PH&N Core Plus Bond Fund

Fund Performance

Performance Comparison as of March 31, 2021 (%)

	3 Mo	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr	SI *
PH&N Core Plus Bond Fund	**-4.84**	**6.02**	**5.41**	**5.32**	**4.53**	**4.46**	**4.98**
FTSE Canada Universe Bond Index	*-5.04*	*1.62*	*3.03*	*3.77*	*3.16*	*2.83*	*3.64*
Relative Performance	+0.20	+4.40	+2.38	+1.55	+1.37	+1.63	+1.34

Series O returns. Total returns are gross-of-fee and reported in Canadian dollars. Periods less than one year are not annualized.

* Inception date: June 30, 2013.

Fund Attribution

Attribution as of March 31, 2021 (%)

	Relative Performance	
	3 Mo	1 Yr
Interest rate anticipation		
Duration & yield curve	-0.22	-0.31
Real return bonds	0.08	0.37
Foreign sovereign bonds	0.00	0.06
Credit & liquidity		
Provincial & quasi-government bonds	0.06	0.11
Investment grade corporate bonds	0.10	0.94
High yield corporate bonds	0.27	2.32
Mortgages	0.03	0.19
Emerging market debt	-0.12	0.68
Other	0.00	0.04
Total	**+0.20**	**+4.40**

First Quarter Review

Strategy Summary for Quarter Ending March 31, 2021 (relative contribution to duration exposure)			
Strategy	**Change Over Q1**	**Position Ending Q1**	**Our View**
Duration & Yield Curve	Unchanged	Small short duration	Reward-for-risk continues to favour credit and liquidity strategies at this time
Real Return Bonds	Decreased	Small position	Market-implied inflation expectations continued to rise, but remain below the BoC's 2% inflation target
Foreign Sovereign Bonds	Unchanged	No position	Monitoring the yield differential between U.S. Treasuries and Government of Canada bonds
Provincial and Quasi-Government Bonds	Unchanged	Medium overweight in provincials; underweight in federal agencies	Valuations more attractive for provincial bonds relative to federal agencies
Investment Grade Corporate	Decreased	Medium overweight	Valuations have compressed while technicals remain robust
High Yield	Unchanged	Significant position	Reward-for-risk profile remains compelling
Mortgages	Unchanged	Small position	Liquidity premium remains at appealing levels
Emerging Market Debt	Unchanged	Medium position	Reward-for-risk profile remains compelling

- Global economies continued to experience strong and swift recoveries as we continued to see progress on vaccine roll-outs, combined with ongoing government and central bank support. Against this backdrop, rising inflation pressures permeated the market and caused bond yields to rise considerably higher. Higher yields resulted in negative performance for the FTSE Canada Universe Bond Index, which returned -5.0% in the first quarter.
- Active positioning of the portfolio, particularly within credit and liquidity strategies, resulted in the portfolio finishing the quarter modestly ahead of the benchmark. Overall, the portfolio's risk budget remained focused on credit and liquidity strategies over interest rate anticipation strategies, and we continued to upgrade the credit quality of the portfolio during the quarter.
- The portfolio's duration positioning contributed slightly to relative performance, while yield curve positioning was the largest detractor during the quarter. Positioning across the yield curve is a function of where we see the most attractive opportunities within credit and liquidity strategies.
- Market-implied long-term inflation expectations continued to rise over the quarter, resulting in a positive contribution from the out-of-benchmark position in real return bonds.
- Provincial bonds contributed to relative performance as a result of the portfolio's overweight to mid- and long-term provincial bonds, whose spreads tightened over the quarter.

