

# **Davis-Rea Enhanced Income Fund**

## **Financial Statements**

(Expressed in Canadian Dollars)

**For the Years Ended December 31, 2017 and  
2016**



## INDEPENDENT AUDITORS' REPORT

### To the Unitholders of Davis-Rea Enhanced Income Fund

We have audited the accompanying financial statements of Davis-Rea Enhanced Income Fund, which comprise the statements of financial position as at December 31, 2017 and December 31, 2016, and the statements of comprehensive income, changes in net assets attributable to holders of redeemable units and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

#### *Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of Davis-Rea Enhanced Income Fund as at December 31, 2017 and December 31, 2016, and the results of its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

*RSM Canada LLP*

Chartered Professional Accountants  
Licensed Public Accountants  
March 23, 2018  
Toronto, Ontario

**THE POWER OF BEING UNDERSTOOD**  
AUDIT | TAX | CONSULTING

**Davis-Rea Enhanced Income Fund**  
**Statements of Financial Position**  
**As at December 31, 2017 and 2016**  
(Expressed in Canadian Dollars)

|                                     | 2017              | 2016              |
|-------------------------------------|-------------------|-------------------|
| <b>Assets</b>                       |                   |                   |
| Investments at fair value (Note 13) | \$ 41,118,619     | \$ 38,204,872     |
| Receivable for investments sold     | 1,029,139         | -                 |
| Subscriptions receivable            | -                 | 10,000            |
| Accrued interest receivable         | 297,007           | 242,618           |
| Accrued dividends receivable        | 9,370             | 2,661             |
| Other assets                        | -                 | 392               |
| <b>Total assets</b>                 | <b>42,454,135</b> | <b>38,460,543</b> |

**Liabilities**

|                          |                   |                   |
|--------------------------|-------------------|-------------------|
| Bank overdraft           | 12,316            | 3,710,702         |
| Investments sold short   | 23,736,417        | 15,847,853        |
| Redemptions payable      | -                 | 641,474           |
| Other accrued expenses   | 18,933            | 18,571            |
| Accrued interest payable | 61,068            | 56,833            |
| Accrued management fees  | 67,637            | 65,666            |
| <b>Total liabilities</b> | <b>23,896,371</b> | <b>20,341,099</b> |

**Net assets attributable to holders of redeemable units (Note 5)**      \$ 18,557,764      \$ 18,119,444

**Net assets attributable to holders of redeemable units per class (Note 5)**

CLASS A      \$ 18,557,764      \$ 18,119,444

**Net assets attributable to holders of redeemable units per unit**

CLASS A      \$ 10.46      \$ 10.10

Approved on behalf of the Board of Directors of Davis Rea Ltd., the Manager

"John M. O'Connell" (signed)  
John M. O'Connell  
Director  
Davis Rea Ltd.

"P. Zachary Curry" (signed)  
P. Zachary Curry  
Director  
Davis Rea Ltd.

**Davis-Rea Enhanced Income Fund**  
**Statements of Comprehensive Income**  
**Years and Period Ended December 31, 2017 and 2016**  
(Expressed in Canadian Dollars)

|   | 2017                | 2016                |
|---|---------------------|---------------------|
| <b>Investment Income</b>  |                     |                     |
| Interest for distribution purposes  | \$ 1,454,524        | \$ 1,783,507        |
| Dividend income   | 116,260             | 7,918               |
|   | <b>1,570,784</b>    | <b>1,791,425</b>    |
| <b>Net Gain (Loss) on Investments</b>   |                     |                     |
| Net realized gain (loss)  | (99,011)            | 349,485             |
| Change in unrealized appreciation   | 741,539             | 1,184,220           |
| Net other loss  | (4,859)             | (83,461)            |
| Net foreign exchange gain on cash   | 4,054               | -                   |
|   | <b>641,723</b>      | <b>1,450,244</b>    |
| <b>Net Investment Income</b>  | <b>2,212,507</b>    | <b>3,241,669</b>    |
| <b>Expenses</b>   |                     |                     |
| Audit fees  | 5,847               | 14,189              |
| Commissions expense   | 2,859               | 11,280              |
| Custodial fees  | 3,366               | 2,210               |
| Fund administration expense   | 27,406              | 18,298              |
| Harmonized sales tax  | 34,673              | 36,559              |
| Interest expense  | 8,859               | 3,505               |
| Interest expense, short positions   | 421,836             | 496,388             |
| Legal fees  | 983                 | 2,434               |
| Management fees   | 229,994             | 250,261             |
| Performance fees  | 55,568              | 97,834              |
| Security lending expense  | 75,507              | 109,733             |
| Trustee fees  | 2,475               | 2,224               |
| Unitholder communication fees   | 6,087               | 5,631               |
|   | <b>875,460</b>      | <b>1,050,546</b>    |
| <b>Increase in net assets attributable to holders of redeemable units</b>           | <b>\$ 1,337,047</b> | <b>\$ 2,191,123</b> |
| <b>Increase in net assets attributable to holders of redeemable units per class</b> |                     |                     |
| CLASS A   | \$ 1,337,047        | \$ 2,191,123        |
| <b>Average redeemable units outstanding</b>   |                     |                     |
| CLASS A   | 1,769,244           | 2,015,796           |
| <b>Increase in net assets attributable to holders of redeemable units per unit</b>  |                     |                     |
| CLASS A   | \$ 0.76             | \$ 1.09             |

**Davis-Rea Enhanced Income Fund****Statements of Changes in Net Assets Attributable to Holders of Redeemable Units****Years Ended December 31, 2017 and 2016**

