

Palos Equity Income Fund
Interim Financial Statements
(Unaudited)
For the six-month period ended June 30, 2011

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Contents

Financial Statements

Statement of Net Assets	2
Statement of Operations	3
Statement of Changes in Net Assets	4
Statement of Cash Flows	5
Statement of Investments	6
Summary of Significant Accounting Policies	9
Notes to Financial Statements	12

Palos Equity Income Fund Statement of Net Assets

As at June 30, 2011 (Unaudited) and December 31, 2010 (Audited)

	June 30, 2011	December 31, 2010
Assets		
Investments, at fair value	\$ 12,781,120	\$ 10,487,615
Cash	996,021	203,065
Subscriptions receivable	66,914	2,485
Accrued income receivable	53,623	45,298
Other receivables	44,844	34,551
	13,942,522	10,773,014
Liabilities		
Securities sold short, at fair value	485,272	-
Accounts payable and accrued liabilities (Note 2)	126,606	10,350
Redemptions payable	-	11,265
Distributions payable	34,336	29,714
	646,214	51,329
Net Assets representing Unitholders' equity	\$ 13,296,308	\$ 10,721,685
Units outstanding (Note 5)	1,602,313	1,238,901
Net Asset Value per Unit (Note 3)	\$ 8.30	\$ 8.65

On behalf of the Manager, Palos Management Inc.

(s) Charles Marleau Director of Palos Management Inc.

(s) Robert Boisjoli Director of Palos Management Inc.

Palos Equity Income Fund Statement of Operations

For the six-month period ended June 30 (Unaudited)

	2011	2010
Income		
Dividends	\$ 166,951	\$ 69,207
Interest	56,330	18,279
Income from income trust units	-	93,187
	223,281	180,673
Expenses		
Management fees (Note 2)	103,973	60,937
Performance fees (Note 2)	84,797	-
Administration and other professional fees	62,344	2,418
Trustee's fees	17,600	-
Audit fees	10,000	6,910
Interest and bank charges	1,607	155
Legal fees	1,240	750
	281,561	71,170
Net investment (loss) income	(58,280)	109,503
Realized and unrealized gains (losses) on investments		
Net realized gain on sale of investments	248,636	128,385
Transaction costs	(15,445)	(4,478)
Change in unrealized depreciation in value of investments	(138,004)	(109,762)
Net realized loss on foreign exchange	(773)	-
Unrealized foreign exchange loss	(2,339)	-
	92,075	14,145
Net gain on investments	92,075	14,145
Increase in net assets from operations	\$ 33,795	\$ 123,648
Increase in net assets from operations per unit	\$ 0.03	\$ 0.12

Palos Equity Income Fund Statement of Changes in Net Assets

For the six-month period ended June 30 (Unaudited)

	2011	2010
Net Assets , beginning of period	\$ 10,721,685	\$ 6,687,227
Increase in net assets from operations	33,795	123,648
Capital transactions	10,755,480	6,810,875
Unit transactions		
Proceeds from issuance of Fund units	3,726,208	1,812,374
Reinvested distributions	508,243	353,180
Payments on redemptions	(1,121,324)	(78,613)
	3,113,127	2,086,941
Distributions to Unitholders		
Net investment income	-	(103,148)
Realized gain on sale of investments	(232,418)	-
Return of capital	(339,881)	(299,396)
	(572,299)	(402,544)
Net Assets , end of period	\$ 13,296,308	\$ 8,495,272

Palos Equity Income Fund Statement of Cash Flows

For the six-month period ended June 30 (Unaudited)

	2011	2010
Operating activities		
Increase in net assets from operations	\$ 33,795	\$ 123,648
Adjustments to reconcile to operating cash flows		
Proceeds from investments sold	8,273,108	1,887,528
Purchase of investments	(9,970,709)	(3,550,726)
Net realized gain on sale of investments	(248,636)	(128,385)
Change in unrealized depreciation in value of investments	138,004	109,762
	(1,808,233)	(1,681,821)
Changes in non-cash working capital balances		
Accrued income receivable	(8,325)	(1,169)
Subscriptions receivable	(64,429)	-
Other receivables	(10,293)	(5,672)
Accounts payable and accrued liabilities	116,256	(7,772)
Redemptions payable	(11,265)	(11,241)
Distributions payable	4,622	(21,188)
	26,566	(47,042)
Cash flow used in operating activities	(1,747,872)	(1,605,215)
Financing activities		
Proceeds from issuance of Fund units	3,726,208	1,812,374
Payment on redemptions	(1,121,324)	(78,613)
Distributions paid to Unitholders	(64,056)	(49,364)
Cash flows from financing activities	2,540,828	1,684,397
Increase in cash during the period	792,956	79,182
Cash, beginning of period	203,065	123,868
Cash, end of period	\$ 996,021	\$ 203,050