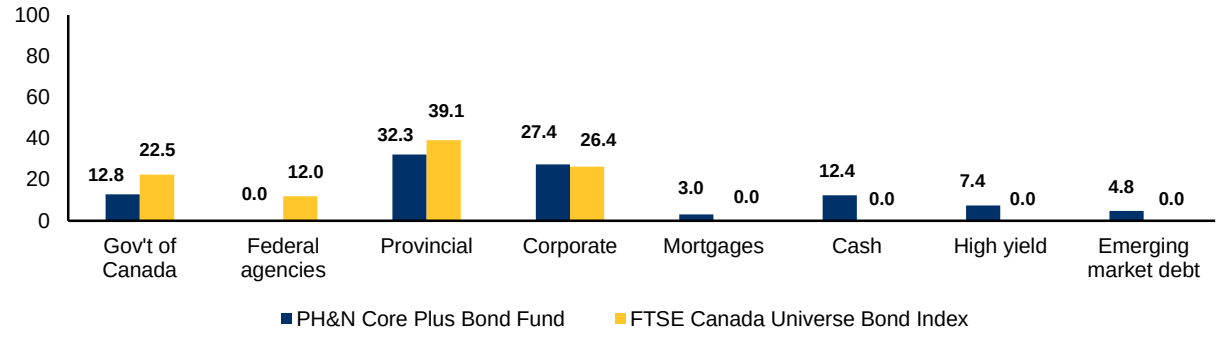
- The portfolio's overweight exposure to investment grade corporate bonds as well as security selection decisions within this segment of the bond market both contributed to added value.
- The portfolio's position in high yield bonds was a significant contributor to relative performance as the sector performed remarkably well on the back of risk-on sentiment amongst investors.
- Mortgages contributed slightly to relative performance as spreads continued to recover over the quarter.
- Emerging market debt (EMD) was a drag on relative performance as both hard and local currency bonds posted negative returns on the back of rising bond yields.

PH&N Core Plus Bond Fund Portfolio Structure as of March 31, 2021

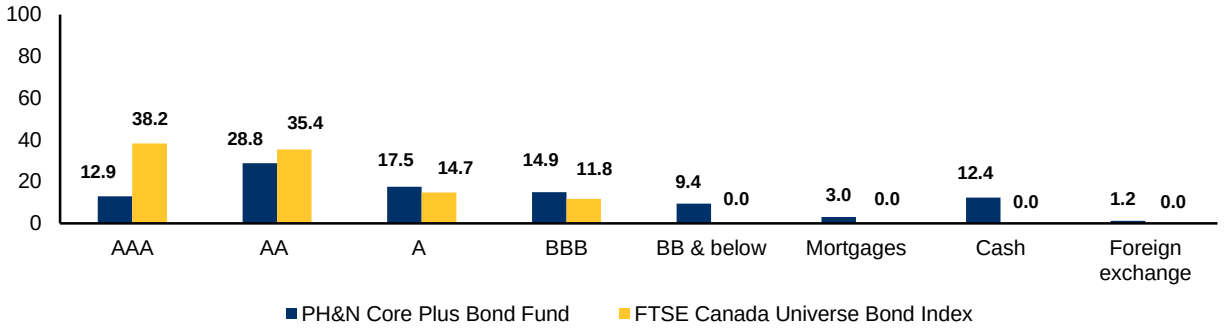
Fund Characteristics

	Modified Duration (Yrs)	Term to Maturity (Yrs)	Yield to Maturity (%)
PH&N Core Plus Bond Fund	7.72	11.17	2.43
FTSE Canada Universe Bond Index	*7.93*	*10.63*	*1.72*

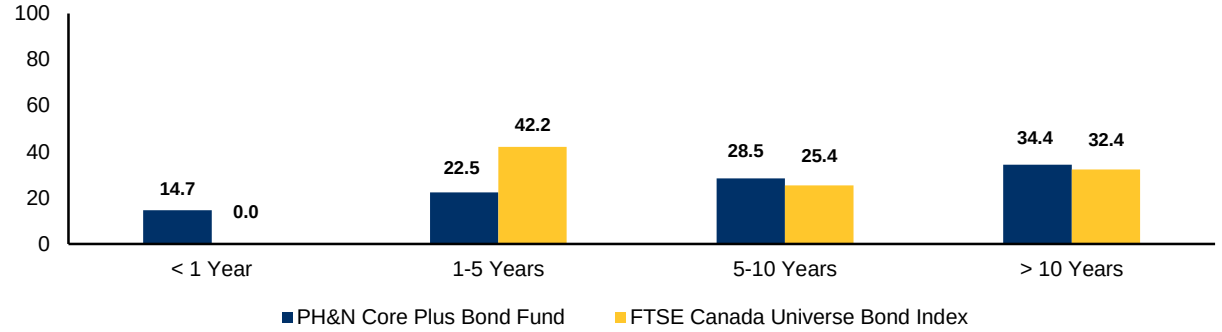
Issuer Analysis (%)