(Expressed in Canadian Dollars)

| <b>Total</b>   | <b>2017</b>          | <b>2016</b>          |
|--|----------------------|----------------------|
| <b>Net assets attributable to holders of redeemable units at beginning of year</b>       | <b>\$ 18,119,444</b> | <b>\$ 21,051,758</b> |
| <b>Increase in net assets attributable to holders of redeemable units</b>                | <b>1,337,047</b>     | <b>2,191,123</b>     |
| <b>Distributions paid or payable to holders of redeemable units</b>                      |                      |                      |
| From net investment income   | <b>(695,340)</b>     | <b>(667,127)</b>     |
| From net realized capital gains  | <b>-</b>             | <b>(32,296)</b>      |
| <b>Total distributions to holders of redeemable units</b>                                | <b>(695,340)</b>     | <b>(699,423)</b>     |
| <b>Redeemable unit transactions</b>  |                      |                      |
| Amount received from the issuance of units   | <b>603,060</b>       | <b>35,752</b>        |
| Amount received from reinvestment of distributions                                       | <b>688,903</b>       | <b>687,016</b>       |
| Amount paid on redemptions of units  | <b>(1,495,350)</b>   | <b>(5,146,782)</b>   |
| <b>Net decrease from redeemable unit transactions</b>                                    | <b>(203,387)</b>     | <b>(4,424,014)</b>   |
| <b>Net increase (decrease) in net assets attributable to holders of redeemable units</b> | <b>438,320</b>       | <b>(2,932,314)</b>   |
| <b>Net assets attributable to holders of redeemable units at end of year</b>             | <b>\$ 18,557,764</b> | <b>\$ 18,119,444</b> |
| <b>Class A</b>   | <b>2017</b>          | <b>2016</b>          |
| <b>Net assets attributable to holders of redeemable units at beginning of year</b>       | <b>\$ 18,119,444</b> | <b>\$ 21,051,758</b> |
| <b>Increase in net assets attributable to holders of Class A units</b>                   | <b>1,337,047</b>     | <b>2,191,123</b>     |
| <b>Distributions Paid or Payable to Unitholders</b>                                      |                      |                      |
| From net investment income   | <b>(695,340)</b>     | <b>(667,127)</b>     |
| From net realized capital gains  | <b>-</b>             | <b>(32,296)</b>      |
| <b>Total distributions to holders of redeemable units</b>                                | <b>(695,340)</b>     | <b>(699,423)</b>     |
| <b>Redeemable unit transactions</b>  |                      |                      |
| Amount received from the issuance of units   | <b>603,060</b>       | <b>35,752</b>        |
| Amount received from reinvestment of distributions                                       | <b>688,903</b>       | <b>687,016</b>       |
| Amount paid on redemptions of units  | <b>(1,495,350)</b>   | <b>(5,146,782)</b>   |
| <b>Net decrease from redeemable unit transactions</b>                                    | <b>(203,387)</b>     | <b>(4,424,014)</b>   |
| <b>Net increase (decrease) in net assets attributable to holders of redeemable units</b> | <b>438,320</b>       | <b>(2,932,314)</b>   |
| <b>Net assets attributable to holders of redeemable units at end of year</b>             | <b>\$ 18,557,764</b> | <b>\$ 18,119,444</b> |

**Davis-Rea Enhanced Income Fund**  
**Statements of Cash Flows**  
**Years and Period Ended December 31, 2017 and 2016**  
(Expressed in Canadian Dollars)

|   | 2017               | 2016                  |
|---|--------------------|-----------------------|
| <b>Cash provided by (used in)</b>                                 |                    |                       |
| <b>Operations</b>   |                    |                       |
| Increase in net assets attributable to holder of redeemable units | \$ 1,337,047       | \$ 2,191,123          |
| Adjustments for:  |                    |                       |
| Net realized loss (gain) on sale of investments                   | 99,011             | (349,485)             |
| Net change in unrealized appreciation of investments              | (741,539)          | (1,184,220)           |
| Purchase of investments   | (91,263,873)       | (165,251,604)         |
| Proceeds from the sale of investments                             | 95,852,079         | 164,301,106           |
| Interest receivable   | (54,389)           | 149,051               |
| Dividends receivable  | (6,709)            | 17,439                |
| Other assets  | 392                | (392)                 |
| Other liabilities   | 6,568              | (72,441)              |
| Net foreign exchange gain on cash                                 | (4,054)            | -                     |
|   | <b>5,224,533</b>   | <b>(199,423)</b>      |
| <b>Financing activities</b>                                       |                    |                       |
| Amount received from the issuance of units                        | 613,060            | 25,750                |
| Amount paid on redemptions of units                               | (2,136,824)        | (4,799,633)           |
| Distributions paid to unitholders                                 | (6,437)            | (20,744)              |
|   | <b>(1,530,201)</b> | <b>(4,794,627)</b>    |
| <b>Increase (decrease) in bank indebtedness during the year</b>   | <b>3,694,332</b>   | <b>(4,994,050)</b>    |
| Change in unrealized foreign exchange gain on cash                | 4,054              | -                     |
| <b>Cash (bank indebtedness), beginning of year</b>                | <b>(3,710,702)</b> | <b>1,283,348</b>      |
| <b>Bank indebtedness, end of year</b>                             | <b>\$ (12,316)</b> | <b>\$ (3,710,702)</b> |

**Supplemental Disclosure**

|  |              |              |
|--|--------------|--------------|
| Interest received                            | \$ 1,400,135 | \$ 1,932,558 |
| Interest expense, short positions            | \$ 426,460   | \$ 553,824   |
| Dividends received, net of withholding taxes | \$ 109,551   | \$ 25,357    |

**Davis-Rea Enhanced Income Fund**  
**Schedule of Investment Portfolio**  
**As at December 31, 2017**  
(Expressed in Canadian Dollars)

