

# 2018

## ANNUAL MANAGEMENT REPORT OF FUND PERFORMANCE

For the year ended December 31, 2018

Offered by Educators Financial Group  
Portfolio Manager: HSBC Global Asset Management (Canada) Limited, Toronto, Ontario

### Educators Mortgage & Income Fund



This annual management report of fund performance contains financial highlights but does not contain the complete annual financial statements of the investment fund. You can get a copy of the annual financial statements at your request, and at no cost, by calling 1.800.263.9541, by writing to us at Educators Financial Group, 2225 Sheppard Ave. East, Suite 1105, Toronto, Ontario, M2J 5C2, or by visiting our website at [www.educatorsfinancialgroup.ca](http://www.educatorsfinancialgroup.ca) or SEDAR at [www.sedar.com](http://www.sedar.com).

Securityholders may also contact us using one of these methods to request a copy of the investment fund's interim financial report, proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure.

## MANAGEMENT DISCUSSION OF FUND PERFORMANCE

### Investment Objectives and Strategies

The investment objective of the Educators Mortgage & Income Fund (the "Fund") is to provide income by investing in high quality fixed income securities including mortgages, mortgage-related securities, and corporate and government bonds. The Fund seeks to achieve lower volatility of return than the overall bond universe, adequate diversification of assets and a reasonable level of net real return while not being exposed to undue market risk. The fundamental investment objective of the Fund may not be change without the prior approval of the unitholders.

### Risk

The risks of investing in the Fund remain as discussed in the Simplified Prospectus. No changes affecting the overall level of risk of investing in the Fund were made to the Fund in the one-year period ending December 31, 2018.

### Results of Operations

The Fund's net assets decreased by 25.3% to \$140.5 million at the end of December 2018, down from \$188.0 million at the end of December 2017.

#### Investment Performance

For the year ending December 31, 2018 (the 'period'), the Educators Mortgage & Income Fund – Class A Series provided a return of 0.54%, versus the FTSE TMX Canada Short Term Bond Index (the 'Benchmark') return of 1.91%. Investors cannot invest in the Benchmark without incurring fees, expenses and commissions which are not reflected in index returns.

Risk assets ended a volatile year, with one of the worst quarters in recent memory taking place in the fourth quarter. Ongoing, heightened trade tensions and geopolitical risks were joined by concerns over the outlook for global growth to create multiple headwinds for financial markets. 2018 was the first year since the early 1970s in which none of the most influential global asset classes delivered positive returns of 5% or more. The silver lining for investors was that safety assets, such as fixed income and gold, delivered small positive returns in the last quarter to help offset some of the pain in equity markets.

In North American fixed income markets, solid but slowing U.S. economic growth drove bond yields sharply lower in the fourth quarter, which helped to push year-to-date returns back into the black. The 5-year Government of Canada bond yield, commonly looked at as a proxy for the broad short-term market, fell by 53 basis points (*bps*) to 1.89% in the fourth quarter—versus 2.34% in the third, 2.07% in the second, and 1.97% in the first quarters (*and 1.87% at the end of 2017*). This was the largest quarterly decline since the first quarter of 2015.

Overall, short-term bond yields finished the year at 2.36%, down from 2.59% in the third quarter, 2.34% in the second quarter, 2.18% in the first quarter, and 2.05% at the end of 2017. This resulted in a return for the overall short-term bond market of 1.91% for 2018. Over the past year, sector returns have been very similar, with Canada, Provincial, and Corporate bonds returning 1.94%, 2.01%, and 1.81%, respectively.

The yield curve flattened further in the fourth quarter, with the difference between 2-year and 10-year Government of Canada bonds falling 10 bps to 11 bps on the quarter—versus 21 basis points in the third quarter, 25 basis points in the second quarter, and 32 basis points in the first quarter (*with 2018 having started out at 37 basis points*).

Broad posted mortgage rates were higher overall in 2018, with the yield on the FTSE Residential Mortgage Index rising to 4.29% by year-end from 4.15% in the third quarter, 4.04% in the second quarter, 3.94% in the first quarter, and 3.74% at the end of 2017. The yield differential between 5-year fixed mortgage rates and the 5-year Government of Canada bond widened to 346 bps in the fourth quarter from 300 bps in the third quarter, 327 bps in the second quarter, 317 bps in the first quarter, and 312 bps at the end of 2017. Overall mortgages underperformed short-term government bonds in the fourth quarter, but were in-line over the full year (*as their higher-running yield was offset by the widening in mortgage yield spreads*). We believe that mortgage rates represent attractive value at current levels. With the yield spread now wider than its long-term historical average, the incremental yield advantage is considerable, given the historically low interest rate environment.

