algonquin Power & Utilities Corp.	35,000	380,049	477,750
Crius Energy Trust	45,500	375,085	471,835
Northland Power Inc.	7,500	173,631	173,250
Superior Plus Corp.	25,700	317,494	293,494
<b>Total utilities</b>		<u>1,246,259</u>	<u>1,416,329</u>
<b>Total common stock</b>		<u>20,000,469</u>	<u>23,116,621</u>
<b>Total investments</b>		<u>22,190,373</u>	<u>25,433,257</u>
<b>Other assets, less liabilities</b>			<u>706,189</u>
<b>Net assets attributable to holders of redeemable units</b>			<u>26,139,446</u>

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### 1 General information

Palos Equity Income Fund (the “Fund”) was formed in January 3, 2008 under the laws of the Province of Quebec pursuant to a trust agreement (the agreement), as amended for the last time on August 26, 2013, between Computershare Trust Company of Canada (the trustee) and Charles Marleau (the settlor). The address of the Fund’s registered office is 1 Place Ville-Marie, Suite 1670, Montréal, Québec, H3B 2B6, Canada. The Fund is an open-ended mutual fund, is qualified as a unit trust and is a registered investment fund under Section 204.4 of the Income Tax Act (Canada).

Series A opened on January 3, 2008 and Series F opened on February 24, 2012.

The Fund acts as an investment holding unit trust for the benefit of unitholders by acquiring, investing in, holding, transferring, disposing of, or otherwise dealing with such investments as the trustee and the investment fund manager determine, at their discretion, in accordance with the investment objectives of the Fund, which are to preserve capital, to provide an attractive and steady stream of income and to deliver trading-enhanced returns.

The investment fund manager and portfolio advisor is Palos Management Inc. (the Manager).

These financial statements have been authorized for issue by the Board of Directors of the Manager on August 23, 2017.

### 2 Basis of presentation

These financial statements have been prepared in compliance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Boards (IASB).

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### 3 Summary of significant accounting policies

#### Financial instruments

##### Recognition

Regular way purchases and sales of financial assets are recognized at their trade date. The Fund's investment assets and liabilities are measured at fair value through profit or loss (FVTPL), including certain investments in debt securities which have been designated at FVTPL. The Fund's non-derivative investments are designated at FVTPL upon initial recognition and all derivatives are classified in this category as held for trading. The Fund's obligation for net assets attributable to holders of redeemable units is classified as a financial liability and is measured at amortized cost which corresponds to the redemption amount. The redemption amount is determined as the net difference between total assets and all other liabilities for which accounting policies are described herein. All other financial assets and financial liabilities are classified as loans and receivables and other financial liabilities respectively and are measured at amortized cost. Under this method, financial assets and financial liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract's effective interest rate. The Fund's accounting policies for measuring the fair value of its investments and derivatives are identical to those used in measuring its net asset value (NAV) for transactions with unitholders.

##### Income recognition

The interest income for distribution purposes shown on the statements of comprehensive income (loss) represents the contractual interest accounted for on an accrual basis. The Fund does not amortize premiums paid or discounts received on the purchase of fixed income securities except for zero coupon bonds and loans which would be amortized on a straight-line basis. Dividend income is recorded on the ex-dividend date.

Realized gain (loss) on sale of investments and unrealized appreciation (depreciation) of investments are determined on an average cost basis. Average cost does not include amortization of premiums or discounts on fixed income securities with the exception of zero coupon bonds.

#### Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of financial assets and financial liabilities traded in active markets (such as publicly traded derivatives and marketable securities) are based on quoted market prices at the close of trading on the reporting date. The Fund uses the last traded market price for both financial assets and financial liabilities where the last traded price falls within that day's bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, the Manager determines the point within the bid-ask spread that is most representative of fair value based on the specific facts and circumstances.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

The fair value of financial assets and financial liabilities that are not traded in an active market, including over-the-counter derivatives, is determined using valuation techniques. The Fund uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques include the use of comparable recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and others commonly used by market participants and which make the maximum use of observable inputs.

