

Palos Equity Income Fund

Interim Financial Statements (unaudited)

June 30, 2019 and 2018

(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 (unaudited)

As at June 30, 2019 and December 31, 2018

	June 30, 2019	December 31, 2018
ASSETS		
Current assets		
Investments at fair value through profit or loss (FVTPL)	\$ 26,748,432	\$ 24,527,554
Cash	366,417	524,906
Receivable for investments sold	–	4,865
Accrued income receivable	132,450	44,086
Prepaid expenses	14,346	–
	<u>27,261,645</u>	<u>25,101,411</u>
LIABILITIES		
Current liabilities		
Redemptions payable	1,645	35,383
Distributions payable	78,886	80,142
Accrued liabilities	37,688	54,136
Management fees payable	–	29,135
Performance fees payable	68	68
	<u>118,287</u>	<u>198,864</u>
Net Assets Attributable to Holders of Redeemable Units	<u>\$ 27,143,358</u>	<u>\$ 24,902,547</u>
Net Assets Attributable to Holders of Redeemable Units per Series		
Series A	\$ 17,102,674	\$ 15,862,490
Series F	10,040,684	9,040,057
	<u>\$ 27,143,358</u>	<u>\$ 24,902,547</u>
Net Assets Attributable to Holders of Redeemable Units per Unit		
Series A	\$ 5.71	\$ 5.35
Series F	6.12	5.69

Approved by the Manager, Palos Management Inc.

(s) Charles Marleau

Director

(s) Robert Boisjoli

Director

Palos Equity Income Fund

Statements of Profit or (Loss) and Comprehensive Income (unaudited) For the periods ended June 30, 2019 and 2018

	2019	2018
Income		
Dividend income	\$ 355,620	\$ 285,247
Interest income for distribution purposes	79,914	61,641
Other income	–	264
Net realized (loss) gain on sale of investments	(564,127)	1,694,966
Net change in unrealized appreciation (depreciation) of investments	3,154,718	(1,741,389)
	<u>3,026,125</u>	<u>300,729</u>
Expenses		
Management fees (Note 8)	187,382	207,415
Administration and other professional fees	69,812	55,972
Transaction costs	26,388	49,014
Audit fees	25,885	20,594
Legal fees	22,082	25,891
Trustee fees	8,023	6,356
Independent Review Committee fees (Note 8)	5,951	5,951
Withholding tax expense	2,026	108
Bank charges and interest	1,592	1,756
Performance fees (Note 8)	–	68
	<u>349,141</u>	<u>373,125</u>
Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units	<u>\$ 2,676,984</u>	<u>\$ (72,396)</u>
Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per Series		
Series A	\$ 1,679,995	\$ (68,442)
Series F	996,989	(3,954)
	<u>\$ 2,676,984</u>	<u>\$ (72,396)</u>
Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per Unit (Note 10)		
Series A	\$ 0.56	\$ (0.02)
Series F	0.62	–

Palos Equity Income Fund

Statements of Changes in Net Assets Attributable to Holders of Redeemable Units (unaudited)

For the periods ended June 30, 2019 and 2018

	Net assets attributable to holders of redeemable units, beginning of period	Proceeds from redeemable units issued	Redemption of redeemable units	Distributions to holders of redeemable units*	Reinvestment of distributions to holders of redeemable units	Increase in net assets attributable to holders of redeemable units	Net Assets attributable to holders of redeemable units, end of period
June 30, 2019							
Series A	\$ 15,862,490	\$ 238,853	\$ (566,663)	\$ (592,720)	\$ 480,719	\$ 1,679,995	\$ 17,102,674
Series F	9,040,057	467,506	(419,165)	(321,627)	276,924	996,989	10,040,684
	<u>\$ 24,902,547</u>	<u>\$ 706,359</u>	<u>\$ (985,828)</u>	<u>\$ (914,347)</u>	<u>\$ 757,643</u>	<u>\$ 2,676,984</u>	<u>\$ 27,143,358</u>

