

Palos Equity Income Fund

Financial Statements
December 31, 2020 and 2019
(expressed in Canadian dollars)



Independent auditor's report

To the Unitholders and Trustee of Palos Equity Income Fund (the Fund)

Our opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2020 and 2019 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as published by the International Accounting Standards Board (IFRS).

What we have audited

The Fund's financial statements comprise:

- the statements of financial position as at December 31, 2020 and 2019;
- the statements of comprehensive income for the years then ended;
- the statements of changes in net assets attributable to holders of redeemable units for the years then ended;
- the statements of cash flows for the years then ended; and
- the notes to financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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"PwC" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership.



Other information

Management is responsible for the other information of the Fund. The other information comprises the Management Report of Fund Performance and the information, other than the financial statements and our auditor's report thereon, included in the annual report.

Our opinion on the financial statements does not cover the other information, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements of the Fund, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements of the Fund or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Fund's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.



As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers LLP¹

Montréal, Quebec
March 30, 2021

¹ CPA auditor, CA, public accountancy permit No. A125840

Palos Equity Income Fund

Statements of Financial Position As at December 31, 2020 and 2019

	2020	2019
ASSETS		
Current assets		
Investments at fair value through profit or loss (FVTPL)	\$ 23,899,701	\$ 24,572,008
Cash	1,314,626	1,288,990
Receivable from investments sold	11,776	-
Accrued income receivable	60,835	60,063
Subscription receivable	4,449	-
Prepaid expenses	2,201	2,275
	<u>25,293,588</u>	<u>25,923,336</u>
LIABILITIES		
Current liabilities		
Securities sold short	-	272,000
Payable for investments purchased	56,000	-
Accrued liabilities	42,393	46,479
Distributions payable	18,605	84,473
Management fees payable	1,081	-
	<u>118,079</u>	<u>402,952</u>
Net assets attributable to holders of redeemable units	<u>\$ 25,175,509</u>	<u>\$ 25,520,384</u>
Net assets attributable to holders of redeemable units per series		
Series A	\$ 17,923,956	\$ 17,011,039
Series F	<u>7,251,553</u>	<u>8,509,345</u>
	<u>\$ 25,175,509</u>	<u>\$ 25,520,384</u>
Net assets attributable to holders of redeemable units per series per unit		
Series A	\$ 6.38	\$ 5.72
Series F	6.96	6.17

Approved by the Manager, Palos Management Inc.

(s) Charles Marleau

Director

Palos Equity Income Fund

Statements of Comprehensive Income For the years ended December 31, 2020 and 2019

	2020	2019
Income		
Dividend income	\$ 555,837	\$ 676,838
Interest income for distribution purposes	134,695	146,041
Net realized gain on sale of investments	756,589	54,218
Net change in unrealized appreciation of investments	1,745,931	3,441,996
	<u>3,193,052</u>	<u>4,319,093</u>
Expenses		
Management fees (Note 7)	324,681	373,102
Administration and other professional fees	102,525	124,624
Transaction cost	62,872	47,830
Audit fees	46,492	44,536
Legal fees	31,737	66,800
Trustee fees	13,871	14,972
Independent review committee fees	12,034	12,001
Bank charges and interest	4,373	2,851
Withholding tax expense	3,457	3,577
Dividend expense on securities sold short	-	4,000
	<u>602,042</u>	<u>694,293</u>
Increase in Net Assets Attributable to Holders of Redeemable Units	<u>\$ 2,591,010</u>	<u>\$ 3,624,800</u>
Increase in Net Assets Attributable to Holders of Redeemable Units per series		
Series A	\$ 2,104,652	\$ 2,270,370
Series F	486,358	1,354,430
	<u>\$ 2,591,010</u>	<u>\$ 3,624,800</u>
Increase in Net Assets Attributable to Holders of Redeemable Units per Unit (Note 9)		
Series A	\$ 0.73	\$ 0.76
Series F	0.42	0.86

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 years ended December 31, 2020 and 2019

	Net assets attributable to holders of redeemable units, beginning of year	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 year
December 31, 2020							
Series A	\$ 17,011,039	\$ 636,109	\$ (1,775,702)	\$ (287,934)	\$ 235,792	\$ 2,104,652	\$ 17,923,956
Series F	8,509,345	297,874	(2,017,641)	(114,464)	90,081	486,358	7,251,553
	<u>\$ 25,520,384</u>	<u>\$ 933,983</u>	<u>\$ (3,793,343)</u>	<u>\$ (402,398)</u>	<u>\$ 325,873</u>	<u>\$ 2,591,010</u>	<u>\$ 25,175,509</u>

