

### **Introduction**

SONA is registered as a Portfolio Manager in British Columbia, Ontario, and Quebec. As such SONA is permitted to direct trades on a discretionary basis within and across the Portfolio of an Investor subject to the Investor's Mandate.

Our head office is located at 1565 Carling Avenue, Suite 602, Ottawa, Ontario, K1Z 8R1

Phone (343) 317-7220 [www.sonawealthcounsel.com](http://www.sonawealthcounsel.com)

Agents for Service

Outside of Ontario, Investors may serve legal processes on our agent in their province of residence:

**British Columbia:** Farris, Vaughn, Wills & Murphy LLP, 1800-1631 Dickson Avenue, Kelowna, British Columbia V1Y 0B5, Phone: 250-869-3868.

**Quebec:** CRAC, 500-4428 Boulevard Saint-Laurent, Montréal, Quebec, H2W 1Z5, Phone: 514-861-2722

You can confirm SONA WEALTH COUNSEL INC.'s Portfolio Manager's registration by visiting the Canadian Securities Administrators' website at <http://www.securities-administrators.ca/>.

### **SONA's PARTNERS AND RELATED PARTIES**

**National Bank Independent Network Inc. (NBIN)** - SONA has retained the services of National Bank Independent Network Inc., a division of National Bank Financial Inc., to act as SONA's correspondent broker and custodian for all client accounts. All client trading activity takes place in NBIN investment accounts and NBIN also acts as the trustee for any registered accounts (RRSP, RRIF, TFSA, etc.).

As the Portfolio Manager's correspondent broker, NBIN will furnish monthly brokerage trade confirmations and statements for each Account, as well as an annual report of performance, transactions and fees in accordance with applicable requirements.

These statements provide an accounting of your current holdings, and confirm all activity (i.e. purchases and sales of securities, contributions and withdrawals, dividends, interest earned and paid, transfers, etc.) that occurred in your account(s) over the previous month. The monthly account statement also provides you with your net equity, which represents the net value of your portfolio within each account based on the closing values as of the date on the statement.

**Ryan Lamontagne Inc. (RLI)** is an independent company that provides financial planning, tax preparation and other related services. RLI is considered a Related Party as the business partners who own RLI also have a controlling ownership interest in SONA WEALTH COUNSEL INC.

RLI may from time to time provide services to Investors. Any services that RLI provides to Investors are provided exclusively by RLI under a separate RLI agreement, and are independent of any agreement that Investors have with SONA.

RLI also provides SONA with certain management and administrative services for which SONA pays RLI a management fee. Employees of SONA may also be employees of RLI, and in some cases are providing services to Investors as an employee of both organizations.

SONA has carefully examined the relationship that it has with RLI, as well as the relationship that Investors may have from time to time with RLI, including employees of both organizations. SONA has determined that there is no conflict of interest. However, if at any time it is determined that a conflict of interest may arise or has arisen, SONA will immediately notify the Investor of the conflict, and then take immediate steps to resolve the issue.

### **SONA WEALTH COUNSEL INC. SERVICES**

SONA is licensed as a Portfolio Manager in the Provinces of B.C, Quebec and Ontario. As such, SONA is responsible for all investment related activity in a client's investment accounts, which includes providing advice, developing appropriate asset allocation strategies, selecting securities, and directing trades within your portfolio.

A portfolio is defined as a collection of securities diversified across a number of asset classes and combined in such a manner as to minimize risk and optimize returns relative to an Investor's risk profile.

The cash and securities in the account(s) of your portfolio are not in our custody but rather are held in your trading account(s) at NBIN. It is important for clients to understand that your MIAA only grants SONA the authority to instruct the custodian to buy and sell securities in your account(s) and to withdraw our fees as set out in the Managed Investment Account Agreement.

We are required under securities laws to adhere to certain requirements when we provide you with our services. These requirements include the following:

**Fiduciary Duty** – we are required to act honestly, in good faith and always in your best interests.

**Protect Your Privacy** – we must keep all information that we obtain from you private and confidential within the context of managing and servicing your account(s) and any legal requirements we may have.