	Net assets attributable to holders of redeemable units, beginning of period	Proceeds from redeemable units issued	Redemption of redeemable units	Distributions to holders of redeemable units*	Reinvestment of distributions to holders of redeemable units	Decrease in net assets attributable to holders of redeemable units	Net Assets attributable to holders of redeemable units, end of period
June 30, 2018							
Series A	\$ 19,092,155	\$ 924,240	\$ (677,794)	\$ (579,929)	\$ 463,357	\$ (68,442)	\$ 19,153,587
Series F	11,159,813	789,675	(1,120,425)	(309,344)	266,816	(3,954)	10,782,581
	<u>\$ 30,251,968</u>	<u>\$ 1,713,915</u>	<u>\$ (1,798,219)</u>	<u>\$ (889,273)</u>	<u>\$ 730,173</u>	<u>\$ (72,396)</u>	<u>\$ 29,936,168</u>

June 30, 2019

	From net investment income	From net realized gains on investments and derivatives	From return of capital	Total distributions to unitholders
*Detailed Distributions to unitholders				
Series A	\$ -	\$ -	\$ (592,720)	(592,720)
Series F	-	-	(321,627)	(321,627)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (914,347)</u>	<u>(914,347)</u>

June 30, 2018

	From net investment income	From net realized gains on investments and derivatives	From return of capital	Total distributions to unitholders
*Detailed Distributions to unitholders				
Series A	\$ -	\$ (579,929)	\$ -	(579,929)
Series F	(35,691)	(273,653)	-	(309,344)
	<u>\$ (35,691)</u>	<u>\$ (853,582)</u>	<u>\$ -</u>	<u>(889,273)</u>

Palos Equity Income Fund

Statements of Cash Flows (unaudited)

For the periods ended June 30, 2019 and 2018

	2019	2018
Cash provided by (used in):		
Operating Activities		
Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units	\$ 2,676,984	\$ (72,396)
Adjustments for non-cash items		
Net change in unrealized (appreciation) depreciation of investments	(3,154,718)	1,741,389
Net realized loss (gain) on sale of investments	564,127	(1,694,966)
Foreign exchange (gain) loss on cash	(986)	3,925
Change in non-cash balances		
Increase in accrued income receivable	(88,364)	(7,542)
Increase in prepaid expenses	(14,346)	-
(Decrease) increase in accrued liabilities	(16,448)	10,618
Decrease in management fees payable	(29,135)	(580)
Decrease in performance fees payable	-	(66,014)
Proceeds from sale of investments	9,202,430	13,927,211
Purchase of investments	<u>(8,827,853)</u>	<u>(13,653,455)</u>
Cash provided by (used in) operating activities	<u>311,691</u>	<u>188,190</u>
Financing Activities		
Proceeds from issuance of redeemable units	645,791	1,713,915
Amount paid on redemption of redeemable units	(958,997)	(1,798,219)
Distributions paid to holders of redeemable units, net of reinvested distributions	<u>(157,960)</u>	<u>(236,096)</u>
Cash used in financing activities	<u>(471,166)</u>	<u>(320,400)</u>
Decrease in cash during the period	(159,475)	(132,210)
Foreign exchange gain (loss) on cash	986	(3,925)
Cash, beginning of period	<u>524,906</u>	<u>1,007,807</u>
Cash, end of period	\$ <u>366,417</u>	\$ <u>871,672</u>
Supplemental information*		
Interest paid	\$ 247	\$ 195
Interest received	68,020	45,580
Dividends received, net of withholding taxes	331,256	300,540

*Included as a part of cash flows from operating activities

Palos Equity Income Fund

Schedule of Investment Portfolio (unaudited)

