PH&N Core Plus Bond Fund

Fund Performance

Performance Comparison as of June 30, 2022 (%)							
	3 Mo	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr	SI *
PH&N Core Plus Bond Fund	**-6.08**	**-11.36**	**-5.79**	**-0.69**	**1.26**	**1.21**	**3.11**
FTSE Canada Universe Bond Index	*-5.66*	*-11.39*	*-7.02*	*-2.30*	*0.04*	*0.18*	*1.94*
Relative Performance	-0.42	+0.03	+1.23	+1.61	+1.22	+1.03	+1.17

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 June 30, 2022 (%)		
	Relative Performance	
	3 Mo	1 Yr
Interest rate anticipation		
Duration & yield curve	-0.01	0.19
Real return bonds	0.00	0.05
Foreign sovereign bonds	0.00	0.00
Credit & liquidity		
Provincial & quasi-government bonds	-0.01	0.07
Investment grade corporate bonds	0.03	0.16
High yield corporate bonds	-0.23	-0.18
Mortgages	-0.04	0.02
Emerging market debt	-0.16	-0.30
Other	0.00	0.02
Total	**-0.42**	**+0.03**

Second Quarter Review

Strategy Summary for the Quarter Ending June 30, 2022 (relative contribution to duration exposure)			
Strategy	**Change Over Q2**	**Position Ending Q2**	**Our View**
Duration & Yield Curve	Decreased	Slight short duration	Uncertain economic outlook and volatile rate environment prompting modest duration positioning
Real Return Bonds	Eliminated	No position	Long-term market-implied inflation expectations in line with our view of fair value
Foreign Sovereign Bonds	Increased	Small position	Divergence in Canada vs. U.S. bond yields provided a favourable opportunity for a short position in 10-year U.S. treasuries
Provincial and Quasi-Government Bonds	Decreased	Moderate overweight in provincials; underweight in federal agencies	Valuations more attractive for provincial bonds relative to federal agencies
Investment Grade Corporate	Decreased	Moderate overweight	Reducing exposure and increasing focus on high-quality credits against backdrop of potential economic slowdown and rising recession risk
High Yield	Decreased	Medium position	Valuations improving, but we are mindful of the growing list of risks in the current environment
Mortgages	Unchanged	Small position	Liquidity premium remains at appealing levels
Emerging Market Debt	Decreased	Small position	Trimmed allocation to reduce credit risk, however reward-for-risk profile remains appealing

- Over the quarter, inflation data continued to exceed market expectations, and central banks increased policy rates aggressively in response. This prompted a significant rise in bond yields across the yield curve for the second consecutive quarter, with the 10-year Government of Canada bond yield now 180 basis points (bps) higher year-to-date. Unsurprisingly, bonds experienced another quarter of meaningful negative performance against this backdrop, with the FTSE Canada Universe Bond Index returning -5.66%.
- While the sharp rise in yields so far this year has resulted in negative returns for the portfolio, it is important to consider that it also produces a significantly higher yield for your portfolio as compared to the beginning of the year. All else being equal, this should lead to meaningfully higher expected returns going forward.
- The portfolio finished considerably behind its benchmark over the period, with positive contributions from investment grade corporate bonds, which were more than offset by weakness from off-benchmark credit strategies, specifically higher yield and emerging market debt. Overall, the portfolio's risk exposures were reduced over the quarter in light of the uncertain market environment we find ourselves in.
- The portfolio's duration and yield curve positioning was a neutral contributor to relative performance, with the portfolio ending the quarter with a slight short duration position as compared to the index.