**Fair Allocation** – we act for many clients and we are obligated to allocate investment opportunities fairly amongst all of our clients in a manner that does not intentionally favor one client over another.

**Conflicts of Interest** – we are required by securities laws to adopt policies and procedures in order to ensure the proper handling of conflicts of interest.

**Best Execution** – when we trade securities for your account, we seek to achieve the best possible result having regard to price of the security, speed of execution, quality of execution and total transaction cost.

**Use of Brokerage Commissions** – for some clients, when we instruct a dealer to trade securities in your account the dealer receives a trade commission that is paid from your account. We make sure that,

when paying the trade commissions, we are not paying for goods or services from the investment dealer other than for order execution.

#### Statement of Accounts

You will receive monthly brokerage statements directly from NBIN that will include details of all transactions by account. SONA, as the Portfolio Manager, will also provide an annual report of performance by account including all transactions and fees in accordance with applicable requirements.

SONA also provides the Investor with a quarterly Portfolio report that includes details of trading activity during the period, a holdings report (including adjusted cost base and unrealized gains or losses), your portfolio's performance over various periods, and we may also include certain market commentary from your portfolio managers.

SONA also provides periodic market commentary and economic forecasts that will be delivered directly to you or accessed on our website. We also maintain archived copies of our periodic commentaries and economic forecasts on our website.

SONA has opted to suppress individual trade confirmation slips for each individual trade within the various accounts as these slips are redundant given the detailed reporting that is provided as noted above.

#### **THE SONA PLATFORM**

Accounts opened on the SONA Platform are referred to as your **Managed Investment Account(s)**.

All transactions that take place in your Managed Investment Accounts are executed on a discretionary basis by SONA. Any trades implemented by SONA will be conducted within the overall Mandate of your MIAA and will always conform to the standards of a reasonable Portfolio.

SONA charges its standard investment management fees as set out in Schedule "A" of the MIAA for all Managed Accounts.

Certain investments and funds that Investors may transfer onto the SONA Platform may be subject to liquidity constraints, redemption impediments such as deferred sales charges ("DSCs" are also known as early redemption fees) or the disposition of a particular security would result in the realization of a significant taxable capital gain. SONA may choose, or may be compelled, to hold such funds in the Account for the Investor until SONA can properly redeem and re-invest those funds in accordance with the investment Mandate.

SONA remains responsible for suitability, oversight and reporting for all investments held in all Accounts. Mutual funds generally pay a trailing service fee or commission, which will be collected and retained by the Dealer of Record (i.e. NBIN).

**THE MANAGED INVESTMENT ACCOUNT AGREEMENT (MIAA)**

Your MIAA sets out the terms between you and SONA regarding our discretionary management of your Portfolio. In particular, the MIAA: Outlines the Asset Mix Guidelines for the various investment mandates; Encourages effective communication between you and SONA; Discloses the various fees applicable to your Portfolio; aids us in our compliance with all fiduciary and due diligence requirements, and with all applicable laws, rules and regulations from various provincial, federal and international political and regulatory entities that may impact your investments; and confirms that SONA will conduct itself with trustworthiness and integrity and act in an honest and fair manner in all dealings with you and all our clients.

**SONA'S INVESTMENT PHILOSOPHY**

SONA manages portfolios in a manner that is similar to how a pension plans manage their assets. We apply the principles of asset allocation and combine this with low-cost, tax-efficient investments to maximize client returns at any risk level.

We understand the risk-return trade-off. In order to achieve above average returns an investor must assume greater investment risk. Risk is often defined as the variability of returns over a defined period of time, or the degree to which the value of the capital will go up or down during a particular time period.

Our objective is to achieve the best possible risk-adjusted returns for our clients which means that we endeavour to extract the maximum possible unit of return for each unit of risk within the context of your personal situation and financial market conditions.

To achieve that objective, SONA believes that investments should be diversified, and that asset allocation determines up to 85% of a portfolio's total return.

