

Palos Equity Income Fund

Interim Financial Statements (unaudited)

June 30, 2022 and 2021

(expressed in Canadian dollars)

Palos Equity Income Fund

Notice

The following Palos Equity Income Fund interim financial statements have not been reviewed by the Fund's external auditors.

Palos Equity Income Fund

Statements of Financial Position (unaudited)

As at June 30, 2022 and December 31, 2021

	2022 \$	2021 \$
ASSETS		
Current assets		
Investments at fair value through profit or loss (FVTPL)	25,188,385	29,594,503
Cash	631,236	469,162
Accrued income receivable	62,778	78,817
Receivable from investments sold	34,754	-
Prepaid expenses	9,770	2,164
Subscription receivable	500	5,950
	<u>25,927,423</u>	<u>30,150,596</u>
LIABILITIES		
Current liabilities		
Accrued liabilities	40,827	46,070
Distributions payable	17,409	375,698
Management fees payable	-	658
	<u>58,236</u>	<u>422,426</u>
Net assets attributable to holders of redeemable units	<u>25,869,187</u>	<u>29,728,170</u>
Net assets attributable to holders of redeemable units per series		
Series A	19,381,265	22,004,759
Series F	6,487,922	7,723,411
	<u>25,869,187</u>	<u>29,728,170</u>
Net assets attributable to holders of redeemable units per series per unit		
Series A	6.28	7.24
Series F	6.76	7.77

Approved by the Manager, Palos Management Inc.

(s) Philippe Marleau

Director

Palos Equity Income Fund

Statements of Comprehensive Income or (loss) (unaudited) For the periods ended June 30, 2022 and 2021

	2022	2021
Income		
Dividend income	\$ 291,788	\$ 259,005
Interest income for distribution purposes	69,287	71,393
Net realized gain on sale of investments	901,645	2,199,883
Net change in unrealized appreciation of investments	<u>(4,679,248)</u>	<u>2,327,864</u>
	<u>(3,416,528)</u>	<u>4,858,145</u>
Expenses		
Management fees (Note 7)	217,024	197,900
Administration and other professional fees	45,940	51,113
Audit fees	24,916	24,365
Legal fees	24,795	21,026
Transaction cost	20,004	31,882
Bank charges and interest	11,604	2,375
Trustee fees	6,860	6,860
Independent review committee fees	5,951	5,951
Withholding tax expense	<u>425</u>	<u>851</u>
	<u>357,519</u>	<u>342,323</u>
Increase (decrease) in net assets attributable to holders of redeemable units	<u>\$ (3,774,047)</u>	<u>\$ 4,515,822</u>
Increase (decrease) in net assets attributable to holders of redeemable units per series		
Series A	\$ (2,848,028)	\$ 3,223,945
Series F	<u>(926,019)</u>	<u>1,291,877</u>
	<u>\$ (3,774,047)</u>	<u>\$ 4,515,822</u>
Increase (decrease) in net assets attributable to holders of redeemable units per unit (Note 9)		
Series A	\$ (0.92)	\$ 1.15
Series F	(0.96)	1.30

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 (unaudited)

For the periods ended June 30, 2022 and 2021

	Net assets attributable to holders of redeemable units, beginning of year \$	Proceeds from redeemable units issued \$	Redemption redeemable units \$	Distributions to holders of redeemable unit* \$	Reinvestment of distribution to holders of redeemable units \$	Increase (decrease) in net assets attributable to holders of redeemable units \$	Net assets attributable to holders of redeemable units end of year \$
June 30, 2022							
Series A	22,004,759	1,119,143	(870,015)	(155,022)	130,428	(2,848,028)	19,381,265
Series F	7,723,411	287,223	(586,154)	(47,528)	36,989	(926,019)	6,487,922
	<u>29,728,170</u>	<u>1,406,366</u>	<u>(1,456,169)</u>	<u>(202,550)</u>	<u>167,417</u>	<u>(3,774,047)</u>	<u>25,869,187</u>
June 30, 2021							
Series A	17,923,956	575,634	(899,040)	(139,311)	114,560	3,223,945	20,799,744
Series F	7,251,553	359,517	(951,560)	(48,477)	37,543	1,291,877	7,941,453
	<u>25,175,509</u>	<u>935,151</u>	<u>(1,850,600)</u>	<u>(187,788)</u>	<u>152,103</u>	<u>4,515,822</u>	<u>28,740,197</u>

