



**Annual Information Form  
dated February 24, 2012**

**Palos Equity Income Fund (Series A and F)**

No securities regulatory authority has expressed an opinion about these units and it is an offence to claim otherwise.

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## Name, formation and history of the Fund

In this document, we use the following terms:

- **We, us, our**, the **Manager, Portfolio Advisor** and **Palos** refer to Palos Management Inc.;
- **You** refers to an individual investor and everyone who invests or may invest in the Fund;
- **Fund** refers to the Palos Equity Income Fund, the units of which are being offered by us under the simplified prospectus relating to this annual information form;
- **Trustee** refers to Computershare Trust Company of Canada;
- **Unitholders** refer to unitholders of the Fund;
- **Dealer** refers to both the dealer and the registered representative in your province who advises you on your investments, or the dealer that trades on the securities of Fund pursuant to your instructions.

The Fund is a mutual fund trust established under the laws of Québec pursuant to and governed by an amended and restated trust agreement dated as of November 24, 2010, as further amended and restated on January 7, 2011, and as further amended and restated on July 15, 2011, and as further amended on February 24, 2012 (the “Trust Agreement”). The Fund was initially settled as a unit trust pursuant to a trust agreement dated January 3, 2008 (the “Original Trust Agreement”). Prior to February 18, 2011 and commencing on January 3, 2008, the Fund was a private mutual fund which distributed its securities on a private placement basis. Effective November 24, 2010, the Unitholders of the Fund approved the amendment and restatement of the Original Trust Agreement which included, among other things, (i) the replacement of the original trustee, Mr. Hubert Marleau, by Palos Corporate Services Inc.; and (ii) the exchange, on a one to one basis effective November 24, 2010, of all of the issued and outstanding units of the Fund that had been authorized and issued pursuant to the Original Trust Agreement for an equivalent number of Series A Units of the Fund created pursuant to the Trust Agreement. The Trust Agreement was subsequently amended on January 7, 2011 in order to appoint BNY Trust Company of Canada as the trustee of the Fund. With the resignation of BNY Trust Company of Canada as Trustee of the Fund effective August 31, 2011, the Trust Agreement was amended and restated on July 15, 2011 (effective September 1, 2011) to appoint Computershare Trust Company of Canada as successor trustee to BNY Trust Company of Canada. Effective February 24, 2012, Series F Units of the Fund were created.

Palos is the investment fund manager of the Fund. The Manager is a corporation formed under the laws of Québec in June 2001.

The Trustee of the Fund is Computershare Trust Company of Canada, which is a corporation formed pursuant to the *Canada Business Corporations Act* on February 29, 2000.

The registered offices of the Fund and the Manager are located at 1 Place Ville Marie, Suite 1812, Montréal, Québec, H3B 4A9.

The registered office of the Trustee is located at 100 University Avenue, 11<sup>th</sup> floor, Toronto, Ontario, M5J 2Y1.

This annual information form contains details about the Fund. It is intended to be read along with the simplified prospectus of the Fund. If you have questions after reading these documents, please contact your Dealer or us.

## **Investment restrictions**

The Fund is subject to certain standard investment restrictions and practices contained in securities legislation, including National Instrument 81-102 – *Mutual Funds*, as amended from time to time (“NI 81-102”) (or any successor instrument). This helps to ensure that the investments of the Fund are diversified and relatively liquid and helps to ensure the proper administration of the Fund. Except as set out below, the Fund adheres to, and is managed in accordance with, these standard investment restrictions and practices.

The fundamental investment objectives of the Fund are set out in the simplified prospectus of the Fund. Any change to the investment objectives of the Fund requires the approval of a majority of Unitholders at a meeting called for that purpose. The Manager may change the Fund’s investment strategies from time to time at its discretion.

## ***Short selling***

The Fund has obtained relief from the Canadian securities regulatory authorities to deviate from NI 81-102 by selling securities short, by providing a security interest over Fund assets in connection with the short sales and by depositing Fund assets with dealers as security in connection with such transactions. A short sale by the Fund involves borrowing securities from a lender and selling those securities in the open market (or selling short the securities). At a later date, the same number of securities are repurchased by the Fund and returned to the lender. In the interim, the proceeds from the first sale are deposited with the lender and the Fund pays compensation to the lender on the borrowed securities. If the value of the securities declines between the time that the Fund borrows the securities and the time it repurchases and returns the securities to the lender, the Fund will make a profit for the difference (less any compensation the Fund is required to pay to the lender). Selling short provides the Fund with more opportunities for profits when markets are generally volatile or declining.

The Fund engages in short selling only within certain controls and limitations. Securities are sold short only for cash and the Fund receives the cash proceeds within normal trading settlement periods for the market in which the short sale is made. All short sales are effected only through market facilities through which those securities normally are bought and sold and the Fund short sells a security only if: (i) the security is listed and posted for trading on a stock exchange and either the issuer of the security has (I) a market capitalization of not less than CDN\$100 million, or the equivalent thereof, at the time the short sale is effected, or (II) the portfolio advisor has prearranged to borrow for the purposes of such short sale; or (ii) the security is a

bond, debenture or other evidence of indebtedness of or guaranteed by the Government of Canada or any province or territory of Canada or the Government of the U.S. As well, at the time securities of a particular issuer are sold short by the Fund, the aggregate market value of all securities of that issuer sold short do not exceed 5% of the net assets of the Fund. The Fund also places a “stop-loss” order (effectively, a standing instruction) with a dealer to immediately repurchase for the Fund the securities sold short if the trading price of the securities exceeds 120% (or a lower percentage determined by us, typically 110%) of the price at which the securities were sold short. The aggregate market value of all securities sold short by the Fund does not exceed 20% of its net assets on a daily marked-to-market basis. The Fund may deposit assets with lenders in accordance with industry practice in relation to its obligations arising under short sale transactions. The Fund also holds cash cover in an amount, including the Fund’s assets deposited with lenders, that is at least 150% of the aggregate market value of all securities it sold short on a daily marked-to-market basis. No proceeds from short sales are used by the Fund to purchase long positions other than cash cover.

Where a short sale is effected in Canada, every dealer that holds Fund assets as security in connection with the short sale must be a registered dealer and a member of a self-regulatory organization that is a participating member of the Canadian Investor Protection Fund. Where a short sale is effected outside Canada, every dealer that holds Fund assets as security in connection with the short sale must be a member of a stock exchange and have a net worth in excess of the equivalent of \$50 million determined from its most recent audited financial statements. The aggregate assets deposited by the Fund with any single dealer as security (except if the Fund’s custodian or sub-custodian holds the security on behalf of the dealer) in connection with short sales will not exceed 10% of the Fund’s net assets at the time of deposit.

The Manager has instituted a risk management framework in order to ensure that the Fund remains within the limits described above. The Manager has appointed a risk manager to develop and oversee the risk management framework. The Manager ensures that the risk manager has the necessary proficiencies to perform his duties in regard to the short selling framework. Usually, the risk manager is one of the portfolio managers of the Fund. On a daily basis, the risk manager verifies that there is sufficient cash coverage for every short sale trade and that the securities sold short are otherwise in compliance with the restrictions described above.

The risk manager also performs stress tests on the portfolio in order to measure the theoretical maximum loss under a variety of historical scenarios. The risk manager uses tools such as the Bloomberg Scenario Analysis to forecast such potential loss. The risk manager performs stress testing whenever there is unusual market volatility, and at minimum, once per month.

The Canadian Securities Administrators (“CSA”) have published on February 9, 2012 changes to *Regulation 81-102 respecting mutual funds* (“Regulation 81-102”) that allow for mutual funds to effect limited short sales of securities under certain conditions. Those changes will come into force on April 30, 2012. At that time, the Manager will comply with the new short sales rules in Regulation 81-102. The Manager does not expect the changes to have a material impact on its current short selling policies and procedures.

