

# **Canso Credit Income Fund**

Semi-Annual Management Report of Fund Performance

June 30, 2016



Lysander Funds



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# **Canso Credit Income Fund**

## **Semi-Annual Management Report of Fund Performance**

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### ***Management Report of Fund Performance***

As at June 30, 2016

#### ***A NOTE ABOUT FORWARD LOOKING STATEMENTS***

This semi-annual Management Report of Fund Performance includes certain statements that are “forward looking statements”. All statements, other than statements of historical fact, included in this Management Report of Fund Performance that address activities, events or developments that the Fund expects or anticipates will or may occur in the future, including such things as anticipated financial performance, are forward looking statements. The words “may”, “could”, “would”, “should”, “believe”, “plan”, “anticipate”, “expect”, “intend”, “forecast”, “objective” and similar expressions are intended to identify forward looking statements.

These forward looking statements are subject to various risks and uncertainties, including the risks described in the simplified prospectus of the Fund, which could cause actual financial performance and expectations to differ materially from the anticipated performance or other expectations expressed. Readers are cautioned not to place undue reliance on these forward looking statements. All opinions contained in forward looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

The Fund has no specific intention of updating any forward looking statements whether as a result of new information, future events or otherwise, except as required by securities legislation. Certain research and information about specific holdings in the Fund, including any opinion, is based upon various sources believed to be reliable, but it cannot be guaranteed to be current, accurate or complete. It is for information only, and is subject to change without notice.

# **Canso Credit Income Fund**

## **Semi-Annual Management Report of Fund Performance**

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### ***Management Report of Fund Performance***

December 31, 2015

This semi-annual management report of fund performance of Canso Credit Income Fund (the "Fund") contains financial highlights but does not contain the complete financial statements of the investment fund. This report should be read in conjunction with the semi-annual financial statements of the Fund for the year ended June 30, 2016. You can get a copy of the financial statements at your request, and at no cost, by calling toll-free 1 877 308 6979, by writing to us at Lysander Funds Limited, 100 York Boulevard Suite 501, Richmond Hill Ontario, L4B 1J8, by visiting our website at [www.lysanderfunds.com](http://www.lysanderfunds.com) or at SEDAR at [www.sedar.com](http://www.sedar.com).

Unitholders may also contact us using one of these methods to obtain a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure.

### ***Management Discussion of Fund Performance***

#### ***Investment Objective and Strategies***

Canso Credit Income Fund (the "Fund") is a closed-end investment fund managed by Lysander Funds Limited (the "Manager"). The Class A units of the Fund ("Class A Units") trade under the symbol PBX.UN on the Toronto Stock Exchange ("TSX"). The Fund also has issued and outstanding Class F units (the "Class F Units" and together with the Class A Units, the "Units") which are not listed on the TSX. Until June 30, 2015 through a forward agreement (the "Forward Agreement") between the Fund and Bank of Nova Scotia (the "Counterparty"), the Fund was exposed to a portfolio of securities (the "Portfolio") held by Canso Credit Trust (the "Trust"). The Portfolio is comprised primarily of corporate bonds. The Portfolio is managed by Canso Investment Counsel Ltd. ("Canso" or "Portfolio Manager").

The Fund was created to achieve the following investment objectives (the "Investment Objectives"): (i) to maximize total returns for holders of Units ("Unitholders"), on a tax-advantaged basis, while reducing risk; and (ii) to provide Unitholders with attractive monthly tax-advantaged cash distributions, targeted to be \$0.50 per Unit per annum, representing an semi-annual yield of 5.00% based on the original issue price of \$10.00 per Unit, by obtaining exposure to the Portfolio which consists primarily of corporate bonds. At the end of 2014, the Fund was distributing the equivalent of 5%, based on the original issue price of \$10.00 per Unit, annually on a tax advantaged, monthly basis.

