PH&N Core Plus Bond Fund

Fund Performance

Performance Comparison as of September 30, 2021 (%)							
	3 Mo	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr	SI *
PH&N Core Plus Bond Fund	**-0.37**	**-1.60**	**4.26**	**6.05**	**5.00**	**3.68**	**4.87**
FTSE Canada Universe Bond Index	*-0.51*	*-3.35*	*1.73*	*4.32*	*3.65*	*2.29*	*3.56*
Relative Performance	+0.14	+1.75	+2.53	+1.73	+1.35	+1.39	+1.31

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 September 30, 2021 (%)		
	Relative Performance	
	3 Mo	1 Yr
Interest rate anticipation		
Duration & yield curve	0.04	-0.21
Real return bonds	0.01	0.19
Foreign sovereign bonds	0.00	0.00
Credit & liquidity		
Provincial & quasi-government bonds	-0.02	0.00
Investment grade corporate bonds	0.09	0.40
High yield corporate bonds	0.02	1.03
Mortgages	0.02	0.12
Emerging market debt	-0.03	0.27
Other	0.01	-0.05
Total	**+0.14**	**+1.75**

Third Quarter Review

Strategy Summary for the Quarter Ending September 30, 2021 (relative contribution to duration exposure)			
Strategy	**Change Over Q3**	**Position Ending Q3**	**Our View**
Duration & Yield Curve	Decreased	Moderate short duration	We believe rates will normalize higher than what is currently priced into the bond market
Real Return Bonds	Unchanged	Medium position	Long-term market-implied inflation expectations remain below the BoC's 2% inflation target
Foreign Sovereign Bonds	Unchanged	No position	Monitoring the yield differential between foreign sovereigns and Government of Canada bonds
Provincial and Quasi-Government Bonds	Unchanged	Small 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 to pre-COVID levels, but technicals remain robust
High Yield	Unchanged	Small 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

- The global economic recovery continued in the third quarter, albeit at a slower pace than the first half of this year, while concerns surrounding elevated inflation continued to be top of mind for bond investors. Another major theme has been central bank monetary policy, the unwinding of that support, and the eventual normalization of policy rates. Overall, Government of Canada bond yields ended the third quarter slightly higher than where they began, resulting in modest negative bond returns.
- Active positioning within both interest rate anticipation strategies and credit and liquidity strategies resulted in the portfolio finishing the quarter 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 short duration position was a positive contributor to relative performance, while yield curve positioning was neutral. Positioning across the yield curve is primarily a function of where we see the most attractive opportunities within credit and liquidity strategies.
- Market-implied long-term inflation expectations ended the quarter unchanged, resulting in a neutral contribution from the out-of-benchmark position in real return bonds.
- The portfolio's exposure to provincial and quasi-government bonds was a neutral contributor to relative performance, as spreads were broadly unchanged over the quarter.
- The portfolio's overweight exposure to investment grade corporate bonds and active security selection within this segment of the bond market contributed to added value.

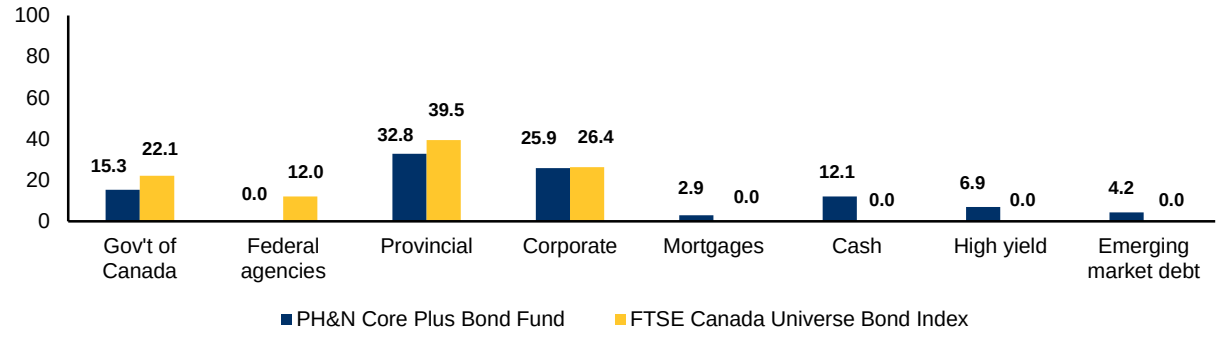
- The out-of-benchmark positions in high yield bonds and mortgages contributed to relative performance, as they benefited from higher yield accrual and spread compression, respectively.
- Emerging market debt (EMD) was a drag on relative performance owing to increased volatility caused by rising yields and concerns surrounding global growth.