	Net assets attributable to holders of redeemable units, beginning of year	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 year
December 31, 2019							
Series A	\$ 15,862,490	\$ 440,232	\$ (1,335,021)	\$ (1,184,222)	\$ 957,190	\$ 2,270,370	\$ 17,011,039
Series F	9,040,057	613,782	(2,404,559)	(613,631)	519,266	1,354,430	8,509,345
	<u>\$ 24,902,547</u>	<u>\$ 1,054,014</u>	<u>\$ (3,739,580)</u>	<u>\$ (1,797,853)</u>	<u>\$ 1,476,456</u>	<u>\$ 3,624,800</u>	<u>\$ 25,520,384</u>

December 31, 2020

*Detailed Distributions to unitholders	From net investment income	From net realized gains on investments and derivatives	From return of capital	Total distributions to unitholders
Series A	\$ 12,750	\$ 33,349	\$ 241,835	287,934
Series F	17,582	9,830	87,052	114,464
	<u>\$ 30,332</u>	<u>\$ 43,179</u>	<u>\$ 328,887</u>	<u>402,398</u>

December 31, 2019

*Detailed Distributions to unitholders	From net investment income	From net realized gains on investments and derivatives	From return of capital	Total distributions to unitholders
Series A	\$ -	\$ -	\$ (1,184,222)	(1,184,222)
Series F	(37,222)	-	(576,409)	(613,631)
	<u>\$ (37,222)</u>	<u>\$ -</u>	<u>\$ (1,760,631)</u>	<u>(1,797,853)</u>

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

Palos Equity Income Fund

Statements of Cash Flows

For the years ended December 31, 2020 and 2019

	2020	2019
Cash provided by (used in):		
Operating Activities		
Increase in Net Assets Attributable to Holders of Redeemable Units	\$ 2,591,010	\$ 3,624,800
Adjustments for non-cash items		
Net realized gain on sale of investments	(756,589)	(54,218)
Net change in unrealized appreciation of investments	(1,745,931)	(3,441,996)
Foreign exchange (gain) loss on cash	1,247	(1,264)
Change in non-cash balances		
(Increase) decrease in accrued income receivable	(772)	(15,977)
Increase in prepaid expenses	74	(2,275)
(Decrease) increase in accrued liabilities	(4,086)	(7,657)
(Decrease) increase in management fees payable	1,081	(29,135)
Decrease in performance fees payable	-	(68)
Proceeds from sale of investments	28,022,788	20,999,228
Purchase of investments	<u>(25,075,737)</u>	<u>(17,270,603)</u>
Cash provided by operating activities	<u>3,033,085</u>	<u>3,800,835</u>
Financing Activities		
Proceeds from issuance of redeemable units	929,534	848,369
Amount paid on redemption of redeemable units	(3,793,343)	(3,569,318)
Distributions paid to holders or redeemable units, net of reinvested distributions	<u>(142,393)</u>	<u>(317,066)</u>
Cash used in financing activities	<u>(3,006,202)</u>	<u>(3,038,015)</u>
Decrease in cash during the year	26,883	762,820
Foreign exchange gain (loss) on cash	(1,247)	1,264
Cash, beginning of year	<u>1,288,990</u>	<u>524,906</u>
Cash, end of year	<u>\$ 1,314,626</u>	<u>\$ 1,288,990</u>
Supplemental information *		
Interest paid	\$ 1,166	\$ 251
Interest received	97,701	176,421
Dividends paid	-	3,000
Dividends received, net of withholding taxes	553,505	686,352