As a result of changes to the Income Tax Act (Canada), the Forward Agreement settled on June 30, 2015 and the Fund did not enter into a new forward agreement. On June 25, 2015 the Fund acquired the assets and liabilities of Canso Credit Trust and has since continued to invest its assets directly in securities of the kind previously held in the Canso Credit Trust. Canso Credit Trust was terminated on June 30, 2015. Accordingly upon the acquisition of the portfolio from Canso Credit Trust, the Fund's investment objective was changed to the following: (i) to maximize total returns for Unitholders while reducing risk; and (ii) to provide Unitholders with monthly cash distributions, by taking long and short positions in a portfolio of primarily corporate bonds and other income securities. The return to Unitholders is dependent on the return of the Portfolio pursuant to the Forward Agreement until June 30, 2015 and the return on the securities held directly by the Fund for the remainder of the year. This Management Report of the Fund Performance will use the term "Portfolio" to refer to the Fund's holdings throughout the year.

The Portfolio's holdings are not restricted by credit ratings. In addition, Canso engages in short selling of securities primarily to hedge credit and interest rate risk. This allows the Portfolio to be positioned more defensively in both rising interest rate environments and credit downturns.

#### ***Risks***

No changes affecting the overall level of risk associated with investing in the Fund were made during the period. The risks of this Fund remain as discussed in the Fund's most recent prospectus or its amended public disclosure documents.

# **Canso Credit Income Fund**

## **Semi-Annual Management Report of Fund Performance**

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### ***Management Discussion of Fund Performance - continued***

#### ***Results of Operations***

From the inception date of the Fund, Canso has positioned the Portfolio to isolate and take advantage of wide credit spreads, primarily by shorting Government of Canada bonds against long corporate bond positions. The net effect of these long/short positions is to help insulate the Fund against an increase in interest rates, which Canso expects over the medium term, and to exploit attractive credit spreads of the corporate bond positions.

The Fund's performance in the period (0.6% for Class A and 0.8% for Class F) was driven by the yield produced by its various holdings as credit spreads (the additional yield over Government bonds provided by the debt securities held by the Fund) were relatively stable in the period. In addition, the Fund's equity positions had a mixed impact on results. Postmedia equity declined to almost zero as the company's print revenues declined more than expected and they struggled under a high debt load. Subsequent to the end of the period on July 7, the company announced a proposed recapitalization transaction that would reduce their outstanding debt and interest costs. On the positive side, shares in Bombardier posted a significant recovery and were up over 40% in the period. In addition, the share price of Yellow Pages was up almost 20% as the company continued to execute on its transformation to digital and to pay down its debt.

The net assets of the Fund decreased to \$201,636,957 at Jun 30, 2016 from \$240,665,781 at December 31, 2015. This was mainly due to cash distributions of \$5,418,834 and redemptions of \$34,750,371. A number of sales of securities were made to fund these redemptions.

#### ***Report on Borrowing***

The Fund did not borrow money, other than immaterial operating overdrafts. As discussed above, the Portfolio consists of both long and short positions. This exposes the Fund to a variety of risks resulting from selling securities short. Selling securities short may result in the loss of an amount greater than the amount invested since there is theoretically no limit to the price to which the securities that have been sold short may rise before the short position is closed out. In addition, the supply of securities which can be borrowed in order to maintain short positions fluctuates from time to time. There is no assurance that the lender of securities or financial instruments will not require the security to be repaid before Canso wishes to do so, thereby requiring the Fund or Trust to borrow the security elsewhere or purchase the security in the market at an unattractive price. In addition, the borrowing of securities entails the payment of a borrowing fee. There is no assurance that any borrowing fee will not increase during the borrowing period, adding to the expense of a short sale strategy. In addition, there is no assurance that a security sold short can be repurchased due to supply and demand constraints in the marketplace.

#### ***Recent Developments***

During the period, the Fund participated in a refinancing of Tuckamore Capital's existing debt through a combination of senior secured notes and convertible bonds. Tuckamore has withstood the downturn in the oil and gas industry by diligently controlling costs and maintaining margins. It has also offloaded its non-core businesses that were a drag to profitability. Canso believes that the new financing has improved the company's financial flexibility, thereby allowing it to focus its efforts on its key asset, ClearStream and execute on its business plan.