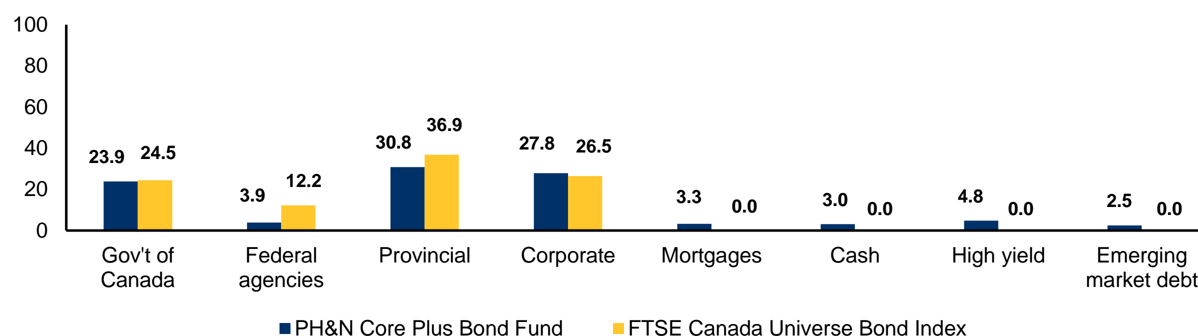
- A small out-of-benchmark position in real return bonds was a neutral contributor to performance and was eliminated in the quarter as long-term market implied inflation expectations reached our current assessment of fair value.
- We initiated a small short U.S. treasury position as the spread basis between Government of Canada and U.S. treasury bonds widened to levels not seen in nearly a decade. This position had a neutral impact on relative performance.
- Exposure to provincial and government agency bonds detracted value as spreads moved wider.
- The portfolio's overweight to investment grade corporate bonds added value despite spread widening due to conservative positioning biased towards higher-quality issuers.
- The out-of-benchmark positions in high yield bonds and mortgages detracted from relative performance as these assets saw significant spread widening over the quarter.
- The portfolio's out-of-benchmark position in emerging market debt detracted from performance as mounting recession fears, rising government yields, and the ongoing uncertainty surrounding the war in Ukraine caused the sector to post meaningfully negative returns.

PH&N Core Plus Bond Fund Portfolio Structure as of June 30, 2022

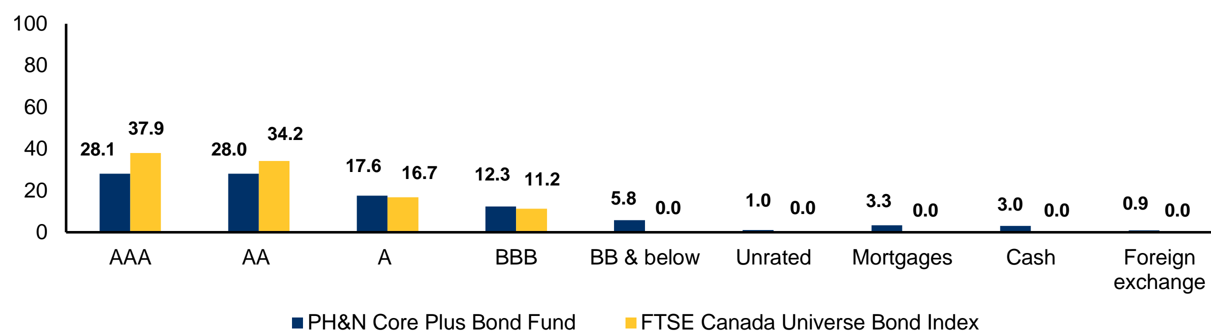
Fund Characteristics

	Modified Duration (Yrs)*	Term to Maturity (Yrs)	Yield to Maturity (%)
PH&N Core Plus Bond Fund	7.33	10.72	4.35
FTSE Canada Universe Bond Index	*7.39*	*10.18*	*3.92*

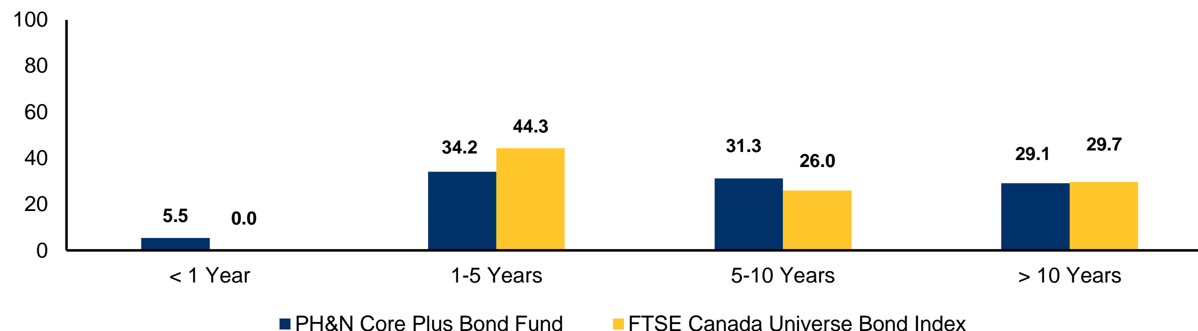
Issuer Analysis (%)



Rating Analysis** (%)



Maturity Analysis (%)



* 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.

