

## **Management Report of Fund Performance**

For the fiscal year ended December 31, 2019

This MRFP contains financial highlights but does not contain the complete annual financial statements of the Heritage Plans (the “Plans”). You can obtain a copy of the annual financial statements of the Plans at your request, and at no cost, by calling us at 1-800-739-2101 or by writing to us at 50 Burnhamthorpe Road West, Suite 1000, Mississauga, Ontario, L5B 4A5. Alternatively, you can visit our website at [www.knowledgefirstfinancial.ca](http://www.knowledgefirstfinancial.ca) or SEDAR at [www.sedar.com](http://www.sedar.com).

Currently, the investments of the Plans are limited to specified government bonds, guaranteed investment certificates, short term investments and corporate debt securities with an approved credit rating, Canadian equity securities, and U.S. equities via an exchange-traded fund (ETF), both of which must be traded on a stock exchange in Canada or the U.S. The investment income earned in the Plans may be invested in exchange-traded funds and equity securities listed on a stock exchanges in Canada and US, such as the TSX. For the Plans’ equity securities, the portfolio advisors have been delegated the authority to vote on any matter for which the Plans receive, in their capacity as security holders, proxy materials for a meeting of security holders.

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## Management Discussion of Fund Performance

### Investment Objective and Strategy

The investment objective of the Plans is to preserve capital while maximizing the long-term rate of return for investors, within guidelines set out in the Statement of Investment Policies & Procedures (“SIPP”). The Plans’ principal contributions and grants are invested in federal, provincial and corporate bonds, bank deposit notes, and short-term investments with an approved credit rating under National Instrument 81-102. The investment income earned in the Plans may be invested in equity securities and exchange traded funds listed on a stock exchanges in Canada and US.

### Risk

The Plans are a conservative investment fund suitable for investors focusing on a long-term saving program, intended to fund post-secondary education, and generally for those investors having lower tolerance risk. The risk of investing in the Plans and its suitability for investors, is discussed in the prospectus of the Plans.

### Results of Operations and Financial Market Review

The net assets of the Plans were \$2.68 billion as at December 31, 2019 (2018: \$2.54 billion). The increase in net assets is mainly due to contributions received from subscribers’ during the year and the appreciation in the market value of investments generated by strong markets. The asset mix for the Plans changed from the previous year largely due to the elimination of principal protected notes (“PPNs”) and addition of the US equities.

At December 31, 2019, 78.4% (2018: 80.7%) of the Plans’ portfolio was invested in government bonds, corporate debt and short-term investments, 6.2% (2018:19.3%) was invested in Canadian equities, and 15.4% (2018: 0.0%) was invested in US equities.

Over the past five years, the Plan’s net rate of return was 3.7% per annum. For fiscal 2019, the Plan’s net rate of return was 8.0% versus a return of 6.4% for the FTSE Canada Universe All Government Bond Index (formerly called DEX All Government Bond Index). S&P 500 Index returned 31.5%, while TSX Composite returned 22.9% in 2019. Unlike the Index, the Plan’s return is after fees for administration, portfolio management, custody and independent review committee.

Despite a negative market in late 2018, 2019 was very positive for both bonds and equity markets. Q1 was especially strong, with North American equity markets delivering double digit returns. Accommodative policies from the central banks around the world, somewhat easing trade tensions, more clarity surrounding Brexit after the majority Conservative government victory, strong labour markets, and renewed optimism about the economic outlook despite slowing economic growth - all helped to deliver robust returns across the markets for both risky and risk-off assets, which was unusual.

After the sharp fall in equities at the end of the last year, the global central banks signaled a reversed course, where instead of increasing interest rates they would provide more accommodative policy to support the economic expansion. This resulted in strong performance for bonds despite the historically low level of interest rates. The Canadian yield curve shifted down and partially inverted. 5Y Canadian government bond yield decreased from its high of 1.96% at the beginning of the year, to the lowest of 1.13% for the year in August before recovering to 1.68% at the end of the year. 10Y Canadian government bond yield followed the suit decreasing from the highest 2.03% in January to the lowest of 1.09% in August before recovering to 1.7% at the end of the year. In 2019, Canadian Government bonds returned 6.4%, and Corporate spreads tightened resulting in Canadian Corporate bonds returning 8.1%.