|  | Number of<br>Shares / Par<br>Value | Average<br>Cost*<br>\$ | Fair Value<br>\$  |
|--|------------------------------------|------------------------|-------------------|
| <b>INVESTMENTS HELD LONG - 221.57%</b>                                     |                                    |                        |                   |
| <b>CANADIAN BONDS - 181.12%</b>  |                                    |                        |                   |
| <b>Government of Canada and Guaranteed bonds - 0.50%</b>                   |                                    |                        |                   |
| Government of Canada, 1.25%, 2018/03/01                                    | 50,000                             | 50,565                 | 50,019            |
| Government of Canada, 0.75%, 2021/03/01                                    | 44,000                             | 44,251                 | 42,627            |
|  |                                    | 94,816                 | 92,646            |
| <b>Corporate Bonds - 180.62%</b>   |                                    |                        |                   |
| AGT Food and Ingredients Inc., Callable, 5.88%, 2021/12/21                 | 500,000                            | 500,000                | 505,208           |
| Air Canada, Callable, 4.75%, 2023/10/06                                    | 1,500,000                          | 1,500,000              | 1,555,000         |
| Alliance Grain Traders Inc., Callable, 3.06%, 2024/07/26                   | 1,000,000                          | 1,000,000              | 995,401           |
| Allied Properties REIT, Series 'B', Callable, 3.93%, 2022/11/14            | 600,000                            | 600,000                | 611,509           |
| Allied Properties REIT, Series 'C', Callable, 3.64%, 2025/04/21            | 1,000,000                          | 1,000,000              | 973,675           |
| Altalink L.P., Series '2016-1', Callable, 2.75%, 2026/05/29                | 1,000,000                          | 1,000,000              | 1,000,051         |
| Artis REIT, Series 'A', 3.75%, 2019/03/27                                  | 2,000,000                          | 2,051,680              | 2,012,938         |
| Brookfield Infrastructure Finance ULC, Callable, 3.32%, 2024/02/22         | 500,000                            | 500,000                | 498,063           |
| CES Energy Solutions Corp., Callable, 6.38%, 2024/10/21                    | 500,000                            | 500,000                | 509,583           |
| Crew Energy Inc., Callable, Restricted, 6.50%, 2024/03/14                  | 1,250,000                          | 1,250,000              | 1,225,130         |
| Crombie REIT, Series 'D', Callable, 4.07%, 2022/11/21                      | 400,000                            | 400,000                | 399,544           |
| Dollarama Inc., 3.10%, 2018/11/05  | 2,000,000                          | 2,063,880              | 2,019,838         |
| Emera Inc., 2.90%, 2023/06/16  | 1,000,000                          | 1,000,000              | 998,279           |
| Fairfax Financial Holdings Ltd., Callable, 4.25%, 2027/12/06               | 1,000,000                          | 999,920                | 990,946           |
| Federated Co-Operatives Ltd., Restricted, Callable, 3.92%, 2025/06/17      | 1,500,000                          | 1,500,000              | 1,485,026         |
| Fiera Capital Corp., Convertible, Restricted, Callable, 5.00%, 2023/06/30  | 200,000                            | 200,000                | 204,100           |
| First Capital Realty Inc., Series 'T', Callable, 3.60%, 2026/05/06         | 1,000,000                          | 1,000,000              | 992,491           |
| FortisBC Energy Inc., Callable, 2.58%, 2026/04/08                          | 550,000                            | 549,665                | 542,721           |
| Kraft Canada Inc., Variable Rate, Restricted, 1.70%, 2018/07/06            | 1,000,000                          | 1,000,000              | 1,002,930         |
| Kraft Canada Inc., Restricted, Callable, 2.70%, 2020/07/06                 | 2,000,000                          | 2,001,400              | 2,006,466         |
| Mattamy Group Corp., Callable, 6.50%, 2025/10/01                           | 500,000                            | 500,000                | 522,344           |
| Morguard Corp., Series 'B', 4.01%, 2020/11/18                              | 2,000,000                          | 2,060,480              | 2,027,604         |
| Osisko Gold Royalties Ltd., Convertible, 4.00%, 2022/12/31                 | 1,000,000                          | 1,000,000              | 1,045,000         |
| Parkland Fuel Corp., Callable, 5.50%, 2021/05/28                           | 1,500,000                          | 1,543,125              | 1,556,250         |
| Precision Drilling Corp., Restricted, Callable, 7.13%, 2026/01/15          | 1,000,000                          | 1,295,749              | 1,278,009         |
| RioCan REIT, 2.18%, 2020/08/26   | 1,500,000                          | 1,500,000              | 1,486,467         |
| RioCan REIT, Series 'Y', 2.83%, 2022/10/03                                 | 700,000                            | 699,979                | 695,143           |
| SNC-Lavalin Group Inc., Series '1', 2.69%, 2020/11/24                      | 500,000                            | 500,000                | 499,965           |
| Suncor Energy Inc., Callable, 5.39%, 2037/03/26                            | 1,304,000                          | 1,422,260              | 1,551,576         |
| Superior Plus L.P., Restricted, Callable, 5.25%, 2024/02/27                | 925,000                            | 935,750                | 944,078           |
| Toromont Industries Ltd., Callable, 3.84%, 2027/10/27                      | 200,000                            | 200,000                | 204,756           |
| Toronto Hydro Corp., Series '12', Callable, 2.52%, 2026/08/25              | 1,200,000                          | 1,199,808              | 1,179,271         |
|  |                                    | 33,473,696             | 33,519,362        |
| <b>TOTAL CANADIAN BONDS</b>  |                                    | <b>33,568,512</b>      | <b>33,612,008</b> |
| <b>U.S. BONDS - 32.51%</b>   |                                    |                        |                   |
| Apple Inc., Callable, 2.51%, 2024/08/19                                    | 1,000,000                          | 1,000,000              | 990,309           |
| AT&T Inc., Series 'Maple', Restricted, 3.83%, 2020/11/25                   | 2,000,000                          | 2,128,879              | 2,069,520         |
| Goldman Sachs Group Inc. (The), Variable Rate, Callable, 3.31%, 2025/10/31 | 1,000,000                          | 1,000,000              | 999,808           |
| Walt Disney Co. (The), 2.76%, 2024/10/07                                   | 1,000,000                          | 1,000,000              | 1,000,495         |
| Wells Fargo & Co., Restricted, 2.98%, 2026/05/19                           | 1,000,000                          | 1,000,000              | 972,635           |
|  |                                    | 6,128,879              | 6,032,767         |
| <b>TOTAL FOREIGN BONDS</b>   |                                    | <b>6,128,879</b>       | <b>6,032,767</b>  |
| <b>TOTAL BONDS - 213.63%</b>   |                                    | <b>39,697,391</b>      | <b>39,644,775</b> |
| <b>CANADIAN EQUITIES - 7.94%</b>   |                                    |                        |                   |
| <b>Energy - 5.90%</b>  |                                    |                        |                   |
| AltaGas Ltd., Subscription Receipts  | 38,600                             | 1,146,302              | 1,095,082         |
| <b>Real Estate - 2.04%</b>   |                                    |                        |                   |
| Automotive Properties REIT   | 34,717                             | 382,810                | 378,762           |
| <b>TOTAL CANADIAN EQUITIES</b>   |                                    | <b>1,529,112</b>       | <b>1,473,844</b>  |
| <b>TOTAL INVESTMENTS HELD LONG</b>   |                                    | <b>41,226,503</b>      | <b>41,118,619</b> |