Canso also took advantage of the decline in bond prices of commodity producers to purchase Teck Resources at attractive yields of between 11-14%. Teck is exposed to the soft global steel industry through its metallurgical coal business, but its other operations in zinc and copper mining have been resilient. The company has aggressively reduced costs to offset the sharp decline in commodity prices. Canso believes in Teck's ability to manage its finances prudently which gives it the ability to withstand a prolonged downturn in the industry.

The Fund also participated in the distressed bonds of Intelsat Jackson, the operator of the world's largest satellite services business at high yields of between 10-19%. Intelsat's services are used by world's leading media and telecom companies. The company faces extensive competition and refinancing risk in the near term, but Canso believes that the potential value of the notes far outweighs their current trading price.

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

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### ***Management Discussion of Fund Performance - continued***

The holding in Bombardier bonds and equity rose sharply as the company landed a large order for its C Series passenger jet from Delta Air Lines. Even as the company made a 'contract provision' for selling the planes at a discount, Canso believes this order following Air Canada's earlier in the year should improve cash flow going forward. Bombardier has also diligently addressed the liquidity concerns by raising funds from the Province of Quebec and Caisse de depot et placement du Quebec (CDPQ). Bombardier's future success now rests on the successful performance of the C Series and positive feedback from airlines.

At period end, the Portfolio held long positions that were approximately 130% of the net asset value of the Fund with short positions of approximately 30%. At the end of the period, the yield-to-maturity (before allowing for any expenses) was 6.2% versus 7.3% at the end of the prior period. This reflects decreases in the yields of certain holdings, for example, the Bombardier bonds as well as a reduction in the total value of the long positions of the Fund compared to the end of the prior period. At the end of the period the Fund held approximately 14% in cash and cash equivalents to satisfy redemption payments shortly after the period

There were no changes to the membership of the Fund's Independent Review Committee ("IRC").

### ***Related Party Transactions***

For the period January 1 to June 30, 2015 the Manager received a management fee from the Fund equal to 0.25% per annum of the net asset value of the Fund (or 0.75% in total when combined with the management fee also received from the Trust), calculated weekly and payable monthly in arrears, plus applicable taxes, plus a service amount (the "Service Amount") calculated and paid after the end of each calendar quarter, equal to 0.40% per annum of the net asset value attributable to the Class A Units of the Fund. The Manager paid the Service Amount to brokers based on the number of Class A Units of the Fund held by clients of such brokers at the end of the relevant quarter. For the period ended June 30, 2016, the Manager earned a management fee from the Fund of 0.75% per annum totalling \$873,332 excluding HST (June 30, 2015: \$346,587). The Service Amount charged to the Fund for the same period was \$393,566 (June 30, 2015: \$444,799).

The Manager is also entitled to receive a performance fee (the "Performance Fee") under certain conditions as described in the Prospectus. For the ended June 30, 2016, the Performance Fee accrued payable by the Fund was \$Nil, excluding HST (June 30, 2015: \$1,181,140 accrued by the Trust).

Pursuant to investment advisory agreements, the Manager has retained Canso to provide investment advisory and portfolio management services to the Manager, the Fund, and the Trust. The Manager and Canso are related parties. Out of the management fee the Manager receives for managing the Fund and Trust, the Manager pays a fee to Canso for the investment advisory and portfolio management services that Canso provides. The Manager will also pay to Canso a percentage of any Performance Fee that the Manager receives, such percentage to be agreed upon between the Manager and the Portfolio Manager from time to time.

For the period ended June 30, 2016 the fees paid by the Manager to Canso amounted to \$407,555 (June 30, 2015: \$166,164) for services provided to the Fund and \$Nil (June 30, 2015: \$1,232,022) for services and accrued performance fees in respect of the Trust.

The Fund did not rely on any approval, positive recommendation or standing instruction from its IRC with respect to any related party transactions.

### ***Management Fees***

Please refer to the discussion under the heading "Related Party Transactions" for a discussion of the management fees paid by the Fund and the Trust.