The U.S. economy performed relatively well in 2019, defying recession fears that dominated the headlines throughout the year. The real GDP growth is estimated to be 2.3% (down from 2.9% in 2018), and the unemployment rate is at 50-year low of 3.5%. Low interest rates continued to support the longest-running bull market in US stocks. The US Federal Reserve cut interest rates three times in 2019 by a combined 75 basis points, providing support for risky assets and elongating the longest-ever economic expansion cycle. US equities (S&P 500) triumphed, posting a 31.5% total return, with even the lagging Energy sector posting an impressive 11.8% gain in 2019. The best performing sector, Information Technology, returned 50.3%.

Canadian GDP is forecasted at 1.7% for the year, and the labor market remained strong in 2019. Many of the Bank of Canada's international peers cut rates and loosened monetary policy responding to the global economy weakness, however Bank of Canada kept its interest rate unchanged in 2019. Canadian equity markets performed well, with S&P TSX Composite returning 22.9%, and the frontrunner Information Technology sector being up 64.9%. Out of 11 sectors in the Composite, 10 sectors generated double digit positive returns in the year.

As geopolitical risks receded and global economic activity stabilized, global equities finished the year on a strong note with nearly every region posting positive returns. The MSCI World index returned 28.4% in 2019.

### Recent Developments

In March 2019, the Plans began to implement changes to its equity portfolio managers and its allocation to equities. By the end of April 2019, the Plans held approximately 14% of its total assets in hedged and unhedged US equities by way of passive ETFs (exchange traded funds) provided by BMO Asset Management. Approximately 6% of the Plans' total assets were invested in Canadian equities managed actively by Connor, Clark & Lunn Investment Management Ltd.

The Heritage Educational Foundation (the "Foundation") has engaged portfolio advisers to manage the Plans assets. Scotia Institutional Asset Management, a division of 1832 Asset Management L.P. (a wholly owned subsidiary of Scotiabank, "SIAM"), and, starting September 2019, Fiera Capital Corporation ("Fiera") manage the fixed income portion of the Plan. Prior to April 2019, Yorkville Asset Management Inc., Guardian Capital LP and TD Asset Management Inc managed the Plan's Canadian equity portfolio. Since April 2019, The Plan's Canadian equity securities are actively managed by Connor, Clark & Lunn Investment Management ("CCL). In April 2019, US equities were introduced to the Plan by the way of passive ETFs managed by BMO Asset Management Inc. ("BMO"). The portfolio advisers manage the assets of the Plans on a discretionary basis within set parameters established under the prospectus and the SIPP.

### Related Party Transactions

The Plans are sponsored by the Foundation. During the year ended December 31, 2019, the Foundation and the Distributor were under a common management as the directors of the Distributor constituted the board members of the Foundation.

Account maintenance and administrative fees are paid by the Plans to the Foundation, and then by the Foundation to Knowledge First Financial. The Foundation pays these fees to Knowledge First Financial for expenses incurred in assisting the Foundation with the administration of the Plans. The administration fees are annual fees of 0.5% charged on all funds related to the Plans' net assets. The total administrative fees of \$14,612,127 (2018 - \$13,756,571) were paid by the Foundation to Knowledge First Financial from the subscribers' contributions received for the Plans. The account maintenance fee is an annual fee which is deducted quarterly from subscriber's contributions.

As at December 31, 2019, the amount due from the Foundation to the Plans was \$77,606,618 (2018 - due from the Foundation to the Plans of \$13,430,434) with the amount due from the Foundation representing net subscribers' contributions yet to be settled between the Foundation and the Plans.

IRC fees are paid to the IRC members. The fees paid are outlined in the terms of the Prospectus. The fees to the Heritages Plans are prorated based on the net asset value of the Plans. For the year ended December 31, 2019, the IRC fees paid by the Plans were \$53,560 (2018 - \$31,581).

### Administrative Fees

An annual administrative fee of 0.5%, comprising the Plans' administrative and processing fees, was paid to the Foundation and administrator of the Plans pursuant to the Education Savings Plan Contract entered into with subscribers. This totaled \$14,612,127 for the fiscal year 2019 (2018 - \$13,756,571). The administration of the Plans includes processing and call centre services related to new agreements, payments, government grants (Canada Education Savings Grant, Canada Learning Bond, Quebec Education Savings Incentive, Saskatchewan Advantage Grant for Education Savings and British Columbia Training and Education Savings Grant), plan modifications, cancellations, maturities and Educational Assistance Payments. The Foundation paid the administrative fees to the Distributor for assisting in the administration of the Plans. The annual administrative fee is calculated as 0.5% of the sum of contributions less fees, income in subscribers' accounts, as well as government grants, including realized and unrealized income, gains net of losses earned thereon.