**Davis-Rea Enhanced Income Fund**  
**Schedule of Investment Portfolio (Cont'd)**  
**As at December 31, 2017**  
(Expressed in Canadian Dollars)

|   | Number of<br>Shares / Par<br>Value | Average<br>Cost*<br>\$ | Fair Value<br>\$    |
|---|------------------------------------|------------------------|---------------------|
| <b>INVESTMENT SOLD SHORT - (127.92%)</b>                                    |                                    |                        |                     |
| <b>CANADIAN BONDS - (127.92%)</b>   |                                    |                        |                     |
| <b>Government of Canada and Guaranteed Bonds - (127.92%)</b>                |                                    |                        |                     |
| Government of Canada, 1.25%, 2018/09/01                                     | (2,327,000)                        | (2,367,945)            | (2,325,408)         |
| Government of Canada, 1.75%, 2019/03/01                                     | (1,965,000)                        | (2,051,962)            | (1,969,553)         |
| Government of Canada, 3.50%, 2020/06/01                                     | (4,182,000)                        | (4,654,764)            | (4,356,927)         |
| Government of Canada, 0.75%, 2020/09/01                                     | (2,409,000)                        | (2,393,114)            | (2,348,100)         |
| Government of Canada, 3.25%, 2021/06/01                                     | (10,000)                           | (11,245)               | (10,483)            |
| Government of Canada, 2.75%, 2022/06/01                                     | (1,243,000)                        | (1,358,542)            | (1,291,344)         |
| Government of Canada, 1.00%, 2022/09/01                                     | (400,000)                          | (388,080)              | (384,668)           |
| Government of Canada, 1.50%, 2023/06/01                                     | (1,341,000)                        | (1,381,726)            | (1,313,954)         |
| Government of Canada, 2.50%, 2024/06/01                                     | (3,890,000)                        | (4,054,043)            | (4,019,977)         |
| Government of Canada, 2.25%, 2025/06/01                                     | (2,201,000)                        | (2,358,006)            | (2,239,986)         |
| Government of Canada, 1.50%, 2026/06/01                                     | (2,700,000)                        | (2,672,190)            | (2,591,104)         |
| Government of Canada, 1.00%, 2027/06/01                                     | (971,000)                          | (899,633)              | (884,913)           |
| <b>TOTAL CANADIAN BONDS</b>   |                                    | <b>(24,591,250)</b>    | <b>(23,736,417)</b> |
| <b>TOTAL INVESTMENTS SOLD SHORT</b>   |                                    | <b>(24,591,250)</b>    | <b>(23,736,417)</b> |
| <b>TOTAL COST AND FAIR VALUE OF INVESTMENTS - 93.65%</b>                    |                                    | <b>16,635,253</b>      | <b>17,382,202</b>   |
| <b>TRANSACTION COST INCLUDED IN AVERAGE COST</b>                            |                                    | <b>(941)</b>           | <b>-</b>            |
| <b>TOTAL INVESTMENTS - 93.65%</b>   |                                    | <b>16,634,312</b>      | <b>17,382,202</b>   |
| <b>OTHER ASSETS AND LIABILITIES - 6.35%</b>                                 |                                    |                        | <b>1,175,562</b>    |
| <b>NET ASSETS ATTRIBUTABLE TO HOLDERS OF REDEEMABLE UNITS -<br/>100.00%</b> |                                    |                        | <b>18,557,764</b>   |

\*Cost includes transaction costs

Percentage shown relates to investments at fair value to Net Assets Attributable to Holders of Redeemable Units (Net Assets) as at December 31, 2017.

# Davis-Rea Enhanced Income Fund

## Notes to Financial Statements

December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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### 1. ESTABLISHMENT OF TRUST

The Davis-Rea Enhanced Income Fund (the "Fund") is an open ended unincorporated unit trust that was established under the laws of the Province of Ontario by a declaration of trust dated May 31, 2015. CIBC Mellon Trust Company is the trustee (the "Trustee") and the custodian (the "Custodian") of the Fund. Davis-Rea Ltd. is the manager (the "Manager") of the Fund. The Fund offers Class A, B, F, N and O units. Class A and Class B units are intended for accredited investors or an investor investing at least \$500,000 in units of a class of the Fund. Class F units of the Fund are intended for investors who participate in a fee based program through their dealer. Class O units were designed exclusively for institutional investors and individual investors that have been approved by the Manager. Class N units can only be purchased by another Davis-Rea fund.

The financial statements of the Fund for the year ended December 31, 2017 were authorized for issue on March 23, 2018.

### 2. BASIS OF PRESENTATION

The financial statements have been prepared in compliance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB").

#### **Basis of Measurement**

These financial statements have been prepared on a historical cost basis, except for financial assets and financial liabilities at fair value through profit or loss which are presented at fair value.

#### **Functional and Presentation Currency**

These financial statements are presented in Canadian dollars, which is the Fund's functional currency.

### 3. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed by the Fund.

#### **Financial Instruments**

The Fund recognizes a financial asset or a financial liability when it becomes a party to the contractual provisions of the instrument. Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market-place (regular way trades) are recognized on the trade date, i.e., the date that the Fund commits to purchase or sell the asset.

The Fund classifies its financial assets and financial liabilities at initial recognition into the following categories, in accordance with IAS 39 Financial Instruments: Recognition and Measurement.

## **Davis-Rea Enhanced Income Fund**

### **Notes to Financial Statements**

**December 31, 2017 and 2016**

(Expressed in Canadian Dollars)

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### **3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

#### **Financial Assets and Liabilities at Fair Value to Profit or Loss ("FVTPL")**

The Fund classifies its investments as financial assets at FVTPL. These financial assets are designated upon initial recognition on the basis that they are in accordance with risk management and investment strategies of the Fund, as set out in the Fund's offering memorandum. The Fund makes short sales in which a borrowed security is sold in anticipation of a decline in the market value of that security, or it may use short sales for various arbitrage transactions. Short sales are classified as financial liabilities at fair value through profit or loss.

Subsequent to initial recognition, all financial assets and financial liabilities at FVTPL are measured at fair value. Gains and losses arising from changes in the fair value of the 'financial assets or financial liabilities a FVTPL category are presented in the Statement of Comprehensive Income within 'changes in unrealized appreciation (depreciation)' in the year in which they arise. Interest and dividends earned or paid on these instruments are recorded separately in interest income or expense and dividend income or expense.

#### **Loans and Receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Financial assets classified as loans and receivables are initially measured at fair value and subsequently measured at amortized cost. Transaction costs are included in the initial carrying amount of the asset. The Fund includes in this category accrued interest receivable, accrued dividends receivable, subscriptions receivable, and other assets.

#### **Other Financial Liabilities**

This category includes all financial liabilities, other than those classified at FVTPL. Financial liabilities classified as other financial liabilities are initially measured at fair value and are subsequently measured at amortized cost. Transaction costs are included in the initial carrying amount of the liability. The Fund includes in this category, accrued management fees, other accrued expenses, bank overdraft, accrued interest payable and redemptions payable.