## ***Eligibility under the Income Tax Act***

The Fund qualifies as a mutual fund trust as defined in the *Income Tax Act* (Canada) (the “Tax Act”) and is expected to continue to qualify at all times in the future. The Fund will not engage in any undertaking other than the investment of its funds in property for the purposes of the Tax Act. Units of the Fund are qualified investments for trusts governed by registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), registered education savings plans (RESPs), deferred profit sharing plans (DPSPs), registered disability savings plans (RDSPs) and tax free savings accounts (TFSA) (collectively, the “Registered Plans”).

Units of the Fund will not be “prohibited investments” under the Tax Act for TFSA provided that you, as the holder of the TFSA or persons or partnerships that do not deal at arm’s length with you, own units having a fair market value that is less than 10% or more of all of the units of the Fund.

## **Description of the securities offered by the Fund**

The Fund is divided into units. The Fund is permitted to have an unlimited number of series of units and may issue an unlimited number of units in each series, although the Manager reserves the right to limit subscriptions. Currently, the Fund offers two series of units of the Fund; “Series A Units” and “Series F Units”.

No Unitholder holds any assets of the Fund. Unitholders have those rights mentioned in this annual information form, in the simplified prospectus and as created in the Trust Agreement. The Fund derives its value from the portfolio assets held by it and the income earned in respect thereof. We calculate the net asset value (“NAV”) for the Fund’s Series A Units by taking the value of the assets attributable to the Series A Units, subtracting any liabilities attributable specifically to the Series A Units and subtracting the proportionate share of the Fund liabilities attributable to Series A Units and dividing the balance by the number of Series A Units investors hold. The same process is performed for each other series offered by the Fund. We calculate NAV at 4:00 p.m. (Eastern time) on each valuation day. A valuation day is each day that the Toronto Stock Exchange is open for a full day of business. The Fund is valued and may only be bought in Canadian dollars. The NAV of the Fund and for each series of units is determined as described under “Calculation of Net Asset Value” on page 10 and “Valuation of Portfolio Securities” on page 7.

Each holder of a whole unit of the Fund is entitled to one vote per unit at meetings of Unitholders of the Fund, other than meetings at which holders of one series of units of the Fund are entitled to vote separately as a series

Subject to management fee distributions and rebates, all units of each series are treated equally with respect to distributions and on any liquidation or winding-up of the Fund based on the relative NAV of each series of the Fund.

All units of the Fund are fully paid and non-assessable when issued. Units of any series of the Fund may be switched at any time into units of another series of the Fund, or a series of another

fund, in the event Palos creates additional additional funds (see “Switches” on page 11). There are currently no additional funds in respect of which you may switch your units. There is no guarantee that Palos will create additional funds. Details and additional information relating to switching between (i) series of the Fund; and (ii) series of different funds, if any, are also available in the simplified prospectus of the Fund.

Fractions of units may be issued. Fractional units carry the rights and privileges, and are subject to the restrictions and conditions, applicable to whole units in the proportions which they bear to one unit; however, the holder of a fractional unit is not entitled to vote in respect of such fractional unit.

Unitholders can redeem all or any of their units at the NAV of those units as described under “Redemption of securities” on page 12. All units are transferable without restriction. Transfers must be done in writing in a form acceptable to the Trustee or transfer agent and registrar, and pursuant to their reasonable requirements.

The Trustee may modify, alter or add to the provisions of the Trust Agreement without notice to Unitholders unless such amendment would constitute a “material change” for purposes of National Instrument 81-106 – *Investment Fund Continuous Disclosure*, as amended from time to time (“NI 81-106”) (or any successor instrument), in which case the Trust Agreement may be amended on at least 21 days prior written notice to Unitholders or such longer period as may be required by applicable law.

The Fund does not hold regular meetings. Unitholders of the Fund are permitted to vote on all matters that require Unitholder approval under NI 81-102 or under the Trust Agreement. These matters include:

- a change in the basis of the calculation of a fee or expense that is charged to the Fund or directly to its Unitholders, or the introduction of a fee or expense to be charged to the Fund, or directly to its Unitholders, that could result in an increase in charges to the Fund or its Unitholders, and the Fund is not at arm’s length to the person or company charging the fee or expense;
- a change in the investment fund manager of the Fund (other than to an affiliate of the Manager);
- any change in the fundamental investment objectives of the Fund;
- any decrease in the frequency of calculating NAV of the Fund;
- in certain cases, if the Fund undertakes a reorganization with, or transfer of its assets to, another mutual fund or acquires another mutual fund’s assets; and
- any other matter which is required by the Trust Agreement or by the laws applicable to the Fund or by any agreement to be submitted to a vote of the Unitholders of the Fund.

Approval of these matters requires an affirmative vote of at least a majority of the Unitholders present at a meeting called to consider these matters.

If approved by the independent review committee (“IRC”), the Fund may change its auditors by sending you a written notice of any such change at least 60 days before it takes effect. Likewise, if approved by the IRC, we may merge the Fund into another mutual fund provided the merger fulfills the requirements of NI 81-102 and National Instrument 81-107 – *Independent Review Committee for Investment Funds*, as amended from time to time (“NI 81-107”) (or any successor instrument) relating to mutual fund mergers and we send you a written notice of the merger at least 60 days before it takes effect. In either case, no meeting of Unitholders of the Fund may be called to approve the change.

## **Valuation of portfolio securities**

The value of any security or property held by the Fund or any of its liabilities will be determined in the following way:

- 1) the value of any cash on hand, on deposit or on call loan, prepaid expenses, cash dividends and other distributions declared and interest accrued and not yet received, shall be deemed to be the face amount thereof, unless we determine that any such deposit or call loan is not worth the face amount thereof, in which event the value thereof shall be deemed to be such value as we determine to be the fair value thereof;
- 2) the value of any bonds, debentures and other debt obligations shall be valued by taking the average of the bid and ask prices on a valuation day at the close of business on each valuation day. Short-term investments including notes and money market instruments shall be valued at their fair value and that cost plus accrued interest will most often approximate the fair value;
- 3) the value of any security, index futures or index options which is listed on any recognized exchange shall be determined by the closing price at the valuation time or, if there is no closing sale price, the average between the closing bid and the closing asked price on the day on which the NAV of the Fund is being determined, all as reported by any report in common use or authorized as official by a recognized stock exchange; provided that if such stock exchange is not open for trading on that date, then on the last previous date on which such stock exchange was open for trading;
- 4) the value of any security or other asset for which a market quotation is not readily available shall be its fair market value as determined by us;
- 5) the value of any security, the resale of which is restricted or limited, shall be the fair value thereof. The Fund determines fair value of such security as being the lesser of the value thereof based on reported quotations in common use and that percentage of the market value of securities of the same class, the trading of which is not restricted or limited by reason of any representation, undertaking or agreement or by law, equal to the percentage that the Fund’s acquisition cost was of the market value of such securities at the time of the acquisition; provided that a gradual taking into account of

the actual value of the securities may be made where the date on which the restriction will be lifted is known;

- 6) purchased or written clearing corporation option, option on futures or over-the-counter options, debtlike securities and listed warrants shall be valued at the current market value thereof;
- 7) where a covered clearing corporation option, option on futures or over-the-counter option is written, the premium received by the Fund shall be reflected as a deferred credit which shall be valued at an amount equal to the current market value of the clearing corporation option, option on futures or over-the-counter option that would have the effect of closing the position. Any difference resulting from revaluation of such options shall be treated as an unrealized gain or loss on investment. The deferred credit shall be deducted in arriving at the NAV of the Fund. The securities, if any, which are the subject of a written clearing corporation, or over-the-counter option shall be valued at their then current market value;
- 8) the value of a futures contract, or forward contract, shall be the gain or loss with respect thereto that would be realized if, at the valuation time, the position in the futures contract, or the forward contract, as the case may be, were to be closed out unless daily limits are in effect in which case fair value shall be based on the current market value of the underlying interest;
- 9) margin paid or deposited in respect of futures contracts and forward contracts shall be reflected as an account receivable and margin consisting of assets other than cash shall be noted as held as margin;
- 10) the value of all assets of the Fund quoted or valued in a foreign currency and all liabilities and obligations of the Fund payable by it in foreign currency shall be converted into Canadian dollars by applying the rate of exchange obtained from the best available sources to the Trustee, including but not limited to, the valuation agent or any of its affiliates;
- 11) all expenses or liabilities (including fees payable to the Trustee, if any) of the Fund shall be calculated on an accrual basis;
- 12) the value of the non-public investments will be valued by us (or any third party administrator which may be appointed by the Trustee) at fair market value. In determining fair market value, our objective will be to establish what the transaction price would have been on the valuation day in an arm's length transaction motivated by normal business considerations. Fair market value will be estimated based on the results of a valuation technique that makes maximum use of inputs observed from markets, and relies as little as possible on inputs generated by us. In addition, we incorporate factors that market participants would consider in setting the price and is consistent with accepted economic methods for pricing such financial instruments and will be in accordance with CICA Handbook Section 3855, paragraphs A47-A65; and

- 13) if any investment cannot be valued under the foregoing rules or if the foregoing rules are at any time considered by us to be inappropriate under the circumstances, then notwithstanding the foregoing rules, we shall make such valuation as we consider fair and reasonable.