**SONA'S INVESTMENT MANAGEMENT PROCESS**

As a licensed Portfolio Manager, SONA manages Portfolios on a discretionary basis at the Portfolio Level within the Mandate and Asset Mix Guidelines defined in your MIAA.

The starting point for the creation of a viable long-term investment strategy is a detailed understanding of your investment objectives including your time horizon, risk profile, tax considerations, need for investment income, as well as other factors including the need for liquidity or periodic withdrawals of capital. The Investor Profile Questionnaire will provide valuable input regarding your individual risk profile. This information coupled with your specific investment objectives will help your SONA registered advisors in establishing the appropriate investment Mandate.

Each SONA Portfolio is managed on a discretionary basis. The Portfolio will be constructed in accordance with the asset allocation guideline of the applicable Mandate. The individual securities that will be used to construct the mandate may include a combination of individual securities, exchange

traded funds, mutual funds, bonds, GICs, cash, or any other security that is deemed appropriate for the Mandate.

Once a Portfolio is implemented according to the Investor's Mandate, the weighting of each asset class is regularly monitored by SONA. A reasonable range of weighting variations is permitted to account for investment market conditions and daily fluctuations in security values. However, periodic rebalancing will be required. Rebalancing is the process of adjusting the components of an Investor's Portfolio to account for changing market conditions and, as necessary, realign it with the asset mix guidelines of the Mandate.

Our investment management process is designed to provide stable risk adjusted rates of return over an extended time-period. Using a proven asset allocation investment strategy, we use the inherent investment characteristics of different asset classes to achieve enhanced rates of return while at the same time managing the underlying investment risks. Periodic adjustments to the asset allocation combined with a structured rebalancing program helps to deliver consistent returns even during challenging economic times.

SONA, as Portfolio Manager, will only buy and sell securities that are appropriate for your Mandate.

The Mandate selected in the MIAA reflects the objectives and risk tolerances of the entire Portfolio. However, SONA recognizes that there may be different objectives for specific accounts within the Portfolio. The Locked-in Retirement Account (LIRA) account may be managed as an Income Mandate, whereas the Tax-Free Savings Account (TFSA) account may fall under a Growth Mandate. While specific accounts may have different objectives, the overall "Risk Profile" of the Portfolio must remain in line with the Portfolio Mandate. A Portfolio that is set up as a Balanced Mandate could have an Income Mandate account and a Growth Mandate account so long as the Mandate for the entire Portfolio is a Balanced Mandate.

Investors have an obligation to inform SONA in a timely manner of any changes in financial their personal or financial circumstances, or any changes in their investment objectives.

### **ACCOUNT OPENING PROCESS**

During the account opening process SONA will gather certain information to complete your MIAA, determine your Portfolio Mandate and open the NBIN account(s). Information that we will collect may include:

Personal information, including names, family or marital status, dependents, dates of birth and Social Insurance Numbers;

Contact details including address, phone numbers and email address;

Employment information including current occupation, employer's name, length of employment, and additional details if you are self-employed or retired;

- Financial information including annual income, net worth and net investable assets;
- Risk tolerance, investment time horizon, and details of any planned major expenditures; and
- Other information that is relevant to your circumstances.

Canada's anti-money laundering regulations require us to verify your identity and ascertain the sources and intended uses of your investment funds before we (SONA together with NBIN) can open accounts, accept deposits of funds or securities, or execute any transactions on your behalf. Accepted methods of identity verification are prescribed in the regulations of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Canada) administered by the Financial Transactions and Reporting Analysis Centre of Canada (FINTRAC).

It is important that you continue to provide SONA with up-to-date information in order to provide you with the best possible service and advice. SONA will make every effort to contact you periodically – at a minimum through our annual update questionnaire – to update this information and record any changes that may affect your investment profile.

It is important that you inform us of any significant changes in the information as soon as possible. Relevant changes may include an address change, a change in employment, marital status or number of dependents, a change in your income requirement or tax situation, etc. When we become aware of significant changes, we will update your Investment Profile (and, as necessary, your account documents) to ensure all such information remains current.

