



**PERSONAL & CONFIDENTIAL**

Dear Investor,

**Montreal, July 03, 2007** – Palos Income Trust Fund, L.P. For the quarter ended June 30, 2007, the Fund generated a positive return of 9.9% as opposed to 8.7% for the S&P TSX Income Trust Total Return Index. Please note that the Fund recorded its second best performing quarter since inception. The Fund has consistently created alpha through excellent stock-picking and strategic sector allocation. As such the Fund outperformed the benchmark by 5.8% for the past six month period.

**Real Estate Investment Trusts (REITs)**

The REIT index declined 1.9% during the second quarter. M&A activity cooled because Cap Rates expanded under rising interest rates. REIT's have now become more attractive from a risk/return standpoint and accordingly management is closely monitoring the sector for entry opportunities.

**Energy Trusts & Exploration & Producers (E&P's)**

The Canadian Energy Trust Index was extremely strong during the quarter, rising 10.0% and the price of oil increase by 7.3% from \$65.87 to \$70.68. Volatility within the sector was concentrated in the natural gas producers and energy services companies. Natural gas prices were volatile due to weather and record stockpiles of natural gas. The decision to shift the portfolio from natural gas producers to oil weighted producers at the beginning of the year proved to be timely. From a risk/return perspective, the oil sector is very attractive. Hence Palos increased its energy exposure by taking a large position in Enerplus Resources Fund.

Stock picking in the E&P's and energy services sector proved to be rewarding. Our core positions Petro-Canada, and CCS Income Trust appreciated by 26.0% and 26.7% respectively for the period under review. CCS Income Trust, agreed to be taken private by its management and a group of private equity firms led by Goldman Sachs. M&A activity is expected to increase in the energy service sector as many issues are trading at attractive multiples. Management is also monitoring this sector for trading opportunities.

**Utility Trusts**

The fund did not change it's exposure to the utility sector, as utility trusts offered attractive yields around 9.5%. Comparatively, the S&P U.S. Utility Index yields 3.0% and the S&P Canadian Utility Index yields 4.4%.

Stock picking in the utility trust sector also proved to be successful. For example, Northland Power Income Fund, a core position appreciated by 11.6% for the period.





**Business Trusts & Dividend Paying Stock**

Moreover the fund was successful in picking the right business trusts and dividend paying stocks. For example, three of our core positions Cineplex Galaxy, Telus Corporation and Gateway Casino Income Fund, appreciated by 14.1%, 8.9% and 28.9% respectively for the period. Gateway Casino Income Trust, agreed to be taken private by New World Gaming Partners. Management anticipates M&A activity to remain high within the sector as smaller trusts are still trading at very attractive multiples and in turn trading opportunities can be anticipated.

The fund has generated the following monthly net returns since inception:

**Monthly Performance Net of All Fees (Since Inception)**

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Year
<b>2007</b>	2.47%	2.56%	0.40%	5.88%	4.70%	-0.87							15.94%
<b>2006</b>	5.09%	-0.27%	1.04%	0.76%	-1.18%	-1.90%	2.43%	1.78%	-0.73%	2.52%	-11.46%	3.36%	0.42%
<b>2005</b>	4.68%	1.97%	1.18%	-5.07%	2.22%	2.93%	5.01%	1.51%	0.74%	-9.52%	7.41%	2.72%	15.65%
<b>2004</b>	2.99%	4.95%	0.59%	-6.66%	0.24%	3.12%	2.58%	1.83%	3.57%	1.04%	3.86%	2.83%	22.48%
<b>2003</b>	3.04%	0.90%	-0.98%	4.16%	1.32%	3.08%	2.82%	4.80%	-1.37%	2.45%	3.35%	4.97%	32.29%
<b>2002</b>	2.07%	5.40%	3.39%	-3.97%	3.63%	3.48%	-2.47%	1.51%	3.37%	-0.37%	-4.12%	4.28%	16.76%
<b>2001</b>									0.24%	0.21%	2.31%	5.50%	8.43% <sup>(1)</sup>

(1) Does not include full year.

Best regards,

Charles Marleau  
*Head Trader*