Current market value means the most recently available sale price applicable to the relevant security on the principal exchange on which it is traded immediately preceding the valuation time on the valuation day, provided that, if no sale has taken place on a valuation day, the average of the bid and ask quotations immediately prior to the valuation time on the valuation day shall be used.

Except as described below, NI 81-106 requires an investment fund, such as the Fund, to calculate its net assets in accordance with Canadian generally accepted accounting principles ("GAAP"). Canadian GAAP was modified by the introduction of section 3855 *Financial Instruments - Recognition and Measurement* of the handbook of the Canadian Institute of Chartered Accountants. Section 3855 redefines fair value as being the closing bid price for long positions and the closing ask price for short positions, in lieu of the closing or last trade price for all positions. Section 3855 applies to interim and annual financial statements for fiscal years beginning on or after October 1, 2006. Therefore, the combined effect of NI 81-106 and section 3855 would require the Fund to determine the value of securities listed on a recognized public securities exchange using the fair value as defined by section 3855.

The financial statements of the Fund will contain a reconciliation of the net assets per unit that is reported in such financial statements in accordance with Canadian GAAP to the NAV per unit used by the Fund for all other purposes in the event that there is a difference between Canadian GAAP and the NAV per unit. If there is no difference, the financial statements of the Fund will not contain a reconciliation.

## **Calculation of net asset value**

The purchase and redemption price of securities of any series of units of the Fund is based on the NAV per unit for that specific series determined after the receipt of a purchase or redemption order. We calculate the NAV for a series of units by taking the value of the assets attributable to that series, subtracting any liabilities attributable specifically to that series and subtracting the proportionate share of the Fund liabilities attributable to that series and dividing the balance by the number of units of that series investors hold. We calculate NAV at 4:00 p.m. (Eastern time) on each valuation day. A valuation day is each day that the Toronto Stock Exchange is open for a full day of business. The Fund is valued and may only be bought in Canadian dollars.

## **Purchases and switches**

Units of the Fund are offered for sale on a continuous basis through registered dealers. Individuals must be of majority age in their province of residence in order to purchase units and

may hold such units in trust for a minor. Purchase orders must be placed with dealers or brokers registered in an investor's province.

The Fund currently only offers Series A Units and Series F Units.

Series A Units are available to all investors. There are no fees payable by an investor to the Fund in connection with the initial purchase of Series A Units of the Fund or, with the exception of a short-term trading fee, if applicable, upon redemption of same.

If you buy Series A Units, the sales commission is negotiable between you and your Dealer.

Series F Units are available to investors who participate in fee-based programs through their Dealer and whose Dealer has signed a Series F Agreement with us. Instead of paying sales charges, these investors pay an annual fee to their Dealer for investment advice and other services. We do not pay any commission to Dealers who sell Series F Units, which means that we can charge a lower management fee.

## ***Purchases***

You can buy units of the Fund, transfer from the Fund to another fund (in the event Palos creates another prospectus qualified mutual fund) or change units of one series to another series of the Fund through a qualified Dealer. Transferring, which involves moving money from one investment to another, is also known as switching.

You can purchase units of the Fund through Dealers who will send your order to us. The series of units of the Fund are qualified for distribution in all Canadian provinces pursuant to the simplified prospectus. Your order must be in the proper form and include all necessary supporting documents. Your Dealer is responsible for sending your order to us by courier, priority post or telecommunications facility without cost to you.

If we receive your properly completed order before 4:00 p.m. (Eastern time) on a valuation day, we will process it using that day's NAV. If we receive your order after that time, we will use the NAV on the next valuation day. The valuation day used to process your order is called the "trade date". Your Dealer or we will send you a confirmation of your order once we have processed your order. A confirmation shows details of your transaction, including the name of the Fund, the number and series of units you bought, and the purchase price and the trade date. We do not issue certificates of ownership for units of the Fund.

We may reject your purchase order within one business day of receiving it. If rejected, any money sent with your order will be returned immediately, without interest, once the payment clears. If we accept your order but do not receive payment within three business days, we will redeem your units on the next business day. If the proceeds are greater than the payment you owe, the difference will belong to the Fund. If the proceeds are less than the payment you owe, your Dealer will be required to pay the difference and is entitled to collect this amount and any associated expenses from you.

The minimum initial investment in Series A Units or Series F Units must be at least \$1,000. Each additional investment in Series A Units or Series F Units must be at least \$500. If the value of your Series A Units or Series F Units in the Fund is less than \$500, we can sell your units and send you the proceeds. We will give you 30 days' notice first. The Trustee reserves the right to change the minimum investment level required at its discretion.

You don't pay any sales charge to the Manager when you purchase units of the Fund. You negotiate your sales charges, if any, directly with your Dealer. These sales charges typically range from 0% to 5% of the purchase price of the securities. The amount of sales charges you pay to your dealer will reduce the amount of money invested in the Fund.

## ***Switches***

You may switch your units of the Fund between the different series of units offered, subject to the rules and criteria mentioned below.

### **Transferring to another Fund**

In the event Palos creates additional prospectus qualified mutual funds, you may transfer from the Fund to another prospectus qualified mutual fund by contacting your Dealer. Give your Dealer the name of the Fund and the series of units you hold, the dollar amount or number of units you want to transfer and the name of the fund and the series to which you are transferring. You may transfer your units of the Fund to units of another series of another prospectus qualified fund only if you are eligible to buy that other series. There are currently no additional funds in respect of which you may switch your units. There is no guarantee that Palos will create additional funds.

You may have to pay your Dealer a fee up to 2% of the value of the units you are transferring, which is deducted from the amount you transfer by redeeming a sufficient number of units. However, the transfer fee is negotiable. If you have held the units for 90 business days or less, you may also have to pay a short-term trading fee.

Any transfer is a disposition for tax purposes. If you hold your units outside a registered plan, you may realize a capital gain (or capital loss). For more information on the tax consequences, see "Income tax considerations" on page 26.

### **Changing to another series**

You will generally be able to switch your units of one series to units of another series of the Fund by contacting your Dealer. You will be able to switch units into a different series of units only if you are eligible to buy that other series. No fees apply, other than the short-term trading fee, if applicable.

If we determine that you are no longer eligible to hold Series F Units of the Fund or if you move your account to a dealer that has not entered into a Series F Agreement with us, we will switch you to Series A Units of the Fund.

Changing units from one series to another series of the Fund is not a disposition for tax purposes except to the extent that units are redeemed to pay a short-term trading fee. If those redeemed units are held outside a registered plan, you may realize a capital gain (or capital loss). For more information on the tax consequences, see "Income tax considerations" on page 26.

## **Redemption of securities**

To sell your units, send your signed instructions in writing to your Dealer. Your Dealer will forward your redemption order to us on the same day the Dealer received it from you. Once we receive your order, you cannot cancel it.