### **FEES AND EXPENSES**

#### Management fees charged by SONA

SONA earns fees from investment management services only. Our fees are calculated as a percentage of the market value of assets under management in your Managed Investment Account(s) at the end of the preceding month. The fee is then charged to your account in the following month. The fees are set out in Schedule "A" of your MIAA, and can only be changed by SONA with a minimum of 60 days' written notice.

#### Fees charged by SONA Custodians

#### Trading Costs

We execute trades through NBIN, our correspondent broker and custodian of your accounts. For most client, SONA pays all of the NBIN trading fees as this service is included as part of the SONA Investment Management Fee. Certain clients do pay NBIN a per transaction charge as set out in the client's MIAA.

NBIN may also levy additional fees in connection with the maintenance of your brokerage account as per the NBIN fee schedule. Please refer to the NBIN *Accounts and Services Agreement and Disclosures* for specific details. The relationship between NBIN and SONA is such that NBIN will often waive some of these fees.

### Trustee Fees

Clients do not pay any trustee fees for their registered account while they are on the Sona platform. As part of our arrangements with NBIN, clients have access to many types of registered accounts (i.e. RRSPs, RRIFs, LIFs and TFSAs) and, through a service agreement with SONA, NBIN does not charge trustee fees on any such accounts.

### Management Expense Ratio (MER)

Certain securities such as mutual funds and exchange traded funds may have an underlying Management Expenses Ratio (MER) fee that is paid directly through the fund. Details of the MER of each individual security can be found in the respective fund prospectus.

### Additional Compensation

As stated previously, SONA does not receive any additional compensation beyond the management fees that it receives for investment management services. SONA may determine it to be in the interests of its clients to engage the services of, or invest in financial products offered by, another service provider, including NBIN, that are appropriate to the client's circumstances. If any fees are to be paid by a service provider to SONA for such services, the service provider and SONA shall provide each client with the disclosure required by section 13.10 of National Instrument 31-103.

### **CONFLICTS OF INTEREST**

SONA has policies and procedures in place to address the handling of conflicts of interest. Please refer to SONA's CONFLICTS OF INTEREST DISCLOSURE DOCUMENT for additional details.

A conflict of interest arises where an action or decision by us has the effect of benefiting us at your expense.

In situations where our interest may compete with your interest, your interest is always given priority. To ensure fairness and objectivity in our relationship with you, SONA always discloses all important conflicts of interest, both actual and potential.

### Addressing of Conflicts of Interest

SONA may adopt one or more of the following measures or procedures when addressing conflicts of interest:

Control of information – preventing or controlling the exchange of information between opposing sides of a conflict of interest, for example, by establishing an ethical wall.

Separate supervision – ensuring that employees on opposite sides of a conflict of interest are supervised by different people.

Neutralizing financial incentives – removing the financial incentive of an employee to favour a particular product or service.

Removing inappropriate influence – preventing one employee from inappropriately influencing another employee where such influence could impair integrity or judgment.

Segregation of tasks – controlling the simultaneous or sequential involvement of employees in separate tasks or services.

### **TRADE EXECUTION**

The purchase and sale of portfolio securities will be arranged through registered brokers or dealers selected on the basis of SONA's assessment of the ability of the broker or dealer to execute transactions promptly and on favourable terms, and the quality and value of services provided by the broker or dealer, such as research, statistical and other services used in assessing potential investments.

Further, SONA typically invests only in blue chip liquid securities that have tight bid-ask spreads. Because we are trading liquid securities and the fact that NBIN directs SONA orders to all appropriate exchanges, we believe NBIN provides best execution services.

SONA periodically reviews its relationship with NBIN and, from time to time, confirms transaction costs through third party brokers so as to ensure that we are meeting our best execution obligation.