As at June 30, 2019

Description	Currency	Number of shares	Average cost \$	Fair value \$
Investments owned (98.55%)				
Equities (89.03%)				
Basic Materials (10.43%)				
Agnico Eagle Mines Ltd.	CAD	6,800	300,530	456,552
B2Gold Corp.	CAD	57,000	210,810	226,860
Franco-Nevada Corp.	CAD	4,200	311,141	466,830
Lundin Mining Corp.	CAD	76,400	446,723	550,844
Nutrien Ltd.	CAD	5,752	385,249	402,928
Sociedad Quimica y Minera de Chile SA	USD	4,600	241,989	187,326
Stelco Holdings Inc.	CAD	16,000	353,792	243,200
Teck Resources Ltd.	CAD	9,800	291,956	296,156
Total Basic Materials			2,542,190	2,830,696
Communications (1.15%)				
Quebecor Inc.	CAD	10,000	313,626	311,900
Total Communications			313,626	311,900
Consumer, Cyclical (10.34%)				
Alimentation Couche-Tard Inc.	CAD	4,200	244,701	346,122
Dollarama Inc.	CAD	7,000	191,946	322,490
Goodfood Market Corp.	CAD	30,000	105,000	78,300
Horizon North Logistics Inc.	CAD	136,400	303,619	253,704
Magna International Inc.	CAD	4,800	329,807	312,768
NFI Group Inc.	CAD	7,800	297,765	287,820
Pollard Banknote Ltd.	CAD	10,400	196,416	251,160
Superior Plus Corp.	CAD	21,600	267,424	288,576
The Stars Group Inc.	CAD	11,000	343,153	245,850
Wal-Mart Stores Inc.	USD	2,900	348,596	419,431
Total Consumer, Cyclical			2,628,427	2,806,221
Consumer, Non-cyclical (10.56%)				
Boyd Group Income Fund	CAD	1,500	129,733	248,205
Brookfield Business Partners LP	CAD	5,000	259,430	254,950
Curaleaf Holdings Inc.	CAD	9,000	78,300	83,970
Green Thumb Industries Inc.	CAD	8,100	132,084	118,098
Jamieson Wellness Inc.	CAD	14,500	243,650	291,595
K-Bro Linen Inc.	CAD	7,200	285,007	288,000
Loblaws Cos Ltd.	CAD	4,100	229,372	274,905
Park Lawn Corp.	CAD	8,000	196,000	230,160
People Corp.	CAD	30,700	175,293	248,670
Premium Brands Holdings Corp.	CAD	2,500	178,847	223,775
Savaria Corp.	CAD	16,300	209,595	219,561
Sienna Senior Living Inc.	CAD	19,700	354,225	383,165
Total Consumer, Non-cyclical			2,471,536	2,865,054

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

Palos Equity Income Fund

Schedule of Investment Portfolio (unaudited) As at June 30, 2019 (continued)

Description	Currency	Number of shares	Average cost \$	Fair value \$
Energy (14.92%)				
Enbridge Inc.	CAD	5,757	274,848	272,306
Kelt Exploration Ltd.	CAD	61,100	289,910	238,290
Keyera Corp.	CAD	14,500	483,022	488,650
Parex Resources Inc.	CAD	12,000	254,002	252,120
Parkland Fuel Corp.	CAD	7,750	212,574	322,013
Pembina Pipeline Corp.	CAD	8,249	356,934	402,139
Secure Energy Services Inc.	CAD	59,100	508,657	421,974
Suncor Energy Inc.	CAD	11,000	508,166	449,350
Tidewater Midstream and Infrastructure Ltd.	CAD	261,500	359,068	373,945
TORC Oil & Gas Ltd.	CAD	105,500	574,124	431,495
Whitecap Resources Inc.	CAD	93,500	397,310	397,375
Total Energy			4,218,615	4,049,657
Financial (23.66%)				
Acreage Holdings Inc.	USD	2,500	75,681	53,702
Bank of Montreal	CAD	9,000	842,886	890,280
CannaRoyalty Corp.	CAD	9,000	112,167	82,710
ECN Capital Corp.	CAD	65,200	245,788	275,144
InterRent Real Estate Investment Trust	CAD	26,100	186,393	360,180
Manulife Financial Corp.	CAD	18,800	439,712	447,440
National Bank of Canada	CAD	10,080	632,562	627,077
Royal Bank of Canada	CAD	10,000	782,066	1,040,699
StorageVault Canada Inc.	CAD	106,100	239,941	305,568
The Bank of Nova Scotia	CAD	14,100	978,539	991,794
The Toronto-Dominion Bank	CAD	14,614	630,064	1,118,262
Tricon Capital Group Inc.	CAD	23,000	245,302	230,000
Total Financial			5,411,101	6,422,856
Funds (0.61%)				
iShares 1-5 Year Laddered Corporate Bond Index ETF	CAD	8,800	163,415	164,296
Total Funds			163,415	164,296
Industrial (9.17%)				
Badger Daylighting Ltd.	CAD	5,500	156,116	262,790
Canadian National Railway Co.	CAD	2,500	282,667	303,000
Canadian Pacific Railway Ltd.	CAD	1,950	440,140	601,439
CCL Industries Inc.	CAD	6,200	241,280	398,164
Martinrea International Inc.	CAD	27,820	352,167	302,125
NanoXplore Inc.	CAD	91,600	151,140	109,920
Neo Performance Materials Inc.	CAD	20,000	307,335	250,200
TFI International Inc.	CAD	6,600	280,919	261,558
Total Industrial			2,211,764	2,489,196