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

### Financial Highlights

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance for the period ended June 30, 2015 and December 31, 2014, 2013, 2012, 2011 and 2010:

Class A	Period ended	June 30, 2016	Dec 31, 2015	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012	Dec 31, 2011
<b>Net assets Per Unit <sup>1</sup></b>							
	Net Assets, Beginning of period	\$10.75	\$11.43	\$10.71	\$10.00	\$8.46	\$9.57
<b>Increase (decrease) from operations:</b>							
	Total revenue	0.47	0.26	-	-	-	-
	Total expenses	(0.11)	(0.11)	(0.12)	(0.11)	(0.10)	(0.11)
	Realized gains (losses)	(0.24)	4.66	0.15	0.11	0.02	(0.01)
	Unrealized gains (losses)	(0.07)	(5.00)	1.18	1.21	2.11	(0.68)
	<b>Total increase (decrease) from operations<sup>2</sup></b>	0.05	(0.19)	1.21	1.21	2.03	(0.80)
<b>Distributions:</b>							
	From income (excluding dividends)	(0.25)	-	-	-	-	-
	From capital gains	-	(3.55)	-	-	-	-
	Return of capital	-	-	(0.50)	(0.50)	(0.50)	(0.50)
	<b>Total Distributions<sup>3</sup></b>	(0.25)	(3.55)	(0.50)	(0.50)	(0.50)	(0.50)
	<b>Net assets, End of period<sup>2</sup></b>	\$10.55	\$10.75	\$11.43	\$10.71	\$10.00	\$8.46

### Notes

1. The information is derived from the Fund's unaudited semi-annual financial statements. All per unit figures presented in the 2016, 2015, 2014 and 2013 periods are referenced to net assets determined in accordance to IFRS. All other comparatives periods are based on Canadian GAAP.
2. Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial period. This table is not intended to be a reconciliation of beginning to ending net assets per unit.
3. Total distributions in 2015 were paid in cash (\$0.50/unit) and special non-cash distributions (\$3.0513/unit). Prior year distributions were paid in cash.

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

Class F	Period ended	June 30, 2016	Dec 31, 2015	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012	Dec 31, 2011
<b>Net assets Per Unit <sup>1</sup></b>							
	Net Assets, Beginning of period	\$11.47	\$12.10	\$11.27	\$10.46	\$8.80	\$9.89
<b>Increase (decrease) from operations:</b>							
	Total revenue	0.51	0.27	-	-	-	-
	Total expenses	(0.10)	(0.07)	(0.08)	(0.07)	(0.06)	(0.03)
	Realized gains (losses) for the period	(0.25)	5.01	0.16	0.11	0.02	(0.01)
	Unrealized gains (losses) for the period	(0.10)	(5.34)	1.29	1.25	2.22	(0.86)
	<b>Total increase (decrease) from operations<sup>2</sup></b>	0.06	(0.13)	1.37	1.29	2.18	(0.90)
<b>Distributions:</b>							
	From income (excluding dividends)	(0.25)	-	-	-	-	-
	From capital gains	-	(3.95)	-	-	-	-
	Return of capital	-	-	(0.50)	(0.50)	(0.50)	(0.50)
	<b>Total Distributions<sup>3</sup></b>	(0.25)	(3.95)	(0.50)	(0.50)	(0.50)	(0.50)
	<b>Net assets, End of period<sup>2</sup></b>	\$11.30	\$11.47	\$12.10	\$11.27	\$10.46	\$8.80

### Notes

1. The information is derived from the Fund's unaudited semi-annual financial statements. All per unit figures presented in the 2016, 2015, 2014 and 2013 periods are referenced to net assets determined in accordance to IFRS. All other comparatives periods are based on Canadian GAAP.
2. Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial period. This table is not intended to be a reconciliation of beginning to ending net assets per unit.
3. Total distributions in 2015 were paid in cash (\$0.50/unit) and special non-cash distributions (\$3.4473/unit). Prior year distributions were paid in cash.

