

Palos Equity Income Fund

Financial Statements

June 30, 2016 and 2015

(expressed in Canadian dollars)

Palos Equity Income Fund

Notice

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

Palos Equity Income Fund

Statements of Financial Position

(expressed in Canadian dollars)

	As at June 30, 2016 \$	As at December 31, 2015 \$
Assets		
Current assets		
Investments	21,616,373	20,163,672
Cash	360,912	154,653
Prepaid	13,799	-
Receivable from investments sold	267,690	-
Subscriptions receivable	402,275	-
Accrued income receivable	44,407	50,936
	<hr/> 22,705,456	<hr/> 20,369,261
Liabilities		
Current liabilities		
Investments purchased payable	151,040	-
Distributions payable	72,990	148,966
Accrued liabilities	32,845	29,983
Management fees payable	-	274
Performance fees payable	-	110,290
	<hr/> 256,875	<hr/> 289,513
Net assets attributable to holders of redeemable units	<hr/> 22,448,581	<hr/> 20,079,748
Net assets attributable to holders of redeemable units per series		
Series A	17,827,143	17,441,588
Series F	4,621,438	2,638,160
Net assets attributable to holders of redeemable units per series per unit		
Series A	5.94	5.93
Series F	6.18	6.13

Approved by the Manager, Palos Management Inc.

(s) Charles Marleau

Director

(s) Robert Boisjoli

Director

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

Palos Equity Income Fund
Statements of Comprehensive Income
For the periods ended June 30, 2016 and 2015

(expressed in Canadian dollars)

	Note	2016 \$	2015 \$
Income			
Dividend income		245,350	257,720
Interest income for distribution purposes		66,823	76,771
Other changes in fair value of investments			
Net realized gain on sale of investments		665,343	1,026,733
Net change in unrealized appreciation of investments		467,802	21,216
Total income (net)		1,445,318	1,382,440
Expenses			
Management fees	8	163,852	172,076
Performance fees	8	-	168,134
Administration and other professional fees		41,676	39,246
Trustee fees		6,842	6,804
Audit fees		20,675	15,165
Legal fees		7,666	11,015
Bank charges and interest		3,160	2,249
Independent review committee fees		5,951	5,918
Transaction cost		42,692	18,127
Withholding tax expense		1,962	4,079
Total expenses (net)		294,476	442,813
Increase in net assets attributable to holders of redeemable units		1,150,842	939,627
Increase (decrease) in net assets attributable to holders of redeemable units per series			
Series A		921,082	828,269
Series F		229,760	111,358
Increase (decrease) in net assets attributable to holders of redeemable units per series per unit			
Series A		0.31	0.29
Series F		0.41	0.33

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

Palos Equity Income Fund

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

For the periods ended June 30, 2016 and 2015

(expressed in Canadian dollars)

	Series A		Series F	
	2016 \$	2015 \$	2016 \$	2015 \$
Net assets attributable to holders of redeemable units – Beginning of period	17,441,588	19,195,000	2,638,160	1,873,710
Increase in net assets attributable to holders of redeemable units	921,082	828,269	229,759	111,358
Distributions to holders of redeemable units				
Net investment income	(36,578)	-	(21,995)	-
From net realized gains on investments and derivatives	(520,742)	(805,363)	(103,724)	(113,049)
Return of capital	(325,641)	(339,872)	(58,404)	(37,241)
Total distributions to holders of redeemable units	(882,961)	(1,145,235)	(184,123)	(150,290)
Redeemable unit transactions				
Proceeds from redeemable units issued	627,156	1,257,355	1,823,467	1,267,907
Reinvestments of distributions to holders of redeemable units	667,042	850,014	179,140	133,436
Redemption of redeemable units	(946,764)	(1,451,063)	(64,965)	(334,740)
Net increase from redeemable unit transactions	347,434	656,306	1,937,642	1,067,603
Net increase in net assets attributable to holders of redeemable units	385,555	339,340	1,983,278	1,028,671
Net assets attributable to holders of redeemable units – End of period	17,827,143	19,534,340	4,621,438	2,902,381