Palos Equity Income Fund

Schedule of Investment Portfolio (unaudited)

As at June 30, 2019 (continued)

Description	Currency	Number of shares/ Nominal value	Average cost \$	Fair value \$
Technology (2.77%)				
BlackBerry Ltd.	CAD	18,000	297,533	175,680
Kinaxis Inc.	CAD	3,100	230,894	253,177
Open Text Corp.	CAD	6,000	298,241	324,240
Total Technology			826,668	753,097
Utilities (5.42%)				
Algonquin Power & Utilities Corp.	CAD	28,500	329,076	452,295
Capital Power Corp.	CAD	9,900	299,970	298,485
Northland Power Inc.	CAD	28,300	640,291	721,650
Total Utilities			1,269,337	1,472,430
Total Equities			22,056,679	24,165,403
Fixed Income (9.48%)				
Energy (3.03%)				
Innergex Renewable Energy Inc., - 4.75% / June 30, 2025	CAD	600,000	579,000	619,026
Parkland Fuel Corp., - 5.50% / May 28, 2021	CAD	200,000	200,000	204,000
Total Energy			779,000	823,026
Financial (1.43%)				
Fiera Capital Corp., - 5.00% / Jun. 30, 2023	CAD	375,000	374,692	387,750
Total Financial			374,692	387,750
Industrial (2.14%)				
Chemtrade Logistics Income Fund, - 5.25% / Jun. 30, 2021	CAD	240,000	240,000	238,560
North American Construction Group Ltd., - 5% / Mar. 31, 2026	CAD	350,000	350,000	341,250
Total Industrial			590,000	579,810
Utilities (2.88%)				
Boralex Inc., - 4.50% / Jun. 30, 2020	CAD	300,000	300,000	309,273
Northland Power Inc., - 4.75% / Jun. 30, 2020	CAD	400,000	426,004	472,520
Total Utilities			726,004	781,793
Total Fixed Income			2,469,696	2,572,379

Palos Equity Income Fund

Schedule of Investment Portfolio (unaudited) As at June 30, 2019 (continued)

Description	Currency	Number of shares/ Nominal value	Average cost \$	Fair value \$
Warrants (0.04%)				
Critical Elements Corp., - \$1.25 / May 01, 2020	CAD	35,000	–	–
HashChain Technology Inc., - \$1.225 / Jan. 10, 2020	CAD	73,000	–	–
Sherritt International Corp., - \$1.95 / Jan. 25, 2021	CAD	48,000	–	1,200
Drone Delivery Canada Corp., - \$1.50 Mar. 25, 2021	CAD	35,000	5,390	9,450
NanoXplore Inc., - \$2.30 / Mar. 27, 2020	CAD	45,800	–	–
Nouveau Monde Graphite Inc., - \$0.40 / Oct. 20, 2019	CAD	60,000	–	–
Total Warrants			5,390	10,650
Total investments owned			24,531,765	26,748,432
Commissions and other portfolio transaction costs			(33,104)	–
Net investments owned (98.55%)			24,498,661	26,748,432
Other assets, net (1.45%)				394,926
Net Assets Attributable to Holders of Redeemable Units (100%)				27,143,358

Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2019

(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, between Computershare Trust Company of Canada (the trustee) and Charles Marceau (the settlor). The address of the Fund’s registered office is 1 Place Ville-Marie, Suite 1670, Montréal, Quebec, Canada H3B 2B6. The Fund is an open-ended mutual fund, is qualified as a unit trust and is a registered investment fund under Section 204.4 of the Income Tax Act (Canada).