Rating Analysis* (%)



Maturity Analysis (%)



[1] Duration includes the duration of foreign instruments. Due to the Fund's foreign bonds having a much lower correlation to Canadian interest rates than implied by a conventional duration calculation, the reported duration measure does not correctly estimate true economic sensitivity of the Fund to Canadian base rates.

* Current ratings based on average across rating agencies (DBRS, Moody's, S&P) where available. Ratings at the time of purchase may differ.

Totals may not add to 100% due to rounding.

First Quarter Review

Duration and Yield Curve

Global economies continued to experience strong and swift recoveries as vaccine roll-outs allowed for lockdown restrictions to ease, and as a result, most central banks' growth projection for 2021 improved materially. In light of the robust economic rebound, rising inflation pressures permeated the market and caused bond yields to increase meaningfully over the quarter. The volatility in bond yields was further exacerbated by a number of technical factors at the end of February; as a result, that month the 10-year Government of Canada (GoC) bond yield experienced its largest one-month increase in over a decade. GoC bond yields increased precipitously across all tenors of the yield curve during the first quarter, and the yield curve steepened as a result of the improved economic outlook. Overall, the rise in yields is partly a function of the normalization of yields back to pre-pandemic levels.

Despite the increase in the volatility of bond yields, the Bank of Canada (BoC) announced it would begin to unwind the emergency liquidity programs it deployed last year at the height of the pandemic. The bond market's reaction to the announcement was muted, as it was largely anticipated amongst market participants who expect the tapering of the bond purchase programs to occur in April. There is broad consensus amongst investors that the need for these liquidity enhancement programs is no longer warranted given how much the market has recovered. Additionally, there is comfort in knowing that the BoC has the ability to quickly reinitiate the purchase programs should market conditions deteriorate again. That said, the BoC has remained committed to keeping interest rates low for the foreseeable future until the economy has achieved its full potential.

For most of the quarter, the portfolio's sensitivity to the movement of interest rates was in line with the benchmark. However, mid-quarter the portfolio had a slight long duration position relative to the benchmark based our view that yields had risen too high too fast. This position was short lived as yields continued to increase further. As a result, we reverted the portfolio's duration profile back to broadly neutral until the end of March, when we initiated a small short duration position. This was predicated on the view that over the short-term, bond yields are well-supported to move higher on the back of vaccine roll-outs, improving economic conditions, and rising inflation pressures. The portfolio's duration size relative to the benchmark is modest, reflecting our belief that the reward-for-risk trade-off continues to favour credit and liquidity strategies. Similarly, the portfolio's yield curve positioning is partly a function of where we see the most attractive opportunities within credit and liquidity strategies, and we currently have a preference for mid- to longer-term credit. Overall, yield curve positioning detracted from relative returns over the quarter as mid- and longer-term yields increased the most as the yield curve steepened.

Government of Canada Yields (%)					
	1 Yr	2 Yr	5 Yr	10 Yr	30 Yr
March 31, 2021	0.17	0.23	0.99	1.56	1.98
Forward Curve for March 31, 2022	0.32	0.56	1.29	1.78	2.06
Implied Change (1 year)	**+0.15**	**+0.33**	**+0.30**	**+0.22**	**+0.08**

Source: FTSE Global Debt Capital Markets Inc., RBC GAM (BondLab)

Looking ahead, the majority of bond market participants have revised their expectations, and now anticipate yields will be modestly higher over the next year as a result of the improving economic outlook. Our view is generally in line with what is priced into the bond market; however, we do believe that yields are likely to exhibit modest volatility in the near term as rising inflation, especially in year over year measures, is likely to contribute to investors' apprehension that central banks' commitment to allowing inflation to run higher than 2% could lead to longer term inflation risks. Ultimately, the concept of average inflation targeting could be the correct course of action to revive the economy, but that doesn't preclude a lapse in investor confidence in the interim.