Palos Equity Income Fund Statement of Investments

As at June 30, 2011 (Unaudited)

Par Value / Quantity	Description	Average Cost	Fair Value
CONVERTIBLE BONDS			
100,000	Aecon Group Inc 7% 9/30/2014	\$ 100,000	\$ 101,750
100,000	Altus Group Ltd 5.75% 12/31/2017	100,000	97,100
50,000	Angle Energy Inc 5.75% 1/31/2016	50,000	53,000
70,000	Bellatrix Exploration Ltd 4.75% 4/30/2015	70,000	73,850
50,000	Boralex Inc 6.75% 6/30/2017	50,000	51,125
44,000	CanWel Holdings Corporation 5.85% 4/30/2017	43,036	42,394
90,000	InnVest Real Estate Investment Trust 6% 9/30/2017	90,861	91,665
100,000	Just Energy Group Inc 6% 6/30/2017	100,188	99,550
45,000	NAL Energy Corp 6.25% 12/31/2014	45,000	46,350
60,000	Neo Material Technologies Inc 5% 12/31/2017	58,758	57,858
40,000	Parex Resources Inc 5.25% 6/30/2016	40,000	40,000
50,000	Pembina Pipeline Corporation 5.75% 11/30/2020	50,000	51,625
70,000	Progress Energy Resources Corp 5.75% 6/30/2016	70,000	71,925
100,000	Provident Energy Ltd 5.75% 12/31/2017	100,000	100,220
50,000	Provident Energy Ltd 5.75% 12/31/2018	50,000	49,750
50,000	Student Transportation Inc 6.25% 6/30/2018	48,675	46,286
		<u>1,066,518</u>	<u>1,074,448</u>
CORPORATE BONDS & OTHER BONDS			
70,000	Connacher Oil and Gas Limited 8.75% 8/1/2018	70,000	70,000
50,000	Fédération des Caisses Desjardins du Québec 5.541% 6/1/2021	50,000	53,819
70,000	Flint Energy Services Ltd 7.50% 6/15/2019	69,300	69,300
50,000	Manulife Financial Corp 7.405% 12/31/2108	50,000	57,397
60,000	Perpetual Energy Inc 8.75% 3/15/2018	60,000	60,731
100,000	SkyLink Aviation Inc 12.25% 3/15/2016	100,000	100,000
50,000	Sun Life Capital Trust II 5.863% 12/31/2108	50,000	53,042
70,000	Trident Exploration Corp 8.25% 4/13/2018	70,000	69,388
		<u>519,300</u>	<u>533,677</u>
PREFERRED SHARES			
2,000	BCE 4.15% Ser AK	50,000	50,000
2,000	Bell Aliant Inc 4.85% Ser A	50,000	50,000
1,900	Brookfield Properties Corp 6.75% Ser L	47,784	50,065
2,000	First National Financial 4.65% Ser 1	50,000	45,500
3,000	GMP Capital Inc 5.50% Ser B	75,000	73,950
3,000	Innergex Renewable Energy 5% Ser A	75,000	73,740
3,000	RONA Inc 5.25% Ser 6	75,000	75,000
		<u>422,784</u>	<u>418,255</u>
COMMON STOCK			
Consumer Discretionary			
5,470	Magna International Inc	267,617	284,714
9,572	Cineplex Inc	201,080	254,615
		<u>468,697</u>	<u>539,329</u>
Consumer Staples			
3,070	The Coca-Cola Company	175,618	199,176
3,250	Philip Morris International Inc	176,406	209,161
		<u>352,024</u>	<u>408,337</u>