If we receive your redemption order before 4:00 p.m. (Eastern Time) on any trading day, your redemption price will be based on the applicable NAV per unit applicable to the series of units you are redeeming on that date. Otherwise, your redemption price will be based on the applicable NAV per unit on the next trading day.

We will send you a confirmation once we have processed your order. We will send your payment within three business days of receiving your properly completed order. You will receive payment in Canadian dollars.

Your signature on your instructions must be guaranteed by a bank, trust company, or Dealer if the sale proceeds are more than \$25,000, or paid to someone other than the registered owner. If the registered owner of the units is a corporation, partnership, agent, fiduciary or surviving joint owner, we may require additional information. If you are unsure whether you need to provide a signature guarantee or additional information, check with your Dealer or us. If we don't receive all of the documentation we need from you to complete the redemption order within 10 business days of the trade date, we must reissue units of the same series to you.

If the issue price is greater than the redemption price for the units of that series, your Dealer will be required to pay the difference and the associated costs. Your Dealer may require you to reimburse the amount paid. If the issue price is less than the redemption price for the units of that series, the difference belongs to the Fund.

We reserve the right to redeem all of the units that you hold, if your investment in the Fund falls below \$500. We will give you 30 days' notice first. We also intend to observe all redemption policies that may be implemented from time to time by industry participants, such as FundSERV, the provider of the transaction system used by mutual funds in Canada.

If you hold your units in a non-registered account, you may realize a capital gain (or capital loss) when your units are sold. For more information on the tax consequences, see "Income tax considerations" on page 26.

## **Suspending your right to sell units**

Securities regulations allow us to temporarily suspend your right to sell your units and postpone payment of your sale proceeds:

- during any period when normal trading is suspended on any exchange on which securities or derivatives that make up more than 50% of the Fund's value or its underlying market exposure are traded, provided those securities or derivatives are not traded on any other exchange that is a reasonable alternative for the Fund, or
- with the approval of securities regulators.

We will not accept orders to buy any series of units of the Fund during any period when we have suspended investors' rights to sell any series of units of the Fund.

## **Short term trading fees**

We may charge you a short-term trading fee of up to 2.00% of the total amount you redeem, if you sell or transfer your units within 90 business days of buying them. We will redeem a sufficient number of units to pay the short-term trading fee. This fee does not apply if you transfer your units of one series to a different series of the same Fund, if applicable. We may also refuse to accept further purchase orders from you.

We will adopt policies on short-term trading mandated by regulation, if and when implemented by securities regulators. These policies will be adopted without amendment to the simplified prospectus or notice to you, unless otherwise required by securities laws.

## **Responsibility for mutual fund operations**

### ***Manager of the Fund***

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The Manager has been granted the exclusive power to manage and administrate the business and affairs of the Fund pursuant to an investment and fund management agreement (the "Management Agreement") dated July 15, 2011 between the Trustee on behalf of Fund and the Manager, which became effective on September 1, 2011, as amended on February 24, 2012. The Manager is a corporation formed under the laws of Québec in June 2001 and is indirectly

owned by Hubert Marleau and Charles Marleau, among others. Palos acts as both the investment fund manager and the portfolio manager to the Fund.

The Manager is responsible for the day-to-day activities of the Fund, including management of the investment portfolio, the establishment of investment policies and guidelines and the provision of investment analysis relating to the Fund. In addition, the Manager provides the office space and facilities, clerical help, bookkeeping and the internal accounting services required by the Fund. Record keeping and transfer agency services, distribution crediting services and all Unitholder servicing requirements are also furnished by or on behalf of the Manager.

Under the Management Agreement, Palos covenants to act at all times honestly, in good faith and in the best interests of the Fund and its Unitholders, and to exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Either party may terminate the Management Agreement, without payment of any penalty, including in the following circumstances:

- i. the other party has ceased to carry on business, become bankrupt or insolvent, resolved to wind up or liquidate or if a receiver of any of the assets of the other party is appointed;
- ii. the other party has committed any material breach of the Management Agreement or any relevant law, and has not remedied such breach within 30 days after written notice requiring the material breach to be remedied;
- iii. the assets of the other party have become subject to seizure or confiscation by any public or governmental organization;
- iv. the other party has lost any registration, license or other authorization required by it to perform the services described in the Management Agreement; or
- v. the Trust Agreement and the Fund are terminated.

**Directors and officers of the Manager**

The name and municipality of residence of each of the directors and applicable officers of the Manager and their principal occupation during the past five years are as follows:

<b>Name and Municipality of Residence</b>	<b>Position with Manager</b>	<b>Principal Occupation</b>
Charles Marleau Lachine, Quebec	President, Director and Ultimate Designated Person	Portfolio Manager, Palos Management Inc.
Robert Boisjoli	Director	Managing Director,

Montreal, Quebec		Atwater Financial Group (financial advisory firm)
Peter J. Malouf Montreal, Quebec	Director	President P.J. Malouf & Co Inc. (family holding company)
Alain Lizotte Montreal, Quebec	Chief Financial Officer	Chief Financial Officer, Palos Management Inc.
Noah Billick Montreal, Quebec	Vice-President, Legal Affairs and Secretary	Vice-President, Legal Affairs, Palos Management Inc.
Robert J. Sands Jr. Montreal, Quebec	Chief Compliance Officer	Chief Compliance Officer, Palos Management Inc.

During the past five years, all of the directors and officers of the Manager listed above have held their present principal occupations (or similar positions with their present employer or its affiliates) except for: (i) Robert Boisjoli who, prior to April 2010 was the Chief Financial Officer of Topigen Pharmaceuticals from October 2008 until March 2010, and Chief Financial Officer of Theranostics Inc. from October 2001 until September 2008; (ii) Alain Lizotte who, prior to November 2011, was not employed full-time from July of 2011 until November of 2011; Director of Finance at Keops Technologies Inc. from May of 2010 to July of 2011; not employed full-time from November of 2009 to May of 2010; Chef de division gestion budgétaire at the Société de Transport de Montréal (STM) from May of 2008 to November of 2009; a full-time student from February of 2008 to May of 2008; Director of Operations, Forecasts and Performance at Quebecor Media Inc. from November of 2006 to February of 2008; and Financial Analyst at CGI Group Inc. from July of 2006 to November of 2006; (iii) Noah Billick who, prior to April 2010, was a lawyer in Fasken Martineau DuMoulin LLP's Litigation and Dispute Resolution Department from June 2008 to April 2010, a Student-at-Law at Fasken Martineau DuMoulin LLP from June 2007 until June 2008, and a self-employed real estate agent in Saint Kitts from May 2006 to June 2007; and (iv) Robert J. Sands Jr. who, prior to December 2010, was the Chief Compliance Officer of Palos Capital Corporation.

### ***Trustee***

The Trustee, Computershare Trust Company of Canada, has been appointed the trustee of the Fund under the Trust Agreement. In its capacity as trustee, the Trustee has ultimate responsibility for the undertaking of the Fund and must carry out the terms of the Trust Agreement. The Trustee may resign as trustee of the Fund by giving 60 days prior written notice to Unitholders. If a successor trustee can be found and agrees to accept the appointment, such successor trustee will assume the duties and obligations of the incumbent trustee within the relevant period. If a successor trustee cannot be found or is not appointed by investors in accordance with the provisions of the Trust Agreement, then the Fund will be terminated at the expiry of the relevant period.

The Trustee delegated the task of administering the Fund to the Manager pursuant to the Management Agreement.

## ***Portfolio advisor***

Pursuant to the Management Agreement, the Trustee has appointed Palos as the Portfolio Advisor for the Fund. The head office of the Portfolio Advisor is located at 1 Place Ville Marie, Suite 1812, Montréal, Québec, H3B 4A9.

The Portfolio Advisor provides investment advisory and portfolio management services to the Fund pursuant to the Management Agreement between the Trustee and the Portfolio Advisor. Decisions regarding the purchase and sale of securities and the execution of transactions for the Fund will be made by the Portfolio Advisor, in accordance with and subject to the terms of the Management Agreement. Palos acts as both the Manager and the Portfolio Adviser to the Fund.