#### **Impairment of Financial Assets**

Financial assets are de-recognized when the rights to receive cash flows from the investments have expired or the Fund has transferred substantially all risks and rewards of ownership. The Fund de-recognizes a financial liability when its contractual obligations are discharged or cancelled, or expire. On de-recognition of a financial asset, the difference between the carrying amount of the asset and the consideration received is recognized in the Statement of Comprehensive Income.

A financial asset not classified at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence of impairment. A financial asset or a group of financial assets is 'impaired' if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset(s) and that loss event(s) had an impact on the estimated future cash flows of that asset(s) that can be estimated reliably.

**3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

**Impairment of Financial Assets (Cont'd)**

Objective evidence that financial assets are impaired includes significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of the amount due on terms that the Fund would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or adverse changes in the payment status of the borrowers.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against receivables. If an event occurring after the impairment was recognized, causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss to a maximum of the carrying amount of the asset had the impairment not been recognized.

**Investment Transactions and Income Recognition**

The accrual method of recording income and expenses is followed by the Fund, with investment transactions accounted for on the trade date basis and dividend income recorded on the ex-dividend date. Gains and losses on the sale of investments are determined using an average cost basis. Distributions from income trusts are recognized on the ex-distribution date and are recorded as income, capital gains or return of capital, based on the best information available. Those treated as return of capital reduce the average costs of the underlying investment. Interest for distribution purposes, as disclosed in Statement of Comprehensive Income on debt securities at FVTPL is recognized on accrual basis and represents the coupon interest received. The Fund does not amortize premiums paid or discounts received on the purchase of fixed income securities except zero coupon bonds which are amortized on a straight line basis.

**Valuation of Investments**

Investments held that are traded in an active market through recognized public stock exchanges, over-the-counter markets, or through recognized investment dealers, are valued at their last traded market price where the last traded market price falls within the day's bid-ask spread. In circumstances where the last traded price is not within that day's bid-ask spread, the Manager determines the point within the bid-ask spread that is most representative of fair value based on specific facts and circumstances. The Fund's policy is to recognize transfers into and out of the fair value hierarchy levels as of the date of the event or change in circumstances giving rise to the transfer. Investments held, such as bonds, with no active market or available bid prices are valued at their closing sale prices.

For all other financial instruments not traded in an active market, the fair value is determined by using valuation techniques deemed to be appropriate in the circumstances. Valuation techniques include discounted cash flow analysis and option pricing models, which considers factors such as the market value of the underlying security, strike price, volatility and terms of the warrants or options.

**3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

**Valuation of Investments (Cont'd)**

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

The breakdown of the Fund into the three-level hierarchy is provided in Note 12.

**Distributions**

Each unitholder's share of income, net of the Fund's expenses and net capital gain, is distributed quarterly.

**Income Taxes**

The Fund qualifies as a unit trust under the Income Tax Act (Canada), and accordingly, is not subject to income tax on the portion of its income, including net realized capital gains, that is distributed to unitholders other than Alternative Minimum Tax. A unit trust may be subject to Alternative Minimum Tax in certain circumstances. All or substantially all of the income for income tax purposes of the Fund is distributed to unitholders in each taxation year.

**Foreign Currency Translation**

The Fund's subscriptions and redemptions are denominated in Canadian dollars.

Portfolio securities and other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the prevailing rate of exchange on each valuation date. Purchases and sales of investments, income and expenses are translated at the rate of exchange prevailing on the respective dates of such transactions. Foreign exchange gains and losses on the sale of investments are included in net realized gain (loss) on the Statement of Comprehensive Income.

**Commissions and Other Transaction Costs**

Commissions and other transaction costs are incremental costs that are directly attributable to the acquisition, issue, or disposal of an investment, which include fees and commissions paid to agents, advisors, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Commissions and transaction costs are expensed in the Statement of Comprehensive Income.

## **Davis-Rea Enhanced Income Fund**

### **Notes to Financial Statements**

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### **3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

#### **Valuation of Fund Units**

Net asset value per unit for each class is calculated at the end of the last business day of the month in which the Fund's Manager is open for business ("valuation day") by dividing the net asset value of each class by its outstanding units. The net asset value of each class is computed by calculating the value of the class' proportionate share of the Fund's assets less the class' proportionate share of the Fund's common liabilities and less class-specific liabilities. Expenses directly attributable to a class are charged to that class while common fund expenses are allocated to each class in a reasonable manner as determined by the Manager. Other income and realized and unrealized gains and losses are allocated to each class of a fund based on that class' prorate share of total net asset value of that fund. Amounts received on the issuance of units and amounts paid on the redemption of units are included on the Statement of Changes in Net Assets Attributable to Holders of Redeemable Units.

#### **Increase in Net Assets Attributable to Holders of Redeemable Units per Unit**

The increase in net assets attributable to holders of redeemable units per unit in the Statement of Comprehensive Income represents the increase in net assets attributable to holders of redeemable units for the period divided by the weighted average units outstanding during the period for each class.

#### **Other Assets and Liabilities**

Accrued interest receivable, accrued dividends receivable, subscriptions receivable and other assets are recorded at amortized cost. Similarly, redemptions payable, accrued management fees, accrued interest payable and other accrued expenses are recorded at amortized cost. These balances are short term in nature, therefore, amortized cost approximates fair value for these assets and liabilities.

#### **Cash**

Cash is comprised of deposits with financial institutions. For the purpose of the Statement of Cash Flows, cash is presented net of outstanding bank overdrafts.

#### **Redeemable Participating Shares/Units**

Redeemable units are redeemable at the unitholder's option and are classified as other financial liabilities and are recorded at the present value of the redeemable amount. Net asset value per unit of each series is calculated on the last day of the month (unless such day is not a business day, in which case the last business day prior to such day is used) (each a "valuation day") by dividing the net asset value of each series by the outstanding units of that series. The net asset value of each series is computed by calculating the fair value of the assets less liabilities of the series.

## **Davis-Rea Enhanced Income Fund**

### **Notes to Financial Statements**

**December 31, 2017 and 2016**

(Expressed in Canadian Dollars)

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#### **4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

The preparation of financial statements requires management to use judgement in applying its accounting policies and to make estimates and assumptions about the future. The following discusses the most significant accounting judgements and estimates that the Fund has made in preparing the financial statements:

##### **Fair Value Measurement and Securities not Quoted in an Active Market**

When the Fund holds financial instruments that are not quoted in active markets, the fair values of such instruments are determined using valuation techniques and may be determined using reputable pricing sources. Broker quotes as obtained from the pricing sources may be indicative and not executable. Where no market data is available, the Fund may value positions using its own models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. The models used to determine fair values are validated and periodically reviewed by the Manager, independent of the party that created them. The models used for private equity securities are based mainly on earnings multiples adjusted for a lack of marketability as appropriate.