Palos Equity Income Fund Statement of Investments

As at June 30, 2011 (Unaudited)

Par Value / Quantity	Description	Average Cost	Fair Value
Energy			
13,083	ARC Resources Ltd	\$ 291,013	\$ 326,683
6,857	Baytex Energy Corp	293,140	359,444
12,712	Bonavista Energy Corp	302,704	361,402
4,500	Cameco Corp	121,280	114,210
5,667	Canadian Oil Sands Ltd	175,686	157,429
19,300	Canyon Services Group Inc	241,553	256,883
4,558	Genovus Energy Inc	142,345	165,501
3,599	Crescent Point Energy	160,351	160,407
33,614	Daylight Energy Ltd	325,938	312,946
13,940	Enbridge Inc	388,825	436,322
10,000	Gibson Energy Inc	160,000	160,400
3,264	iShares S&P/TSX Capped Energy Fund	64,055	64,497
8,793	Keyera Corp	282,512	384,166
11,830	NAL Energy Corp	148,006	130,367
2,230	Penn West Petroleum Ltd	50,126	49,551
8,711	Suncor Energy Inc	335,054	328,230
5,715	Vermilion Energy Inc	227,720	290,665
		<u>3,710,308</u>	<u>4,059,103</u>
Financials			
12,965	Altus Group Ltd	166,984	92,181
7,275	Bank of Nova Scotia	392,023	422,605
7,507	Boardwalk Real Estate Investment Trust	316,929	361,837
7,228	Brookfield Office Properties Canada	159,023	160,606
7,909	Calloway Real Estate Investment Trust	192,803	198,911
2,000	Intact Financial Corp - Subscription Receipt	95,600	109,300
3,439	National Bank of Canada	185,810	268,620
3,095	Power Corp of Canada	80,532	82,977
11,753	RioCan Real Estate Investment Trust	225,071	303,933
6,161	Royal Bank of Canada	292,046	339,073
4,955	Toronto-Dominion Bank	397,320	405,071
		<u>2,504,141</u>	<u>2,745,114</u>
Industrials			
1,000	Canadian Pacific Railway Ltd	59,400	60,050
3,593	Emerson Electric Co	165,087	194,822
11,289	Morneau Shepell Inc	107,135	113,342
16,733	Progressive Waste Solutions Ltd	386,959	401,592
5,514	SNC-Lavalin Group Inc	268,346	324,223
		<u>986,927</u>	<u>1,094,029</u>
Materials			
1,700	Agrium Inc	152,015	143,735
2,800	Barrick Gold Corp	122,836	122,276
2,000	Domtar Corp	169,501	181,540
2,700	Fortress Paper Ltd	159,258	98,307
18,268	Kinross Gold Corp	339,620	277,674
15,000	Primero Mining Corp	51,700	47,550
6,245	Teck Resources Ltd	249,694	305,068
		<u>1,244,624</u>	<u>1,176,150</u>

Palos Equity Income Fund Statement of Investments

As at June 30, 2011 (Unaudited)

Par Value / Quantity	Description	Average Cost	Fair Value
	Telecommunication Services		
8,160	Telus Corporation	\$ 383,793	\$ 432,970
		<u>383,793</u>	<u>432,970</u>
	Utilities		
18,627	Northland Power Inc	291,432	299,708
		<u>291,432</u>	<u>299,708</u>
	Total - Long Position	<u>11,950,548</u>	<u>12,781,120</u>
	Energy		
(2,500)	Peyto Exploration & Development Corporation	(49,750)	(53,875)
(1,165)	TransCanada Corp	(49,767)	(49,349)
		<u>(99,517)</u>	<u>(103,224)</u>
	Financials		
(2,000)	Intact Financial Corp	(106,317)	(111,034)
(4,700)	iShares S&P/TSX Capped REIT Index Fund	(69,296)	(70,312)
(2,750)	Power Financial Corp	(80,362)	(81,950)
		<u>(255,975)</u>	<u>(263,296)</u>
	Industrials		
(850)	Canadian National Railway Co	(59,400)	(65,569)
		<u>(59,400)</u>	<u>(65,569)</u>
	Materials		
(1,600)	Market Vectors Junior Gold Miners ETF	(50,772)	(53,183)
		<u>(50,772)</u>	<u>(53,183)</u>
	Total - Short Position	<u>(465,664)</u>	<u>(485,272)</u>
	Total Investments	<u>\$ 11,484,884</u>	<u>\$ 12,295,848</u>