*Included as a part of cash flows from operating activities

Palos Equity Income Fund

Schedule of Investment Portfolio as at December 31, 2020

Expressed in Canadian Dollars

Description	Currency	Number of shares	Average cost \$	Fair value \$
Investments owned (94.93%)				
Equities (91.16%)				
Basic Materials (6.73%)				
Dundee Precious Metals Inc.	CAD	24,270	181,096	222,071
Equinox Gold Corp.	CAD	14,240	166,915	187,541
First Quantum Minerals Ltd	CAD	12,700	160,092	290,195
K92 Mining Inc.	CAD	11,000	79,326	83,710
Lundin Mining Corp.	CAD	23,940	143,464	270,522
Nutrien Ltd	CAD	3,612	241,919	221,199
Sandstorm Gold Ltd	CAD	21,500	218,043	196,080
Teck Resources Ltd	CAD	9,650	190,933	222,915
Total Basic Materials			1,381,788	1,694,233
Communications (5.19%)				
Quebecor Inc.	CAD	11,840	361,676	387,878
Shopify Inc.	CAD	400	198,483	574,928
TELUS Corp.	CAD	13,590	323,544	342,604
Total Communications			883,703	1,305,410
Consumer, Cyclical (8.80%)				
Air Canada	CAD	9,000	212,581	204,930
Alimentation Couche-Tard Inc.	CAD	4,890	149,278	212,128
BRP Inc.	CAD	2,960	115,139	248,906
Canadian Tire Corp Ltd	CAD	1,500	152,855	250,995
Denny's Corp.	USD	4,000	63,210	74,889
Dine Brands Global Inc.	USD	1,400	118,646	103,558
Dollarama Inc.	CAD	4,380	185,533	227,234
Pollard Banknote Ltd	CAD	7,120	134,326	254,469
Restaurant Brands International Inc.	CAD	2,560	209,557	199,245
Sleep Country Canada Holdings Inc.	CAD	6,600	134,709	174,702
Wal-Mart Stores Inc.	USD	1,440	173,096	264,732
Total Consumer, Cyclical			1,648,930	2,215,788
Consumer, Non-cyclical (7.79%)				
Boyd Group Services Inc.	CAD	1,010	190,129	221,756
Curaleaf Holdings Inc.	CAD	15,810	135,819	240,944
Empire Co., Ltd	CAD	1,000	35,238	34,790
Green Thumb Industries Inc.	CAD	7,220	108,569	225,120
Jamieson Wellness Inc.	CAD	5,630	126,300	203,412

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

Palos Equity Income Fund

Schedule of Investment Portfolio as at December 31, 2020 (continued)

Expressed in Canadian Dollars

Description	Currency	Number of shares	Average cost \$	Fair value \$
Consumer, Non-cyclical (continued)				
K-Bro Linen Inc.	CAD	7,580	258,847	295,393
Park Lawn Corp.	CAD	6,350	168,577	177,419
Premium Brands Holdings Corp.	CAD	3,070	263,340	309,241
Savaria Corp.	CAD	13,840	179,574	200,126
Subversive Capital Acquisition Corp.	USD	4,200	55,350	54,207
Total Consumer, Non-cyclical			1,521,743	1,962,408
Energy (6.61%)				
Canadian Natural Resources Ltd	CAD	11,300	247,965	345,667
Enbridge Inc.	CAD	7,417	343,145	301,946
Keyera Corp.	CAD	13,920	394,093	314,870
Pembina Pipeline Corp.	CAD	7,449	287,222	224,215
Secure Energy Services Inc.	CAD	8,900	17,675	21,894
Tamarack Valley Energy Ltd	CAD	88,300	85,651	112,141
Tourmaline Oil Corp.	CAD	17,120	205,766	293,779
Trican Well Service Ltd	CAD	30,000	44,850	50,400
Total Energy			1,626,367	1,664,912
Financial (27.74%)				
Alaris Equity Partners Income	CAD	8,000	114,710	120,880
Bank of Montreal	CAD	9,236	814,732	893,860
Boardwalk Real Estate Investment Trust	CAD	7,417	268,795	250,250
Brookfield Asset Management Inc.	CAD	4,300	151,402	226,266
Canadian Apartment Properties REIT	CAD	2,800	125,975	139,972
Crombie Real Estate Investment Trust	CAD	16,160	227,733	231,896
Dream Industrial Real Estate Investment Trust	CAD	17,080	220,206	224,602
ECN Capital Corp.	CAD	25,300	128,020	163,691
Equitable Group Inc.	CAD	2,560	210,838	258,560
Flagship Communities REIT	USD	10,000	199,827	188,242
InterRent Real Estate Investment Trust	CAD	17,300	240,554	236,837
National Bank of Canada	CAD	7,260	458,021	520,106
Royal Bank of Canada	CAD	9,640	782,179	1,008,248
StorageVault Canada Inc.	CAD	53,420	129,762	215,817
The Bank of Nova Scotia	CAD	13,880	969,840	954,944
The Toronto-Dominion Bank	CAD	12,864	590,684	925,179
Tricon Residential Inc.	CAD	19,610	208,656	224,142
WPT Industrial Real Estate Investment Trust	USD	10,800	184,134	199,029
Total Financial			6,026,068	6,982,521