### **Classification of redeemable units**

The Fund's outstanding redeemable units are in different series which do not have identical features. Consequently, the Fund's outstanding redeemable units are classified as financial liabilities and recorded as net assets attributable to holders of redeemable units, in accordance with the requirements of International Accounting Standard (IAS) 32, Financial Instruments: Presentation.

### **Foreign currency translation**

The Fund's subscriptions and redemptions are denominated in Canadian dollars, which is also its functional and presentation currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates that transactions occur. Foreign currency assets and liabilities denominated in a foreign currency are translated into the functional currency using the exchange rate prevailing at the measurement date. Foreign exchange gains and losses relating to cash and to other financial assets and financial liabilities are presented as "Net realized gain on sale of investments" and "Net change in unrealized appreciation (depreciation) of investments" in the statements of comprehensive income (loss).

### **Offsetting financial assets and financial liabilities**

Financial assets and financial liabilities are offset in the Fund's statements of financial position when and only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The Fund has a legally enforceable right to offset a financial asset and financial liability when such right is enforceable in the normal course of business and in the event of default, insolvency or bankruptcy.

Over-the-counter derivatives, securities lending, repurchase agreements and receivable for investments sold and payable for investments purchased are subject to master netting or similar agreements that do not meet the criteria for offsetting in the statements of financial position as they give a right to set-off that is enforceable only in the event of default, insolvency or bankruptcy.

### **Cash**

Cash comprises deposits with financial institutions and bank overdraft.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### **Increase (decrease) in net assets attributable to holders of redeemable units per unit per series**

The increase (decrease) in net assets attributable to holders of redeemable units per unit of each series is calculated by dividing the increase (decrease) in net assets attributable to holders of redeemable units of each series by the weighted average number of units outstanding during the period.

### **Taxation**

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada). All of the Fund's net income for tax purposes and sufficient net capital gains realized in any period are required to be distributed to unitholders such that no income tax is payable by the Fund. As a result, the Fund does not record income taxes. Since the Fund does not record income taxes, the tax benefit of capital and non-capital losses has not been reflected in the statements of financial position as a deferred income tax asset.

The Fund currently incurs withholding taxes imposed by certain countries on investment income and capital gains. Such income and gains are recorded on a gross basis and the related withholding taxes are shown as a separate expense in the statements of comprehensive income (loss).

### **Accounting standards issued but not yet adopted relevant to the Fund**

#### IFRS 9 – Financial Instruments

In July 2014, the IASB issued the complete and final version of IFRS 9, which will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 includes, among others, the requirements for the classification and measurement of financial assets and financial liabilities.

IFRS 9 sets out a new classification and measurement model for financial assets to determine whether a financial asset should be classified at amortized cost, at FVTPL or at fair value through other comprehensive income. This model is based on the contractual cash flow characteristics of the financial asset and the business model under which the financial asset is held. The valuation basis of financial assets, namely amortized cost or fair value, may need to be changed, as well as the recognition of unrealized gains and losses arising from changes in fair value. For the classification and measurement of financial liabilities, the new standard essentially carries forward the current requirements under IAS 39.

The Fund will have to adopt IFRS 9 retrospectively for annual periods beginning on or after January 1, 2018. However, the restatement of comparative periods is not mandatory, as an exemption from applying the standard allows comparative periods to be presented in accordance with the previous GAAP under certain conditions. The Manager continues to assess the impact of adopting IFRS 9.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### 4 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and to make estimates and assumptions about the future. The following discusses the most significant accounting judgments and estimates that the Manager has made in preparing the financial statements:

- a) Fair value measurement of derivatives and securities not quoted in an active market

The Fund may hold financial instruments that are not quoted in active markets, including derivatives. Fair values of such instruments are determined using valuation techniques and may be determined using reputable pricing sources or indicative prices from market makers. Broker quotes as obtained from the pricing sources may be indicative and not executable or binding. Where no market data is available, the Manager may value positions using its own models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. The models used to determine fair values are validated and periodically reviewed by experienced personnel of the Manager. The models used for private equity securities are based mainly on earnings multiples adjusted for a lack of marketability as appropriate.