Second Quarter Review

Duration and Yield Curve

While the economic damage from the pandemic has largely vanished, the global economic recovery is now losing pace as headwinds to growth continue to mount, most notably unacceptably high inflation. Over the quarter, inflation continued to surpass market expectations, rising to multi-decade highs and broadening significantly. Meanwhile supply chain problems have proven difficult to resolve, and China's proclivity to lock down economic activity due to its zero-tolerance COVID-19 policy combined with sanctions targeting Russia have added additional pressure to the prices of many goods. With inflation elevated and financial conditions tight, global central banks have been forced to act urgently, with the BoC being no exception. In April, the BoC raised its policy rate by an outsized 0.50%, the biggest hike in more than two decades. This was followed by another 0.50% increase in June, leaving the policy rate at 1.5% to end the quarter. The BoC also ended its policy of reinvesting proceeds from maturing bonds held on their balance sheet during the quarter and began the process of quantitative tightening. Against this backdrop, GoC bond yields rose sharply, with longer-term yields rising more or less in tandem with shorter-term yields, resulting in an upward shift of the GoC yield curve.

Amidst rising yields, the portfolio's sensitivity to interest rates was managed fairly closely to that of the benchmark for the majority of the quarter, ending the period slightly shorter than the benchmark. This relatively neutral positioning reflects our lack of conviction on the near-term direction of interest rates due to a wide range of potential outcomes. Although yields could continue to rise if extremely high inflation persists, if inflation ultimately moderates through the second half of this year, it could put a ceiling on further rate increases. The portfolio's yield curve positioning remains 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, the portfolio's duration positioning was a positive contributor to relative performance over the quarter, which was offset by a detraction from yield curve positioning.

Government of Canada Yields (%)

	1 Yr	2 Yr	5 Yr	10 Yr	30 Yr
June 30, 2022	3.07	3.10	3.11	3.22	3.13
Forward Curve for June 30, 2023	3.12	3.10	3.12	3.23	3.15
Implied Change (1 year)	+0.05	+0.00	+0.01	+0.01	+0.02

Source: Bloomberg, RBC GAM (BondLab)

Looking forward, the bond market expects short-term yields to rise modestly over the coming year, and long-term yields are expected to remain relatively unchanged from current levels. While this is driven largely by market expectations that the BoC will continue to increase policy rates, it does suggest that much of the future tightening has already been priced into the Canadian bond market, and participants see little need for yields to rise drastically from current levels. Our view is generally in line with what is priced into the bond market; however, we believe that yields will continue to exhibit heightened volatility in the

near term, mostly as a result of central bank monetary policy and investor confidence in their ability to reign in runaway inflation. Periods of market volatility provide opportunities for value added and we will continue to be tactical in our duration positioning to capitalize on such an environment.

Real Return Bonds

The annual inflation rate, as measured by headline Consumer Price Index (CPI), accelerated to 7.7% in May, which is the highest level since August 1983. The significant uptick in inflation managed to outpace already lofty expectations. Furthermore, the drivers of higher inflation continued to broaden in scope and the market consensus is for above-average inflation to persist over the short term.