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

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### *Ratios and Supplemental Data*

Class A	June 30, 2016	Dec 31, 2015	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012	Dec 31, 2011
Total net asset value (000's) <sup>1</sup>	\$179,096	\$212,656	\$223,935	\$206,327	\$188,891	\$155,739
Number of units outstanding <sup>1</sup>	16,968,007	19,783,017	19,586,958	19,261,249	18,882,722	18,403,818
Management expense ratio <sup>2</sup>	2.14%	1.77%	3.18%	5.87%	1.87%	3.04%
Trading expense ratio <sup>3</sup>	0.05%	-	-	-	-	-
Portfolio turnover rate <sup>4</sup>	7.11%	128.59%	5.42%	5.94%	6.40%	12.98%
Net asset value per unit <sup>1</sup>	\$10.55	\$10.75	\$11.43	\$10.71	\$10.00	\$8.46
Closing market price per unit <sup>1</sup>	\$10.14	\$10.50	\$12.05	\$10.97	\$10.25	\$9.15

### Notes

1. This information is provided as at the end of the period.
2. Management expense ratio is based on total expenses of both the Fund and the Trust, as applicable (excluding commissions and other portfolio transaction costs but including issuance costs) for the stated period and is expressed as an annualized percentage of monthly average net asset value during the period.
3. The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of monthly average net asset value during the period.
4. The Fund's portfolio turnover rate indicates how actively the Fund's Portfolio Manager manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a fund.

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

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### *Ratios and Supplemental Data*

Class F	June 30, 2016	Dec 31, 2015	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012	Dec 31, 2011
Total net asset value (000's) <sup>1</sup>	\$22,541	\$28,009	\$32,630	\$34,120	\$35,818	\$34,456
Number of units outstanding <sup>1</sup>	1,994,744	2,442,940	2,696,472	3,027,762	3,424,384	3,917,463
Management expense ratio <sup>2</sup>	1.76%	1.33%	2.73%	5.42%	1.41%	2.26%
Trading expense ratio <sup>3</sup>	0.05%	-	-	-	-	-
Portfolio turnover rate <sup>4</sup>	7.11%	128.59%	5.42%	5.94%	6.40%	12.98%
Net asset value per unit <sup>1</sup>	\$11.30	\$11.47	\$12.10	\$11.27	\$10.46	\$8.80

### Notes

1. This information is provided as at the end of the period.
2. Management expense ratio is based on total expenses of both the Fund and the Trust, as applicable (excluding commissions and other portfolio transaction costs but including initial issuance costs) for the stated period and is expressed as an annualized percentage of monthly average net asset value during the period.
3. The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of monthly average net asset value during the period.
4. The Fund's portfolio turnover rate indicates how actively the Fund's Portfolio Manager manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a fund.

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

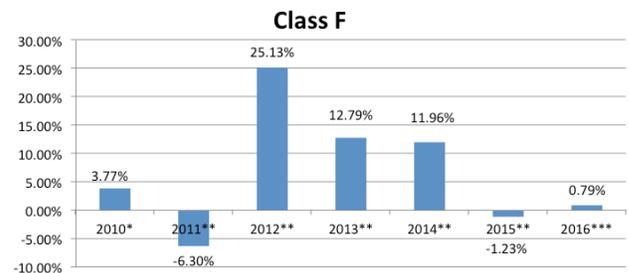
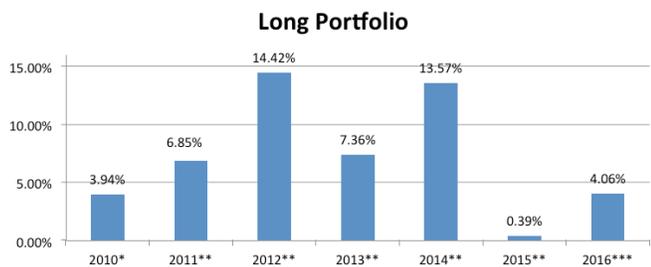
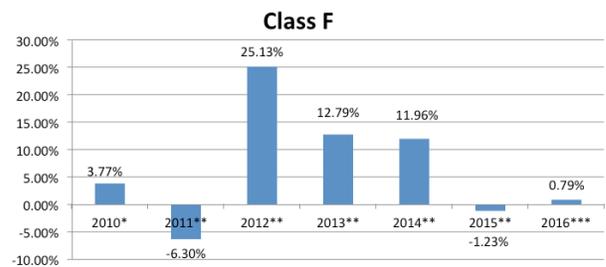
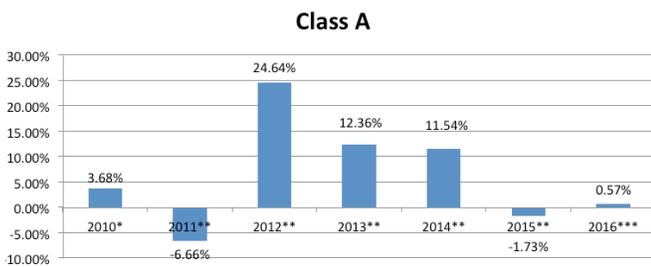
### Past Performance