The individual principally responsible for providing investment advisory services to the Fund is Charles Marleau.

Charles Marleau is the President and co-founder of Palos and is also the lead portfolio manager of the Portfolio Advisor since July, 2010. Between September, 2001 and July, 2010, Mr. Marleau acted as senior analyst, associate portfolio manager and senior trader of the Fund. Mr. Marleau is responsible for managing and trading the funds managed by Palos and also supervises the Fund's administration. Mr. Marleau graduated from McGill University with a Bachelor's degree in Economics and completed the Canadian Investment Manager designation. He serves on the board of directors of numerous private companies, a private school and a Canadian public company. Charles Marleau is also a member of the Institutional Equity Traders Association, Montreal University Club, Montreal Oil Club and the Entrepreneurs Organization.

For any details about the Management Agreement, please see the "Manager of the Fund" section on page 14.

## ***Brokerage arrangements***

Decisions as to the purchase and sale of portfolio securities and decisions as to the execution of all portfolio transactions, including selection of market, dealer or broker and the negotiation, where applicable, of commissions, are made by Palos and are the ultimate responsibility of Palos.

In effecting portfolio transactions, Palos seeks to obtain the best combination of price and execution with respect to portfolio transactions for the Fund. The best net price, giving effect to brokerage commissions, spreads and other costs, is normally an important factor in this decision, but a number of other factors are considered as they are deemed relevant. These factors may include, but are not limited to:

- Palos' knowledge of negotiated commission rates and spreads currently available;
- the nature of the security being traded;
- the size and type of transaction;

- the nature and character of the markets for the security to be purchased or sold;
- the desired timing of the trade;
- the existing and expected activity in the market for the particular security;
- confidentiality, execution, clearance and settlement capabilities as well as the reputation and perceived soundness of the broker-dealer selected;
- the portfolio advisor's knowledge of actual or apparent operational problems of any broker-dealer;
- the broker-dealer's execution services rendered on a continuing basis and in other transactions; and
- the reasonableness of spreads or commissions.

Palos may also consider the quality of research provided by executing brokers or dealers and its usefulness in the management of accounts. When appropriate under its discretionary authority and consistent with its duty to seek best execution, Palos may direct brokerage transactions for client accounts to broker-dealers who provide Palos with research and brokerage products and services.

Broker-dealers typically provide a bundle of services including research and execution of transactions. The research provided can be either proprietary (created and provided by the broker-dealer, including tangible research products as well as access to analysts and traders) or third-party (created by a third party, but provided by a broker-dealer). Palos may use soft dollar commission arrangements to acquire either type of research.

Palos makes decisions as to the purchase and sale of the Fund's portfolio securities and decisions as to the execution of portfolio transactions, including the selection of market, dealer and the negotiation, where applicable, of commissions. Palos regularly compares the order execution delivered by various dealers. The primary factor in Palos' decision to use a dealer is the quality of its trade execution. Palos may receive as a result of placing trades with certain dealers, "order execution goods and services" or "research goods and services" as defined in National Instrument 23-102. Palos makes a good faith determination that the goods and services received on behalf of the Fund benefit the Fund and the Fund's unitholders because the goods and services received either reduce the expenses charged to the Fund or provide Palos with a valuable research tool.

Since the date of the last annual information form, Palos has entered into brokerage transactions whereby client brokerage commissions were directed to a dealer in return for the provisions of goods and services other than order execution. These goods and services include, among other things, software for market data or database feeds.

None of these goods or services was provided by an affiliated entity of Palos.

The name of any third party that provided a good or service paid for with soft dollars will be provided upon request by contacting Palos at (514) 397-0188 (or toll-free at 1 (855) PALOS88 (1-855-725-6788)) or by e-mailing [info@palosmanagement.com](mailto:info@palosmanagement.com).

### ***Custodian***

The custodian holds the assets of the Fund in safekeeping. The custodian for the Fund is CIBC World Markets Inc., Toronto, Ontario pursuant to a custodial services agreement dated January 7, 2011 (the "Custodian Agreement"). The custodian is independent of Palos. Where the Fund effects a short sale, the Fund may deposit assets as security with its custodian or dealer from whom the Fund borrowed the securities forming part of the short sale. CIBC World Markets Inc. will also act as custodian for any derivatives in which the Fund may invest – see "Fund Governance – Policy on the use of derivatives" on page 24 below.

### ***Auditors***

The auditors of the Fund are BDO Canada LLP of Montreal, Québec.

### ***Transfer Agent and Registrar***

Independent of the Manager, The Investment Administration Solution Inc. ("IAS") is the transfer agent and registrar of the Fund. IAS maintains the register of securities of the Fund at its principal office in Toronto, Ontario. IAS keeps track of owners of units of the Fund, processes purchases and redemption orders, issues investor account statements and trade confirmations and issues annual tax reporting information. IAS is also responsible for providing administrative services to the Fund, including fund valuation and NAV calculation, Performance Fee calculation and financial reporting services. The Manager continues to be responsible for the services provided by IAS.

## **Conflicts of interest**

### ***Principal holders of securities***

As of February 20, 2012, Mr. Hubert Marleau, a registered representative of the Portfolio Advisor and indirect owner of the Manager and Portfolio Advisor, owns 301,658.8 Series A Units of the Fund, representing 15.27 % of the issued and outstanding Series A Units of the Fund. To the knowledge of the Manager, as at the date hereof, no other person or company owns, beneficially or of record, directly or indirectly, more than 10% of the units of the Fund.

The Manager is a corporation and is a wholly-owned subsidiary of Palos Capital Corporation. To the knowledge of the Manager, as at the date hereof, the following persons own, beneficially or of record, directly or indirectly, more than 10% of the issued and outstanding voting securities of Palos Capital Corporation: (i) The Marleau Capital Corporation Inc. (49.01%); (ii) Palodun

Management Inc. (18.38%); (iii) Sopamy Consulting Inc. (14.95%); and (iv) Gus Kan Inc. (10.40%). To the knowledge of the Manager, as at the date hereof: (i) Mr. Hubert Marleau (indirectly), Mr. Philippe Marleau and Mr. Charles Marleau each beneficially owns 33.3% of the voting securities of The Marleau Capital Corporation Inc.; (ii) Mr. Stuart H. Dunn is the beneficial owner of all of the voting securities of Palodun Management Inc.; (iii) the Hanna Family Trust is the beneficial owner of all of the voting securities of Sopamy Consulting Inc; (iv) and Thomas Kaneb is the beneficial owner of all voting securities of Gus Kan Inc.

To the knowledge of the Manager, as of February 20, 2012, the directors and officers of the Manager, in aggregate, own, beneficially or of record, directly or indirectly, 22.37 % of the issued and outstanding voting securities of the Manager.

To the knowledge of the Manager, as of February 20, 2012, the directors and senior officers of the Manager, in aggregate, do not own, beneficially or of record, directly or indirectly, any voting securities of any person or company that provides services to the Fund or the Manager, other than as disclosed above.

The members of the IRC do not own, beneficially or of record, directly or indirectly, in aggregate: (a) any class of voting or equity securities of the Manager; (b) more than 10% of any class of voting securities of any person or company that provides services to the Fund or the Manager; or (c) more than 10% of the units of the Fund.

### ***Affiliated entities***

Palos acts as both the portfolio advisor and the investment fund manager to the Fund.

Disclosure of the amount of fees received from the Fund by each affiliated entity of the Manager is contained in the audited financial statements of the Fund.

Mr. Charles Marleau, the principal portfolio manager, is the President, Ultimate Designated Person and a director of Palos, the portfolio advisor and investment fund manager to the Fund.

### **Fund governance**

The Trustee has the ultimate and overriding authority to manage and direct the activities and affairs of the Fund, subject to applicable law and the Trust Agreement. The Trustee has delegated certain powers of administration to the Manager pursuant to the Management Agreement. The Manager has adopted formal written policies with respect to business practices, risk management controls and internal conflicts of interest.