Series A opened on January 3, 2008 and Series F opened 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 21, 2019.

2 Basis of presentation

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

Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2019

(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 classified as FVTPL. The Fund's derivative and non-derivative investments are classified as FVTPL upon initial recognition. The Fund's obligation for net assets attributable to holders of redeemable units is classified as a financial liability at the redemption amount which approximates fair value. 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 subsequently measured at amortized cost 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. Dividend income is recorded on the ex-dividend date.

Realized loss on sale of investments and unrealized appreciation of 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

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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.

Investment entities

The Fund meets the definition in IFRS 10, Consolidated Financial Statements, for investment entities and accounts for its investments in underlying entities at FVTPL.

Structured entities

The Fund may invest in other investment funds ("underlying funds") by holding redeemable shares of the underlying funds which entitle the holder to a proportionate share of the underlying funds' net assets. The Fund does not invest in underlying funds for the purpose of exercising management or control. Such investments expose the Fund to the risk that underlying funds may not perform as expected and indirectly to all of the risks applicable to investments in underlying funds.

The carrying value of investments in underlying funds is included in "Investments" in the statements of financial position and also represents the maximum exposure to losses. Changes in fair value of investments in underlying funds are included within "Net change in unrealized appreciation of investments" in the statements of comprehensive income.

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 and recorded as net assets attributable to holders of redeemable units, 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 (loss) gain on sale of investments" and "Net change in unrealized appreciation (depreciation) of investments" in the statements of comprehensive income.

Palos Equity Income Fund

Notes to financial statements (unaudited)

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(expressed in Canadian dollars)

Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset in the Fund's statements 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 financial 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 statements 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 per series

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

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 statements 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 statements of comprehensive income.

Accounting standard issued and adopted by the Fund

IFRS 9, Financial Instruments

In July 2014, the IASB issued the complete and final version of IFRS 9, which has replaced IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 includes, among others, the requirements for the classification and measurement of financial assets and financial liabilities.

Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2019

(expressed in Canadian dollars)

IFRS 9 sets out a new classification and measurement model for financial assets to determine whether a financial asset should be classified at amortized cost, at FVTPL or at fair value through other comprehensive income. This model is based on the contractual cash flow characteristics of the financial asset and the business model under which the financial asset is held. The valuation basis of financial assets, namely amortized cost or fair value, may need to be changed, as well as the recognition of unrealized gains and losses arising from changes in fair value. For the classification and measurement of financial liabilities, the recent standard essentially carries forward the current requirements under IAS 39.

IFRS 9 requires that an entity recognize a loss allowance for expected credit losses on financial assets which are measured at amortized cost or FVOCI. Financial assets held by the Fund which are measured at FVTPL will not be subject to the recent impairment requirements.

With respect to receivables, the Fund considers both historical analysis and forward looking information in determining any expected credit loss. As at the statement of financial position date, all receivables are due to be settled within the short term. The Fund considers the probability of default to be close to zero as these instruments have a low risk of default and the counterparties have a strong capacity to meet their contractual obligation in the near term. Given the limited exposure of the Fund to credit risk from financial assets recorded at amortized cost, no loss allowance has been recognized as any such impairment will not have a significant impact on the financial statements.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018 and has been applied by the Fund retrospectively to January 1, 2017. The application of IFRS 9 has not resulted in any restatement of comparative figures.

Accounting standards issued but not yet adopted will have no impact on the financial statements of the Fund.

4 Changes in accounting policies

The Fund has applied IFRS 9 retrospectively from January 1, 2017, which has resulted in changes in accounting policies. The following accounting policies relating to classification of financial assets and financial liabilities have been changed to comply with IFRS 9 which replaces the provisions of IAS 39.

Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2019

(expressed in Canadian dollars)

Reclassifications of financial instruments on application of IFRS 9.