The following charts and table show the past performance of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future. The information shown assumes that cash distributions made by the Fund in the periods shown were reinvested in additional units of the Fund.

### Year – by – Year Returns

The bar charts show the Fund’s total return for Class A and Class F. The returns of the long and short portfolio shown below are gross of all fees. Prior year comparatives of performance of the long and short portfolios have been restated to be consistent with the current period. Returns exclude security issuance costs which are not recurring.

The charts show, in percentage terms, how an investment held on the first day of each period would have changed by the last day of the period.



\*For the period July 16 to December 31, 2010

\*\*For the period January 1 to December 31

\*\*\*For the period January 1 to June 30

# Canso Credit Income Fund

## Semi-Annual Management Report of Fund Performance

### Summary of Investment Portfolio

As at June 30, 2016

#### Top 25 Issuers<sup>2</sup>

Long Positions	% of NAV	Asset Mix	% of NAV
Cash and cash equivalents	13.6%	Canadian Bonds - Corporate	88.9%
Enbridge Inc (Debt)	10.4%	Foreign Bonds - Corporate	20.2%
Royal Bank Of Canada (Debt)	10.0%	Canadian Equities	18.0%
Royal Bank Of Scotland plc (Debt)	9.0%	Cash and cash equivalents	13.6%
Blackberry Ltd (Debt)	9.0%	Foreign Equities	4.0%
Navient Corp (Debt)	8.8%	Canadian Corporate Debt - Short	-0.5%
Xplornet Communications Inc (Debt)	8.4%	Canadian Equities - Short	-6.1%
Yellow Pages Limited (Equity)	6.7%	Foreign Government Debt - Short	-8.2%
Strait Crossing Development (Debt)	6.3%	Canadian Government Debt - Short	-15.4%
Bombardier Inc (Debt)	5.2%	Other asset less liabilities	-14.5%
Postmedia Network Inc (Debt)	4.8%	Total	100.0%
Videotron Ltd (Debt)	4.4%		
Shaw Communications Inc (Debt)	4.0%		
Techmedianetwork Inc (Purch) (Equity)	4.0%		
Yellow Pages Digital & Media (Debt)	3.7%		
Tuckamore Capital Mgmt Inc (Debt)	3.7%		
Loblaw Companies Ltd (Debt)	3.7%		
Bombardier Inc (Equity)	3.6%		
Black Press (Debt)	2.7%		
NHA MBS Merrill Lynch Cda Inc (Debt)	2.6%		
Intelsat Jackson Holdings SA (Debt)	2.4%		

#### Short Positions

	% of NAV
Genworth MI Canada Inc (Equity)	-3.0%
Home Capital Group Inc (Equity)	-3.0%
U S Treasury Bond (Debt)	-8.2%
Government Of Canada (Debt)	-14.2%
Total Long & Short	98.6%
Total Portfolio Long Positions	130.2%
Total Portfolio Short Positions	(30.2%)

1. The investment portfolio may change due to ongoing transactions. Quarterly updates are available within 60 days of quarter-end.

2. Prepared in accordance with National Instrument 81-106 Form 81-106F1

Lysander Funds



100 York Boulevard, Suite 501  
Richmond Hill, Ontario  
L4B 1J8

[www.lysanderfunds.com](http://www.lysanderfunds.com)