PH&N Core Plus Bond Fund Portfolio Structure as of September 30, 2021

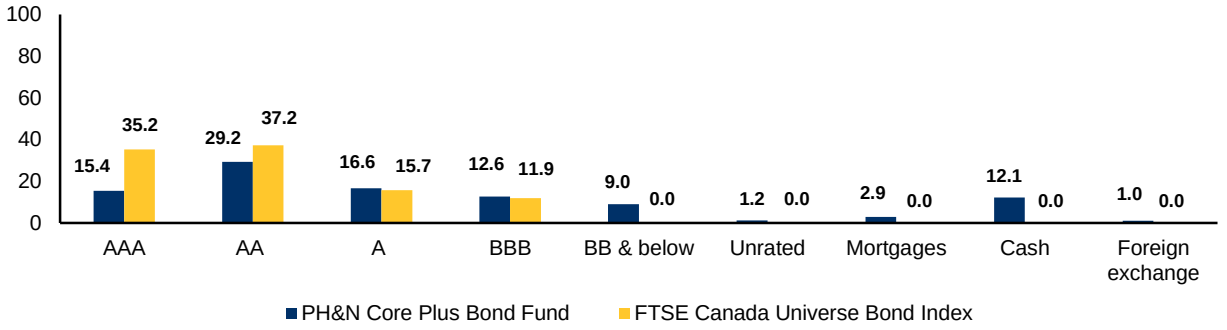
Fund Characteristics

	Modified Duration (Yrs)1	Term to Maturity (Yrs)	Yield to Maturity (%)
PH&N Core Plus Bond Fund	7.74	11.14	2.33
FTSE Canada Universe Bond Index	*8.14*	*10.86*	*1.81*

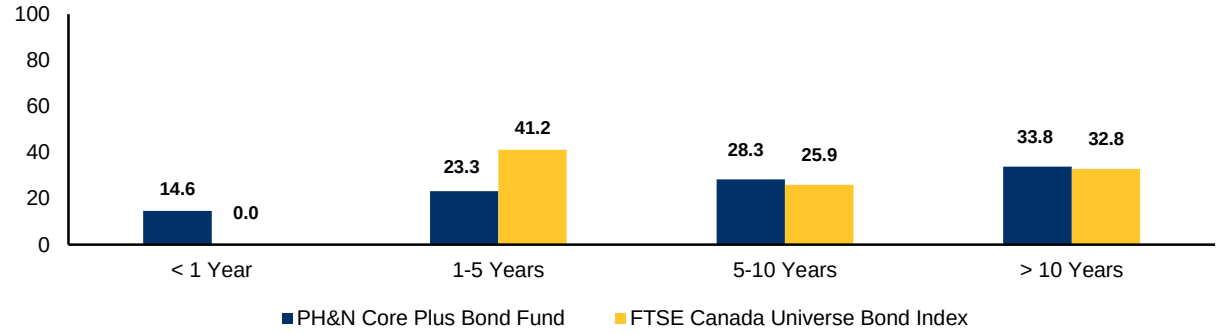
Issuer Analysis (%)



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.