Real Return Bonds

The market's expectations for long-term inflation (estimated as the difference in yield between a nominal and real return bond) rose alongside nominal bond yields, moving 0.2% higher to end the quarter at 1.7%. The damage to liquidity conditions in the real return bond (RRB) market in early 2020 has now been fully repaired, primarily as a result of the BoC's continued support via its asset purchase program. While market-implied long-term inflation expectations have risen, they remain below the BoC's 2% target and in line with levels of the past decade. Given the strong performance over the quarter, we took the opportunity to further trim the portfolio's allocation to RRBs, bringing it back to pre-pandemic levels. This strategy contributed positively to relative performance during the first quarter as RRBs outperformed nominal bonds when market-implied, long-term inflation expectations rose.

Actual inflation, as measured by the Consumer Price Index (CPI), has stabilized mainly due to the recovery in the price of oil, though it remains muted. Inflation is anticipated to print higher over the next few months, which is in part a reflection of the current low CPI base level as a result of the significant price declines at the onset of the pandemic. However, the anticipated higher inflation print is expected to be transitory. Overall, we believe market-implied long-term inflation expectations are likely to continue moving higher over the medium term.

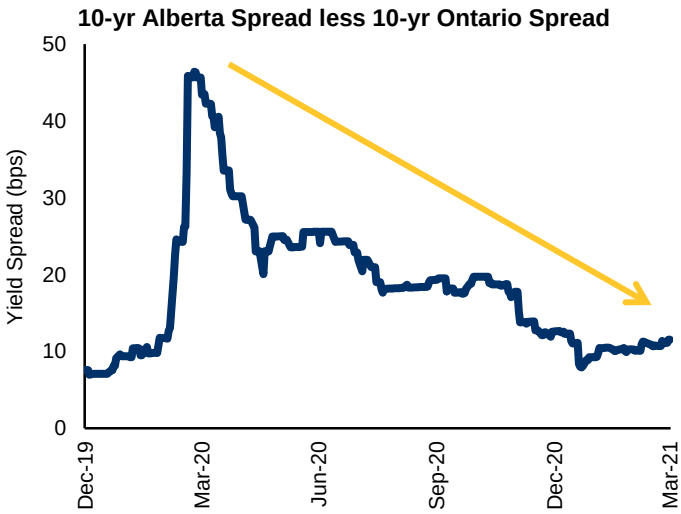
Foreign Sovereign Bonds

We may choose to hold a tactical position in foreign sovereign bonds, such as U.S. Treasury bonds and U.S. T-Bills, when they are attractively valued, and/or because of their diversification benefits. We do not currently have a position in foreign sovereign bonds, but we will continue to monitor this strategy as market conditions evolve.

Quasi-Government Bonds

The outlook for provincial economies has gotten brighter as vaccination campaigns accelerate and government stimulus measures continue to provide a significant boost to the recovery. That being said, the damage done to the labour market will take some time to fully heal, and the resumption of activity in certain industries such as the hospitality sector could be a bumpy process. As such, the provinces stayed active in the primary market, issuing approximately $30 billion of new supply during the quarter to help mitigate any potential setbacks on the path to recovery. Provincial bond spread levels were resilient despite the ample new supply coming to market, with broad spreads unchanged quarter over quarter. One notable development during the quarter was the BoC's announcement that it would let its Provincial Bond Purchase Program (PBPP) expire in May, as bond market conditions remain robust and the liquidity environment remains healthy. Note, the BoC only bought around $17 billion of provincial bonds since the initiation of the program last May (program size limit was $50 billion). Overall, the announcement was broadly expected by market participants and therefore had minimal impact on provincial bond spreads.