* Detailed distributions to unitholders

	From net investment income \$	From net realized gains on investments and derivatives \$	From return of capital \$	Total distributions to unitholder \$
June 30, 2022				
Series A	-	(155,022)	-	(155,022)
Series F	-	(47,528)	-	(47,528)
	<u>-</u>	<u>(202,550)</u>	<u>-</u>	<u>(202,550)</u>
June 30, 2021				
Series A	-	(139,311)	-	(139,311)
Series F	(5,689)	(42,788)	-	(48,477)
	<u>(5,689)</u>	<u>(182,099)</u>	<u>-</u>	<u>(187,788)</u>

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

Palos Equity Income Fund

Statements of Cash Flows

For the periods ended June 30, 2022 and 2021

	2022	2021
Cash provided by (used in)		
Operating Activities		
Increase (decrease) in net assets attributable to holders of redeemable units	\$ (3,774,047)	\$ 4,515,822
Adjustments for non-cash items		
Net realized gain on sale of investments	(901,645)	(2,199,833)
Net change in unrealized (appreciation) depreciation of investments	4,679,248	(2,327,864)
Foreign exchange on cash	203	(10,947)
Change in non-cash balances		
Decrease in accrued income receivable	16,039	5,043
Increase in prepaid expenses	(7,606)	(639)
(Decrease) increase in accrued liabilities	(658)	1,993
(Decrease) in management fees payable	(5,243)	(1,081)
Proceeds from sale of investments	9,160,243	11,905,361
Purchase of investments	<u>(8,566,482)</u>	<u>(11,933,288)</u>
Cash provided by operating activities	<u>600,052</u>	<u>(45,483)</u>
Financing Activities		
Proceeds from issuance of redeemable units	1,411,816	939,600
Amount paid on redemption of redeemable units	(1,456,169)	(1,850,600)
Distributions paid to holders or redeemable units, net of reinvested distributions	<u>(393,422)</u>	<u>(35,882)</u>
Cash used in financing activities	<u>(437,775)</u>	<u>(946,882)</u>
Increase (decrease) in cash during the year	162,277	(992,365)
Foreign exchange on cash	(203)	10,947
Cash, beginning of year	<u>469,162</u>	<u>1,314,626</u>
Cash, end of period	\$ <u>631,236</u>	\$ <u>333,208</u>
Supplemental information *		
Interest paid	\$ 130	\$ 922
Interest received	61,489	68,219
Dividends received, net of withholding taxes	315,157	256,285

*Included as a part of cash flows from operating activities

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares	Average cost \$	Fair value \$
Investments owned (97.37%)				
Equities (94.07%)				
Basic material (7.39%)				
Agnico Eagle Mines Ltd	CAD	3,861	241,814	227,490
Dundee Precious Metals Inc.	CAD	32,270	247,168	206,851
K92 Mining Inc.	CAD	27,300	193,906	212,121
Lundin Mining Corp.	CAD	25,540	205,153	208,406
Neighbourly Pharmacy Inc.	CAD	9,324	264,057	228,438
Nutrien Ltd	CAD	2,462	180,631	252,380
Teck Resources Ltd	CAD	9,450	310,137	371,952
Wheaton Precious Metals Corp.	CAD	4,400	231,434	204,072
			<u>1,874,300</u>	<u>1,911,170</u>
Communications (3.73%)				
Quebecor Inc.	CAD	15,740	474,788	433,007
Shopify Inc.	CAD	4,850	342,976	195,067
TELUS Corp.	CAD	11,740	282,556	336,586
			<u>1,100,320</u>	<u>964,660</u>
Consumer, cyclical (5.70%)				
AutoCanada Inc.	CAD	10,700	349,989	262,792
Canadian Tire Corp Ltd	CAD	1,730	208,614	280,952
Gamehost Inc.	CAD	4,800	41,515	40,032
Hardwoods Distribution Inc.	CAD	8,500	330,303	240,210
Pet Valu Holdings Ltd	CAD	7,100	221,330	219,390
Pollard Banknote Ltd	CAD	8,670	253,727	174,874
Wal-Mart Stores Inc.	USD	1,640	209,044	256,624
			<u>1,614,522</u>	<u>1,474,874</u>
Consumer, non-cyclical (4.87%)				
Altus Group Ltd	CAD	5,300	280,970	236,327
dentalcorp Holdings Ltd	CAD	13,500	172,133	160,785
Green Thumb Industries Inc.	CAD	18,213	452,979	187,230
Park Lawn Corp.	CAD	7,150	218,471	243,386
Premium Brands Holdings Corp.	CAD	2,670	236,657	249,084
Savaria Corp.	CAD	14,040	198,663	183,082
			<u>1,559,873</u>	<u>1,259,894</u>
Energy (14.55%)				
Canadian Natural Resources Ltd	CAD	5,900	160,799	408,103
Cenovus Energy Inc.	CAD	11,550	199,966	282,860
CES Energy Solutions Corp.	CAD	60,000	139,643	139,800
Freehold Royalties Ltd	CAD	21,300	222,262	271,362
Headwater Exploration Inc.	CAD	45,000	239,988	243,450
Keyera Corp.	CAD	10,820	307,467	318,108