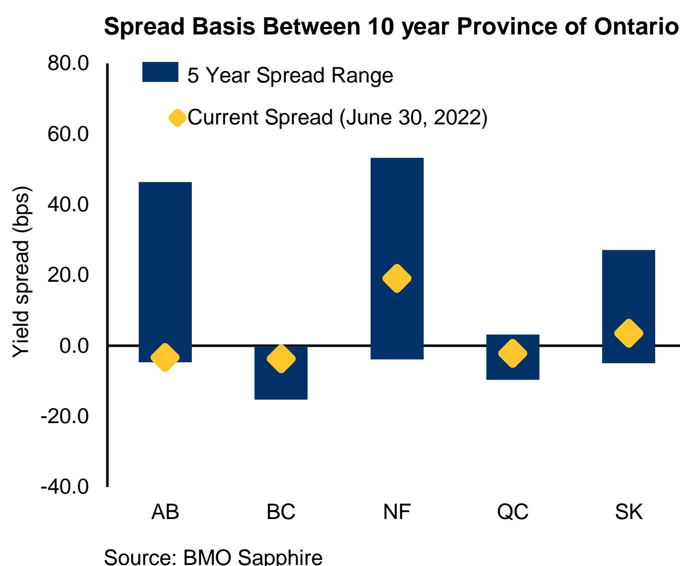
During the quarter, we eliminated the portfolio's out-of-benchmark real return bond allocation as the bond market's expectations for long-term inflation (estimated as the difference in yield between a nominal and a real return bond) increased to levels in line with our view of fair value. Overall, real return bonds were a neutral contributor to relative performance as our remaining position size entering the period was modest. Going forward, we will continue to monitor the strategy as actual and expected inflation conditions evolve.

Foreign Sovereign Bonds

Over the quarter, the Bank of Canada (BoC) was surprisingly hawkish following their June 1st meeting, causing the spread basis between 10-year Government of Canada (GoC) and U.S. Treasury (UST) bond yields to increase to the widest levels seen in almost 10 years. The divergence in bond yields was notable as Canada and the U.S typically exhibit monetary policies (and yields) that move in lockstep. While we expect the dislocation to be shorter-term in nature, we opted to take advantage of the divergence by implementing a short position in currency hedged 10-year USTs which was predicated on the thesis that the yield differential between 10-year GoCs and USTs should return to more normalized levels. Over the quarter, this position had a neutral impact on relative portfolio performance.

Quasi-Government Bonds

Risk assets remained under pressure over the quarter, with spreads widening across all provinces and terms to varying degrees. Somewhat unsurprisingly, commodity-sensitive provinces were the most resilient over the quarter, as they benefitted from higher oil prices. Alberta was the clear standout as they also benefitted from a return to a balanced budget and positive credit-rating action – S&P raised the Province of Alberta's credit rating to A+ from A, driven by a strong revenue and economic backdrop. Despite market volatility, provincial new issuance was robust in the second quarter with approximately $22 billion coming to market, which represents the completion of 25% of provincial funding needs for the current fiscal year. Looking forward, as we continue to emerge from the COVID-19 pandemic, the improved fiscal trajectory, coupled with a reduction in borrowing needs, should remain supportive for provincial credit spreads. That said, if a recession comes to fruition, provincial bonds, alongside other risk assets, would experience weakness.

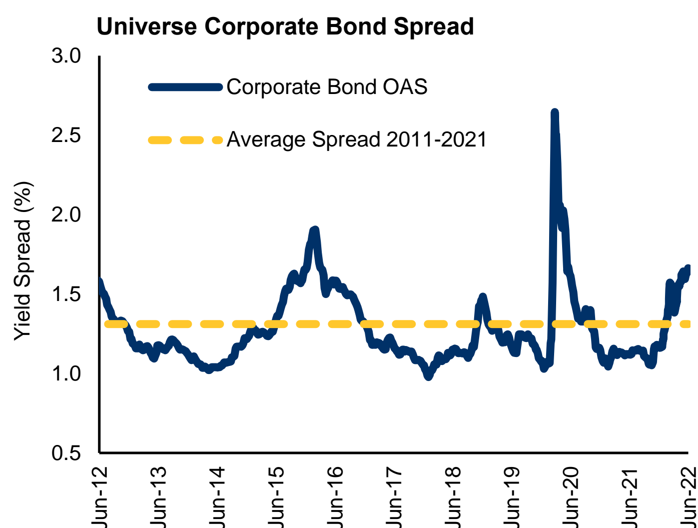


Source: BMO Sapphire

During the quarter, we opportunistically increased the portfolio's overweight exposure to Ontario, which offers superior liquidity and steady fundamentals relative to the other provinces, and allows us to be tactical in our provincial trading. Although we subsequently reduced this exposure in the latter half of the quarter, returning it to the level where it began, it remains the largest relative provincial exposure in the portfolio. The portfolio's largest underweights continue to be the provinces of British Columbia and Quebec due to expensive valuations relative to Ontario. The portfolio's exposure to Quebec was also slightly reduced during the quarter, increasing its relative underweight. Overall, the portfolio's provincial overweight was slightly decreased over the period. Furthermore, 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 strategies. As such, the portfolio remains positioned with an underweight exposure to this segment of the quasi-government bond market. In aggregate, the portfolio has a small underweight exposure to provincial and quasi-government bonds, and maintains a meaningful bias toward provincial bonds given their yield advantage over government agency bonds.