### Enrolment Fees

The Distributor deducts enrolment fees from subscribers' deposits to the Plans equivalent to \$100 per unit purchased. All the subscribers' deposits to the Plans are applied against the enrolment fee until one half of the total enrolment fee has been paid. Thereafter, one half of subsequent deposits to the Plans are applied against the enrolment fee until the fee is paid in full. Out of the enrolment fees received by the distributor, approximately 75% of the enrolment fees are paid out as sales commissions to the licensed sales representatives and branch directors of the distributor.

### Account Maintenance Fees

Account maintenance fees of \$1,852,020 (2018 - \$1,940,994) were deducted from subscribers' deposits. The account maintenance fee is an annual fee for processing subscribers' deposits. This fee is dependent upon the deposit frequency chosen by the subscriber: monthly, annual or single deposit. Special processing fees are one-time fees for specific transactions in the subscribers' deposit account. Pursuant to the Fund Management Agreement dated October 30, 2006 between the Foundation and the Distributor (now KFFI), 100% of the account maintenance fees collected from subscribers and 100% of special processing fees are paid to KFFI as these fees are directly related to plan administration activities.

### Insurance Premiums

Insurance premiums of \$4,425,977 (2018 - \$4,790,364) were deducted from subscribers' deposits prior to depositing the balance into the Plans. The insurance premium for the embedded group life and total disability insurance is calculated at 5% of subscribers' deposits. No premium is deducted for one-time deposits or if the subscriber is under the age of 18 or over the age of 64. Pursuant to the Fund Management Agreement dated October 30, 2006 between the Foundation and the Distributor (now KFFI), 100% of insurance administration-related fees are paid to Financial. Insurance administration fees are estimated to be 20% of the insurance premium.

### Financial Highlights

The following table show selected key financial information about the Plans and are intended to help you understand the Fund's financial performance for the past five years.

<b>\$ in thousands</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Statements of Financial Position</b>					
Total Assets	2,680,258	2,540,881	2,566,306	2,523,035	2,439,974
Net Assets Attributable to Subscribers and Beneficiaries <sup>(1)</sup>	2,678,587	2,539,362	2,519,533	2,483,378	2,405,987
% Change of Net Assets	5.5%	0.8%	1.5%	3.2%	0.2%
<b>Statement of Comprehensive Income</b>					
Educational Assistance Payments	75,200	70,179	83,192	80,020	65,301
Government Grant payments, repayments and transfers	37,894	36,639	29,170	25,732	21,416
Net Investment Income <sup>(2)</sup>	65,773	59,605	43,566	118,303	23,091
<b>Other</b>					
Total number of units outstanding	3,115 <sup>(3)</sup>	3,262 <sup>(3)</sup>	3,773	3,737	3,682
% change in total number of units	(4.51%)	(13.54%)	0.96%	1.49%	2.96%

<sup>(1)</sup> "Net Assets" represents total assets less total liabilities.

<sup>(2)</sup> Net investment income excludes realized gains (losses) on investments and the net change in unrealized gains on investments.

<sup>(3)</sup> 2019 units outstanding only includes active agreements, whereas prior years reflect both active and matured agreements.

### Investment Counsel Fees

An annual investment counsel fee of \$2,318,436 (2018 - \$2,664,958) for portfolio advisory services was paid to the portfolio advisers for the year ended December 31, 2019. Portfolio advisers provide advisory and discretionary managed account services with respect to purchasing, selling and otherwise dealing in securities and other investments of the Plans.

The investment counsel fee is calculated on the market value of the assets in the Plans at the end of each quarter based on a graduated fee schedule and is paid on a quarterly basis.

### Independent Review Committee Fees

For the year ended December 31, 2019, a total fee of \$53,560 (2018 - \$31,581) was paid to the Independent Review Committee (“IRC”). The IRC for Investment Funds is an initiative of the Canadian Securities Administrators and is created pursuant to requirements of National Instrument 81-107 requiring that each publicly offered investment fund have an IRC. Its role is to oversee all decisions involving an actual or perceived conflict of interest between the Foundation or Distributor and the Plans.

### Past Performance

Past performance of the Plans is set out in the following chart and compound returns table. Investment returns have been calculated using market values and time-weighted cash flows during the relevant periods.