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

Palos Equity Income Fund

Statements of Cash Flows

For the periods ended June 30, 2016 and 2015

(expressed in Canadian dollars)

	2016 \$	2015 \$
Cash flows from operating activities		
Increase in net assets attributable to holders of redeemable units	1,150,841	939,627
Adjustments for		
Foreign exchange loss on cash	(195,095)	(9,096)
Net realized gain on sale of investments	(665,343)	(1,026,732)
Net change in unrealized appreciation of investments	(467,802)	(21,216)
Proceeds from sale and maturity of investments	11,635,828	11,351,472
Purchases of investments	(12,072,034)	(11,377,504)
Prepaid	(13,799)	-
Accrued income receivable	6,529	13,945
Accrued liabilities	2,862	271
Management fees payable	(274)	506
Performance fees payable	(110,290)	168,134
Net cash from (used in) operating activities	<u>(728,577)</u>	<u>39,407</u>
Cash flows from financing activities		
Distributions paid to holders of redeemable units, net of reinvested distributions	(296,879)	(310,267)
Proceeds from issuance of redeemable units	2,048,348	2,574,923
Amount paid on redemption of redeemable units	(1,011,729)	(1,798,821)
Net cash from (used in) financing activities	<u>739,741</u>	<u>465,835</u>
Foreign exchange loss on cash	<u>195,095</u>	<u>9,096</u>
Net change in cash during the period	206,259	514,338
Cash – Beginning of period	<u>154,653</u>	<u>455,982</u>
Cash – End of period	<u>360,912</u>	<u>970,320</u>
Supplementary information on cash flows from operating activities		
Interest received	68,685	81,659
Dividends received, net of withholding taxes	249,997	265,765

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

Palos Equity Income Fund

Schedule of Investment Portfolio

As at June 30, 2016

(expressed in Canadian dollars)

	Maturity date	Coupon or dividend rate	Number of shares or par value	Average cost \$	Fair value \$
Bonds					
Convertible bonds					
Boralex Inc.	June 30, 2020	4.500%	300,000	300,000	344,820
Chemtrade Logistics Inc.	June 30, 2021	5.250%	240,000	240,000	242,760
DH Corp.	Sept. 30, 2020	5.000%	350,000	350,000	359,590
Element Financial Corp.	June 30, 2019	5.125%	250,000	259,525	269,375
Northland Power Inc.	June 30, 2020	4.750%	250,000	250,000	275,000
Total convertible bonds				<u>1,399,525</u>	<u>1,491,545</u>
Corporate bonds					
Canadian Energy Service & Technology Corp.	April 17, 2020	7.375%	250,000	264,375	236,250
DHX Media Ltd.	Dec. 2, 2021	5.875%	500,000	500,000	492,500
Parkland Fuel Corp.	May 28, 2021	5.500%	200,000	200,000	202,000
Total corporate bonds				<u>964,375</u>	<u>930,750</u>
Total bonds				<u>2,363,900</u>	<u>2,422,295</u>
Common stocks					
Consumer discretionary					
Cineplex Inc.			5,000	221,249	257,900
DHX Media Ltd - Class B			37,000	301,873	244,200
Dollarama Inc.			4,500	354,006	405,900
Enercare Inc.			15,000	231,375	256,500
Gildan Activewear Inc.			8,000	283,418	302,720
Goeasy Ltd			11,000	215,885	202,290
Imvescor Restaurant Group Inc.			40,000	106,381	108,000
Linamar Corp.			7,000	324,149	322,140
Martinrea International Inc.			20,000	202,140	160,000
Restaurant Brands International Inc.			8,000	396,139	430,240
Sleep Canada Holdings Inc.			17,000	279,822	404,940
Spin Master Corp.			13,000	345,800	346,450
Stingray Digital - Subordinate			40,120	306,602	280,840
Total consumer discretionary				<u>3,568,839</u>	<u>3,722,120</u>