### **FAIR AND EQUITABLE ALLOCATION**

The principal determination used in allocating investment opportunities amongst Managed Investment Accounts is the suitability of purchase and sale transactions as determined by the MIAA Mandate established for each investor. SONA's policy is that no single account will receive preference in the allocation of investment opportunities.

When orders for more than one account are entered as a combined order and transactions are executed at varying prices, the shares are accumulated in the SONA average price account. Once the order has been completed, an average price is determined and SONA allocates the securities to client accounts at the average price.

When orders for more than one account are entered as a combined order and executed as a block, SONA will generally attempt to make allocation pro rata on the basis of order size. However, we also take into consideration the return expectations and risk reduction benefits that a new security brings to the Portfolio, and may allocate based on that assessment rather than on a pro-rata basis.

SONA will endeavour to ensure that the orders, as well as any modification or cancellation of such orders, are recorded in electronic form or in writing and time-stamped.

Subject to market conditions and stock exchange procedures, SONA will use its best efforts to ensure that orders on behalf of client accounts are grouped, executed and allocated fairly on a daily basis. The foregoing procedures will be revised from time to time in keeping with changes in regulatory requirements and industry practices.



**CONFIDENTIALITY AND PRIVACY**

SONA has adopted a privacy policy in accordance with the Personal Information Protection and Electronic Documents Act (Canada). This policy states that SONA will only disclose this information to third parties or its affiliates in limited specific circumstances on a strictly confidential basis, or if specifically directed to do so in writing by the client. As an example, information may be shared with your RLI financial advisor, however only as specifically permitted in your signed Information Sharing Agreement.

**DISPUTE RESOLUTION AND MEDIATION SERVICES**

Independent dispute resolution or mediation services are available at the firm's expense to resolve any dispute that might arise between the client and the firm about any trading or advising activity of the firm or one of its representatives.

**INVESTMENT RISKS**

You should be comfortable about where your money is invested. You therefore must have an understanding of your own risk tolerance relative to the risk level of your investments.

Your accounts hold different kinds of investments depending on each account's investment objectives within your overall Mandate. The value of investments in any account will fluctuate on a daily basis, reflecting changes in interest rates, economic conditions and markets as well as news about any specific companies that you are invested in. The net value of your Portfolio will fluctuate from day to day, and the value that you receive when and as you redeem all or part of your Portfolio may be more or less than its value when you were invested.

The value of the securities in your portfolio is not guaranteed. Unlike bank accounts or guaranteed investment certificates (up to certain limits), stocks, bonds, money market securities and mutual funds are not covered by the Canada Deposit Insurance Corporation or any other government deposit insurer.

A higher-risk Portfolio will fluctuate in value more than a lower-risk Portfolio. It is therefore important to understand what we mean by "fluctuation." Within a given period of time, a security's market value may fluctuate, that is, it may go up or down. High-risk investments generally fluctuate more in market value than low-risk ones, which means that high risk investments may fluctuate negatively (i.e. lose market value) more often and to a greater degree than lower-risk investments.

The following is a list of the material risks that may affect the various investment strategies employed by SONA. Please do not hesitate to contact your Portfolio Manager should you wish to review any of the specific risks that relate to you.

**Concentration Risk**

Concentration risk results from having a large proportion of assets invested in securities issued by one issuer, in a single asset class or in a single sector. When an account lacks diversification it may be

significantly impacted by changes in the market value of a single security, asset class, or sector. SONA strives to mitigate concentration risk by ensuring that all clients portfolios are broadly diversified.

#### Credit Risk

An account can lose money if the issuer of a bond or other fixed income security cannot pay interest or repay principal when it comes due. This risk is higher if the fixed income security has a low credit rating or no rating at all. Fixed income securities with a low credit rating usually offer a higher yield than securities with a high credit rating, but they also have the potential for substantial loss. These are known as “high yield securities”. SONA strives to mitigate so called “default risk” by purchasing investment grade fixed income securities on behalf of our clients and by ensuring that all clients’ fixed income holdings are broadly diversified among several issuers.