Palos Equity Income Fund

Summary of Significant Accounting Policies

June 30, 2011 (Unaudited)

Status and Nature of Operations

Palos Equity Income Fund (the "Fund") was formed on January 3, 2008, under the laws of Quebec pursuant to a trust agreement (the "Agreement") made between Hubert Marleau (the "Trustee") and Charles Marleau (the "Settlor"). Effective November 24, 2010, following the receipt of the necessary approvals from the Unitholders of the Fund, the Trust Agreement was amended and restated (the "Amended and Restated Trust Agreement"). Effective January 7, 2011, the Trustee was changed to BNY Trust Company of Canada. Effective September 1, 2011, the Trustee will change to Computershare Trust Company of Canada. The Fund is an open-ended mutual fund qualified as a unit trust and is registered as a registered investment under section 204.4 of the Income Tax Act.

The Fund shall act as an investment holding unit trust for benefit of the Unitholders by acquiring, investing in, holding, transferring, disposing of, or otherwise dealing with such investments as Trustee and the investment fund manager may, in their discretion, determine in accordance with investment objectives of the Fund.

The investment fund manager and portfolio advisor is Palos Management Inc. (the "Manager"). The Fund shall continue its activities until its dissolution in accordance with terms of the Amended and Restated Trust Agreement.

Valuation of Investments

In accordance with Accounting Guideline 18 - Investment Companies, the Fund's investments are deemed to be categorized as held-for-trading, and are recorded at fair value as defined by CICA Handbook Section 3855, Financial Instruments - Recognition and Measurement ("Section 3855"). The net assets of the Fund for financial reporting purposes ("Net Assets") are calculated in accordance with Section 3855.

The Fund records its investments at fair value. The difference between the fair value and the cost of the investments held is shown as change in unrealized appreciation (depreciation) in value of investments.

The fair value of investments is determined as follows:

- (i) Securities listed on a recognized public stock exchange are valued at their closing bid/ask price on valuation date.
- (ii) Bonds are valued at closing price as reported by a recognized investment dealer.

The Fund calculates its daily Net Asset Value for the purchase and redemption of units ("Transactional Net Asset Value") based on the fair value of the investment Fund's assets and liabilities (being the last traded price for the day). The net asset value is compared to the transactional net asset value and is disclosed in Note 3.

Financial Instruments

The Fund's financial instruments consist of investments, cash, subscriptions receivable, accrued income receivable, other receivables, securities sold short, accounts payable and distributions payable.

The Fund classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired. The Fund's accounting policy for each category is as follows:

Held-for-trading

Financial instruments classified as held-for-trading are carried in the statement of net assets at fair value with changes in fair value recognized in the statement of operations. Transaction costs related to instruments classified as held-for-trading are expensed as incurred. Investments, cash and securities sold short are classified as held-for-trading.

Palos Equity Income Fund Summary of Significant Accounting Policies

June 30, 2011 (Unaudited)

Financial Instruments (Continued)

Loans and Receivables

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. They arise principally through the investment in income bearing investments, but also incorporate other types of contractual monetary assets. They are initially recognized at fair value and subsequently carried at amortized cost, using the effective interest rate method, less any provision for impairment. Transaction costs related to loans and receivables are expensed as incurred. Subscriptions receivable, accrued income receivable, and other receivables are classified as loans and receivables.

Other Financial Liabilities

Other financial liabilities include all financial liabilities other than those classified as held-for-trading, and comprise trade payables and other short-term monetary liabilities. These liabilities are initially recognized at fair value and subsequently carried at amortized cost using the effective interest rate method. Transaction costs related to other financial liabilities are expensed as incurred. Accounts payable and distributions payable are classified as other financial liabilities.

Investment Transactions and Income Recognition

Investment transactions are accounted for on a trade-date basis. Dividends are recorded on the ex-dividend date. Interest is recorded on an accrual basis. Gains or losses arising from the sale of investments and unrealized appreciation or depreciation in value of investments are determined on an average-cost basis.