The Manager has a written Internal Control and Compliance Manual (the "Manual") that is annually revised by the Manager's Vice President, Legal Affairs, and approved by the Board of Directors of the Manager and signed on an annual basis by all of the Manager's employees. The Manual addresses topics such as the opening of client accounts, the management of client accounts, anti-money laundering practices, insider trading, calculation of fund performance,

complaint handling procedures, supervision of employees, obligations to the regulator, financial reporting, insurance, advertising, maintenance of client privacy and proxy voting policies and procedures. The Manual also sets out the Manager’s risk management framework, which includes a detailed breakdown of liquidity risk, leverage risk, market risk, counterparty credit risk and operational risk. The Manager also has a detailed business continuity plan in the case of a catastrophe or other type of business interruption. With regards to managing conflicts of interest, the Fund has a detailed policy that sets out certain specific prohibitions, as well as a general policy against entering into any relationships which could cause a conflict of interest. All employees of the Manager are prohibited from accepting any gifts or compensation which could influence their decision-making and from engaging in outside activities which could compromise their decision-making. The Manager has also established an Independent Review Committee in accordance with NI 81-107. The Manager’s procedure for dealing with any conflict of interest is to specifically disclose the conflict to any of the Manager’s clients whose interests could be materially affected by the conflict; to determine the significance of the conflict of interest, and if the manager determines that a reasonable person would conclude that the Manager’s interests would interfere with its abilities to act in the best interests of its investors, forward the issue, along with the Manager’s proposed actions, to the IRC with a mandate to fairly resolve the issue.

The Manual also sets out specific policies and procedures that relate to the Short Selling objectives and the specific risk management associated with Short Selling.

With regard to sales practices, the Manager complies with National Instrument 81-105 *Mutual Fund Sales Practices*.

### ***Independent review committee***

In accordance with NI 81-107 (or any successor instrument), the Manager has established an IRC to provide impartial judgment on conflicts of interest matters related to the operations of the Fund.

The IRC is composed of three individuals, each of whom is independent of the Fund, the Manager and its affiliates. The current members of the IRC, and their principal occupations, are as follows:

<b>Name</b>	<b>Principal Occupation</b>
Laurent Biron	Vice-President, Quebec Sales, NexGen Financial L.P.
Richard Ness	Managing Director Tactico, Inc.
Liam Cheung	Managing Director Tactico, Inc.

The IRC became fully operational on January 7, 2011. The IRC has adopted a written charter that includes its mandate, responsibilities and functions, and the policies and procedures it will follow when performing its functions.

Laurent Biron is the Vice-President, Quebec Sales, of NexGen Financial L.P. (“NexGen”), an independent financial services firm focused on value-added investment solutions for financial advisors and their clients. Mr. Biron is mandated with developing the Quebec market for NexGen.

Richard Ness and Liam Cheung are Managing Directors of Tactico, Inc. (“Tactico”). Tactico implements strategic solutions that solve immediate business challenges and position companies for long-term success. The company provides consulting, venture and transition management, interim c-level staffing and technology solutions for the financial services industry. Tactico’s managing directors oversee and take fiduciary and regulatory responsibility for each assignment.

In accordance with NI 81-107, the mandate of the IRC is to consider and provide recommendations to the Manager or to approve or refuse the Manager’s proposals on conflicts of interest to which the Manager is subject when managing the Fund. The Manager is required under NI 81-107 to identify conflicts of interest inherent in its management of the Fund, and request input from the IRC on how it manages those conflicts of interest, as well as on its written policies and procedures outlining its management of those conflicts of interest.

The Manager must refer its proposed course of action in respect of any such conflict of interest matters to the IRC for its review. Certain matters require the IRC’s prior approval, but in most cases the IRC will provide a recommendation to the Manager as to whether or not, in the opinion of the IRC, the Manager’s proposed action provides a fair and reasonable result for the Fund. For recurring conflict of interest matters, the IRC can provide the Manager with standing instructions.

The members of the IRC are indemnified by the Manager and the Fund, in keeping with NI 81-107. The costs and expenses of the IRC are paid by the Fund. However, the Manager has arranged for a director and officer liability insurance policy in respect of the IRC members and their related activities. The IRC members will be indemnified by the Manager for matters or amounts not covered under that insurance policy. The IRC members are not responsible for the investments made by the Fund, or for the performance of the Fund. While the Manager does not currently manage any other funds that require an IRC, the members of the IRC may serve in a similar capacity in respect of other investment funds managed by the Manager in the event the Manager creates other funds that would require an IRC. The IRC members set their own compensation in accordance with NI 81-107. In addition, the IRC has the authority, pursuant to NI 81-107, to retain independent counsel or other advisors, at the expense of the Fund, if the members deem it necessary to do so.

The IRC prepares, at least annually, a report of its activities for investors in the Fund which is available on our website at [www.palosmanagement.com](http://www.palosmanagement.com) or upon request by any investor, at no cost, by calling: (514) 397-0188 (or toll-free at 1 (855) PALOS88 (1-855-725-6788)) or e-mailing to: [info@palosmanagement.com](mailto:info@palosmanagement.com).

Certain matters relating to the Fund may not be acted upon except with the consent of the Unitholders. These matters include a change in the Manager (except to an affiliate), any change in the fundamental investment objectives and any other matter required by law to be put to a

vote of Unitholders. Unitholder approval will not be required for a change in the auditors of the Fund provided the IRC has approved such change and Unitholders receive notice 60 days in advance of any such change in auditors. Subject to the specific provisions and criteria of NI 81-102, Unitholder approval will not be required for the Fund's reorganization with or transfer of assets to another mutual fund managed by the Manager or an affiliate of the Manager provided the IRC has approved such reorganization, Unitholders receive notice 60 days in advance of any such reorganization and Unitholders of the Fund become Unitholders in the other mutual fund. These provisions only apply to the terminating fund.

### ***Policies on proxy voting***

It is the Manager's standing policy to monitor corporate actions and vote proxies in accordance with the best interests of the Fund and the Unitholders of the Fund. The Manager has adopted proxy voting guidelines (the "Proxy Voting Guidelines") that provide that the portfolio advisor will generally vote the securities in the Fund in the best interests of the Unitholders of the Fund, if the Manager feels the participation in the vote will provide value to the Unitholders, or it has a chance to influence the result of the vote. The Proxy Voting Guidelines provide that routine, uncontested matters to be considered at annual general meetings will generally be ignored or voted in accordance with management's recommendations, as long as, in the opinion of the Manager, there is sufficient accountability, transparency, and alignment of management and shareholder interests. More complex, non-routine matters (i.e. certain issues related to the compensation and liability of directors, amendments to the constating documents of an issuer, share and debt issuances, related party transactions, reorganizations, restructurings, shareholder proposals and proposals relating to corporate social responsibility) will be decided on a case-by-case basis, and voted on if the Manager feels the participation in the vote will provide value to the Unitholders, or it has a chance to influence the result of the vote. From time to time, the Manager may also assume an "activist" role in the proxy voting context. For example where an issuer (held in the Fund's investment portfolio) disregards Unitholders concerns or interests in connection with a substantive matter (e.g. a proposed merger) facing that issuer, the Manager may take an "activist" role in relation to that matter if such activism is believed to benefit the Unitholders of the Fund. Such issues will be actively voted upon on a case-by-case basis based upon the merits of each situation. The Manager reviews the proxy voting record of the Fund on a quarterly basis to ensure that its policies and procedures are followed.

If a vote relating to any of the portfolio securities of the Fund presents a conflict of interest between the interests of the Unitholders and those of the Manager, or any affiliate or associate of the Manager or the Fund, the Manager will refer the matter to the IRC for review.