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

Palos Equity Income Fund

Schedule of Investment Portfolio as at December 31, 2020 (continued)

Expressed in Canadian Dollars

Description	Currency	Number of shares	Average cost \$	Fair value \$
Funds (5.90%)				
iShares 1-5 Year Laddered Corporate Bond Index ETF	CAD	35,000	669,855	670,250
iShares 1-5 Year Laddered Government Bond Index ETF	CAD	44,770	817,387	816,157
Total Funds			1,487,242	1,486,407
Industrial (10.85%)				
Aecon Group Inc.	CAD	11,520	169,938	188,467
Badger Daylighting Ltd	CAD	6,420	220,009	244,153
Canadian National Railway Co.	CAD	2,980	336,583	417,021
Canadian Pacific Railway Ltd	CAD	1,060	239,256	468,022
Cargojet Inc.	CAD	1,010	127,225	216,978
CCL Industries Inc.	CAD	4,260	199,709	246,185
GFL Environmental Inc.	CAD	6,500	155,030	241,215
Mullen Group Ltd	CAD	8,800	83,137	95,920
NanoXplore Inc.	CAD	15,600	25,740	65,364
TFI International Inc.	CAD	3,790	159,853	248,359
WSP Global Inc.	CAD	2,000	172,000	241,180
Xebec Adsorption Inc. SUB REC RSTD May 1, 2021	CAD	6,400	37,120	57,600
Total Industrial			1,925,600	2,730,464
Technology (5.17%)				
CGI Inc.	CAD	2,820	261,820	284,792
Kinaxis Inc.	CAD	1,100	109,357	198,374
Lightspeed POS Inc.	CAD	3,250	112,407	291,980
MCI Onehealth Technologies Inc.	CAD	11,200	56,000	56,000
MDF Commerce Inc.	CAD	9,500	97,430	116,660
Open Text Corp.	CAD	4,220	215,510	244,085
Think Research Corp.	CAD	23,600	135,700	109,976
Total Technology			988,224	1,301,867
Utilities (6.38%)				
Algonquin Power & Utilities Corp.	CAD	7,400	139,143	155,030
AltaGas Ltd	CAD	8,400	134,059	157,248
Brookfield Infrastructure Corp.	CAD	2,250	140,063	207,428
Capital Power Corp.	CAD	8,320	238,332	291,034
Innergex Renewable Energy Inc.	CAD	10,000	193,000	273,700
Northern Genesis Acquisition Corp.	USD	3,600	61,037	81,633
Northland Power Inc.	CAD	5,118	120,907	233,739
Brookfield Renewable Partners LP	USD	3,750	124,783	206,368
Total Utilities			1,151,324	1,606,180
Total Equities			18,640,989	22,950,190

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

Palos Equity Income Fund

Schedule of Investment Portfolio as at December 31, 2020 (continued)

Expressed in Canadian Dollars

Description	Currency	Number of shares/ Nominal value	Average cost \$	Fair value \$
Fixed Income (3.60%)				
Basic Materials (2.06%)				
Chemtrade Logistics Income Fund, - 6.5% / Oct 31, 2026	CAD	250,000	250,000	186,458
North American Construction Group Ltd, 5% / Mar 31, 2026	CAD	350,000	350,000	332,570
Total Basic Materials			600,000	519,028
Financial (1.54%)				
Fiera Capital Corp., - 5.00% / Jun. 30, 2023	CAD	375,000	374,692	386,775
Total Financial			374,692	386,775
Total Fixed Income			974,692	905,803
Warrants (0.17%)				
Cresco Labs Inc. \$12.50 / Sept. 24, 2022	CAD	8,500	18,360	35,700
Drone Delivery Canada Corp. \$1.50 / March 25, 2021	CAD	35,000	5,390	2,713
Dundee Precious Metals Inc. \$8 / May 13, 2021	CAD	4,500	–	5,175
Sherritt International Corp. \$1.95 / Jan. 25, 2021	CAD	48,000	–	120
Yamana Gold Inc. \$13.50 / Jan. 15, 2021	CAD	5,000	–	–
Total Warrants			23,750	43,708
Total investments owned			19,639,431	23,899,701
Commissions and other portfolio transaction costs			(22,711)	–
Net investments owned (94.93%)			19,616,720	23,899,701
Other assets, net (5.07%)				1,275,808
Net Assets Attributable to Holders of Redeemable Units (100%)				25,175,509