The Fund's lower duration, or interest rate risk, had a negative impact on relative performance in the second half of the year, but had little impact overall for the year. The Fund's yield curve positioning was a positive contributor to relative returns, while security selection within corporate bonds was a small negative contributor to relative returns.

Emerging-market debt and inflation-linked bond exposures detracted value.

### Recent Developments

Despite market concerns about the growth outlook, global growth remains above 3%. The macro environment continues to be one of cyclical divergence between North America and the rest of the world. U.S. growth continues to track well above trend rates, while other developed countries (*i.e. export-dependent Japan and Europe*) and emerging economies have seen a loss of growth momentum. Therefore, we believe recession risks to be low and that recession fears that have, in part, been the catalyst for recent poor market performance, to be misplaced. Inflation divergence is also at play amid a meaningful pickup in U.S. wage inflation in 2018, while inflationary pressures in other developed markets are still being well contained. The Canadian economy has seen ongoing strong employment growth, partially offset by dislocations in the energy sector. While growth has slowed in the past quarter, the outlook remains for economic growth at, or slightly ahead of potential. There were three increases to the Bank of Canada rate in 2018. Looking ahead we expect one to two further hikes in Canada and similarly, one to two hikes by the U.S. Federal Reserve in 2019. Reasonable valuations and strong earnings growth continue to suggest that equity markets are more attractive than government bonds and cash. Further, solid global economic growth and contained inflation would normally support equity markets.

At this point, with longer-term yields expected to rise modestly over the next year, the objective will be to maintain the Fund's interest rate exposure at, or slightly below the benchmark in the near term. The residential mortgage asset class continues to perform well, with strong asset quality (*delinquency rates near their cycle lows*) and attractive valuations. We feel that the corporate sector remains fundamentally sound with stable to improving earnings growth and defensively-positioned balance sheets. Sector valuations in credit markets have also improved in recent quarters. We will look to overweight mortgages in the Fund and continue to prefer provincial and corporate bonds to Government of Canada bonds (*and will look to remain overweight in these sectors in the non-mortgage portion of the Fund*). Potential risks to our central outlook include disappointing global growth and a larger than expected impact on the domestic economy from dislocation in the energy sector.

### Related Party Transactions

Pursuant to the Fund's investment strategies included in the Fund's Simplified Prospectus, the Fund may invest in other mutual funds and for the period has invested in HSBC Emerging Markets Debt Fund, Institutional Series; and HSBC Mortgage Fund, Institution Series which are funds managed by the Fund's Portfolio Manager.

In 2018 Educators Financial Group did not refer any conflict of interest matters to the Fund's Independent Review Committee (IRC) and accordingly did not rely upon any recommendation of the IRC in respect of any related party transactions.

Educators Financial Group is the Manager and Trustee of the Fund. Educators Financial Group is a wholly-owned subsidiary of the Ontario

Secondary School Teachers' Federation ("OSSTF"). OSSTF may from time to time invest in units of the Fund.

### 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 past five years. Currently Class I units of the Fund are not being offered to purchase.

#### Educators Mortgage & Income Fund – Class A Series – Net Assets per Unit <sup>(1)</sup>

	Year ended December 31				
	2018	2017	2016	2015	2014
Net Assets, beginning of period	\$11.22	\$11.35	\$11.38	\$11.44	\$11.38
<b>Increase (decrease) from operations:</b>					
Total revenue	\$0.32	\$0.32	\$0.35	\$0.37	\$0.38
Total expenses, including transaction costs [excluding distributions]	(\$0.13)	(\$0.14)	(\$0.14)	(\$0.14)	(\$0.14)
Realized gains (losses) for the period	(\$0.13)	(\$0.05)	\$0.04	\$0.00	\$0.03
Unrealized gains (losses) for the period	(\$0.01)	(\$0.10)	(\$0.07)	(\$0.06)	\$0.05
<b>Total increase (decrease) from operations <sup>(2)</sup></b>	<b>\$0.05</b>	<b>\$0.03</b>	<b>\$0.18</b>	<b>\$0.17</b>	<b>\$0.32</b>
<b>Distributions:</b>					
From net investment income (excluding dividends)	\$0.19	\$0.17	\$0.21	\$0.23	\$0.25
From dividends	\$--	\$--	\$--	\$--	\$--
From capital gains	\$--	\$--	\$--	\$--	\$--
Return of capital	\$--	\$--	\$--	\$--	\$--
<b>Total Annual Distributions <sup>(3)</sup></b>	<b>\$0.19</b>	<b>\$0.17</b>	<b>\$0.21</b>	<b>\$0.23</b>	<b>\$0.25</b>
<b>Net Assets, end of period</b>	<b>\$11.09</b>	<b>\$11.22</b>	<b>\$11.35</b>	<b>\$11.38</b>	<b>\$11.44</b>