#### Market Risk

The value of an account will increase or decrease with the market value of the securities in it. If an account holds stocks, the value of its securities will fluctuate in response to changing economic conditions, interest rates, stock market tendencies and other factors. Historically, equity securities are more volatile (i.e. tend to fluctuate more often and to a greater extent) than fixed income securities. Securities of small market capitalization companies are typically, though not always, more volatile than securities of large market capitalization companies.

#### Company Specific Risk

The market value of a particular stock will fluctuate according to the performance of the company that issued the stock. In general terms, if a company post better-than-expected financial results, the value of the stock will rise. And the inverse is true if the company posts worse-than-expected financial results. Other factors that will impact the market value of a particular security include management changes, new competition, regulatory changes or a lawsuit.

#### Interest Rate Risk

Investments can be impacted by interest rate fluctuations. A decline in interest rates may reduce the return of money market securities. An increase in interest rates may reduce the market value of accounts holding debt or fixed income securities. In general terms, the market value of fixed income securities is inversely related to unexpected changes in interest rates. If rates unexpectedly rise, then the value of fixed income investment will likely decline; conversely, if rates unexpectedly drop, the market value of fixed income securities will generally rise.

#### Currency Risk

Whenever a security is purchased in a foreign currency (a currency other than Canadian dollars), or when an entire investment account is denominated in a foreign currency, there are risks relating to exchange rates. As the Canadian dollar fluctuates in value against the other currencies, the value of the portfolio of securities purchased in those other currencies will fluctuate.

All month-end brokerage statements and quarterly performance evaluations provided to you by NBIN and SONA show the value of your holdings in Canadian dollars.

#### Liquidity Risk

Liquidity refers to how quickly and efficiently an asset may be sold and converted into cash. Most of the securities held by an account may be sold easily at a fair price and thus are considered relatively liquid. However, an account may invest in securities that are not liquid, (i.e. they may not be sold quickly or easily). Some securities may not be liquid because of legal restrictions, the nature of the investment, or certain characteristics of the security. The lack of purchasers interested in a given security or market could also explain why a security may be less liquid. If there is difficulty selling illiquid securities, the result may be a loss or a reduced return for an account.

Within Managed Investment Accounts, SONA typically invests only in liquid securities with sufficient average daily trading volume to enable us to easily enter and exit positions on behalf of our clients.

#### Foreign Investment Risk

Accounts that invest in foreign countries may face increased risk because the standards of accounting, auditing and financial reporting in these countries are not as stringent as in Canada and the U.S. In addition, factors such as changes of government or changes in the economy can affect foreign markets. Some foreign investment markets are less liquid, more volatile and have lower trading volumes than the North American markets. Foreign governments may impose exchange controls or devalue currencies, which would restrict the ability of a portfolio manager to redeem investments. SONA-managed Portfolios do not hold disproportionately large concentrations of assets in foreign markets.

#### Capitalization Risk

Securities of small companies can be riskier investments than securities of larger companies. For one thing, they are often newer and may not have a track record, extensive financial resources or a well-established market. This risk is especially true for private companies or companies that have recently become publicly traded. They generally do not have as many shares trading in the market, so it could be difficult to buy or sell small companies' stock when needed. All of this means their share prices can change significantly in a short period of time. SONA managed Portfolios avoid large concentrations of assets in small companies.

#### Risks relating to specialization

Specialization lets the Portfolio Manager focus on specific areas of the economy, however a Portfolio that has excess concentration in a particular industry or geographic area can be more volatile. Events or developments affecting that sector or part of the world may have a greater effect on the portfolio than if it had been more diversified. SONA avoids having an excessive concentration of assets in specific investment sectors and, aside from Canada, geographic sectors.

## Leveraging Risk

Leveraging, or using borrowed money to finance the purchase of securities, involves greater risk than a purchase using cash resources only. When you borrow money to purchase securities, you are responsible for making interest payments as required by the terms of the agreement, as well as repaying the loan. This remains true even if the value of the securities purchased declines.