The portfolio's overweight exposure to provincial bonds detracted slightly from relative performance as a result of wider spreads over the quarter. We will continue to tactically adjust the portfolio's quasi-government positioning based on the attractiveness of opportunities relative to other segments of the bond market.

Investment Grade Corporate Bonds



Source: FTSE Global Debt Capital Markets Inc.

Much like the first quarter of 2022, volatility dominated the narrative for investment grade corporate bonds during the second quarter. We saw reduced risk appetite from investors driven by increasingly hawkish monetary policy and persistent inflationary pressures, which fuelled recessionary concerns and dented investor confidence. Unsurprisingly given the risk-off tone, and with many companies having pre-funded much of their spending needs during the low-rate environment that persisted through 2020 and 2021, corporate issuance underwhelmed with approximately $22 billion of new supply coming to market, down 46% from the second quarter in 2021. Despite the slowdown in primary market activity, broad Canadian corporate bond spreads widened +26 bps over the quarter as a result of the uncertain macroeconomic backdrop, with higher-quality credits faring better than lower-quality credits.

From a fundamental standpoint, high debt levels among consumers and corporations remain our key concern when it comes to vulnerabilities in the Canadian economy. Canadian household debt levels continue to be elevated due to the hot housing market that has driven a surge in mortgage borrowing in recent years, with mortgage debt totalling nearly $2 trillion in Q1/2022, up 10.5% from the same period last year. Currently, the household debt-to-disposable-income ratio sits at 183%, just shy of the 186% record set in the previous quarter. On the corporate side, the biggest potential headwind is sustained high inflation, which may begin to put pressure on corporate earnings.

We were opportunistic in the primary market this quarter, participating selectively in attractively priced new issues. However, the additions to the portfolio were more than offset by bonds we sold into the secondary market, which reduced the portfolio's investment grade corporate bond exposure. The reduction came from multiple segments, including the Infrastructure, Energy, Communication, and Financial sectors. We are cognisant that market conditions appear to be in the later stages of the credit cycle, so along with a decreased overweight exposure relative to the benchmark, we continue to favour the higher-quality, less-cyclical areas of the corporate bond market. This bias helped insulate the portfolio from the spread widening experienced by the broader corporate bond market this quarter, and added value despite the portfolio's overweight exposure.

Private Placement Corporate Bonds

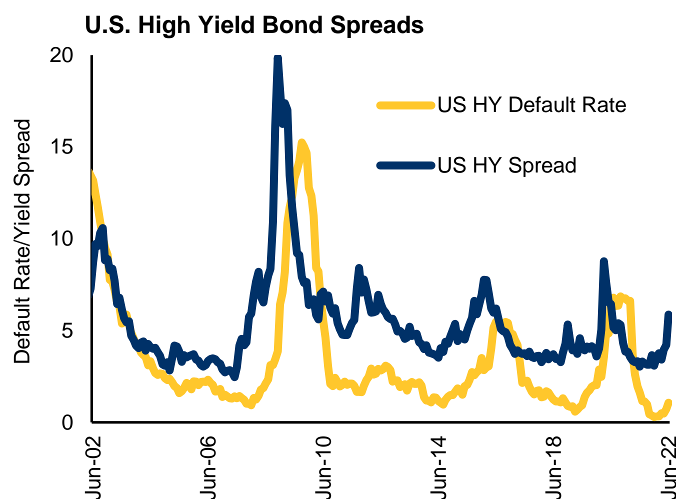
The portfolio's allocation to private placement corporate bonds is achieved through an allocation to the PH&N Private Placement Corporate Debt Fund (PPCDF). The PPCDF invests in investment grade private placement corporate bonds issued primarily in Canada but also abroad. For bonds unrated by an agency, PH&N will assign an internal rating, which must be of investment grade quality 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, private placements often provide attractive illiquidity premiums for investors because they do not tend to have an active secondary market.