#### Ratios and Supplemental Data (based on Net Asset Value)

	Year ended December 31				
	2018	2017	2016	2015	2014
Total Net Asset Value (000's) <sup>(4)</sup>	\$140,483	\$188,011	\$199,421	\$204,316	\$205,273
Number of units outstanding <sup>(4)</sup>	12,668,872	16,764,263	17,566,363	17,955,859	17,939,038
Management expense ratio <sup>(5)</sup>	1.19%	1.19%	1.19%	1.19%	1.19%
Management expense ratio before waivers or absorptions <sup>(6)</sup>	1.24%	1.25%	1.25%	1.25%	1.25%
Trading expense ratio <sup>(7)</sup>	--	--	--	--	--
Portfolio turnover rate <sup>(8)</sup>	30.75%	37.56%	59.84%	28.07%	27.89%
Net Asset Value per unit	\$11.09	\$11.22	\$11.35	\$11.38	\$11.44

- (1) This information is derived from the Fund's audited annual financial statements. For the financial year beginning after January 1, 2014, the financial highlights were derived from the Fund's financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). For the financial year ended December 31, 2013, the financial highlights numbers were restated to comply with IFRS reporting. For financial years beginning after January 1, 2013, all references to "Net Assets" or "Net Assets per Unit" in these financial highlights are references to net assets attributable to holders of redeemable units determined in accordance with IFRS as presented in the financial statements of the Fund.
- (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) Distributions were either paid in cash or reinvested in additional units of the Fund.
- (4) This information is provided as at December 31 of the year shown.
- (5) Management expense ratio is based on total expenses (excluding [distributions], commissions and other portfolio transaction costs) for the stated period and is expressed as an annualized percentage of daily average net asset value during the period.
- (6) The management expense ratio before waivers or absorptions shows what the management expense ratio of the Fund would have been if Educators Financial Group had not charged a lesser amount for its management fee.
- (7) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value during the period.
- (8) 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 rates 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.

## Management Fees

Educators Financial Group is the Manager-Trustee, promoter and principal distributor of the Fund, and is responsible for the day-to-day management and administration of the Fund.

The Manager-Trustee monitors and evaluates the performance of the Fund, and pays for the investment management services of the portfolio manager, as well as all administrative services required by the Fund. As compensation for these services, Educators Financial Group is entitled to receive a fee, payable monthly and calculated daily, based on the Net Asset Value of the Fund, at the annual rate of 1.10% for the Class A Series. The Class I Series is identical in all respects to the Class A Series, except that there is no management fee payable by the Fund in respect of the Class I units.

The Fund is responsible for paying any applicable tax owing on its management fee.

Approximately 11.2% of the total management fees collected were used to pay for portfolio management services, with the remainder of the fees allocated to custodial services, marketing, technology and Manager-Trustee operating expenses.

## PAST PERFORMANCE

### General

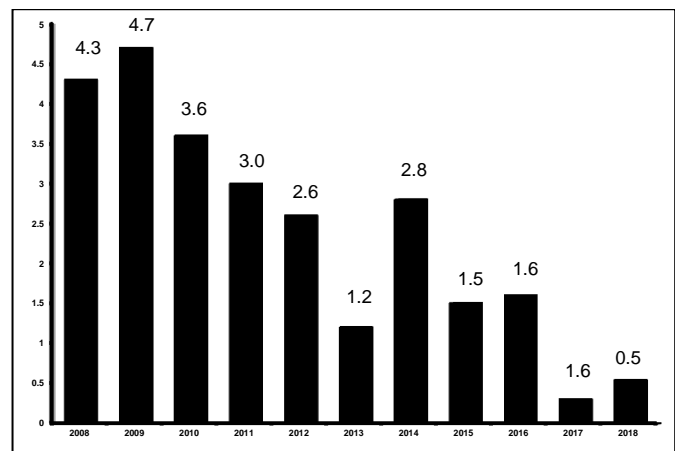
The Fund's performance information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional units of the Fund.