Third Quarter Review

Duration and Yield Curve

The global economic recovery continued in the third quarter, albeit at a slower pace than what was witnessed in the first half of this year. Price pressures continued throughout the quarter, as the global supply chains for many goods remain constrained. Accordingly, we saw elevated inflation data in Canada and the U.S. Both the Bank of Canada (BoC) and the U.S. Federal Reserve (Fed) continue to view these elevated readings as a temporary phenomenon and market-implied inflation expectations have remained mostly consistent with that view over the quarter. With respect to yields, Government of Canada (GoC) bond yields declined for most of the quarter, before reversing course in late September after the Fed signalled that it would begin tapering its quantitative easing (QE) program later this year. This signal from the Fed along with additional details on the expected timeline for ending its QE program gave insight to the market on the possible timing of a normalization of policy rates. This resulted in a meaningful move higher for U.S. Treasury (UST) yields to finish the quarter. Although the BoC had already begun tapering its bond purchases and continued to reduce its purchase amounts over the quarter, GoC bond yields also rose sharply following the announcement and ended the quarter slightly higher than where they began the quarter, as there is generally a high correlation between GoC yields and UST yields. This correlation is largely due to the similarities in investor motivations and strong trade relationships between the two economies.

The portfolio's sensitivity to interest rates at the start of the quarter was lower than the benchmark, as bond yields were supported to move higher over the short term amidst improving economic conditions and increased inflation pressures. As bond yields declined in July over concerns related to the economic impact of the Delta variant, we took the opportunity to decrease the duration of the portfolio further relative to the benchmark and maintained this positioning throughout the rest of the quarter. Nevertheless, the portfolio's short duration position relative to the benchmark remains moderate in size, 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, the portfolio's duration and yield curve positioning was a positive contributor to relative performance over the quarter, primarily a result of its duration positioning.

Government of Canada Yields (%)

	1 Yr	2 Yr	5 Yr	10 Yr	30 Yr
September 30, 2021	0.29	0.53	1.12	1.52	1.99
Forward Curve for September 30, 2022	0.78	0.97	1.35	1.76	2.13
Implied Change (1 year)	**0.49**	**0.44**	**0.23**	**0.24**	**0.14**

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

Looking forward, the bond market expects short-term yields to rise to a greater degree than long-term yields over the next year. This expectation reflects the possibility that the BoC will begin to gradually normalize policy rates from current ultra-accommodative levels as the economic outlook continues to improve. We believe yields may increase by more than what is currently priced in by the bond market, and that yields will likely exhibit modest volatility in the near term, as a multitude of factors will influence the direction and magnitude of yield changes – particularly central bank monetary policy and the future path of the economic recovery. This volatility will provide opportunities for value added through active management.

Real Return Bonds

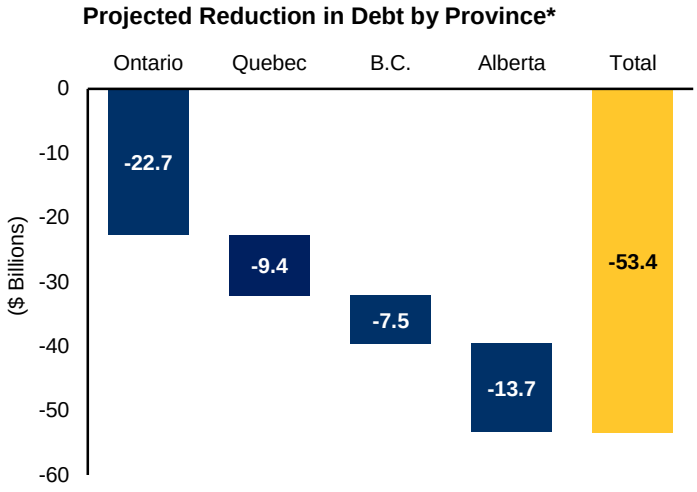
The annual inflation rate, as measured by headline Consumer Price Index (CPI), accelerated at 4.1% in August, the fastest yearly pace since a brief spike in 2003 – exceeding the BoC's inflation range of 1–3% for the fifth consecutive month. This compares to eight consecutive months of inflation printing below 1% from March 2020 to October 2020. The BoC continues to view the higher inflation print to be mostly temporary due in large part to the confluence of several transitory factors. Market consensus is for above-average inflation to persist over the short term driven by a combination of surging demand and supply chain disruptions. Despite headline CPI hovering above the BoC's 1–3% inflation range, the central bank will tolerate the higher inflation print for a period of time to offset the very low inflation levels experienced in 2020. In effect, this will allow the BoC to achieve an average inflation rate that is within its target range.