Distributions received from investments are recorded as income, dividends or capital gains, based on the best information available to management. Due to the nature of these investments, actual allocations could vary from this information. Distributions which represent return of capital reduce the cost base of the investment.

Net Asset Value per Unit

Net asset value per unit is calculated as the value of the Fund's assets less its liabilities divided by the number of units outstanding at the end of the period.

Increase (Decrease) in Net Assets From Operations Per Unit

Increase (decrease) in net assets from operations per unit is based upon the increase (decrease) in net assets from operations for the period divided by the weighted average number of units outstanding for the period.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the period reported. Actual results could differ from those estimates.

Foreign Currency Translation

The fair value of investments and other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the end of the period.

Purchases and sales of investments and investment income denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the respective dates of the transactions.

Realized and unrealized foreign exchange gains (losses) are included in the statement of operations.

Palos Equity Income Fund Summary of Significant Accounting Policies

June 30, 2011 (Unaudited)

New Accounting Pronouncement

A recent accounting pronouncement that has been issued but is not yet effective, and has a potential implication for the Fund, is as follows:

International Financial Reporting Standards

In September 2010, the Canadian Accounting Standards Board approved a one period deferral of the effective date for the changeover to IFRS for investment funds from January 1, 2011 to January 1, 2012. In January 2011, an additional one period extension to the option deferral was approved. Investment funds will now be required to mandatorily adopt IFRS for interim and annual financial statements relating to annual periods beginning on or after January 1, 2013.

Based on the Manager's current evaluation of the differences between Canadian GAAP and IFRS, the Manager does not expect that net assets attributable to Unitholders or net asset value per unit will be impacted by the changeover to IFRS. Currently, the Manager expects that the impact of IFRS on the Fund's financial statements will result in additional disclosures and potentially different presentation of Unitholders interests and certain other items.

Palos Equity Income Fund

Notes to Financial Statements

June 30, 2011 (Unaudited)

1. Change in Accounting Policy

On January 1, 2011, the Fund has adopted the following new Handbook section issued by the CICA:

Handbook Section 3855, Financial Instruments - Recognition and Measurement has been amended to clarify application of the effective interest rate method after a debt instrument has been impaired. The amendment also clarifies when an embedded prepayment option is separated from its host debt instrument for accounting purposes. The adoption of this new standard did not have any material impact on the financial statements.

2. Management Fees and Expenses

Palos Management Inc., the Manager, provides management and advisory services to the Fund in accordance with a Trust Agreement. In return for these services, Palos Management Inc. is paid a management fee and a performance fee. The management fee is calculated as 1/12 of 1.5% of the Net Asset Value of the Series A, payable monthly.

Until November 23, 2010, the performance fee was calculated as 1/12 of 20% of the monthly realized rate minus the hurdle rate multiplied by the book value of the fund at the end of the previous month. The monthly realized rate and hurdle rate are terms that are defined in subsection 1.01 (t) and 1.01 (o) of the Trust Agreement dated January 31, 2008 governing the Fund. Based on the amended and restated Trust Agreement dated November 24, 2010, the performance fee is 20% of the amount by which the fund outperforms its benchmark, the S&P/TSX Composite Index. Any performance fees will be calculated and accrued daily, and paid quarterly.

The management fee for the period ended June 30, 2011 was \$103,973 (June 30, 2010 - \$60,937). The performance fee for the period ended June 30, 2011 was \$84,797 (June 30, 2010 - \$Nil). These transactions are in the normal course of operations and are measured at the exchange value which is the amount of consideration established and agreed to by the related parties.

As at June 30, 2011, the accounts payable and accrued liabilities include \$100,550 (December 31, 2010 - \$Nil) payable to Palos Management Inc.

In addition to management and performance fees, the Fund is responsible for payment of all expenses relating to the operations and the carrying on of its business.