Private placement corporate bond spreads widened by around 18 basis points over the quarter, which was lower than what was witnessed in comparable-term public securities within the broader Canadian corporate bond market. Coupled with higher Government of Canada bond yields over the quarter, the fund returned -5.3%. 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 issuers on potential deals related to renewable power and public private partnerships (P3s). 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 75–100 basis points over public market opportunities of similar credit quality.

High Yield Corporate Bonds

Extending the trend from last quarter, high yield bonds continued to face headwinds, which led investors to sell risk assets and seek safety. The U.S. Federal Reserve hiked its benchmark interest rate by 125 bps in the second quarter, with a 50 bps hike in May followed by a 75 bps hike in June. These large increases extended losses across fixed income markets more broadly, and widening corporate spreads drove both the investment grade and high yield markets to their worst first-half returns in over 40 years of data. The shorter duration nature of high yield bonds once again helped soften this impact relative to government and investment grade corporate bonds.



Source: Bloomberg. US High Yield spread represented by ICE BofA Merrill Lynch US High Yield index. US high yield default rate represented by ICE BofA Merrill Lynch US High Yield index to Dec 31 2019, JPMorgan Jan 31 2020 to current

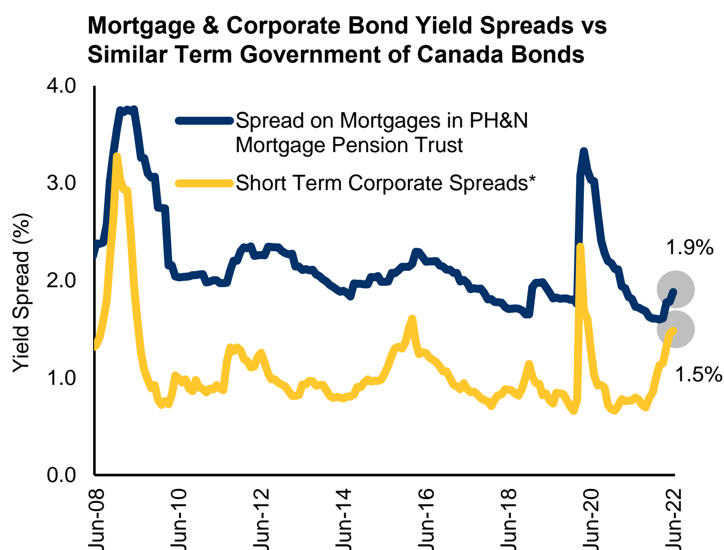
High yield issuance continued to slow in the second quarter as risk-off sentiment impacted demand. Given the escalating conflict in Ukraine, persistent inflation, and increased risk of recession, some issuers are more hesitant to raise funds amidst the uncertainty. In contrast, certain segments of the investment grade market maintained heavy and price-insensitive issuance, presenting potential investment opportunities.

The earnings outlook for corporations is deteriorating, with the estimated earnings growth of the S&P 500 hovering slightly over 4% for Q2. This would mark the slowest earnings growth since Q4 2020. Valuations for high yield bonds have also retreated, with OAS spreads on the ICE BoA U.S. HY index rising by 244 bps during the quarter to finish the period at 587 bps. Oil prices remain both high and volatile in the range of $100-$120 per barrel. While this is generally supportive for oil companies, elevated oil and gas prices are contributing to rising inflation, which is detrimental for the rest of the economy. High yield default activity remains modest, and is not expected to rise materially for the next year.

The portfolio’s high yield position detracted substantially over the quarter against the backdrop of rising spreads. Given the potential for some further spread widening in an economic slowdown, especially in the lower-quality high yield segment, we continue to favour a defensive position from an overall credit quality standpoint. Within the high yield allocation we currently favour certain investment grade segments that have been beaten up, and where valuations are attractive. We have recently found 7%+ yields in undervalued investment grade instruments, so we feel there is little need to take outsized credit risks. The size of our high yield exposure was decreased over the quarter but remains moderate and can be dialled up or down from here depending on how the market unfolds.