The bond market's expectations for long-term inflation (estimated as the difference in yield between a nominal and a real return bond) remained unchanged quarter-over-quarter at 1.7%, resulting in a neutral contribution from the portfolio's out-of-benchmark position in real return bonds. Market-implied long-term inflation expectations remain below the BoC's 2% midpoint target range; we believe the expectations are likely to move higher over the medium term. As such, we have maintained the portfolio's real return bond allocation.

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; however, we will continue to monitor this strategy as market conditions evolve.

Quasi-Government Bonds



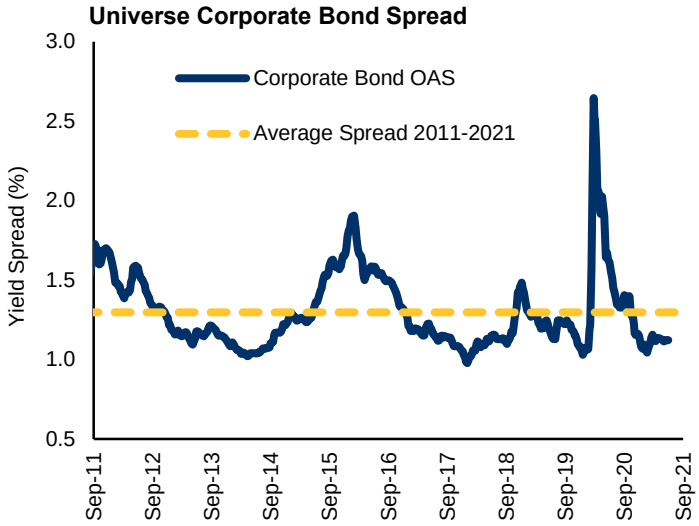
Source: National Bank
* Includes 2020-2021 and 2021-2022 fiscal revisions

The outlook for the provinces continued to improve as restrictions eased and economies reopened, which provided support and positive sentiment for the provincial bond market. As a result of the swifter-than-anticipated recovery, the largest provinces all revised their fiscal projections, erasing over $53 billion of forecasted debt from their budgets. The improved fiscal position has been driven by stronger-than-expected revenues and lower-than-anticipated outlays. The full magnitude of these adjustments won't be known until updated budget revisions are released later this year, but the implication is that provincial bond issuance will likely slow in the fall and winter as borrowing needs decline, which will ultimately be supportive for provincial bond spreads. Against this backdrop, new issuance slowed in the third quarter to $21 billion, approximately half of the issuance size witnessed the prior quarter. The market easily digested the new supply and provincial spreads remained broadly unchanged over the quarter.

With provincial bond spreads hovering below pre-pandemic levels, we maintained our small overweight exposure to Ontario, which offers liquidity and fundamentals that are superior to the other provinces. Earlier this year, we reduced the portfolio's overweight exposure to the smaller and less liquid provinces such as Alberta and New Brunswick, whose spread differential with Ontario had tightened below pre-pandemic levels. The exposure to these smaller provinces was unchanged over the third quarter, as the portfolio remains focused on more liquid issuers. The portfolio's provincial overweight remained relatively steady over the quarter. 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 credits. As such, the portfolio remains positioned with an underweight exposure to this segment of the quasi-government bond market.

Overall, the portfolio's overweight exposure to provincial bonds was a neutral contributor to relative performance, as spreads were broadly unchanged 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.