3. Reconciliation of transactional Net Asset Value to Net Asset Value per GAAP

As at June 30, 2011:

		Per Unit
Published net asset value for purchases and redemptions	\$ 13,320,972	\$ 8.31
Section 3855 adjustment	(24,664)	(0.01)
Net assets per financial statements	<u>\$ 13,296,308</u>	<u>\$ 8.30</u>

As at December 31, 2010:

		Per Unit
Published net asset value for purchases and redemptions	\$ 10,740,290	\$ 8.67
Section 3855 adjustment	(18,605)	(0.02)
Net assets per financial statements	<u>\$ 10,721,685</u>	<u>\$ 8.65</u>

Palos Equity Income Fund

Notes to Financial Statements

June 30, 2011 (Unaudited)

4. Financial Instruments

Fair Value

Subscriptions receivable, accrued income receivable, other receivables, accounts payable, redemptions payable and distributions payable carrying amounts approximate fair values due to their short-term nature.

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: fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: fair value measurements are those derived from 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);
- Level 3: fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Investments at fair value as at June 30, 2011:

	Level 1	Level 2	Level 3	Total
Equities, long	\$ 11,172,995	\$ -	\$ -	\$ 11,172,995
Fixed-income, long	-	1,608,125	-	1,608,125
Equities, short	(485,272)	-	-	(485,272)
	<u>\$ 10,687,723</u>	<u>\$ 1,608,125</u>	<u>\$ -</u>	<u>\$ 12,295,848</u>

Investments at fair value as at December 31, 2010:

	Level 1	Level 2	Level 3	Total
Equities, long	\$ 8,774,881	\$ -	\$ -	\$ 8,774,881
Fixed-income, long	-	1,712,734	-	1,712,734
	<u>\$ 8,774,881</u>	<u>\$ 1,712,734</u>	<u>\$ -</u>	<u>\$ 10,487,615</u>

During the period, there were no transfers of financial instruments between the levels.

Management of Financial Risk

The Fund's investment activities expose it to a variety of financial risks: credit risk, liquidity risk and market risk (including other price, foreign exchange and interest rate risk). The Fund endeavors to mitigate the specific risks through the policies and analysis tools as described below.

Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or meet contractual commitments that it has entered into with the Fund.

Financial instruments that potentially subject the Fund to credit risk consist of investments, cash, accrued income receivable and other receivables.

Palos Equity Income Fund

Notes to Financial Statements

June 30, 2011 (Unaudited)

4. Financial Instruments (Continued)

The Fund's main credit risk concentration is spread among fixed-income securities. To maximize the credit quality of its investments, the Manager performs ongoing credit evaluations based on factors relating to the credit risk of investments, historical trends and other information.

Generally, the greater the credit rating of a security, the lower the probability of it defaulting on its obligations. Ratings for securities that subject the portfolio to credit risk are noted below:

Credit Risk Rating	June 30, 2011 % of total fixed income	December 31, 2010 % of total fixed income
A	10.2%	9.4%
BB	8.7%	0.0%
B	8.1%	0.0%
N/R	73.0%	90.6%
Total	100.0%	100.0%

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 high credit quality institutions. 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 noted above and presented on the statement of net assets. The Fund does not anticipate any losses for non-performances of counterparties. There have been no significant changes in the way the Fund manages its exposure to credit risk since the previous period.

Liquidity Risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. Financial liabilities that potentially subject the Fund to liquidity risk consist of accounts payable and distributions payable. The Fund holds primarily equity investments with high volume, liquid trading and therefore are readily saleable to meet liquidity needs.

The contractual terms to maturity of the financial liabilities of the Fund at June 30, 2011 are all less than 6 months (December 31, 2010 - all less than 6 months).

There have been no significant changes to the way the Fund manages its exposure to liquidity risk since the previous period.

Market Risk

Market risk arises from changes in market prices and rates (including equity prices, interest rates, and foreign exchange rates), the correlations among them, and their level of volatility.

The Fund monitors the portfolio market risk exposure for all securities on a regular basis using a rolling 12-month Value-at-Risk (VaR) test, which determines the amount of the portfolio at risk as at a given date based on historical performance of the investments held. VaR is a statistical measure that estimates the potential loss in value of the Fund's equity positions due to adverse market movements over a defined time horizon with a specified confidence level.

To complement VaR, the Fund also 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 Fund's capital can absorb potential losses from abnormal events.

Other Price Risk (Market Risk)

Other 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 other price risk through its equity investment portfolio, which includes a variety of common and preferred shares in a wide range of industries.