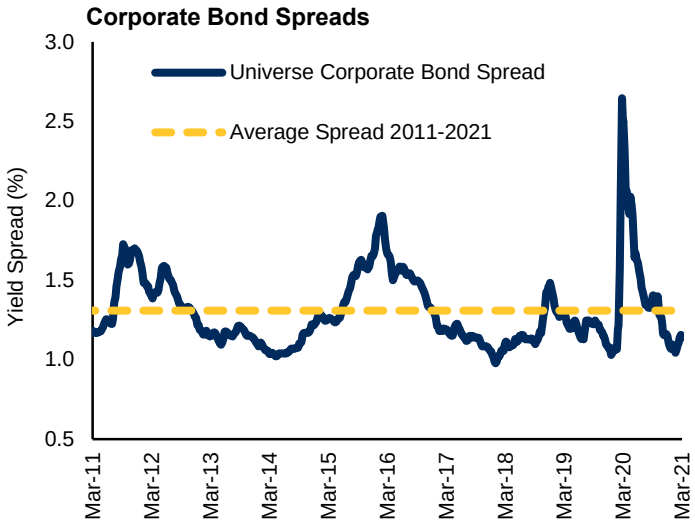
With provincial bond valuations hovering near pre-pandemic levels, we took the opportunity to upgrade the quality of the portfolio by increasing the portfolio's exposure to Province of Ontario, which offers superior liquidity and steady fundamentals relative to the other provinces. In the same vein, we also reduced the portfolio's overweight exposure to the smaller and less liquid Province of Alberta, whose spread differential with Ontario has also returned to pre-pandemic levels. Overall, the portfolio's provincial exposure relative to the benchmark decreased slightly over the quarter. Further, we continue to find the value of federal agency bonds, such as AAA-rated Canada Housing Trust bonds, to be less attractive versus other higher-yielding credit. As such, the portfolio remains positioned with an underweight exposure to this segment of the quasi-government bond market.



Source: BMO Capital Markets

Overall, quasi-government bonds contributed modestly to relative performance, primarily as a result of the portfolio's overweight to mid- and long-term provincial bonds whose spreads tightened over the quarter. We will continue to tactically adjust the portfolio's quasi-government positioning as the attractiveness of opportunities change relative to other segments of the bond market.

Investment Grade Corporate Bonds



Source: FTSE Global Debt Capital Markets Inc.

Canadian investment grade corporate bond spreads were broadly unchanged over the first quarter. With the healthy functioning of markets and corporate bond spreads hovering near pre-pandemic levels, the BoC announced that it would let its Corporate Bond Purchase Program (CBPP) expire in the coming months. Overall, the BoC purchased 76 corporate bonds for a total of only $250 million out of a program size of $10 billion. Despite the fact that only few purchases were made, the corporate bond market was able to thrive on its own. Looking forward, there is comfort in knowing that the BoC has the ability to reinitiate the CBPP should the bond market come under stress again. In terms of new issue supply, corporate issuers continued to capitalize on robust demand from investors, with approximately $33 billion of new supply coming to market during the quarter, which is roughly 6% ahead of last year's strong pace.

From a fundamental standpoint, the elevated levels of debt in the Canadian economy among both consumers and corporations remain a key concern. Canada's household debt to gross domestic product (GDP) is one of the fastest growing in the world, reaching about 110% in Q3 2020. Compared to our U.S. counterparts, the divergence is unusually large – but hasn't always been. The ratio of household debt to GDP in the U.S. was 78% in Q3 2020, about 32% lower than Canada. Only 10 years ago, Canada was flat to the U.S. As for corporations, mergers and acquisitions are off to their fastest-ever start to a year in Canada, driven by a combination of low interest rates, high valuations, and an improving economic outlook. It appears as though an increasing number of issuers are willing to assume more debt in order to access funding at low rates, even at the risk of a rating downgrade, with the expectation of reducing leverage in the future.

During the quarter, we continued to reduce the portfolio's overweight corporate exposure, primarily from the Energy and Real Estate sectors. While doing so, we took the opportunity to rotate part of the portfolio's exposure out of lower-quality, higher-beta issuers into higher-quality, lower-beta issuers. Overall, corporate bonds were a positive contributor to relative performance during the quarter as a result of the portfolio's overweight exposure and security selection. Going forward, we will continue to capitalize on attractive relative value opportunities within the bond market as long as we are being appropriately compensated for the underlying fundamental risks. As such, we continue to employ our thorough, independent, and disciplined credit analysis and security selection process to help insulate the portfolio from these risks.

