



PERSONAL & CONFIDENTIAL

Dear Investor,

Montreal, October 03, 2007 – Palos Income Trust Fund, L.P. For the quarter ended September 30, 2007, the Fund generated a negative return of 0.80% as opposed to 1.72% for the S&P TSX Income Trust Total Return Index. The Fund consistently created alpha by successfully implementing trading strategies and prudently selecting defensive sectors. Consequently, the Fund outperformed the benchmark by 6.7% for the past nine-month period.

Real Estate Investment Trusts (REITs)

The REIT index rose 0.22% during the second quarter. REIT's have now become attractive from a risk/return perspective and, accordingly, management has added RioCan Real Estate Investment Trust to the portfolio. The RioCan assets are diversified into retail, office, industrial, and recreational properties. Management will continue to monitor the sector for further opportunities at attractive valuations.

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

The Canadian Energy Trust Index was weak during the quarter, effectively declining by 2.94%. However, the price of oil increased by 15.53% from \$70.68 to \$81.66. The rise in oil price was due to a weakening US dollar and larger than expected draw in inventory supply. Palos increased its position in Arc Energy Trust to boost its exposure to record-breaking oil price.

Sector volatility was concentrated with natural gas producers and energy services companies. Natural gas prices were volatile due to abnormal weather conditions and unprecedented large stockpiles. However, there has been some consolidation activity in the natural gas sector. Sound Energy Trust, Vault Energy Trust, and PrimeWest Energy Trust have all been acquired. Palos believes further consolidation in the natural gas sector will continue. Consequently, Palos increased its exposure to the commodity sector by taking a trading position in Paramount Resources Fund.

At the beginning of the quarter, the 3:2:1 crack spread experienced a reversal of trend. Management liquidated all investment positions exposed to midstream-assets. This decision proved fruitful because Petro-Canada and Harvest Energy Trust declined by 6.33% and 21.40% respectively for the period under review.

Utility Trusts

The fund did not alter its positions in the utility sector, because utility trusts offered very attractive yields of approximately 9.5%.

Business Trusts & Dividend Paying Stock

Moreover, the fund judiciously selected defensive business trusts and dividend paying stocks. For example, three of our core defensive positions: Shoppers Drug Mart Corporation, Liquor Stores Income Fund and Altus Group Income Fund appreciated by 10.67%, 13.99% and 5.94% respectively for the period under review. These defensive positions compensated for the negative effect that the sub-prime sell-off had on the overall stock market at large.





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
2007	2.47%	2.56%	0.40%	5.88%	4.70%	-0.87%	-0.91%	-2.46%	2.60%				14.98%
2006	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%
2005	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%
2004	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%
2003	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%
2002	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%
2001									0.24%	0.21%	2.31%	5.50%	8.43% ⁽¹⁾

(1) Does not include full year.

Best regards,

Charles Marleau
Head Trader