Models use observable data, to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require the Manager to make estimates. Changes in assumptions about these factors could affect the reported fair values of financial instruments. The Manager considers observable data to be market data that is readily available, regularly distributed and updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

- b) Classification and measurement of investment and application of the fair value option

In classifying and measuring financial instruments held by the Fund, the Manager is required to make significant judgments about whether or not the business of the Fund is to invest on a total return basis for the purpose of applying the fair value option for financial assets under IAS 39. The most significant judgments made include the determination that the fair value option can be applied to all investments as the Fund is managed on a fair value basis.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### 5 Risks associated with financial instruments

#### Risk factors

The Fund's activities expose it to a variety of risks associated with financial instruments, as follows: credit risk, liquidity risk, market risk (including currency risk, interest rate risk and price risk) and concentration risk. The Fund's overall risk management program seeks to maximize the returns derived for the level of risk to which the Fund is exposed and seeks to minimize potential adverse effects on the Fund's financial performance. All investments result in a risk of loss of capital. These risks are moderated through careful selection of securities and other financial instruments within the Fund's investment guidelines. The risks are measured using a method that reflects the expected impact on the results and net assets attributable to unitholders of the Fund from reasonably possible changes in the relevant risk variables.

#### Credit risk

The Fund is exposed to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The majority of the credit risk to which the Fund is exposed arises from its investments in debt securities. In selecting fixed income securities for the Fund, the Manager considers factors such as the debt security's yield, risk of interest rate fluctuation, credit risk, the issuer's capital structure, credit spread and duration. The analysis below summarizes the credit quality of the Fund's debt portfolio as at June 30, 2017 and December 31, 2016.

	<u>June 30, 2017</u>	<u>December 31, 2016</u>
<b>Credit rating</b>	<b>Total fixed income %</b>	<b>Total fixed income %</b>
BB -	8.9	26.9
B -	-	9.8
Non-rated	91.1	63.3
	<u>100.0</u>	<u>100.0</u>

Source: Standard & Poor's

All portfolio transactions in 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 are received by the broker. The trade will not settle if either party fails to meet its obligation. In addition, the Fund lodges its cash with quality institutions which have credit ratings of A- or above. Credit risk with respect to accrued income receivable is limited as the receivables are derived from a portfolio of diversified investments.

The Fund's maximum exposure to credit risk is equal to the carrying value of the assets presented on the statements of financial position. The Fund does not anticipate any significant losses from the non-performance of counterparties.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

(expressed in Canadian dollars)

### Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. The Fund is exposed to daily cash redemptions. Financial liabilities that potentially subject the Fund to liquidity risk consist of payable for investments purchased, redemptions payable, distributions payable, accrued liabilities and management and performance fees payable. The Fund's investment approach focuses on investing in highly liquid securities and moderately liquid securities, which are therefore readily saleable to meet liquidity needs.

The Fund may invest in debt securities and unlisted equity investments that are not traded in an active market. As a result, the Fund may not be able to quickly liquidate its investments in these instruments at amounts which approximate their fair values, or be able to respond to specific events such as deterioration in the creditworthiness of any particular issuer. In accordance with the Fund's policy, the Manager monitors the Fund's liquidity position on a daily basis. The tables below analyze the Fund's financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. The amounts in the tables are the contractual undiscounted cash flows.

	<b>June 30, 2017</b>		
<b>Financial liabilities</b>	<b>On demand</b>	<b>&lt; 3 months</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Payable for investments purchased	-	252,000	252,000
Redemption payable	-	13,893	13,893
Distributions payable	-	74,481	74,481
Accrued liabilities	-	21,810	21,810
Performance fees payable	-	23,041	23,041
Redeemable units	26,139,446	-	26,139,446

  

	<b>December 31, 2016</b>		
<b>Financial liabilities</b>	<b>On demand</b>	<b>&lt; 3 months</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Redemptions payable	-	7,375	7,375
Distributions payable	-	71,264	71,264
Accrued liabilities	-	21,330	21,330
Management fees payable	-	850	850
Performance fees payable	-	70	70
Redeemable units	24,355,203	-	24,355,203

Redeemable units are redeemable on demand at the holder's option. However, the Manager does not expect that the contractual maturity disclosed above will be representative of the actual cash outflows, as holders of these instruments typically retain them for a longer period.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### Market risk

The Fund's investments are subject to market risk which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. To monitor the risk, the Fund's Manager uses stress testing to examine the impact that abnormally large swings in market factors and periods of prolonged inactivity might have on trading portfolios. The stress testing is designed to identify key risks and ensure that the losses from abnormal events are not above the Fund's risk tolerance.