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

Palos Equity Income Fund

Notes to financial statements

As at December 31, 2020 and 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 Marleau (the settlor). The address of the Fund's registered office is 1 Place Ville-Marie, Suite 1670, Montréal, Québec, H3B 2B6, Canada. 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 March 30, 2021.

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 Boards (IASB).

Palos Equity Income Fund

Notes to financial statements

As at December 31, 2020 and 2019

(expressed in Canadian dollars)

3 Summary of significant accounting policies

Financial instruments

Classification

IFRS 9, Financial Instruments, sets out a classification and measurement model for financial assets to determine whether a financial asset should be classified at amortized cost, at fair value through profit or loss (“FVTPL”) or fair value through other comprehensive income (“FVOCI”). 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 Fund managed its investments in financial assets with the objective of realizing cash flows through both the sale of the assets and income generated from those assets. The Manager makes decisions based on the assets’ fair values and managed the assets to realize those fair values.

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 statements of financial position date, all receivables are due to be settle within the short term. The Fund considered 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.

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 derivative and non-derivative investments are classified as FVTPL upon initial recognition. The Fund’s obligation for net assets attributable to holders or 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 measure 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.

Palos Equity Income Fund

Notes to financial statements

As at December 31, 2020 and 2019

(expressed in Canadian dollars)

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 gain 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.

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 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 an appropriate share of the underlying funds' net assets. The Fund does not invest in underlying funds for the purpose of exercising management 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.

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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 gain on sale of investments” and “Net change in unrealized appreciation of investments” in the statements of comprehensive income.

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 year.

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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.

New standards, interpretations and amendments not yet adopted

There are no new standards, interpretations or amendments that have not yet been adopted, that would affect the Fund's financial statements.

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 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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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 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.

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 December 31, 2020 and 2019.

	<u>December 31, 2020</u>	<u>December 31, 2019</u>
Credit rating	Total fixed income %	Total fixed income %
BB	-	8.7
Non-rated	100.0	91.3
	<u>100.0</u>	<u>100.0</u>

Source: Standard & Poor's

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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. 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 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.

	December 31, 2020		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Payable for investments purchased	–	56,000	56,000
Accrued liabilities	–	42,393	42,393
Distributions payable	–	18,605	18,605
Management fees payable	–	1,081	1,081
Redeemable units	25,175,509	–	25,175,509

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Financial liabilities	December 31, 2019		
	On demand \$	< 3 months \$	Total \$
Securities sold short	–	272,000	272,000
Distributions payable	–	84,473	84,473
Accrued liabilities	–	46,479	46,479
Redeemable units	25,520,384	–	25,520,384

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 recent spread of Covid-19 has caused volatility in the global financial markets and a slowdown in the global economy. The Fund's Manager had to take closer look at the market volatility and industry sector that were most affected by the Pandemic and adjusted investment strategy consequently.

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 December 31, 2020 and 2019, 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.

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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, 2020						
U.S. Dollar	\$ (247,201)	1,172,657	925,456	(12,360)	58,633	46,273
	\$ (247,201)	\$ 1,172,657	\$ 925,456	\$ (12,360)	\$ 58,633	\$ 46,273
% of Net Assets						
Attributable to Holders						
of Redeemable Units	(1.0)	4.7	3.7	0.0	0.2	0.2

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, 2019						
U.S. Dollar	\$ 38,606	\$ 429,509	\$ 468,115	\$ 1,930	\$ 21,475	\$ 23,405
	\$ 38,606	\$ 429,509	\$ 468,115	\$ 1,930	\$ 21,475	\$ 23,405
% of Net Assets						
Attributable to Holders						
of Redeemable Units	0.2	1.7	1.9	0.0	0.1	0.1

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 cash that is 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.