The performance information does not take into account sales, redemption, distribution or other optional charges that would have reduced returns or performance. The performance of different fund series may vary for a number of reasons, including differences in management fees and expenses. Please remember that how the Fund has performed in the past does not necessarily indicate how it will perform in the future.

### Year-by-Year Returns

The bar chart shows the Fund's performance for each of its past 10 financial years and illustrates how the Fund's performance has changed for each 12-month period ending December 31. The chart shows, in percentage terms, how much an investment made on the first day of each financial period would have grown or decreased by the last day of each financial period.

Annual Returns – Class A Series



Annual Returns – Class I Series

Currently Class I units of the Fund are not being offered to purchase.

### Annual Compound Returns

This table compares the historical annual compound returns of the Fund with the Benchmark, FTSE TMX Canada Short Term Bond Index. The FTSE TMX Canada Short Term Bond Index is a market capitalization-weighted index consisting of a broadly diversified range of investment grade federal, provincial, municipal and corporate bonds with a term to maturity between one and five years.

**Class A Series**

	<b>1 Year</b>	<b>3 Year</b>	<b>5 Year</b>	<b>10 Year</b>
Educators Mortgage & Income Fund	0.54%	0.83%	1.34%	2.16%
FTSE TMX Canada Short Term Bond Index	1.91%	1.00%	1.73%	2.51%

**Class I Series**

Currently Class I units of the Fund are not being offered to purchase.

The Benchmark returns do not include any costs of investing. See Management Discussion of Fund Performance for a discussion of performance relative to the Benchmark.

**SUMMARY OF INVESTMENT PORTFOLIO**

**(Based on Net Asset Value)**

As at December 31, 2018

<b>Sector Mix</b>	<b>Percentage of Net Asset Value</b>
Canadian Mutual Funds	51.91%
Corporate Bonds	35.16%
Asset-Backed Securities	6.39%
Government Bonds	6.02%
Short-term Investments	0.32%
Cash and Cash Equivalents	0.10%
Net Other Assets	0.10%

**Top 25 Holdings**

<b>Security Name</b>	<b>Percentage of Net Asset Value</b>
HSBC Mortgage Fund, Institutional Series	48.48%
HSBC Emerging Markets Debt Fund, Institutional Series	3.43%
Canadian Government Real Return Bond, 6.86%, December 1, 2021	2.71%
Canada Housing Trust No. 1, 2.35%, June 15, 2027	1.87%
Bank of Nova Scotia, 2.29%, June 28, 2024	1.37%
TMX Group Ltd., 4.46%, October 3, 2023	1.35%
Real Estate Asset Liquidity Trust, 2.56%, October 12, 2049	1.28%
Saputo Inc., 2.83%, November 21, 2023	1.25%
Canadian Imperial Bank of Commerce, 1.64%, July 12, 2021	1.14%
Brookfield Property Finance ULC, 4.35%, July 3, 2023	1.09%
Institutional Mortgage Securities Canada Inc., 1.94%, Sept. 12, 2024	1.09%
Citigroup Inc., 3.39%, November 18, 2021	1.08%
Bank of Montreal, 2.70%, September 11, 2024	1.07%
Province of Alberta, 2.20%, June 1, 2026	1.04%
Goldman Sachs Group Inc., 2.43%, April 26, 2023	1.03%
Granite REIT Holdings LP, 3.87%, November 30, 2023	0.94%
Canadian Western Bank, 2.74%, June 16, 2022	0.89%
Royal Bank of Canada, 3.31%, January 20, 2026	0.89%
Alimentation Couche-Tard Inc., 3.90%, November 1, 2022	0.87%
Suncor Energy Inc., 3.10%, November 26, 2021	0.86%
Anheuser-Busch InBev Finance Inc., 2.60%, May 15, 2024	0.81%

Canadian Natural Resources Ltd., 3.31%, February 11, 2022	0.78%
OVC Inc., 4.85%, April 1, 2024	0.78%
Pembina Pipeline Corp., 3.77%, October 24, 2022	0.77%
Empire Life Insurance Co., 3.38%, December 16, 2026	0.76%

**Total Net Assets (000's) \$140,483**

The top 25 holdings represent approximately 77.64% of the total net assets of the Fund.

The summary of investment portfolio of the Fund is as at December 31, 2018 and may change due to the Fund's ongoing portfolio transactions. Updates are available quarterly. Information about the holdings of the HSBC Funds owned by the Fund is contained in their simplified prospectus, annual information form and fund facts documents available on SEDAR at [www.sedar.com](http://www.sedar.com).

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