Private Placement Corporate Bonds

The portfolio's allocation to private placement corporate bonds is achieved through an allocation to the PH&N Private Placement Corporate Debt Fund (PPCDF). The PH&N PPCDF invests in investment-grade private placement corporate bonds primarily issued in Canada, but also abroad. For bonds unrated by an agency, PH&N will assign an internal rating, which must be investment grade quality in order to qualify.

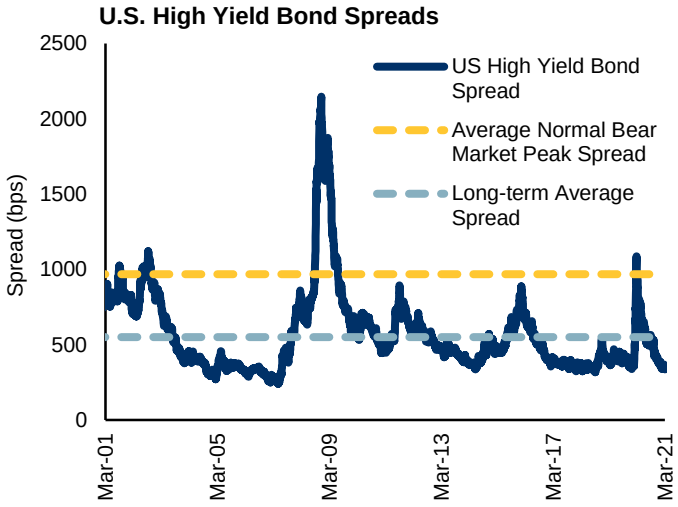
One of the benefits of investing in private debt is the opportunity to expand and diversify investment opportunities. While many of the issues are infrastructure related, the private debt market encompasses many industries and sub-industries not available in the "public" markets. In addition, because private placements do not tend to have an active secondary market, they often provide attractive illiquidity premiums for investors.

The private placement bond market continued to recover over the first quarter, with the overall spread level of the fund tightening by ~10 basis points. This magnitude of compression was however consistent with what was witnessed in the broader Canadian corporate bond market as comparable-term public securities tightened to a similar degree. However, sharply higher Government of Canada bond yields over the quarter weighed on absolute performance, and the fund returned -5.07% during the quarter. The extra spread over public corporate bonds provides an ongoing return tailwind.

The PPCDF did not participate in any new deals over the quarter. With respect to the current pipeline of new opportunities, we are currently engaged with a number of renewable power issuers on potential deals. We access investment opportunities for the PPCDF via the private placement desks of bond dealers that are our traditional counterparties in public corporate bond markets. Our expectations for yield enhancement within this sector are in the order of 75 to 100 basis points over public market opportunities of similar credit quality.

High Yield Corporate Bonds

The recovery in high yield bonds extended into 2021 as high yield spreads tightened a further 50 basis points over the first quarter to approximately 335 basis points, well below the peak of 1,087 basis points witnessed last spring. The broad high yield market returned 0.9% in the first quarter. While this return seems modest, it compares favourably to investment grade bonds which generated negative performance as they faced the headwind of rising interest rates.



Source: Bloomberg, RBC GAM. US high yield daily bond spreads represents the ICE/BofA US High Yield Bond Index as at March 31, 2021. Normal bear market excludes the great financial crisis