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

Palos Equity Income Fund
Schedule of Investment Portfolio ... *continued*
As at June 30, 2016

(expressed in Canadian dollars)

	Number of shares or par value	Average cost \$	Fair value \$
Consumer staples			
Alimentation Couche Tard - Class B	5,000	232,426	277,400
Cott Corporation	13,000	239,885	234,780
Maple Leaf Foods Inc.	14,000	301,883	386,260
Ten Peaks Coffee Co Inc.	15,000	113,250	118,650
Total consumer staples		<u>887,444</u>	<u>1,017,090</u>
Energy			
ARC Resources Ltd.	19,000	334,446	420,090
CalFrac Well Services Ltd.	25,000	93,708	97,000
Canadian Energy Services Technologies	70,000	410,476	284,900
Canyon Services Group Inc.	15,000	86,096	84,750
Crescent Point Energy Trust (New)	17,000	338,785	346,970
Enbridge Inc.	8,000	344,105	437,840
Keyera Corp.	15,200	518,285	600,704
Pembina Pipeline Corp	9,000	280,267	353,340
Secure Energy Services Inc.	54,000	655,625	476,820
Tamarack Valley Energy Ltd.	75,000	205,898	275,250
Tidewater Midstream and Infrastructure Ltd.	200,000	271,250	254,000
Vermilion Energy Inc.	8,300	370,325	341,462
Whitecap Resources Inc.	45,000	547,329	444,600
Total energy		<u>4,682,595</u>	<u>4,417,726</u>
Financials			
Alaris Royalty Corp.	11,000	331,086	315,370
American Hotel Income Properties REIT	25,500	261,904	268,770
Bank of Nova Scotia	4,000	208,179	253,240
Element Financial Corp.	15,000	211,165	205,500
Goldman Sachs Group Inc.	1,600	316,613	307,477
Intact Financial Corp.	4,200	385,243	387,618
Keycorp	10,000	136,426	142,921
Manulife Financial Corp.	13,000	279,500	229,710
Royal Bank of Canada	10,000	755,462	763,400
Sun Life Financial Inc.	12,000	453,658	509,280
Toronto - Dominion Bank	13,514	534,390	749,757
Wells Fargo & Co	6,260	221,533	383,216
Total financials		<u>4,095,159</u>	<u>4,516,259</u>

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

Palos Equity Income Fund
Schedule of Investment Portfolio ... *continued*
As at June 30, 2016

(expressed in Canadian dollars)

	Number of shares or par value	Average cost \$	Fair value \$
Health Care			
Concordia International Corp.	6,000	178,980	166,980
Knight Therapeutics Inc.	19,700	157,600	163,510
Sienna Senior Living – subscription receipt	10,000	158,500	170,900
Total Health care		<u>495,080</u>	<u>501,390</u>
Industrials			
Badger Daylighting Ltd.	15,000	395,856	337,500
Black Diamond Group Inc.	15,000	76,238	80,850
Heroux-Devtek Inc.	12,000	145,306	180,000
Morneau Shepell Inc.	13,635	142,329	241,885
Waste Connections Inc.	2,999	245,613	279,927
WSP Global Inc.	9,000	339,002	355,680
Total industrials		<u>1,344,344</u>	<u>1,475,842</u>
Information technology			
CGI Group Inc. – Class A	4,000	227,998	220,760
Kinaxia Inc.	4,000	143,414	207,520
Shopify inc.	6,000	219,887	238,560
Total information technology		<u>591,299</u>	<u>666,840</u>
Materials			
Agnico-Eagle Mines	7,000	282,653	483,980
Agrium Inc.	2,684	288,594	313,733
AirBoss of America Corp.	11,000	167,329	155,210
CCL Industries Inc. – Class B	1,600	219,107	359,744
Goldcorp Inc.	12,000	274,805	296,640
Lundin Mining Corp.	105,000	488,414	457,800
Nevsun Resources Ltd.	60,000	237,957	227,400
Semafo Inc.	30,000	182,633	186,000
Total materials		<u>2,141,492</u>	<u>2,480,507</u>
Utilities			
Crius Energy Trust	20,800	171,817	174,304
Northland Power Inc.	10,000	157,391	222,000
Total utilities		<u>329,208</u>	<u>396,304</u>
Total common stock		<u>18,135,459</u>	<u>19,194,078</u>
Total investments		<u>20,499,359</u>	<u>21,616,373</u>