The following include sensitivity analyses that show how the net assets attributable to holders of redeemable units would have been affected by a reasonably possible change in the relevant risk variable at each reporting date. In practice, the actual results may differ and the difference could be material.

#### a) Currency risk

The Fund invests in monetary assets denominated in currencies other than Canadian dollar. These investments result in currency risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The table below indicates the foreign currencies to which the Fund had significant exposure as at June 30, 2017 and December 31, 2016, in Canadian dollars. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the Canadian dollar had strengthened or weakened by 5% in relation to each of the other currencies, with all other variables held constant. The monetary exposure presents the impact on cash and the non-monetary exposure presents the impact on investments. Non-monetary items are investments in equity securities and are classified based on the currency in which they were purchased.

Currency	June 30, 2017					
	Exposure			Impact on net assets attributable to holders of redeemable units and the increase (decrease) thereof		
	Monetary \$	Non- monetary \$	Total \$	Monetary \$	Non- monetary \$	Total \$
United States dollar	51,854	-	51,854	2,593	-	2,593
% of net assets attributable to holders of redeemable units	0.2%	-	0.2%	0.01%	-	0.01%

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

(expressed in Canadian dollars)

Currency	December 31, 2016					
	Exposure			Impact on net assets attributable to holders of redeemable units and the increase (decrease) thereof		
	Monetary \$	Non- monetary \$	Total \$	Monetary \$	Non- monetary \$	Total \$
United States dollar	593,966	450,113	1,044,079	29,698	22,506	52,204
% of net assets attributable to holders of redeemable units	2.4%	1.8%	4.2%	0.1%	0.1%	0.2%

### b) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Fund holds securities with fixed interest rates that expose the Fund to fair value interest rate risk. The Fund also holds a limited amount of cash subject to variable interest rates which exposes the Fund to cash flow interest rate risk.

The Fund mitigates interest rate risk by monitoring interest rates and the maturities of its portfolio of interest-bearing financial instruments. The following table summarizes the Fund's exposure to interest rate risk. It includes the Fund's interest-bearing financial assets at fair value, categorized by the earlier of contractual interest rate reset dates or maturity dates. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the prevailing levels of market interest rates changed by 1%, assuming a parallel shift in the yield curve with all other variable held constant.

Terms to maturity	Total exposure	
	June 30, 2017 \$	December 31, 2016 \$
1-5 years	2,316,636	2,641,082
5-10 years	-	-
<b>Total</b>	<b>2,316,636</b>	<b>2,641,082</b>
<b>Impact on net assets attributable to holders of redeemable units</b>	<b>30,255</b>	<b>67,109</b>
<b>Impact on net assets attributable to holders of redeemable units %</b>	<b>0.1%</b>	<b>0.3%</b>

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

c) Price risk

Price risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment or its issuer, or by factors affecting all securities traded in the market. The Fund is exposed to price risk through its equity investment portfolio, which includes a variety of common shares in a wide range of industries. Other assets and liabilities are monetary items that are short term in nature, and as such are not subject to price risk.

As at June 30, 2017, the expected increase or decrease in net assets attributable to holders of redeemable units of the Fund if the S&P/TSX composite index had increased or decreased by 5%, with all other variables held constant would amount to \$1,123,996 and would represent 4.3% of the net assets attributable to holders of redeemable units of the Fund (December 31, 2016 – \$1,193,405 representing 4.9% of the net assets attributable to holders of redeemable units of the Fund).