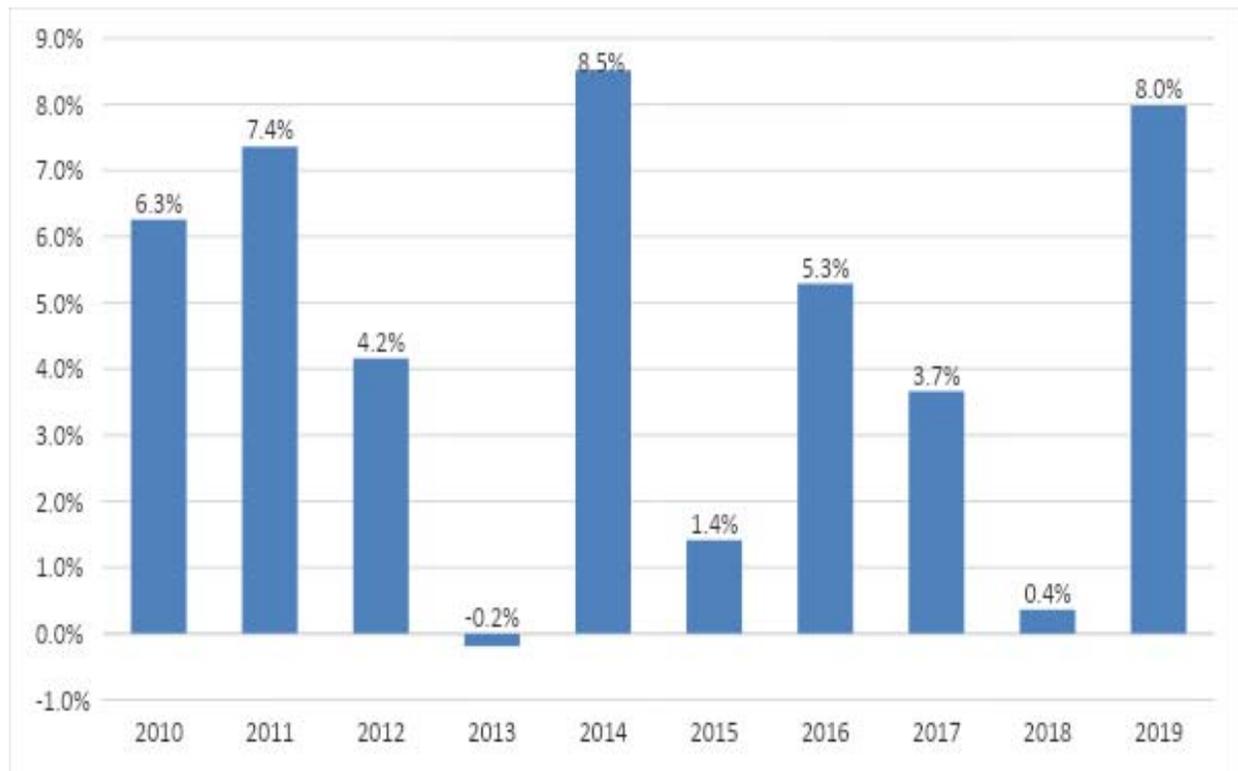
The performance information shown:

- Assumes all income, interest earned, and capital gains distributions are reinvested in the Plans; and
- Is adjusted for the cash flows for administrative and investment counsel fee payments.

Past returns of the Plans do not necessarily indicate how it will perform in the future.

### Year-by-Year Returns

The following bar chart illustrates the Plans’ annual performance in each of the past ten years to December 31.



## Annual Compound Returns

The following table illustrates the Plans annual compound returns for the periods shown ended December 31, 2019.