The policies and procedures that the Fund follows when voting proxies relating to securities held by the Fund are available on request free of charge from the Manager by calling: (514) 397-0188 (or toll-free at 1 (855) PALOS88 (1-855-725-6788)) or e-mailing to [info@palosmanagement.com](mailto:info@palosmanagement.com). The Fund's proxy voting record for the most recent period ended June 30 of each year is available free of charge to any Unitholder upon request at any time after August 31 of that year. The proxy voting record will also be available on the Manager's website at [www.palosmanagement.com](http://www.palosmanagement.com).

## ***Policies on the use of derivatives***

The Fund is permitted to use derivatives from time to time as described in the Fund's simplified prospectus and in compliance with the requirements contained in NI 81-102. Derivative transactions on behalf of the Fund may be initiated only by the portfolio adviser in specified derivatives as permitted by securities regulations. Furthermore, policies, procedures and guidelines regarding investing in derivatives are compiled and reviewed annually by the Manager. The Manager records, values, monitors and reports internally on the derivative transactions that are entered into the Fund's portfolio records. A monthly derivative trading report is prepared identifying the Fund's derivative activity, if any, and the Fund's compliance with regulatory requirements. Exceptions are identified along with applicable corrective action undertaken. Derivatives will not be used to create leverage within the Fund's portfolio unless permitted under NI 81-102. The Fund will primarily engage in writing (selling) covered call and covered put options. Charles Marleau will monitor the Fund's use of derivatives and will be responsible for ensuring that the Fund adheres to the limitations set out in this policy and in NI-81-102.

## ***Short selling risk management***

The Fund may engage in short selling from time to time as described under "Investment restrictions – Short selling" above.

Written policies and procedures relating to short selling by the Fund (including risk management procedures described under "Investment restrictions – Short selling" above) have been developed by the Manager. Any agreements, policies and procedures that are applicable to the Fund relating to short selling (including trading limits and controls in addition to those specified above) have been prepared and reviewed by senior management of the Manager. The IRC will be kept informed of the Manager's short selling policies. The decision to effect any particular short sale will be made by senior portfolio managers and reviewed and monitored as part of the Manager's ongoing compliance procedures and risk control measures.

## ***Short term trading policies***

The Manager has policies and procedures in place to actively monitor, detect and deter inappropriate or excessive short-term trading. The Manager may amend such policies or procedures from time to time, without notice. All Unitholders of the Fund are subject to the short-term trading policies.

The Manager reviews all trades in units of the Fund to identify redemptions and switches that occur within 90 days of the purchase. Such trades are considered by the Manager to be short term trades and, where the Manager, in its discretion, deems the short-term trade to be inappropriate, the trades will be subject to such action as the Manager considers appropriate to deter the continuance of such behaviour.

Such action may include the application of a short term trading fee of up to 2.00% or the rejection of future purchase orders. The short-term trading fee does not apply in certain circumstances, including: (a) if you switch to another series of units in the Fund, if any; (b) redemption of units purchased by the reinvestment of distributions, if any; (c) reclassification of units from one series to another series of the Fund; or (d) redemptions initiated by the Manager. In considering whether a short term trade is inappropriate, the Manager will generally consider the value of the transaction, the potential impact on the Fund, and the account activity.

Where the Manager identifies an inappropriate short term trade, the Manager will review the account to examine trading activity patterns. A letter will generally be sent to the account advisor, describing the Manager's policy in respect of short term trading and advising that the account has been flagged for an automatic fee application of 2.00% in the event of another trade or trades occurring within a 90 day period.

The Fund does not have any arrangements, formal or informal, with any person or company to permit short-term trading.

## **Fees and expenses**

### ***Management fee distributions and rebates***

To encourage large investments in the Fund, we may reduce the management fees we charge. If you make a large investment in the Fund, we may reduce our usual management fee and the Fund will give you the reduction in the form of a special distribution, which is called a management fee distribution.

We negotiate the amount of the reduction with you. It is based on the size of your holdings (generally, your holdings must be more than \$2,000,000), among other things. We calculate management fee distributions and management fee rebates on each business day. They are distributed or paid regularly to eligible investors.

Reductions in management fees and management fee distributions will not have adverse tax consequences to the Fund. See "Income Tax Considerations" below for information on the tax consequences to the Unitholders of management fee distributions or management fee rebates.

Management fee distributions are made first out of net income and net realized capital gains and then out of capital. We will reinvest the distribution or rebate in the Fund that paid the distribution or rebate, unless you tell us you want to receive it in cash or reinvest it in another fund, if any.

## **Income tax considerations**

This section describes the principal Canadian federal income tax considerations applicable to the Fund and to investors who are individuals resident in Canada (other than trusts), who deal with the Fund at arm's length, are not affiliated with the Fund and who hold securities of the Fund as capital property for tax purposes.

This summary takes into account the current provisions of the Tax Act and the regulations under the Tax Act, all proposals to amend the Tax Act and regulations publicly announced prior to the date hereof and the administrative practices and policies of the Canada Revenue Agency published in writing by it prior to the date hereof. This summary does not otherwise take into account or anticipate any change in law or administrative practice, whether by legislative, regulatory, administrative or judicial action. In addition, it does not take into account provincial or foreign tax considerations. This summary assumes that at all material times the Fund will qualify as a mutual fund trust. This summary also assumes that the Fund has elected pursuant to subsection 39(4) of the Tax Act to have all Canadian securities owned by it deemed to be capital property.

This summary is not intended to be exhaustive of all possible income tax considerations. You should consult your own tax adviser for advice with respect to the tax consequences of an investment in the Fund in your particular circumstances.

### ***Taxation of the Fund***

In each taxation year of the Fund, the net income and net realized capital gains, if any, of the Fund as would otherwise be taxable in the Fund will be payable to Unitholders and paid by the Fund in cash or reinvested in additional units of the Fund. Consequently, the Fund will not be liable for income tax under Part I of the Tax Act. Capital or income losses incurred by the Fund cannot be allocated to Unitholders but may, subject to certain limitations, be deducted by the Fund from its capital gains or net income realized in subsequent years.

The Fund is required to compute net income and net realized capital gains in Canadian dollars for the purposes of the Tax Act. As a result, the Fund may realize income or capital gains by virtue of changes in the value of a foreign currency relative to the Canadian dollar.

The Fund will not realize an income, gain or loss as a result of entering into a forward agreement. Gain or loss realized on the physical settlement of a forward agreement will be on capital account. The "suspended loss" rules in the Tax Act may prevent the Fund from recognizing capital losses on the disposition of securities in certain circumstances which may increase the amount of net realized gains of the Fund to be paid to Unitholders.

Generally, gains and losses from derivative transactions (which does not include the forward agreement) and short sales of securities other than Canadian securities will, for tax purposes, be on income account rather than capital account. Short sales of Canadian securities will be on capital account.

The higher the Fund's portfolio turnover rate in a year, the greater the chance the Fund will generate gains and losses in the year.

Generally, a fund that invests in certain publicly traded trusts or partnerships (a "SIFT trust" or "SIFT partnership", as defined in the Tax Act) will be required to include in income as a taxable dividend received from a taxable Canadian corporation, certain amounts in respect of the "non-portfolio earnings" of the SIFT trust or SIFT partnership paid or allocated, as applicable, to the fund.

### ***Units held in registered tax plans***

If units are held in a Registered Plan, income (including dividends) and capital gains received from the Fund, and capital gains realized on selling or transferring the units of the Fund, will not be taxable in such Registered Plans, but any amounts withdrawn from such Registered Plans may be taxable at such time.

Distributions from TFSAs are generally not taxable. Holders of units should consult their own advisors as to whether the units of the Fund will be a prohibited investment for a tax-free savings account in their particular circumstances.

Provided the Fund qualifies as a "mutual fund trust", as defined in the Tax Act, the units of the Fund are qualified investments under the Tax Act for Registered Plans. See "Eligibility under the Income Tax Act".

### ***Securities held in nonregistered accounts***

Unitholders must include in their income all net income and net taxable capital gains, if any, payable to them by the Fund, whether paid by reinvestment in additional units or in cash. To the extent applicable, the Fund intends to make designations to ensure that the maximum portion of its dividends from taxable Canadian corporations (including deemed dividends), foreign income, net realized capital gains and foreign creditable tax will be received by Unitholders as dividends from taxable Canadian corporations, foreign income or taxable capital gains, as the case may be, or will be deemed to be paid by Unitholders in the case of foreign creditable tax.