Models use observable data, to the extent practicable. However, areas such as credit risk, volatilities and correlations require the Manager to make estimates. Changes in assumptions about these factors could affect the reported fair values of financial instruments. The Fund considers observable data to be market data that is readily available, regularly distributed and updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

##### **Classification and Measurement of Investments and Application of the Fair Value Option**

In classifying and measuring financial instruments held by the Fund, the Manager is required to make significant judgements on the classification of these investments as either held for trading or designated as FVTPL under IAS 39, Financial Instruments. Due to the fact the investments have not been acquired or incurred principally for the purpose of selling or repurchasing in the near term and there is no evidence of a recent actual pattern of short term profit taking, the investments are designated as FVTPL and are not considered to be held for trading. Designation is made by being part of a group of financial assets which are managed and have their performance evaluated on a fair value basis.

#### **5. REDEEMABLE UNITS**

The capital of the Fund is represented by Class A issued redeemable units with no par value. Unitholders are entitled to distributions, if any, and to payment of a proportionate share of the net assets based on the Fund's net asset value per unit upon redemption. The Fund has no restrictions or specific capital requirements on the subscription and redemption of units. Capital movements are disclosed in the Statements of Changes in Net Assets Attributable to Holders of Redeemable Units. In accordance with the investment strategies and risk management policies outlined in Note 11, the Fund endeavours to invest its subscriptions received in appropriate investments while maintaining sufficient liquidity to meet redemptions. There were no other class units outstanding as at December 31, 2017.

## Davis-Rea Enhanced Income Fund

### Notes to Financial Statements

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(Expressed in Canadian Dollars)

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#### 5. REDEEMABLE UNITS (Cont'd)

The following table summarizes the changes in the number of Class A units for the years ended December 31, 2017 and 2016:

|                            | 2017      | 2016      |
|----------------------------|-----------|-----------|
| Balance, beginning of year | 1,794,745 | 2,249,490 |
| Units issued               | 58,411    | 3,574     |
| Units redeemed             | (145,000) | (527,831) |
| Reinvestments              | 66,732    | 69,512    |
| Balance, end of year       | 1,774,888 | 1,794,745 |

#### 6. DISTRIBUTIONS PER UNIT

Distributions may be made by the Fund of all or any part of its net income and net realized gains or as a return of capital to unitholders of record as of the close of business on or before the last valuation date in the year or at such other dates as determined by the Fund Manager, according to each unitholder's proportionate share of the Funds less any tax required to be deducted. The Manager intends to automatically reinvest such distributions of the Fund in additional units of the same class of the Fund on behalf of each unitholder.

The Fund had the following distributions:

|                                 | 2017       | 2016       |
|---------------------------------|------------|------------|
| From net realized capital gains | \$ -       | \$ 32,296  |
| From net investment income      | \$ 695,340 | \$ 667,127 |

#### 7. INCOME TAXES

The Fund qualifies as a unit trust under the Income Tax Act (Canada) and thus is not subject to income tax on its net taxable capital gains and its net investment income for the year if it allocates net capital gains and net investment income to unitholders. It is the intention of the Fund Manager to allocate the taxable income and realized gains of the Fund annually to unitholders so as to eliminate any income taxes otherwise payable by the Fund. Occasionally, the Fund may distribute more than it earns. This excess distribution is a return of capital and reduces the cost base of the units at the unitholder level.

The Fund may be subject to alternative minimum tax in a year in which it has a net investment loss for tax purposes as well as net realized capital gain. This alternative minimum tax can be carried forward indefinitely to be applied against future taxes otherwise payable.

Capital losses incurred by the Fund cannot be allocated to unitholders but may be carried forward indefinitely to reduce future realized capital gains. As at December 31, 2017, the Fund had \$115,033 (2016 - \$Nil) capital loss carry forwards available.

## **Davis-Rea Enhanced Income Fund**

### **Notes to Financial Statements**

**December 31, 2017 and 2016**

(Expressed in Canadian Dollars)

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#### **8. MANAGEMENT FEES AND OTHER EXPENSES AND RELATED PARTY TRANSACTIONS**

In accordance with a management agreement, the Manager is responsible for providing investment management administrative services and facilities to the Fund, including general portfolio management, maintenance of accounting records and preparation of reports to unitholders.

The management fee for Class A, Class B and Class F is computed at 1.25%, 1.50% and 1.00% respectively, per annum of the net asset value of the Fund plus applicable taxes, is calculated daily, accrued monthly and payable quarterly to the Manager. Class O unitholders pay management fees directly to the Manager.

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Custodian fees are fixed and payable to the Custodian, and are computed at a per annum rate of 0.07% on the first \$10 million, 0.06% on the next \$40 million, and 0.05% on the remaining average net asset value of the Fund. In addition, transaction fees are payable to the Custodian.

#### **9. ECONOMIC DEPENDENCE**

As at December 31, 2017, 21.51% (2016 - 20.47%) of total net assets are held by one investor.

#### **10. SOFT DOLLAR COMMISSIONS**

The brokerage commissions paid on securities transactions may include "soft dollar" amounts, such as the value of research and other services provided by the broker. Although the Manager uses best efforts to determine the soft dollar portion of commissions paid on portfolio transactions of the Fund, the soft dollar portion, in some instances, is not ascertainable. The Fund paid soft dollar amounts during the year ended December 31, 2017 of \$272 (2016 - \$1,986).

#### **11. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES**

The Fund is exposed to a variety of financial risks: credit risk, liquidity risk, and market risk (including other price risk), in the normal course of business. The value of investments held within the Fund will fluctuate on a daily basis as a result of changes in interest rates, economic conditions, market, and company specific news. The level of risk depends on the Fund's investment objectives and the type of securities in which it invests.

The Fund's overall risk management program seeks to minimize the potentially adverse effect of risk on the Fund's financial performance in a manner consistent with the Fund's investment objectives. The risk management practices include monitoring compliance to investment guidelines. The Manager manages the potential effects of these financial risks on the Fund's performance by employing and overseeing professional and experienced portfolio advisors that regularly monitor the Fund's positions and market events, and diversify investment portfolios within the constraints of the investment guidelines.