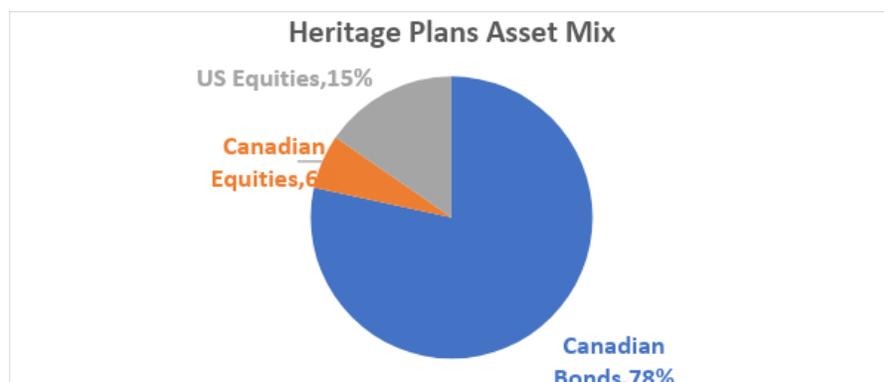
	1 Year	3 Year	5 Year	10 Year
The Plans	8.0%	4.0%	3.8%	4.5%
FTSE Universe All Government Bond Index	6.4%	3.4%	3.0%	4.1%
S&P TSX Composite Index	22.9%	6.9%	n/a	n/a
S&P 500 in USD	31.5%	n/a	n/a	n/a
S&P 500 Index (in CAD)	24.8%	n/a	n/a	n/a

The FTSE Canada Universe All Government Bond Index is designed to be a broad measure of the Canadian government fixed income market. It represents three main borrower categories: bonds issued by the Government of Canada (including Crown Corporations), Provincial bonds (including provincially guaranteed securities) and Municipal bonds. The Plans' returns are net of fees whereas the FTSE index does not include any fees.

The S&P/TSX Composite Index is the flagship index for the Canadian equity market and measures the performance of the largest stocks listed on the Toronto Stock Exchange. The S&P 500 Index is the flagship index for the US equity market and measures the performance of the largest 500 US stocks.

## Summary of Investment Portfolio

Portfolio by Category as at December 31, 2019



## Summary of Top Holdings:

The following table indicates the largest 25 holdings of the Plans at the end of fiscal 2019. This summary of investment portfolio may change due to ongoing portfolio transactions. The Plans are prohibited from holding short positions in securities.

	<b>Name</b>	<b>Coupon %</b>	<b>Maturity Date</b>	<b>% of Investments</b>
1	BMO S&P 500 HEDGED TO CAD INDEX ETF			11.6%
2	CANADA HOUSING TRUST	2.10%	2029-09-15	10.9%
3	GOVERNMENT OF CANADA	2.25%	2029-06-01	7.3%
4	PROVINCE OF ONTARIO	6.50%	2029-03-08	7.1%
5	CANADA HOUSING TRUST	2.65%	2028-03-15	6.7%
6	GOVERNMENT OF CANADA	1.50%	2021-08-01	4.8%
7	CANADA HOUSING TRUST	1.15%	2021-12-15	3.8%
8	BMO S&P 500 INDEX ETF			3.8%
9	PROVINCE OF ONTARIO	2.70%	2029-06-02	2.2%
10	HYDRO-QUEBEC	11.00%	2020-08-15	1.6%
11	ROYAL BANK OF CANADA	2.33%	2023-12-05	1.6%
12	ROYAL BANK OF CANADA	2.95%	2023-05-01	1.3%
13	BANK OF MONTREAL	2.89%	2023-06-20	1.3%
14	TORONTO-DOMINION BANK	1.99%	2022-03-23	1.1%
15	PROVINCE OF ONTARIO	2.40%	2026-06-02	1.0%
16	HSBC BANK CANADA	3.25%	2023-09-15	1.0%
17	MANULIFE BANK OF CANADA	2.08%	2022-05-26	1.0%
18	GOVERNMENT OF CANADA TREASURY BILL	0.00%	2020-04-30	0.9%
19	CANADIAN IMPERIAL BANK OF COMMERCE	2.97%	2023-07-11	0.8%
20	BANK OF NOVA SCOTIA	2.98%	2023-04-17	0.8%
21	TORONTO-DOMINION BANK	3.23%	2024-07-24	0.8%
22	PROVINCE OF ONTARIO	2.60%	2027-06-02	0.7%
23	PROVINCE OF ONTARIO	2.30%	2024-09-08	0.7%
24	BANK OF NOVA SCOTIA	3.10%	2028-02-02	0.7%
25	NATIONAL BANK OF CANADA	1.96%	2022-06-30	0.6%
<b>Largest 25 holdings as a % of total investments</b>				<b>74.1%</b>

### Subsequent event

Since the latter part of February 2020, the financial markets have been very volatile in response to the developing COVID-19 pandemic and the equity markets in particular have experienced significant declines. The investment portfolio of the Plan has been subject to these market fluctuations and are expected to continue to experience significant volatility as the situation evolves.