On the date of initial application of IFRS 9, January 1, 2018, the financial instruments of the Fund were as follows, with any reclassifications from December 31, 2017 noted:

	Classification category		Measurement category		Carrying amount at Jan 1, 2018		
	Original (IAS 39)	New (IFRS 9)	Original (IAS 39)	New (IFRS 9)	Original (IAS 39)	New (IFRS 9)	Difference \$
Financial instruments							
<u>Assets</u>							
Investments	FVTPL - Designated at inception	FVTPL	FVTPL	FVTPL	29,429,789	29,429,789	-
Cash	Amortized cost	Amortized cost	Amortized cost	Amortized cost	1,007,807	1,007,807	-
Receivable for investments sold	Loans and receivables	Amortized cost	Amortized cost	Amortized cost	38,653	38,653	-
Accrued income receivable	Loans and receivables	Amortized cost	Amortized cost	Amortized cost	98,052	98,052	-
<u>Liabilities</u>							
Distributions payable	Financial liabilities	Financial liabilities	Amortized cost	Amortized cost	77,038	77,038	-
Accrued liabilities	Financial liabilities	Financial liabilities	Amortized cost	Amortized cost	29,983	29,983	-
Payable for investments purchased	Financial liabilities	Financial liabilities	Amortized cost	Amortized cost	148,650	148,650	-
Management fees payable	Financial liabilities	Financial liabilities	Amortized cost	Amortized cost	580	580	-
Performance fees payable	Financial liabilities	Financial liabilities	Amortized cost	Amortized cost	66,082	66,082	-

5 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 Manager 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 Manager 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 Manager 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.

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(expressed in Canadian dollars)

b) Classification and measurement of investments 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 manage its portfolio of investments and evaluate performance on a fair value basis and that the portfolio of investments is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The most significant judgments made include assessing and determining the appropriate business model that enables the decision that the Fund's investments are classified as FVTPL.

6 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, 2019 and December 31, 2018.

Credit rating	June 30, 2019	December 31, 2018
	Total fixed income %	Total fixed income %
BBB +	-	10.4
BBB	-	17.7
BBB -	42.4	24.1
BB	44.3	8.4
BB -	-	39.4
B	13.3	-
	<u>100.0</u>	<u>100.0</u>

Source: S&P Global Rating

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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 A 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 statements of financial position. The Fund does not anticipate any significant losses from the non-performance of counterparties.

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 payable for investments purchased, redemptions payable, distributions payable, accrued liabilities and management and performance fees payable. The Fund's investment approach focuses on investing in highly liquid securities and moderately liquid securities, which are therefore 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 tables are the contractual undiscounted cash flows.

Financial liabilities	June 30, 2019		
	On demand \$	< 3 months \$	Total \$
Redemptions payable	–	1,645	1,645
Distributions payable	–	78,886	78,886
Accrued liabilities	–	37,688	37,688
Performance fees payable	–	68	68
Redeemable units	27,143,358	–	27,143,358

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Financial liabilities	December 31, 2018		
	On demand \$	< 3 months \$	Total \$
Redemptions payable	–	35,383	35,383
Distributions payable	–	80,142	80,142
Accrued liabilities	–	54,136	54,136
Management fees payable	–	29,135	29,135
Performance fees payable	–	68	68
Redeemable units	24,902,547	–	24,902,547

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.

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's 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 the 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, 2019 and December 31, 2018 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 bonds, and the non-monetary exposure presents the impact on equity investments. Non-monetary items are investments in equity securities and are classified based on the currency in which they were purchased.

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(expressed in Canadian dollars)

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary	Non-Monetary	Total	Monetary	Non-Monetary	Total
June 30, 2019						
U.S. Dollar	\$ 1,227	\$ 660,459	\$ 661,686	\$ 61	\$ 33,023	\$ 33,084
% of Net Assets						
Attributable to Holders						
of Redeemable Units	0.0	2.4	2.4	0.0	0.1	0.1

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary	Non-Monetary	Total	Monetary	Non-Monetary	Total
December 31, 2018						
U.S. Dollar	\$ 502	\$ 203,350	\$ 203,852	\$ 25	\$ 10,168	\$ 10,193
% of Net Assets						
Attributable to Holders						
of Redeemable Units	0.0	0.8	0.8	0.0	0.0	0.0

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 variables held constant.