## Davis-Rea Enhanced Income Fund

### Notes to Financial Statements

December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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#### 11. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (Cont'd)

##### Credit Risk

Credit risk is the risk that a security issuer or counterparty to a financial instrument will fail to honor its financial obligation or commitment that it has entered into with a Fund. The Fund minimizes credit risk by maintaining its primary bank account at a reputable financial institution.

All transactions in listed securities are settled for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation.

A Fund's source of credit risk is its investments in debt instruments. The fair value of debt instruments includes consideration of the credit-worthiness of the issuer, and accordingly represents the maximum credit risk exposure relating to debt instruments of the Fund.

As at December 31, 2017 and 2016, the Fund invested in debt instruments with the following credit ratings:

| <b>Debt securities by credit rating*</b> | <b>% of Net Assets</b> |               |
|--|------------------------|---------------|
|  | <b>2017</b>            | <b>2016</b>   |
| AAA                                      | (127.41)               | (86.45)       |
| AA                                       | 5.34                   | -             |
| A  | 33.66                  | 61.43         |
| BBB                                      | 123.72                 | 93.73         |
| Below BBB                                | 43.68                  | 52.33         |
| Unrated                                  | 6.73                   | -             |
|  | <b>85.72</b>           | <b>121.04</b> |

\*Extracted from the blended composite debt securities ratings from Bloomberg, which is a blend of a security's Moody's, S&P, Fitch, and DBRS ratings. The rating agencies are evenly weighted when calculating the composite. It is calculated by taking the average of the existing ratings, rounded down to the lower rating in case the composite is between two ratings. A composite is not to be generated if the debt security is rated by only one of the four rating agencies.

##### Liquidity Risk

Liquidity risk is the risk that a Fund may not be able to settle or meet its obligation on time or at a reasonable price. The Fund is exposed to monthly cash redemptions of redeemable units. The units of the Fund are issued and redeemed on demand at the then current Net Asset Value per unit at the option of the unitholder. Liquidity risk is managed by investing the majority of the Fund's assets in investments that can be readily disposed of. In addition, the Fund aims to retain sufficient cash and cash equivalent positions to maintain liquidity for the purpose of funding redemptions. The Fund's financial liabilities are all due within one year, and the Fund has sufficient cash on hand and/or available room in a cash facility to settle these in due course.

## Davis-Rea Enhanced Income Fund

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#### 11. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (Cont'd)

##### Interest Rate Risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments. The Fund holds securities with fixed interest rates that expose the Fund to fair value interest rate risk. The Fund's policy requires the Manager to manage this risk by calculating and monitoring the average effective duration of the portfolio of these securities. The Fund also holds a limited amount of cash subject to variable interest rates which exposes the Fund to cash flow interest rate risk.

The table below summarizes the Fund's exposure to interest rate risks by remaining term to maturity as at December 31, 2017 and 2016.

|                  | 2017                 | 2016                 |
|------------------|----------------------|----------------------|
| Less than 1 year | \$ 747,378           | \$ -                 |
| 1 - 3 years      | 1,428,379            | 4,293,855            |
| 3 - 5 years      | 3,168,786            | 5,655,597            |
| >5 years         | 10,563,815           | 11,983,390           |
|                  | <b>\$ 15,908,358</b> | <b>\$ 21,932,842</b> |

As at December 31, 2017, had the prevailing interest rates raised or lowered by 1%, with all other variables held constant, net assets would have decreased or increased, respectively, by approximately \$905,914 (2016 - \$1,522,832). In practice, actual results may differ from this sensitivity analysis and the difference could be material.

##### Market Risk

##### *Other Price Risk*

Other price risk is the risk that the market value or future cash flows of financial instruments will fluctuate due to changes in market conditions (other than those arising from interest rate risk or currency risk).

All investments represent a risk of loss of capital. The maximum risk resulting from financial instruments is determined by the market value of the financial instruments held by the Fund. Financial instruments held by the Fund are susceptible to market price risk arising from uncertainties about future prices of the instruments.

As at December 31, 2017, a 5% increase or decrease in equity prices would have increased or decreased the Fund's net assets by \$73,692 (2016 - \$21,209). In practice, the actual results may differ from this sensitivity analysis and the difference could be material.

**Davis-Rea Enhanced Income Fund**  
**Notes to Financial Statements**  
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**11. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (Cont'd)**

***Concentration Risk***

Concentration risk arises as a result of the concentration of exposures within the same category, whether it is geographical location, product type, industry sector or counterparty type.

| <b>Portfolio by Asset Type</b>                        | <b>Percentage of Net Assets (%)</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2017</b>                         | <b>2016</b> |
| Corporate Bonds                                       | <b>180.6</b>                        | 176.1       |
| Government of Canada Bonds                            | <b>0.5</b>                          | 20.8        |
| Foreign Bonds   | <b>32.5</b>                         | 11.6        |
| Canadian Equities                                     | <b>7.9</b>                          | 2.3         |
| Canadian Bonds Sold Short, Government of Canada Bonds | <b>(127.9)</b>                      | (87.4)      |
| Other Assets and Liabilities, Net                     | <b>6.4</b>                          | (23.4)      |
|   | <b>100.0</b>                        | 100.0       |

***Currency Risk***

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Currency risk arises from financial instruments (including cash and cash equivalents) that are denominated in a currency other than Canadian dollars, which represents the Fund's functional currency. Changes in the value of the Canadian dollar compared to foreign currencies will affect the value, in Canadian dollar terms, of any foreign securities held in the Fund. These fluctuations may reduce, or even eliminate, any return the Fund has earned on foreign securities. Currency exposure may increase the volatility of foreign investments relative to Canadian investments.

The table below indicates the currencies to which the Fund had significant exposure as at December 31, 2017:

|             | <b>Cash</b>   | <b>Investments</b>  | <b>Total</b>        |
|-------------|---------------|---------------------|---------------------|
| U.S. Dollar | <b>\$ 223</b> | <b>\$ 1,278,009</b> | <b>\$ 1,278,232</b> |

The table below indicates the currencies to which the Fund had significant exposure as at December 31, 2016:

|             | <b>Cash</b> | <b>Investments</b> | <b>Total</b> |
|-------------|-------------|--------------------|--------------|
| U.S. Dollar | <b>\$ -</b> | <b>\$ -</b>        | <b>\$ -</b>  |

As at December 31, 2017, had the Canadian dollar strengthened or weakened by 5% in relation to the U.S. dollar, with all other variables held constant, net assets would have decreased or increased, respectively, by approximately \$63,912 (2016 - \$Nil). In practice, the actual trading results may differ from this sensitivity analysis and the difference could be material.