### Concentration risk

Concentration risk arises as a result of the concentration of exposure within the same category, whether it is geographical location, product type, industry sector or counterparty type. The following is a summary of the Fund's concentration risk by market segment over the total investments market value:

<b>Market segment</b>	<b>June 30, 2017 %</b>	<b>Dec. 31, 2016 %</b>
Consumer discretionary	10.5	15.3
Consumer staples	3.4	2.4
Energy	21.8	23.3
Financials	18.6	23.0
Health care	0.7	2.2
Industrials	14.0	8.1
Information technology	5.9	5.1
Materials	12.9	11.8
Real estate	3.5	2.0
Utilities	8.7	6.8
<b>Asset class weighting</b>	<b>June 30, 2017 %</b>	<b>Dec. 31, 2016 %</b>
Convertible bonds	5.0	6.9
Corporate bonds	3.8	4.0
Common stock	88.4	83.6
Other net assets	2.8	5.5

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### Fair value measurement

The carrying amounts of subscriptions receivable, receivable from investments sold, accrued income receivable, payable for investments purchased, redemptions payable, distributions payable, accrued liabilities and management and performance fees payable approximate their fair values due to the short-term nature of these financial instruments.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: Valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	As at June 30, 2017			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Equities, long	23,116,621	-	-	23,116,621
Fixed income, long	1,318,132	998,504	-	2,316,636

	As at December 31, 2016			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Equities, long	20,361,483	-	-	20,361,483
Fixed income, long	1,672,704	968,378	-	2,641,082

All fair value measurements above are recurring. Fair values are classified as Level 1 when the related security or derivative is actively traded and a quoted price is available. If an instrument classified as Level 1 subsequently ceases to be actively traded, it is transferred out of Level 1. In such cases, the instruments are reclassified into Level 2, unless the measurement of its fair value requires the use of significant unobservable inputs, in which case it is classified as Level 3.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

a) Equities and convertible bonds

The Fund's equity and convertible bond positions are classified as Level 1 when the security is actively traded and a reliable price is observable. All equities and convertible bonds are classified as Level 1 investments.

b) Bonds and short-term investments

Corporate bonds are valued using models with inputs including interest rate curves, credit spreads and volatilities. The inputs that are significant to valuation are generally observable and therefore the Fund's bonds and short-term investments have been classified as Level 2.

There was no transfer between levels during the periods.

## 6 Gains and losses on financial instruments by category

All of the Fund's non-derivative financial assets were designated, at inception, financial assets at FVTPL. As at June 30, 2017, the total value of the non-derivative assets and liabilities was \$25,433,257 (December 31, 2016 – \$23,002,565). All of the Fund's derivative liabilities are classified as held for trading (HFT). As at June 30, 2017, the total value of the derivative liabilities was nil (December 31, 2016 – nil). Furthermore, all of the Fund's financial assets and financial liabilities other than its non-derivative financial assets and financial liabilities and its derivative liabilities were carried at amortized cost.

The following table presents the net gains (losses) on financial instruments at FVTPL by category for the periods ended June 30, 2017 and 2016:

Category	Net gain (loss)	
	2017 \$	2016 \$
<b>Financial assets at FVTPL designated at inception</b>		
Unrealized gain (loss)	(41,635)	467,802
Realized gain	383,064	665,343
<b>Total gain in financial assets at FVTPL designated at inception</b>	<b>341,429</b>	<b>1,133,145</b>
<b>Financial liabilities at FVTPL held for trading</b>		
Unrealized gain	-	-
Realized gain	-	-
<b>Total gain in financial liabilities at FVTPL held for trading</b>	<b>-</b>	<b>-</b>
<b>Total</b>	<b>341,429</b>	<b>1,133,145</b>

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### 7 Redeemable units

During the periods ended June 30, 2017 and 2016 the number of units issued, redeemed and outstanding were as follows:

	2017		2016	
	Series A	Series F	Series A	Series F
<b>Units outstanding - Beginning of period</b>	2,924,098	855,223	2,941,137	430,256
Redeemable units issued	112,352	518,308	108,309	299,398
Redeemable units issued on reinvestments	67,516	31,229	114,416	29,536
Redeemable units redeemed	(340,639)	(70,496)	(160,527)	(10,784)
<b>Units outstanding – End of period</b>	<b>2,763,327</b>	<b>1,334,264</b>	<b>3,003,335</b>	<b>748,406</b>

### Capital structure

Units issued and outstanding are considered to be the capital of the Fund. The Fund does not have any specific capital requirements.