Corporate earnings remain robust alongside continued progression on the economic recovery front. During the third quarter, corporate issuers remained active in the primary market, bringing approximately $27 billion of new supply to market. Although this figure is below the $41 billion of new issuance witnessed last quarter, it is still well ahead of last year's Q3 pace as well as the long-term average. All deals remained well subscribed, as the new supply was met with healthy demand. While the primary market continued to be very active, the secondary market saw lower seasonal trading volume, which helped keep volatility at bay. Overall, investment grade corporate bond spreads were broadly unchanged over the quarter and remain at levels tighter than their long-term average.

From a fundamental standpoint, increasing debt levels in the Canadian economy among consumers and corporations remain a key concern. Canadian households' borrowing rate is far outpacing their income growth. Household debt-to-disposable-income reached 173% in Q2 2021 – up 0.3% from the previous quarter and 8.6% from the same quarter last year. However, consumers are still flush with cash and represent potential for both investment and re-opening spending sprees, a tailwind for risk assets. On the corporate side, the biggest potential headwind remains the elevated merger and acquisition activity funded by debt as ambitious businesses pursue growth.

In the portfolio, we trimmed exposure to investment grade corporate bonds slightly during the quarter. We also continued to upgrade the quality of the corporate bond exposure, rotating from higher-beta areas of the market that have performed well, particularly within the Energy sector, in favour of more defensive, less-cyclical issuers within the Industrial sector. Overall, we continue to have a medium overweight to investment grade corporate bonds, which along with security selection contributed to relative performance this quarter.

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.

The private placement bond market continued to recover over the third quarter, with the overall spread of the fund tightening by around 14 basis points. The compression was much greater than what was witnessed in the broader Canadian corporate bond market, as comparable-term public securities tightened to a lesser degree. Amid higher Government of Canada bond yields over the quarter, the fund returned 1.23%. The extra spread over public corporate bonds provides an ongoing return tailwind.

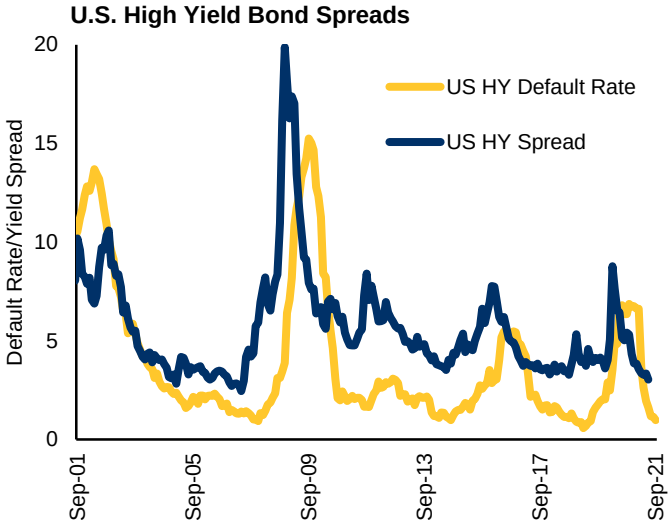
During this quarter, the PPCDF participated in a 28-year deal from **Plenary Americas Investment Holdings Ltd** – a diversified portfolio of critical infrastructure projects in North America that were originated by Canada's top public private partnerships (P3) sponsor, Plenary, and are now owned by one of Canada's largest infrastructure investors, Caisse de dépôt et placement du Québec. Most of the P3s held in the portfolio are familiar to our team and are considered high-quality, essential infrastructure assets. We view this deal favourably due to the strong ownership, solid financial profile of the issuer, and the substantial diversification of project revenue. The bond is internally rated A- and was added at a spread of 217 basis points above Government of Canada yields.

In addition, the PPCDF participated in a narrowly distributed 7-year private deal. The issuer is an investment partnership whose principal investment is a 9% equity ownership in Brookfield Asset Management, a global asset manager focused on Real Assets. The credit quality of the issuer is supported by strong interest coverage and a high level of asset coverage provided by the publicly traded shares held within the structure. The issue was added at a spread of 306 basis points above Government of Canada yields and has an internal rating of BBBh. We are very familiar with the entity and the management team in place.