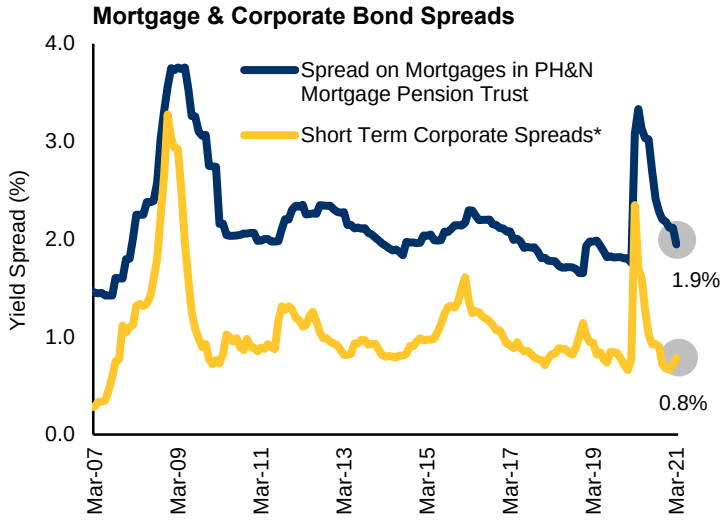
Investor confidence in financial markets and the companies that issue bonds within them continued to improve during the quarter. This confidence, along with a fear of higher interest rates in the future, prompted corporations to continue shoring up balance sheets at affordable rates by issuing a record amount of high yield bonds in the first quarter. This meaningful issuance was met by equally strong demand by yield-hungry investors in this low rate environment. In the past, issuance spikes like this one have often coincided with increases in risk-seeking behaviours such as mergers and acquisitions. However, high yield issuers have demonstrated reasonable financial discipline by using bond proceeds for risk-reduction activities such as refinancing short-term bank lines, replacing existing higher coupon debt, or adding to cash reserves.

High yield bond defaults continued to subside, having peaked last summer at 7% before improving steadily to an annual rate of 5% by the end of the first quarter. This is still above the long-term average of 3-4%, but well below what was feared during the early days of the pandemic. With global vaccine roll-outs underway and the potential end to COVID-19 in the not-too distant future, we believe that the peak in defaults is behind us.

We built the portfolio's high yield position during the dramatic sell-off last spring at attractive valuations and maintained a significant position over the spring and fall of last year. We trimmed the portfolio's exposure slightly in late 2020 as spread levels continued to decline, and maintained this position over the first quarter. The recovery in high yield bonds over the past year has been very beneficial to portfolio performance. The portfolio's exposure is biased towards the high-quality and less cyclical end of the spectrum, and remains focused on those sectors least impacted by COVID-19 shutdowns. We are mindful of the possibility of another wave of COVID-19 infections as well as headwinds associated with a rising rate environment. While high yield spreads have tightened meaningfully over the last year, we believe that continued fiscal and monetary support, vaccine roll-outs, and strong investor demand for yield still provide a conducive environment for high yield bonds.

Mortgages

The portfolio's allocation to commercial mortgages is achieved through an investment in the PH&N Mortgage Pension Trust (MPT).



* FTSE Canada Short Term Corporate Bond Index
Source: FTSE Global Debt Capital Markets Inc. RBC GAM (BondLab)

The social and economic restrictions imposed in response to COVID-19 have impacted many commercial real estate tenants across Canada, but the experience has differed by sector despite widespread and significant support from the federal government. Demand for the highest quality industrial and multi-residential commercial mortgages has exceeded the supply. This has increased competition for new opportunities, and mortgage spreads tightened a further 24 basis points during the first quarter as a result. The sharp rise in underlying GoC bond yields has been supportive of higher coupons on new deals, but this has been partially offset by tighter spreads. All-in coupon rates continue to be attractive for borrowers, as well as to lenders relative to other income-generating asset classes.

Within the office sector, over 75% of the MPT's exposure is located in major urban markets, with 24% in secondary markets. We believe the fund's office exposure is relatively well insulated at this time. Despite some weakness in the office sector over the past year, we continue to watch this area of the market closely as it evolves. We are actively pursuing attractive opportunities where tenant structure is sound, underwriting parameters are conservative, and borrowers are strong.

The MPT's largest industrial exposures are to the light industrial and industrial flex segments, which is positive given these building types are adaptable to a wide variety of uses. Industrial flex space in Canada is increasingly sought after by tech companies and retailers building out their logistics networks. We are aggressively pursuing opportunities based on the fundamentals of this sector, but the challenge is earning a return commensurate with the credit fundamentals in a highly competitive pricing environment.