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2016

(expressed in Canadian dollars)

1 General information

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

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

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

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

These financial statements have been authorized for issue by the Board of Directors of the Manager on August 16, 2016.

2 Basis of presentation and adoption of IFRS

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2016

(expressed in Canadian dollars)

3 Summary of significant accounting policies

Financial instruments

Recognition

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

Income recognition

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

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

Fair value measurement

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2016

(expressed in Canadian dollars)

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

Classification of redeemable units

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

Foreign currency translation

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

Offsetting financial assets and financial liabilities

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

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

Cash

Cash comprises deposits with financial institutions and bank overdraft.

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

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2016

(expressed in Canadian dollars)

Taxation

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

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

Accounting standards issued but not yet adopted

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9, Financial Instruments, which replaces IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 covers requirements related to the classification and measurement of financial assets and financial liabilities, the impairment of financial assets, and hedge accounting.

IFRS 9 establishes a new classification and measurement model for financial assets to determine whether a financial asset must be classified as measured at amortized cost, at fair value through profit or loss or at fair value through other comprehensive income. This model is based on the characteristics of the contractual cash flows of the financial asset and on the business model under which it is held. For the classification and measurement of financial liabilities, the new standard essentially follows the current requirements under IAS 39.

The standard also introduces a single impairment model for financial assets that requires recognizing expected credit losses instead of incurred losses, which is the requirement under the current impairment model. The model provides for a multi-phase approach based on changes in credit quality since initial recognition.

Lastly, IFRS 9 includes a new hedge accounting model to align hedge accounting more closely with risk management activities.

The effective date of IFRS 9 was set for annual periods beginning on or after January 1, 2018. The Fund is currently assessing the impact of adopting this standard and has not yet determined if it will early adopt the new standard.

IFRS 7 – Financial Instruments Disclosures

IFRS 7 is effective for annual periods beginning on or after January 1, 2018. Amendments to IFRS 7 consist of additional disclosures required for the transition from IAS 39 to IFRS 9.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2016

(expressed in Canadian dollars)

4 Critical accounting estimates and judgments

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

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

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

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

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

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2016

(expressed in Canadian dollars)

5 Risks associated with financial instruments

Risk factors

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

Credit risk

The Fund is exposed to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The majority of the credit risk to which the Fund is exposed arises from its investments in debt securities. In selecting fixed income securities for the Fund, the Manager considers factors such as the debt security's yield, risk of interest rate fluctuation, credit risk, the issuer's capital structure, credit spread and duration. The analysis below summarizes the credit quality of the Fund's debt portfolio as at June 30, 2016 and December 31, 2015.

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Credit rating	Total fixed income %	Total fixed income %
BB	28.7	27.5
B	9.8	9.2
Non rated	61.5	63.3
	<u>100.0</u>	<u>100.0</u>

Source: Standard & Poor's

All portfolio transactions in securities are settled or paid for upon delivery using approved brokers. The risk of default is considered minimal as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities are received by the broker. The trade will not settle if either party fails to meet its obligation. In addition, the Fund lodges its cash with quality institutions which have credit ratings of AA- or above. Credit risk with respect to accrued income receivable is limited as the receivables are derived from a portfolio of diversified investments.