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

High yield bonds performed well in the third quarter in light of rising bond yields, outperforming both government bonds and investment grade credit. They once again contributed to portfolio performance, a trend that extends six consecutive quarters to the early days of the pandemic. Overall, high yield spreads traded in a very narrow range over the period and ended the quarter at 315 basis points, which is a similar level to where they began.



Source: Bloomberg. US High Yield performance 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

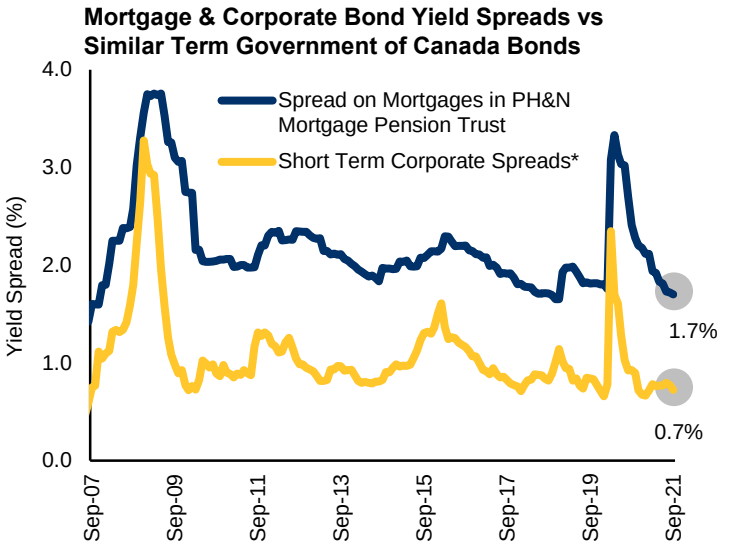
New issuance remains ahead of last year's record pace year-to-date, as corporations continue to lock in historically low financing rates while they still can as the Fed approaches the beginning of its stimulus unwind this winter. The record issuance continues to be comfortably absorbed by yield-hungry investors, who have thus far kept the supply-demand balance in equilibrium. However, any easing of the pace of issuance could lead to further modest spread compression. New issuance proceeds continue to be used predominantly for refinancing higher-cost existing debt and general purposes, but more aggressive uses such as dividend payments and mergers and acquisitions, which were on pause much of last year, have continued to pick up over the last two quarters.

Corporate earnings in the third quarter were strong, as economic activity continued to recover, although a late summer uptick in COVID cases had caused some concerns about the resilience of the recovery as we enter the winter months. Defaults among high yield issuers were once again almost negligible this quarter, resulting in the annual default rate falling to 1.1% in August. This is the lowest rate since 2007 and is the result of a combination of fiscal support, low interest rates, a recovering economy, and, importantly, a default rate that peaked at 6.8% last fall and took out the weakest players. With oil prices now above $70/barrel and the remaining energy companies mostly out of trouble (the energy sector had been the largest contributor to defaults over the past year), it is possible that default rates remain at ultra-low levels into next year, so long as there isn't a meaningful surge in COVID cases.

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. In late 2020, we trimmed the portfolio's exposure slightly as spread levels continued to decline, and have maintained this position since. While we acknowledge the strong performance of high yield bonds since the spring of 2020, we believe that economic conditions and the supply-demand dynamic for high yield remain supportive and provide further runway to collect attractive yield relative to investment grade credit. That said, we are mindful that rate hikes by the BoC and the Fed may be just a year away, and might bring heightened volatility to all asset classes. With this in mind, the portfolio's high yield position remains biased to higher-quality and less-cyclical issuers, as we do not feel that this is the appropriate time in the cycle to be invested in risky, higher-beta issuers.