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares	Average cost \$	Fair value \$
PHX Energy Services Corp.	CAD	16,400	103,992	79,376
Precision Drilling Corp.	CAD	2,850	165,575	235,724
Rubellite Energy Inc.	CAD	27,700	101,068	90,302
Secure Energy Services Inc.	CAD	36,400	220,094	218,400
Spartan Delta Corp.	CAD	16,800	81,064	207,816
Tamarack Valley Energy Ltd	CAD	61,900	207,827	268,027
Topaz Energy Corp.	CAD	15,100	236,464	306,681
Tourmaline Oil Corp.	CAD	7,120	172,191	476,542
Trican Well Service Ltd	CAD	58,900	166,133	217,341
			<u>2,724,533</u>	<u>3,763,892</u>
Financial (30.23%)				
Alaris Equity Partners Income	CAD	13,100	194,491	216,674
Bank of Montreal	CAD	9,619	975,340	1,190,640
Boardwalk Real Estate Investment Trust	CAD	5,867	225,949	245,710
Brookfield Asset Management Inc.	CAD	4,600	186,294	263,396
Brookfield Asset Management Reinsurance Partners Ltd	CAD	33	2,176	1,892
BSR Real Estate Investment Trust	USD	12,200	199,079	235,373
Canadian Net Real Estate Investment Trust	CAD	30,000	219,082	204,000
Canadian Western Bank	CAD	7,800	279,362	203,034
Crombie Real Estate Investment Trust	CAD	16,660	262,957	268,726
Dream Industrial Real Estate Investment Trust	CAD	20,105	282,944	242,868
EQB Inc.	CAD	4,450	206,705	235,742
Flagship Communities REIT	USD	11,000	213,705	217,177
InterRent Real Estate Investment Trust	CAD	17,800	245,327	213,422
National Bank of Canada	CAD	6,410	404,396	541,453
Nexus Industrial REIT	CAD	17,000	200,148	164,730
Royal Bank of Canada	CAD	8,870	732,999	1,105,557
StorageVault Canada Inc.	CAD	40,320	97,941	239,098
The Bank of Nova Scotia	CAD	13,080	913,942	996,434
The Toronto-Dominion Bank	CAD	12,249	583,743	1,033,938
			<u>6,426,580</u>	<u>7,819,864</u>
Funds (6.14%)				
iShares 1-5 Year Laddered Corporate Bond Index ETF	CAD	41,500	793,208	716,290
iShares 1-5 Year Laddered Government Bond Index ETF	CAD	51,970	947,141	871,017
			<u>1,740,349</u>	<u>1,587,307</u>
Industrial (11.35%)				
ATS Automation Tooling Systems Inc.	CAD	5,300	233,117	187,355
Canadian National Railway Co.	CAD	2,880	331,709	416,995
Canadian Pacific Railway Ltd	CAD	4,875	236,374	438,311
Cargojet Inc.	CAD	1,710	256,195	243,692
CCL Industries Inc.	CAD	3,710	176,239	225,716
GFL Environmental Inc.	CAD	7,600	238,998	252,016