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

Palos Equity Income Fund

Notes to financial statements

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(expressed in Canadian dollars)

Liquidity risk

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

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

	June 30, 2016		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Investments purchase payable	-	151,040	151,040
Distributions payable	-	72,990	72,990
Accrued liabilities	-	32,845	32,845
Redeemable units	22,448,581	-	22,448,581
	December 31, 2015		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Distributions payable	-	148,966	148,966
Accrued liabilities	-	29,983	29,983
Management fees payable	-	274	274
Performance fees payable	-	110,290	110,290
Redeemable units	20,079,748	-	20,079,748

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

Palos Equity Income Fund

Notes to financial statements

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(expressed in Canadian dollars)

Market risk

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

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

a) Currency risk

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

The table below indicates the foreign currencies to which the Fund had significant exposure as at June 30, 2016 and December 31, 2015, in Canadian dollars. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the Canadian dollar had strengthened or weakened by 5% in relation to each of the other currencies, with all other variables held constant. The monetary exposure presents the impact on cash and the non-monetary exposure presents the impact on investments. Non-monetary items are investments in equity securities and are classified based on the currency in which they were purchased.

Currency	June 30, 2016					
	Exposure			Impact on net assets attributable to holders of redeemable units and the increase (decrease) thereof		
	Monetary \$	Non- monetary \$	Total \$	Monetary \$	Non- monetary \$	Total \$
United States dollar	1,050,983	833,614	1,884,597	52,549	41,681	94,230
% of net assets attributable to holders of redeemable units	4.7%	3.7%	8.4%	0.2%	0.2%	0.4%

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Currency	December 31, 2015					
	Exposure			Impact on net assets attributable to holders of redeemable units and the increase (decrease) thereof		
	Monetary \$	Non- monetary \$	Total \$	Monetary \$	Non- monetary \$	Total \$
United States dollar	895,965	1,240,843	2,136,808	44,798	62,042	106,840
% of net assets attributable to holders of redeemable units	4.5%	6.2%	10.7%	0.2%	0.3%	0.5%

b) Interest rate risk

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

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

Terms to maturity	Total exposure	
	June 30, 2016 \$	December 31, 2015 \$
1-5 years	1,929,795	1,449,500
5-10 years	492,500	1,047,475
Total	2,422,295	2,496,975
Impact on net assets attributable to holders of redeemable units	79,524	47,717
Impact on net assets attributable to holders of redeemable units %	0.4%	0.2%

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c) Price risk

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

As at June 30, 2016, the expected increase or decrease in net assets attributable to holders of redeemable units of the Fund if the S&P/TSX composite index had increased or decreased by 5%, with all other variables held constant would be \$939,799 and would represent 4.2% of the net assets attributable to holders of redeemable units of the Fund (December 31, 2015 – \$943,748 and represent respectively 4.7% of the net assets attributable to holders of redeemable units of the Fund).

Concentration risk

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

Market segment	June 30, 2016 %	Dec. 31, 2015 %
Consumer discretionary	19.5	18.4
Consumer staples	4.7	3.5
Energy	22.6	19.0
Financials	22.1	28.6
Health care	2.3	2.2
Industrials	6.8	8.0
Information technology	4.7	3.8
Materials	12.6	10.2
Utilities	4.7	6.3
Asset class weighting	June 30, 2016 %	Dec. 31, 2015 %
Convertible bonds	6.6	7.9
Corporate bonds	4.1	4.6
Common stock	85.6	88.0
Other net assets	3.7	(0.5)

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(expressed in Canadian dollars)

Fair value measurement

The carrying amounts of accrued income receivable and others, accrued liabilities, management and performance fees payable, redemptions payable and distributions payable approximate their fair values due to the short term nature of these financial instruments.

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

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

	As at June 30, 2016			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Equities, long	19,194,078	-	-	19,194,078
Fixed income, long	1,491,545	930,750	-	2,422,295

	As at December 31, 2015			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Equities, long	17,666,697	-	-	17,666,697
Fixed income, long	1,579,475	917,500	-	2,496,975

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

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(expressed in Canadian dollars)

a) Equities and convertible bonds

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

b) Bonds and short-term investments

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

There was no transfer between levels during the periods.