Mortgages

The portfolio's allocation to commercial mortgages is achieved through an investment in the PH&N Mortgage Pension Trust (MPT). As of quarter-end, the mortgages held in the MPT had a yield of 170 basis points over similar-term Government of Canada bonds, which represents a 10 basis points decrease from the previous quarter. This compression in spreads is a continuation from prior quarters, as mortgage spreads have lagged the tightening seen in other credit markets – a trend that has been witnessed historically.



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

Overall, the commercial mortgage lending environment remains competitive as lenders continue to work through capital backlogs built up during the pandemic. From a lending perspective, high-quality multi-residential and industrial opportunities continued to generate the most competition among lenders, leading to tighter spreads. Across the mortgage lending market we have seen a greater appetite for office and retail opportunities, and an increase in the willingness of other lenders to offer non-recourse and interest-only mortgages.

Despite the competitive lending environment, we have funded over $630 million of new loans in the MPT year-to-date; of this, $531 million was invested in high-quality industrial and multi-residential opportunities. Our access to a very deep set of opportunities and strong borrower relationship networks through our new origination partners has strongly supported our ability to invest this capital.

While we anticipate competition to remain strong through the remainder of the year, we are prioritizing credit structure over advancing funds, with a primary focus on industrial and multi-residential assets backed by strong borrowers. We will continue to focus on opportunities within the office and retail segments with heightened scrutiny. Within retail, we continue to favour grocer and pharmacy-anchored convenience retail, which tends to be more resilient through periods of volatility. As a result of continued uncertainty within the office segment, including a rising national vacancy rate, we are cautiously pursuing attractive opportunities where the tenant structure is sound, underwriting parameters are conservative, and the borrowers are strong.

The MPT remains well diversified by property type and geography. There are currently 581 mortgages held in the fund, with conservative weighted average metrics of a 1.7x cash flow coverage ratio and a 59% loan-to-value ratio.

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 was a drag on relative returns owing to increased volatility, driven by rising U.S. treasury rates and concerns surrounding global growth. Hard currency sovereign, local currency sovereign, and hard currency corporates all posted negative returns over the quarter. This negative performance was slightly offset by the portfolio's EMFX allocation, which was modestly additive to relative returns over the period.

A more hawkish Fed and concerns over Chinese growth resulted in a stronger USD, which in turn caused local currency assets to depreciate. As a result, local currency sovereign bonds were the worst performing sector over the quarter. Hard currency sovereign bonds were not immune to the market sell-off either, as widening spreads compounded the negative returns caused by rising yields. Within hard currency corporates, the portfolio's bias toward higher yielding bonds hurt returns, as lower quality underperformed the higher-quality segments of the market. Finally, EMFX was modestly additive to relative returns, as the CAD weakened alongside broader EM currencies, such that EMFX was modestly positive on a relative basis.

A notable story over the quarter was Chinese real estate developer Evergrande, which experienced a debt and liquidity crisis – resulting in its bond prices plunging ~70% over the quarter. Your portfolio had a very small positon in Evergrande, which was maintained over the period. While default may be unavoidable, we think there is a likelihood of policy support from the Chinese government, which should result in bond prices trading higher from here. That said, we are monitoring the situation and will revise our positioning if conditions materially change. Overall, our exposure to Evergrande had a negligible impact on your total portfolio's performance.

Looking ahead, the outlook for EMD is mixed. Growth and inflation are two macroeconomic factors we continue to monitor. There is increasing concern of stagflation, which from our perspective is not an unfounded fear. Rising COVID-19 cases have resulted in a lacklustre rebound in many EM countries. On the inflation front, there is significant differentiation across countries. Some central banks have been proactive in raising rates to help curb inflation, while others have been noticeably stagnant. This bifurcation in policy response is likely to lead to differentiation in FX and local rates across EM. Overall, after a difficult third quarter for EMD, we expect modest rebound in the asset class, especially in pockets where investor activity is relatively light. Furthermore, while broad market returns may remain muted, we expect there will be plenty of idiosyncratic opportunities to generate value added.