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares	Average cost \$	Fair value \$
Martinrea International Inc.	CAD	29,700	297,639	246,807
Mullen Group Ltd	CAD	22,000	233,624	248,380
NanoXplore Inc.	CAD	29,000	115,602	95,410
TFI International Inc.	CAD	3,205	262,569	331,173
WSP Global Inc.	CAD	1,720	162,815	250,329
			<u>2,544,881</u>	<u>2,936,184</u>
Technology (5.14%)				
CGI Inc.	CAD	2,570	238,609	263,528
Kinaxis Inc.	CAD	2,600	345,776	361,296
Magnet Forensics Inc.	CAD	11,950	406,272	206,377
Nuvei Corp.	CAD	4,960	406,191	230,739
Open Text Corp.	CAD	5,520	280,425	268,769
			<u>1,677,273</u>	<u>1,330,709</u>
Utilities (4.97%)				
Brookfield Infrastructure Corp.	CAD	3,675	155,829	200,765
Brookfield Renewable Partners LP	USD	4,850	176,484	217,228
Capital Power Corp.	CAD	6,120	197,091	275,461
Innergex Renewable Energy Inc.	CAD	16,900	324,318	292,370
Northland Power Inc.	CAD	7,818	274,819	299,586
			<u>1,128,541</u>	<u>1,285,410</u>
Total Equities			<u>22,391,172</u>	<u>24,334,504</u>

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares/ Nominal value	Average cost \$	Fair value \$
Fixed income (3.26%)				
Basic material (2.14%)				
Chemtrade Logistics Income Fund, - 6.5% / Oct 31, 2026	CAD	250,000	250,000	255,905
North American Construction Group Ltd, 5% / Mar 31, 2026	CAD	300,000	300,000	296,850
			<u>550,000</u>	<u>552,755</u>
Consumer cyclical (1.13%)				
Exchange Income Corp. - 5.25% / Jan. 15, 2029	CAD	300,000	300,000	291,750
			<u>850,000</u>	<u>844,505</u>
Warrants (0.04%)				
Flow Beverage Corp. \$10 / June 29, 2023	CAD	5,220	5,220	26
Star Royalties Ltd \$1 / Feb 19, 2024	CAD	85,000	7,565	9,350
			<u>12,785</u>	<u>9,376</u>
Total investments owned			23,253,957	25,188,385
Commissions and other portfolio transaction costs			<u>(27,258)</u>	-
Net investments owned (97.37%)			<u>23,226,699</u>	<u>25,188,385</u>
Other assets, net (2.63%)				<u>680,802</u>
Net assets attribute to holders of redeemable units (100%)				<u>25,869,187</u>

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(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, 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, Quebec, 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 August 19, 2022.

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).

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 manages 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 manages the assets to realize those fair values.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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 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. Transaction costs are expensed as incurred in the statement of comprehensive income. The Fund's investment assets and liabilities are measured at 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 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. 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 statement 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.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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.

The carrying value of investments in underlying funds is included in Investment at fair value through profit or loss (FVTPL) in the statement 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 statement 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.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

Foreign currency translation

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

Offsetting financial assets and financial liabilities

Financial assets and 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.

Taxation

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

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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:

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.

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.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

5 Risks associated with financial instruments

Risk factors

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

Credit risk

The Fund is exposed to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The majority of the credit risk to which the Fund is exposed arises from its investments in debt securities. In selecting fixed income securities for the Fund, the Manager considers factors such as the debt security's yield, risk of interest rate fluctuation, credit risk, the issuer's capital structure, credit spread and duration. As at June 30, 2022, all investments in fixed income were non-rated (December 31, 2021 – non-rated).

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 statement 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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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.

	June 30, 2022		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Accrued Liabilities	-	40,824	40,824
Distribution payable	-	17,409	17,409
Redeemable units	25,869,187	-	25,869,187

	December 31, 2021		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Distributions payable	-	375,698	375,698
Accrued liabilities	-	46,070	46,070
Management fees payable	-	658	658
Redeemable units	29,728,170	-	29,728,170

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 COVID-19 pandemic has caused volatility in the global financial markets. The Fund's Manager had to take a closer look at the market volatility and industry sectors that were most affected by the pandemic and adjust investment strategy accordingly.

The following tables 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.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

a) Currency risk

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

The table below indicates the foreign currencies to which the Fund had significant exposure as at June 30, 2022 and December 31, 2021, in Canadian dollars. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the Canadian dollar had strengthened or weakened by 5% in relation to each of the other currencies, with all other variables held constant. The monetary exposure presents the impact on cash and the non-monetary exposure presents the impact on investments. Non-monetary items are investments in equity securities and are classified based on the currency in which they were purchased.