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Terms to maturity	Total exposure	
	December 31, 2020 \$	December 31, 2019 \$
Less than one year	-	508,164
1-5 years	386,775	1,228,970
5-10 years	519,028	594,970
Total	905,803	2,332,104
Impact on net assets attributable to holders of redeemable units	32,904	60,783
Impact on net assets attributable to holders of redeemable units %	0.1%	0.2%

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 December 31, 2020, 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 \$1,111,336 and would represent 4.4% of the net assets attributable to holders of redeemable units of the Fund (December 31, 2019 – \$1,129,950 representing 4.4% 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. Over the last year, as a result of Covid-19 Pandemic, the Fund's Manager adjusted concentration of the portfolio to reflect changes in the market due to the pandemic. The following is a summary of the Fund's concentration risk by market segment over the total investments market value:

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Market segment	Percentage (%) of portfolio	
	December 31, 2020	December 31, 2019
Basic Materials	7.1	9.1
Communications	5.5	1.8
Consumer, Cyclical	9.3	7.2
Consumer, Non-cyclical	8.2	13.0
Energy	7.0	16.0
Financial	29.2	25.6
Funds	6.2	1.0
Industrial	11.4	8.9
Technology	5.4	3.2
Utilities	6.7	4.5
Bonds	3.8	9.6
Warrants	0.2	0.1
	100.0	100.0

Asset class weighting	Percentage (%) of Net Assets	
	December 31, 2020	December 31, 2019
Bonds	3.6	9.1
Common stock	91.2	86.0
Warrants	0.2	0.1
Other net assets	5.0	4.8

Fair value measurement

The carrying amounts of receivable from investments sold, accrued income receivable, subscription receivable, prepaid expenses, payable for investments purchased, distributions payable, accrued liabilities and management 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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	December 31, 2020			
	Level 1	Level 2	Level 3	Total
Assets				
Equity	\$ 22,950,190	\$ –	\$ –	22,950,190
Fixed Income	905,803	–	–	905,803
Warrants	38,533	5,175	–	43,708
	\$ 23,894,526	\$ 5,175	\$ –	23,899,701
December 31, 2019				
	Level 1	Level 2	Level 3	Total
Assets				
Equity	\$ 22,224,779	\$ –	\$ –	22,224,779
Fixed Income	2,128,854	203,250	–	2,332,104
Warrants	15,125	–	–	15,125
	\$ 24,368,758	\$ 203,250	\$ –	24,572,008
Liabilities				
Equities	\$ 272,000	\$ –	\$ –	272,000

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.

There was no change in levels during the years 2020 and 2019.

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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6 Redeemable units

During the years ended December 31, 2020 and 2019 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
December 31, 2020					
Series A	2,976,153	114,161	(327,258)	45,414	2,808,470
Series F	1,379,500	47,048	(400,390)	16,198	1,042,356
December 31, 2019					
Series A	2,966,368	77,059	(236,175)	168,901	2,976,153
Series F	1,587,495	99,757	(393,130)	85,378	1,379,500

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.

7 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.

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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 year ended December 31, 2020 amounted to \$324,681 and \$0 respectively (December 31, 2019 – \$373,102 and nil respectively), with \$1,081 in outstanding fees due to the Manager as at December 31, 2020 (December 31, 2019 – nil).

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 year, the Manager did not waive any fees (2019 – did not waive any fees).

b) Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the year ended December 31, 2020 amounted to \$12,034 (December 31, 2019 – \$12,001) and consisted only of fixed fees.

8 Brokerage commissions and soft dollars

The total commissions paid by the Fund to brokers in connection with portfolio transactions for the years ended December 31, 2020 and 2019, 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 years ended December 31, 2020 and 2019 is disclosed below.

	2020	2019
Soft dollars	\$6,296	\$6,090
Percentage of total transaction costs (%)	10%	13%

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9 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 years ended December 31, 2020 and 2019 is calculated as follows:

	Increase in Net Assets Attributable to Holders of Redeemable Units per Series	Weighted Average of Redeemable Units Outstanding During the Period	Increase in Net Assets Attributable to Holders of Redeemable Units per Unit
December 31, 2020			
Series A	\$ 2,104,652	2,898,239	\$ 0.73
Series F	486,358	1,162,722	0.42
December 31, 2019			
Series A	\$ 2,270,370	2,979,246	\$ 0.76
Series F	1,354,430	1,569,858	0.86

10 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, 2020 are nil (December 31, 2019 – nil).