The Fund is authorized to issue an unlimited number of redeemable unit series, as well as an unlimited number of redeemable units within each series. Each series unit enables its bearer to participate equally in the allocations the Fund completes for the given series. Unit fractions may also be issued.

The Fund is composed of more than one redeemable unit series; each redeemable unit series may feature different structures regarding management fees, performance fees and brokerage. As a result, each redeemable unit entitles its holder to one vote and to participate equally in the allocations the Fund completes and, in the case of Fund liquidation, in the allocation of the redeemable unit series' net assets attributable to holders of redeemable units after all current liabilities have been paid.

### 8 Related party transactions

a) Management fees and performance fees

The Manager provides management and advisory services to the Fund in accordance with the agreement. In return for these services, the Manager is paid a management fee and a performance fee. The Series A units of the Fund are subject to a monthly management fee equal to 1/12 of 1.5% of the net asset value of the Series A units. The Manager will pay a trailer fee of 0.75% out of the management fees collected from the Fund with respect to Series A units.

Series F is similar to Series A, but no trailer fee is included in the management fee. Series F charges a monthly management fee of 1/12 of 0.75% of the NAV of Series F.

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

Based on the agreement amended and restated on August 26, 2013, the performance fee is 20% of the amount by which the Fund outperforms its benchmark, the S&P/TSX Composite Index. Performance fees are calculated and accrued daily, and paid annually.

The total management fees and performance fees for the period ended June 30, 2017 amounted to \$185,015 and \$23,042 respectively (June 30, 2016 – \$163,852 and nil respectively), with \$23,041 in outstanding fees due to the Manager as at June 30, 2017 (December 31, 2016 – \$920).

The Manager may waive or absorb the operation of management fees of the Fund. The decision to do so is reviewed regularly and is determined at the sole discretion of the Manager. During the period, the Manager did not waive any fees (2016 – did not waive any fees).

During the period, the Manager sold all 30,654 of its units in the Fund (December 31, 2016 – the Manager held 30,654 units). As a result, as of June 30, 2017, the Manager no longer hold units of the Fund.

### b) Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the period ended June 30, 2017 amounted to \$5,951 (June 30, 2016 – \$5,951) and consisted only of fixed fees.

## 9 Brokerage commissions and soft dollars

The total commissions paid by the Fund to brokers in connection with portfolio transactions for the periods ended June 30, 2017 and 2016, together with other transaction charges, are disclosed in the statements of comprehensive income (loss) of the Fund. Brokerage business is allocated to brokers based on the best net result for the Fund. Subject to this criteria, preference may be given to brokerage firms which provide (or pay for) certain services (arrangements referred to as soft dollar), which may include investment research, analysis and reports, and databases or software in support of these services. The ascertainable soft dollar value received as a percentage of total brokerage commissions paid during the periods ended June 30, 2017 and 2016 is disclosed below.

	<b>2017</b>	<b>2016</b>
Soft dollars	\$3,643	\$3,373
Percentage of total transaction costs (%)	14%	8%

# Palos Equity Income Fund

## Notes to financial statements

As at June 30, 2017

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(expressed in Canadian dollars)

### 10 Increase in net assets attributable to holders of redeemable units per series per unit

The increase in net assets attributable to holders of redeemable units per series per unit for the periods ended June 30, 2017 and 2016 is calculated as follows:

	2017		2016	
	Series A \$	Series F \$	Series A \$	Series F \$
Increase in net assets attributable to holders of redeemable units per series	285,053	82,995	921,082	229,760
Weighted average units outstanding during the period	2,847,314	1,104,346	2,970,204	560,419
Increase in net assets attributable to holders of redeemable units per series per unit	0.10	0.08	0.31	0.41

### 11 Taxes

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada).

All or substantially all of the net income for tax purposes and net taxable capital gains realized in any period, after use of loss carryforwards, are distributed to unitholders such that no income taxes are payable by the Fund.

Capital and non-capital losses determined for tax purposes as at December 31, 2016 are as 0.