6 Gains and losses on financial instruments by category

All of the Fund's non-derivative financial assets were designated, at inception, financial assets at fair value through profit and loss (FVTPL). As at June 30, 2016, the total value of the non-derivative assets and liabilities was \$21,616,373 (December 31, 2015 – \$20,163,672). All of the Fund's derivative liabilities are classified as held for trading (HFT). As at June 30, 2016, the total value of the derivative liabilities was nil (December 31, 2015 – \$nil). Furthermore, all of the Fund's financial assets and financial liabilities other than its non-derivative financial assets and financial liabilities and its derivative liabilities were carried at amortized cost.

The following table presents the net gains on financial instruments at FVTPL by category for the periods ended June 30, 2016 and 2015:

Category	Net gain	
	2016 \$	2015 \$
Financial assets at FVTPL designated at inception		
Unrealized gain	467,802	20,446
Realized gain	665,343	1,002,339
Total financial assets at FVTPL designated at inception	1,133,145	1,022,785
Financial liabilities at FVTPL held for trading		
Unrealized gain	-	770
Realized gain	-	24,393
Total financial liabilities at FVTPL held for trading	-	25,163
Total	1,133,145	1,047,948

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7 Redeemable units

During the periods ended June 30, 2016 and 2015, the number of units issued, redeemed and outstanding was as follows:

	2016		2015	
	Series A	Series F	Series A	Series F
Units outstanding as at January 1	2,941,137	430,256	2,851,909	270,625
Redeemable units issued	108,309	299,398	183,620	181,737
Redeemable units issued on reinvestments	114,416	29,536	126,751	19,279
Redeemable units redeemed	(160,527)	(10,784)	(210,832)	(47,702)
Units outstanding as at June 30	3,003,335	748,406	2,951,448	423,939

Capital structure

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

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

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

8 Related party transactions

a) Management fees and performance fees

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

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

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

The total management fees and performance fees for the period ended June 30, 2016 were \$163,852 and nil respectively (June 30, 2015 – \$172,076 and \$168,134 respectively), with nil in outstanding fees due to the Manager as at June 30, 2016 (December 31, 2015 – \$110,564).

The Manager may waive or absorb the operation of management fees of the Fund. The decision to do so is reviewed regularly and is determined at the sole discretion of the Manager. During the period, the Manager did not waive any fees (2015 – \$0).

The Manager holds 62,442 units of the Fund as at June 30, 2016 (December 31, 2015 – 59,353).

b) Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the period ended June 30, 2016 was \$5,951 (2015 – \$5,918) and consisted only of fixed fees.

9 Brokerage commissions and soft dollars

The total commissions paid by the Fund to brokers in connection with portfolio transactions for the periods ended June 30, 2016 and 2015, together with other transaction charges, are disclosed in the statement of comprehensive income of the Fund. Brokerage business is allocated to brokers based on the best net result for the Fund. Subject to this criteria, preference may be given to brokerage firms which provide (or pay for) certain services (arrangements referred to as soft dollar), which may include investment research, analysis and reports, and data bases or software in support of these services. The ascertainable soft dollar value received as a percentage of total brokerage commissions paid during the periods ended June 30, 2016 and 2015 is disclosed below.

	2016	2015
Soft dollars	\$3,373	\$2,137
Percentage of total transaction costs (%)	8%	12%

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

The increase in net assets attributable to holders of redeemable units per series per unit for the periods ended June 30, 2016 to 2015 is calculated as follows:

	2016		2015	
	Series A \$	Series F \$	Series A \$	Series F \$
Increase in net assets attributable to holders of redeemable units per series	921,082	229,760	828,269	111,358
Weighted average units outstanding during the period	2,970,204	560,419	2,882,796	335,705
Increase in net assets attributable to holders of redeemable units per series per unit	0.31	0.41	0.29	0.33

11 Taxes

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

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

Capital and non-capital losses determined for tax purposes as at December 31, 2015 are as follows:

Capital losses		Non-capital losses	
Amount \$	Expires	Amount \$	Expires
-	-	35,685	2031
-	-	11,873	2032
-	-	165,912	2033