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary \$	Non-monetary \$	Total \$	Monetary \$	Non-monetary \$	Total \$
June 30, 2022						
U.S. dollar	(20,247)	926,402	906,155	(1,012)	46,320	45,308
% of Net assets attributable to holders of redeemable units	(0.1)	3.6	3.5	(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, 2021						
U.S. dollar	(22,717)	1,043,757	1,021,040	(1,136)	52,188	51,052
% of Net assets attributable to holders of redeemable units	(0.1)	3.5	3.4	(0.0)	0.2	0.2

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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.

Terms to maturity	2022 \$	2021 \$
1–5 years	255,905	634,736
5–10 years	588,600	628,050
Total	844,505	1,262,786
Impact on net assets attributable to holders of redeemable units	24,856	29,103
Impact on net assets attributable to holders of redeemable units (%)	0.1%	0.1%

c) Price risk

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

As at June 30, 2022, 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 \$1,216,221 and would represent 4.7% of the net assets attributable to holders of redeemable units of the Fund (December 31, 2021 – \$1,346,550 representing 4.5% of the net assets attributable to holders of redeemable units of the Fund).

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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 investments market value:

Market segment	% of portfolio	
	2022	2021
Basic materials	7.6	7.4
Communications	3.8	3.9
Consumer, cyclical	5.9	6.4
Consumer, non-cyclical	5.0	6.5
Energy	14.9	10.8
Financial	31.1	31.0
Funds	6.3	6.2
Industrial	11.7	12.9
Technology	5.3	5.0
Utilities	5.1	5.5
Bonds	3.3	4.3
Warrants	-	0.1
	<u>100.0</u>	<u>100.0</u>

Market segment	% of portfolio	
	2022	2021
Bonds	3.3	4.2
Common stock	94.1	95.3
Warrants	-	0.1
Other net assets	2.6	0.4

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

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

- Level 3: Valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	June 30, 2022			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Assets				
Equity	24,334,504	-	-	24,334,504
Fixed income	844,505	-	-	844,505
Warrants	9,376	-	-	9,376
	25,188,385	-	-	25,188,385
	December 31, 2021			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Assets				
Equity	28,316,745	-	-	28,316,745
Fixed income	1,262,786	-	-	1,262,786
Warrants	14,972	-	-	14,972
	29,594,503	-	-	29,594,503

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 ended June 30, 2022 and 2021.

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.

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.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

6 Redeemable units

During the periods ended June 30, 2022 and 2021 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, 2022					
Series A	3,038,038	154,891	(124,059)	19,187	3,088,057
Series F	994,079	36,205	(76,223)	5,061	959,122
June 30, 2021					
Series A	2,808,470	83,910	(130,168)	15,908	2,778,120
Series F	1,042,356	46,424	(125,306)	4,771	968,245

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

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 NAV 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.

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

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, 2022 amounted to \$217,024 and nil respectively (June 30, 2021 – \$197,900 and nil respectively), with \$nil in outstanding fees due to the Manager as at June 30, 2022 (December 31, 2021 – \$658).

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 (2021 – did not waive any fees).

Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the period ended June 30, 2022 amounted to \$5,951 (June 30, 2021 – \$5,951) 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 periods ended June 30, 2022 and 2021, 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 these 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, 2022 and 2021 is disclosed below.

	2022	2021
Soft dollars	\$2,212	\$2,986
Percentage of total transaction costs (%)	11%	9%

Palos Equity Income Fund

Notes to financial statements

As at June 30, 2022

(expressed in Canadian dollars)

9 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, 2022 and 2021 calculated as follows:

	Increase (decrease) in net assets attributable to holders of redeemable units per series \$	Weighted average of redeemable units outstanding during the year	Increase (decrease) in net assets attributable to holders of redeemable units per unit
June 30, 2022			
Series A	(2,848,028)	3,091,165	(0.92)
Series F	(926,019)	961,268	(0.96)
June 30, 2021			
Series A	3,223,945	2,792,846	1.15
Series F	1,291,877	992,791	1.30

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 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 June 30, 2022 are nil (December 31, 2021 – nil).