Multi-residential assets are traditionally viewed as the most stable segment of the commercial real estate market and have held up to that reputation through the pandemic so far. This has attracted significant capital to be invested and has made multi-residential opportunities among the most sought-after sectors of the mortgage market. While vacancy rates quoted in the media have focused on an uptick, this has primarily been in the condo market, which is different from the purpose-built rental buildings that we focus on in the MPT. We continue view this sector favourably and believe the rollout of vaccines, resumption of immigration, and the continued growth in employment and students returning to post-secondary institutions will support this sector.

Retail represents 27.5% of the MPT, focused primarily on properties anchored by grocery and pharmacy tenants (Consumer Staples). Our strategy for retail properties has been to invest primarily in strip center retail anchored by grocers and pharmacy tenants. These necessity-based tenancies are defensive in nature and have generally had minimal disruptions and strong operating results amidst the pandemic. As a result, rent collections and occupancy levels for our retail exposure within the fund remain strong, and delinquency rates have been low, resulting in minimal disruptions to our mortgage payment collection. While the short-term outlook remains uncertain, the medium- and long-term fundamentals for retail remain as they were before the pandemic, especially in situations where there is potential mixed-use functionality. Retailers who are able to survive this environment should be rewarded with pent-up consumer demand and high savings rates as Canadian consumers have increased their household savings by an estimated $200 billion through 2020 and rising in 2021, according to RBC Economics.

At the end of 2020 we announced our partnership with three new originators. Since on-boarding these partners, we have experienced a rapid increase in the number of new opportunities we are evaluating, and have developed a deeper understanding of risk in the market as a result. Both of these developments are highly valuable in a private asset class.

We are pleased with the performance of borrowers in the portfolio throughout the pandemic and expect the vaccine rollout and ensuing economic recovery to improve the operating environment further. We continue to focus on opportunities in the industrial and multi-residential sectors, but remain interested in all opportunities where reward-for-risk remains attractive. We believe that in the current competitive environment a focus on deal structuring will allow us to mitigate potential risks and maintain the appropriate balance between reward and risk.

Emerging Market Debt (EMD)

We believe that EMD presents a unique opportunity to diversify sources of value-added within the portfolio, given its attractive yield profile, solid credit quality, and lower correlation to Canadian fixed income instruments. The portfolio's EMD allocation detracted from relative performance over the quarter due to a sharp move higher in bond yields, which resulted in negative returns across hard currency and local currency sovereign bonds. While hard currency corporate bonds also posted negative returns, they fared better than their sovereign counterparts as tightening credit spreads helped partially offset the negative impact of rising yields.

The first quarter of 2021 was dominated by rising U.S. Treasury yields and expectations of higher future growth and inflation. The theme of rising yields permeated the EMD market, as local yields increased by a similar magnitude and speed as U.S. Treasury yields. Against this backdrop, hard currency and local currency sovereign bonds posted negative returns. This was exacerbated in March when Turkey's president abruptly removed the market-friendly and orthodox central bank governor, and replaced him with a controversial successor who is a proponent of unconventional monetary policies. This marked a swift deterioration in investor confidence, and Turkish yields spiked considerably higher and the lira plunged. The portfolio's exposure to Turkey throughout this time was a small drag on relative returns. We have since reduced our overweight position in Turkey across our EMD holdings.

Looking ahead, we believe that EMD is poised to perform well, although uncertainty remains with an emerging 3rd wave of COVID-19, inflation fears, and increasing volatility. We are also conscious of idiosyncratic drivers that risk dominating broader market performance. That said, we think the risk is more balanced for EM assets going forward given the swift repricing in the U.S. Treasury market that occurred during Q1. While it's possible that yields will continue to move higher from here, it's unlikely that they will move at the same pace and magnitude as was experienced in Q1. Additionally, we expect strong growth in the U.S. as the vaccine roll-out continues, which would likely translate into stronger growth for the rest of the world, ultimately offering a supportive backdrop for EMD assets in the near term.