Mortgages

As of quarter end, the mortgages held in the portfolio had a yield of approximately 188 basis points over similar-term GoC bonds, representing a 27 bps increase from the previous quarter. Wider spreads were visible across the mortgage risk spectrum and largely linked to market uncertainty and the experience witnessed in public fixed income proxies.



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

Average asking rents for office properties increased nationally for the fifth consecutive quarter, while subletting continued to decline, reflecting constructive signals for future leasing activity and rental rate growth.[1] National office vacancy has been trending slightly higher, however, the Vancouver and Toronto markets – the largest geographic exposures – still rank among the cities with the lowest office vacancy rates in North America.[2] Industrial assets have continued to benefit from low national vacancy rates (0.9%), with supply reaching critically low levels within major markets.[3] While we remain concerned about the ability of industrial rents to continue moving higher, we do not see catalysts for downward pressure on rents given the very low availability of industrial space in major markets and high construction replacement costs. While higher interest rates and elevated inflation remain considerable headwinds to the retail sector, the negative impact to the sector has been moderated given support from strong household savings rates, record immigration flows, and a very robust labour market. In addition, supply chain constraints that have hampered the retail sector have shown signs of moderating. Strength in the multi-residential sector is supported by strong immigration flows, affordability issues in core housing markets, as well as challenges for developers in bringing new supply to market. Taken together, these factors support further rental rate growth and occupancy stability.

During the quarter, we funded $343 million in new loans. Of this, 72% was invested in loans supported by office properties and 16% was invested in loans supported by retail properties. Despite our lending posture not being focused primarily on office properties, we had the opportunity to fund three significant loans with exceptional quality assets and sponsorship, high occupancy rates, strong locations, and attractive coupons.

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[1] Colliers, “National Market Snapshot 2022 Q2”
[2] Ibid.
[3] Ibid.

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. Alongside other risk assets, EMD suffered a volatile second quarter, which was driven by recession fears, rising UST yields, and continued uncertainty surrounding the war in Ukraine. As a result, the portfolio's EMD allocation detracted from performance. Hard and local currency sovereign bonds, and hard currency corporates posted meaningful negative returns over the quarter. EMFX also posted negative returns, however to a lesser degree than the aforementioned EMD sectors.

The meltdown in EMD this quarter was driven by both macro and idiosyncratic factors. From a macro perspective, slowing growth, higher inflation, and tighter monetary policies created a challenging backdrop for EM assets. Looking through a country-specific lens, many EM countries are going through political and policy transitions, which has spurred volatility. This is in conjunction with the more notable idiosyncratic stories such as the war in Ukraine and China's zero-covid policy, which have dampened the outlook for global growth.

Over the quarter, hard currency sovereign bonds were the worst-performing EMD sleeve, as the sector's longer-duration bias caused it to be more susceptible to rising U.S. treasury yields. Local currency sovereign bonds also struggled on the back of rising local rates. Within hard currency corporates, credit spreads widened as global risk sentiment waned. Finally, although EMFX was the top-performing EMD segment, EM currencies weakened somewhat versus a strengthening CAD, which acted as a slight drag on returns.

Looking ahead, the outlook for EMD is mixed. With the significant repricing that has occurred within the EMD sector, valuations are at very compelling levels and yields have reached decade highs. However, considerable headwinds exist and present challenges for EMD going forward. We think the trajectory of EMD is predicated on three main factors: inflation and monetary policy, potential commodity crisis, and geopolitical tensions.

1) Central banks are swiftly tightening monetary policy in an effort to combat inflation. We think it's possible that USTs could sell off further from here. However, once UST rates stabilize, credit spreads will likely tighten.

2) We are increasingly concerned about a potential commodity crisis if Russia limits gas exports to European countries. If a supply disruption were to happen in Europe, gas prices could rise significantly and rationing may be required, which could cripple some European economies.

3) Finally, there are idiosyncratic factors that pose uncertainty for EM. The most notable headwind is the devastating war in Ukraine, where a potential resolution remains far-off and ambiguous.

As part of an effort to reduce the total risk profile of the portfolio, we trimmed our allocation to EMD over the quarter, but maintain a moderate position. Overall, while the headwinds for EMD are unlikely to ease in the near term, we think current yields more than compensate an investor for the current risks. We continue to see pockets of opportunity across local and hard currency markets. In our opinion, differentiation remains the key to success in EMD.