Palos Equity Income Fund

Notes to Financial Statements

June 30, 2011 (Unaudited)

4. Financial Instruments (Continued)

In addition to measuring VaR, the Fund mitigates the risk of individual investments by diversifying its portfolio to include investments that have low correlations with other investments.

As at June 30, 2011, the one-day VaR of the portfolio due to other price risk, using a 95% confidence level and other specific inputs, was \$92,000 (December 31, 2010 - \$87,000).

Foreign Currency Risk (Market Risk)

The Fund is exposed to foreign currency translation risk due to investments and cash denominated in U.S. dollars. The Fund may choose to be temporarily exposed or hedged against foreign currency.

In addition to measuring VaR, the Fund mitigate foreign currency risk by investing in foreign currency exchange traded funds. The Fund regularly monitors the volatility of the foreign currency to which it is exposed. As at June 30, 2011, the one day VaR of the portfolio due to foreign currency risk, using a 95% confidence level and other specific inputs, was \$6,000 (December 31, 2010 - \$5,000).

Interest Rate Risk (Market Risk)

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments. Interest rate risk arises when the Fund invests in interest-bearing financial instruments. The Fund is exposed to the risk that the value of such financial instruments will fluctuate because of changes in the prevailing levels of market interest rates.

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.

As at June 30, 2011:

	Less Than One Year	1 to 5 Years	5 to 10 Years	Greater Than 10 Years	Total
Financial assets held-for-trading	\$ -	\$ 486,875	\$ 1,010,810	\$ 110,440	\$ 1,608,125

As at December 31, 2010:

	Less Than One Year	1 to 5 Years	5 to 10 Years	Greater Than 10 Years	Total
Financial assets held-for-trading	\$ -	\$ 828,892	\$ 671,869	\$ 211,973	\$ 1,712,734

As at June 30, 2011, had prevailing rates increased or decreased by 1%, assuming a parallel shift in the yield curve, with all other variables held constant, the Net Assets would have decreased or increased by \$86,000 (December 31, 2010 - \$73,000). In practice, actual results may differ from this sensitivity analysis and the difference could be material.

There have been no significant changes in the way the Fund manages its exposure to market risks since the previous period.

Palos Equity Income Fund

Notes to Financial Statements

June 30, 2011 (Unaudited)

5. Unitholders' Equity

The Fund considers its capital to consist of the net assets attributable to Unitholders.

The Manager manages the capital of the Fund in accordance with the Fund's investment objectives, policies and restrictions, as outlined in the Trust Agreement, while maintaining sufficient liquidity to meet Unitholder distributions and redemptions. The Fund's primary objectives are to provide long-term growth, an attractive and steady stream of income, and deliver trade-enhanced returns.

The Fund employs qualitative, quantitative and comparative research to manage a portfolio of select high-grade and undervalued dividend-paying and income-paying securities. The Fund takes both long and short positions and employs market and statistical arbitrage techniques to maximize returns.

The Fund is permitted to issue an unlimited number of Fund units issuable in one or more Series as determined by the Trustee. Each Series has a proportionate share in the assets and property of the Fund less that Series' proportionate share of the Fund's common liabilities and less any specific liabilities of that Series. As at June 30, 2011, only Series A units have been issued by the Fund.

There has been no change during the period in the description of what the Fund manages as capital, nor in its objectives, policies and processes for managing its capital.

The numbers of Fund units issued, redeemed and outstanding as at June 30, 2011 and December 31, 2010 are summarized as follows:

	June 2011	December 2010
Units outstanding, beginning of period	1,238,901	822,383
Units issued from subscriptions	431,575	339,233
Reinvested distributions	59,684	90,840
Units redeemed	(127,847)	(13,555)
	<hr/>	<hr/>
Units outstanding, end of period	1,602,313	1,238,901

6. Income 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, after utilization of loss carryforwards, in any year are distributed to unitholders such that no income taxes are payable by the Fund.

7. Subsequent Event

On July 15, 2011 and effective as of September 1, 2011, the Trustee was changed to Computershare Trust Company of Canada.

8. Comparative Figures

Certain comparative figures have been reclassified to conform with the current period's presentation.