Leveraging magnifies both investment gains and losses. If \$100,000 of securities are purchased and paid for with \$25,000 from available cash and \$75,000 from borrowings, and the value of the securities declines by 10% to \$90,000, the difference between the value of the securities and the amount borrowed declines by 40% i.e. from \$25,000 to \$15,000.

It is important to realize that a leveraged purchase of securities involves greater risk than a purchase using cash resources only. To what extent a leveraged purchase involves undue risk is a determination to be made on an individual case basis by each purchaser and will vary depending on the circumstances of the purchaser and the security purchased.

It is also important to realize that the terms of a loan secured by securities may require that the amount outstanding on the loan not fall below an agreed percentage of the market value of the securities. Should this occur, the borrower must pay down the loan or sell some of the securities so as to return the loan to the agreed to percentage. In our example above, the lender may require that the loan not exceed 75% of the market value of the securities. On a decline of value of the securities to \$90,000 the borrower must reduce the loan to \$67,500 (75% of \$90,000). If the borrower does not have cash available, the borrower must sell securities to provide money to reduce the loan.

## Risks relating to asset-backed and mortgage-backed securities

Asset-backed securities and commercial paper ("ABCP") are debt obligations that are backed by pools of consumer or business loans. Mortgage-backed securities are debt obligations backed by pools of mortgages on commercial or residential real estate. If there are changes in the market's perception of the issuers of these types of securities, or in the creditworthiness of the parties involved, then the value of the securities may be affected. There is also a risk that there may be a drop in the interest rates charged on mortgages, a mortgagor may default on its obligations under a mortgage or there may be a drop in the value of the property secured by the mortgage. SONA does not typically invest in ABCPs or mortgage backed securities.

## Risks relating to derivatives

"Derivatives" are investment instruments that derive their value from the value of other securities or commodities. Futures and options (contracts) are common types of derivatives. Usually, derivatives grant the right or require the holder to buy or sell a specific asset during a certain period of time.

There are many types of derivatives, each based on an underlying asset sold in a market or on a market index. A stock option is a derivative in which the underlying asset is the security of a major corporation. There are also derivatives based on currencies, commodities and market indexes.

In the industry, portfolio managers may seek to improve their rates of return by using derivatives, or may choose to accept a lower, more predictable rate of return through swaps, forward contracts and other such transactions. Derivatives may also be used to reduce the risk of currency fluctuations, stock market volatility and interest rate fluctuations. However, there is no guarantee that using derivatives will prevent losses if the value of the underlying investments falls. In some cases, derivatives may be used instead of direct investments. This reduces transactions costs and can improve liquidity and increase the flexibility of an account. These practices are called hedging. Derivatives may also be used for non-hedging purposes, such as to help increase the speed and flexibility with which trades may be executed, but there is no guarantee that using derivatives will result in positive returns.

The following are examples of risks relating to the use of derivatives:

The use of derivatives to reduce risk associated with foreign markets, currencies or specific stocks, called hedging, is not always effective. There may be an imperfect correlation between changes in the market value of the investment being hedged and the hedging derivative. ☐ There is no assurance that portfolio managers will be able to sell the derivatives to protect a portfolio. Derivatives traded in over-the-counter or foreign markets may be less liquid and therefore have more risk than derivatives traded in North American markets.

There may be a credit risk associated with those who trade in derivatives. The account or fund may not be able to complete settlement because the other party cannot honour the terms of the contract. ☐ There may be credit risk from dealers who trade in derivatives, such as a dealer going bankrupt. ☐ A securities exchange could impose daily limits on derivatives trading, making it difficult to complete an option or futures contract. ☐ If trading in stock index options or futures contracts is restricted by a stock exchange, the account or fund could experience substantial losses. ☐ The price of derivatives based on a stock index or futures contracts could be distorted if trading in some or all of the stocks that make up the index is interrupted. ☐ An account or fund may be unable to close out its position on certain options and futures contracts in a timely or cost-effective manner, thereby affecting the portfolio manager's ability to hedge against losses.