Dividends from taxable Canadian corporations distributed by the Fund, other than capital gains dividends, whether paid by reinvestment in additional units or in cash, are eligible for a dividend tax credit through the gross-up and credit procedure applicable to dividends received from taxable Canadian corporations, including the enhanced gross-up and tax credit available for eligible dividends.

When Unitholders purchase units of the Fund, a portion of the price paid may reflect income and capital gains of the Fund for the year. The amounts paid to Unitholders must be included in their income for tax purposes subject to the provisions of the Tax Act, even though the Fund

earned these amounts before the Unitholders owned the units. This could arise if a Unitholder buys a unit before a distribution date, such as just before end of a fiscal quarter of the Fund or just before a dividend is declared.

Unitholders are generally required to include in their income any management fee distributions paid by the Fund. If distributions by the Fund (including management fee distributions) in any year exceed the Fund's net income and net realized capital gains for the year, the excess amount paid to the Unitholder will not be included in his or her income but will reduce the adjusted cost base of his or her units by the excess amount paid to that Unitholder. If the adjusted cost base of your units of the Fund were to become negative, you would be deemed to realize a capital gain equal to that amount.

Where a Unitholder redeems or otherwise disposes of, or is deemed to dispose of, securities, generally a capital gain (or a capital loss) will be realized to the extent that the proceeds of disposition of the securities exceed (or are exceeded by) the aggregate of the adjusted cost base to the Unitholder of the securities and any reasonable costs of disposition. One-half of a capital gain must be included in computing the Unitholder's income under the Tax Act.

In certain situations where you dispose of units of the Fund and would otherwise realize a capital loss, the loss will be denied. This may occur if you, your spouse or another person affiliated with you (including a corporation controlled by you) has acquired units of the Fund within 30 days before or after you dispose of your securities, which are considered to be "substituted property". In these circumstances, your capital loss may be deemed to be a "superficial loss" and denied. The amount of the denied capital loss will be added to the adjusted cost base for the securities which are substituted property. The adjusted cost base of units of the Fund to a Unitholder is, generally, the amount paid for units of the Fund, plus the amount of reinvested distributions or dividends on the units, minus the capital returned in any distributions, minus the adjusted cost base of securities of the Fund previously redeemed. A consolidation of securities, including a consolidation immediately following a dividend, will not result in a disposition of securities for tax purposes. The aggregate adjusted cost base for your securities will not change as a result of consolidation but the adjusted cost base per security will increase. Unitholders should keep detailed records of the purchase costs, sales charges and dividends or distributions related to their securities.

Individuals are subject to an alternative minimum tax. Capital gains, capital gains dividends and taxable dividends may give rise to liability for such minimum tax.

## **Remuneration of directors, officers and trustees**

No other remuneration, fees or reimbursement of expenses are paid by the Fund to the directors or officers of the Trustee. The Trustee is paid an annual fee for its services in such capacity. Annual fees payable to the Trustee are negotiated between the Trustee and the Manager. The Fund paid the Trustee a fee of \$20,600 for its services in such capacity for the financial year ended December 31, 2011.

Each IRC member is paid \$4,000 per annum. The IRC is ultimately responsible for setting reasonable compensation for its members. Each year the IRC determines and discloses its compensation in its annual report to investors in the Fund.

## **Material contracts**

The following contracts can reasonably be regarded as material to Unitholders of the Fund:

- Amended and Restated Trust Agreement dated July 15, 2011 between the Manager and the Trustee, as amended by Supplemental Trust Agreement dated February 24, 2012 as described under “Name, formation and history of the Fund” beginning on page 3;
- Management Agreement between the Manager and the Trustee, dated July 15, 2011, as amended on February 24, 2012, as described under “Responsibility for mutual fund operations” beginning on page 14;
- Custodian Agreement between CIBC World Markets Inc. and the Manager on behalf of the Fund dated January 7, 2011, as described under “Responsibility for mutual fund operations” beginning on page 14.
- IAS Services Agreement between The Investment Administration Solution Inc. and Palos Capital Corporation dated June 28, 2006, as amended by Addendum Agreement on May 17, 2010, as described under “Responsibility for mutual fund operations” beginning on page 14.

Copies of these material agreements may be inspected during business hours at the principal office of the Manager.

## **Legal and administrative proceedings**

The Fund and the Manager are not involved in any material legal proceedings, nor is the Manager aware of existing or pending legal or arbitration proceedings involving the Fund or the Manager, other than with respect to the following:

On November 23, 2011, the Manager reached a settlement with the Autorité des marchés financiers (the “AMF”) whereby the Manager agreed to pay a monetary administrative penalty of \$26,500 for a failure by the Manager to include certain components of certain financial statements that were filed for the periods ending June 30, 2009, December 31, 2009 and June 30, 2010. The settlement relates to investment funds managed by the Manager and offered under statutory prospectus exemptions, including the Fund before it was offered to the public by simplified prospectus, and another investment vehicle.

## **Auditor's consent**

We have read the Simplified Prospectus and the related Annual Information Form of Palos Equity Income Fund dated February 24, 2012 relating to the issue and sale of units of the Fund. We have complied with Canadian generally accepted standards for the auditors' involvement with offering documents.

We consent to the incorporation by reference in the above-mentioned Simplified Prospectus and the related Annual Information Form of our report to the Unitholders of Palos Equity Income Fund on the statement of investment portfolio as at December 31, 2010, the statements of net assets as at December 31, 2010 and 2009, and the statements of operations, changes in net assets and cash flows for the years then ended. Our report is dated March 30, 2011.

*(s) BDO Canada LLP*  
Chartered Accountants  
CA auditor permit No. 16549

Montreal, Québec  
February 24, 2012

## Certificate of the Fund

This Annual Information Form together with the Simplified Prospectus and the documents incorporated by reference into the Simplified Prospectus, constitute full, true and plain disclosure of all material facts relating to the securities offered by the Simplified Prospectus, as required by the securities legislation of the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador and do not contain any misrepresentations.

DATED the 24<sup>th</sup> day of February, 2012.

Palos Management Inc. is duly authorized on behalf of the Trustee of  
Palos Equity Income Fund

*(signed) Charles Marleau*

Charles Marleau  
President

*(signed) Alain Lizotte*

Alain Lizotte  
Chief Financial Officer

## Certificate of the Manager and the Promoter

This Annual Information Form together with the Simplified Prospectus and the documents incorporated by reference into the Simplified Prospectus, constitute full, true and plain disclosure of all material facts relating to the securities offered by the Simplified Prospectus, as required by the securities legislation of the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador and do not contain any misrepresentations.

DATED the 24<sup>th</sup> day of February 2012.

Palos Management Inc. as Manager and Promoter of  
Palos Equity Income Fund

*(signed) Charles Marleau*

Charles Marleau

President, acting as the Chief Executive Officer

*(signed) Alain Lizotte*

Alain Lizotte

Chief Financial Officer

On behalf of the Board of Directors of Palos Management Inc. as Manager and Promoter of  
Palos Equity Income Fund

*(signed) Peter J. Malouf*

Peter J. Malouf

Director

*(signed) Robert Boisjoli*

Robert Boisjoli

Director



Additional information about the Fund is available in the Fund's Fund Facts, management reports of fund performance and financial statements.

You can get a copy of these documents at your request and at no cost, by calling (514) 397-0188 (or toll-free at 1 (855) PALOS88 (1-855-725-6788)) or by e-mailing [info@palosmanagement.com](mailto:info@palosmanagement.com), or by asking your Dealer.

These documents and other information about the Fund, such as information circulars and material contracts, are also available at the Manager's website at [www.palosmanagement.com](http://www.palosmanagement.com) or at [www.sedar.com](http://www.sedar.com).

Manager of the Fund:

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