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(expressed in Canadian dollars)

	Total exposure	
Terms to maturity	June 30, 2019	December 31, 2018
	\$	\$
Less than one year	781,793	-
1-5 years	830,310	1,819,064
5-10 years	960,276	578,850
Total	2,572,379	2,397,914
Impact on net assets attributable to holders of redeemable units	77,294	59,070
Impact on net assets attributable to holders of redeemable units (%)	0.3%	0.2%

a) 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, 2019, 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 amount to \$1,230,428 and would represent 4.5% of the net assets attributable to holders of redeemable units of the Fund (December 31, 2018 – \$1,152,795 representing 4.6%).

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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 by market segment over the total investment market value:

Market segment	Percentage (%) of portfolio	
	June 30, 2019	December 31, 2018
Basic Materials	10.6	10.8
Communications	1.2	0.3
Consumer, Cyclical	10.5	10.1
Consumer, Non-cyclical	10.7	10.4
Energy	15.2	15.0
Financial	24.0	21.6
Funds	0.6	0.8
Industrial	9.3	14.0
Technology	2.8	1.8
Utilities	5.5	5.4
Bonds	9.6	9.8
	100.0	100.0

Asset class weighting	Percentage (%) of Net Assets	
	June 30, 2019	December 31, 2018
Bonds	9.5	9.6
Common stock	89.1	88.9
Other net assets	1.4	1.5

Fair value measurement

The carrying amounts of accrued income receivable, prepaid expenses, redemptions payable, distributions payable, accrued liabilities and management and performance fees 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).

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June 30, 2019

	Level 1	Level 2	Level 3	Total
Assets				
Equity	\$ 24,165,403	\$ –	\$ –	\$ 24,165,403
Fixed Income	2,368,379	204,000	–	2,572,379
Warrants	10,650	–	–	10,650
	\$ 26,544,432	\$ 204,000	\$ –	\$ 26,748,432

December 31, 2018

	Level 1	Level 2	Level 3	Total
Assets				
Equities	\$ 22,126,760	\$ –	\$ –	\$ 22,126,760
Fixed Income	2,195,414	202,500	–	2,397,914
Warrants	2,880	–	–	2,880
	\$ 24,325,054	\$ 202,500	\$ –	\$ 24,527,554

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.

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.

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7 Redeemable units

During the periods ended June 30, 2019 and 2018, the number of units issued, redeemed and outstanding were as follows:

	Redeemable Units, beginning of period	Redeemable Units Issued	Redemption of Redeemable Units	Reinvestments of Units	Redeemable Units, end of period
June 30, 2019					
Series A	2,966,368	41,773	(98,164)	84,128	2,994,105
Series F	1,587,495	75,438	(68,267)	45,289	1,639,955
June 30, 2018					
Series A	2,857,244	140,748	(102,874)	72,193	2,967,311
Series F	1,587,643	115,678	(164,034)	39,346	1,578,633

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.

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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 NAV of Series F.

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 paid annually.

The total management fees and performance fees for the period ended June 30, 2019 amounted to \$187,382 and \$nil, respectively (June 30, 2018 – \$207,415 and \$68, respectively), with \$68 in outstanding fees due to the Manager as at June 30, 2019 (December 31, 2018 – \$29,203).

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 (2018 – did not waive any fees).

b) Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the period ended June 30, 2019 amounted to \$5,951 (June 30, 2018 – \$5,951) 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, 2019 and 2018, together with other transaction charges, are disclosed in the statements 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 databases 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, 2019 and 2018 is disclosed below.

	2019	2018
Soft dollars	\$2,408	\$5,507
Percentage of total transaction costs	9%	11%

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

The increase (decrease) in net assets attributable to holders of redeemable units per series per unit for the periods ended June 30, 2019 and 2018 is calculated as follows:

	Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per Series	Weighted Average of Redeemable Units Outstanding During the Period	Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per Unit
June 30, 2019			
Series A	\$ 1,679,995	2,973,812	\$ 0.56
Series F	996,989	1,600,210	0.62
June 30, 2018			
Series A	\$ (68,442)	2,900,522	\$ (0.02)
Series F	(3,954)	1,571,544	-

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 carry forwards, 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, 2018 are as follows:

Capital losses		Non-capital losses	
Amount	Expires	Amount	Expires
\$		\$	
-	-	-	-