## Davis-Rea Enhanced Income Fund

### Notes to Financial Statements

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#### 12. FAIR VALUE DISCLOSURES

Financial instruments recorded at fair value on the Statement of Financial Position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

The following fair value hierarchy table presents information about the Fund's assets measured at fair value on a recurring basis as at December 31, 2017:

|                          | Level 1      | Level 2       | Level 3 | Total         |
|--------------------------|--------------|---------------|---------|---------------|
| Canadian Equities        | \$ 1,473,844 | \$ -          | \$ -    | \$ 1,473,844  |
| Canadian Corporate Bonds | -            | 33,519,362    | -       | 33,519,362    |
| Canadian Federal Bonds   | -            | (23,643,771)  | -       | (23,643,771)  |
| Foreign Bonds            | -            | 6,032,767     | -       | 6,032,767     |
|                          | \$ 1,473,844 | \$ 15,908,358 | \$ -    | \$ 17,382,202 |

The following fair value hierarchy table presents information about the Fund's assets measured at fair value on a recurring basis as at December 31, 2016:

|                           | Level 1    | Level 2       | Level 3 | Total         |
|---------------------------|------------|---------------|---------|---------------|
| Canadian Equities         | \$ 424,177 | \$ -          | \$ -    | \$ 424,177    |
| Canadian Corporate Bonds  | -          | 31,907,222    | -       | 31,907,222    |
| Canadian Provincial Bonds | -          | 3,586,045     | -       | 3,586,045     |
| Canadian Federal Bonds    | -          | (15,663,869)  | -       | (15,663,869)  |
| Foreign Bonds             | -          | 2,103,444     | -       | 2,103,444     |
|                           | \$ 424,177 | \$ 21,932,842 | \$ -    | \$ 22,357,019 |

There have been no transfers between level 1, 2 or 3 investments in the years or period ended December 31, 2017 or 2016, respectively.

**Davis-Rea Enhanced Income Fund**  
**Notes to Financial Statements**  
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**13. FINANCIAL INSTRUMENTS BY CATEGORY**

The following tables present the carrying amounts of the Fund's financial instruments by category as at December 31, 2017:

| <b>Assets</b>                   | <b>Financial Assets at FVTPL Designated at Inception</b> | <b>Financial Assets at Amortized Cost</b> | <b>Total</b>         |
|---------------------------------|--|---|----------------------|
| Investments at fair value       | \$ 41,118,619  | \$ -                                      | \$ 41,118,619        |
| Receivable for investments sold | -  | 1,029,139                                 | 1,029,139            |
| Accrued interest receivable     | -  | 297,007                                   | 297,007              |
| Accrued dividends receivable    | -  | 9,370                                     | 9,370                |
| <b>Total</b>                    | <b>\$ 41,118,619</b>                                     | <b>\$ 1,335,516</b>                       | <b>\$ 42,454,135</b> |

| <b>Liabilities</b>       | <b>Financial Liabilities at FVTPL Designated at Inception</b> | <b>Financial Liabilities at Amortized Cost</b> | <b>Total</b>         |
|--------------------------|---|--|----------------------|
| Bank overdraft           | \$ -  | \$ 12,316                                      | \$ 12,316            |
| Investments sold short   | 23,736,417  | -  | 23,736,417           |
| Accrued liabilities      | -   | 86,570   | 86,570               |
| Accrued interest payable | -   | 61,068   | 61,068               |
| <b>Total</b>             | <b>\$ 23,736,417</b>  | <b>\$ 159,954</b>                              | <b>\$ 23,896,371</b> |

**Davis-Rea Enhanced Income Fund**  
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**13. FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)**

The following tables present the carrying amounts of the Fund's financial instruments by category as at December 31, 2016:

| <b>Assets</b>                | <b>Financial Assets at FVTPL Designated at Inception</b> | <b>Financial Assets at Amortized Cost</b> | <b>Total</b>         |
|------------------------------|--|---|----------------------|
| Investments at fair value    | \$ 38,204,872  | \$ -                                      | \$ 38,204,872        |
| Subscriptions receivable     | -  | 10,000                                    | 10,000               |
| Accrued interest receivable  | -  | 242,618                                   | 242,618              |
| Accrued dividends receivable | -  | 2,661                                     | 2,661                |
| Other assets                 | -  | 392                                       | 392                  |
| <b>Total</b>                 | <b>\$ 38,204,872</b>                                     | <b>\$ 255,671</b>                         | <b>\$ 38,460,543</b> |

| <b>Liabilities</b>       | <b>Financial Liabilities at FVTPL Designated at Inception</b> | <b>Financial Liabilities at Amortized Cost</b> | <b>Total</b>         |
|--------------------------|---|--|----------------------|
| Bank overdraft           | \$ -  | \$ 3,710,702                                   | \$ 3,710,702         |
| Investments sold short   | 15,847,853  | -  | 15,847,853           |
| Redemptions payable      | -   | 641,474  | 641,474              |
| Accrued liabilities      | -   | 84,237   | 84,237               |
| Accrued interest payable | -   | 56,833   | 56,833               |
| <b>Total</b>             | <b>\$ 15,847,853</b>  | <b>\$ 4,493,246</b>                            | <b>\$ 20,341,099</b> |

The following table presents the net gains on financial instruments at FVTPL by category for the years ended December 31, 2017 and 2016.

|   | <b>Net Gains</b>    |                     |
|---|---------------------|---------------------|
|   | <b>2017</b>         | <b>2016</b>         |
| Financial assets at FVTPL designated at inception | \$ 1,725,945        | \$ 2,734,651        |
| Financial assets at FVTPL designated at inception | 1,725,945           | 2,734,651           |
| Financial assets at FVTPL designated at inception | 482,508             | 507,018             |
| <b>Total</b>                                      | <b>\$ 2,208,453</b> | <b>\$ 3,241,669</b> |

## **Davis-Rea Enhanced Income Fund**

### **Notes to Financial Statements**

**December 31, 2017 and 2016**

(Expressed in Canadian Dollars)

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#### **14. CAPITAL MANAGEMENT**

The capital of the Fund is represented by issued redeemable units with no par value. The units of the Fund are entitled to distributions, if any, and any redemptions are based on the Fund's NAV per unit. The Fund has no restrictions or specific capital requirements on the subscriptions and redemptions of units. The relevant movements are shown on the Statements of Changes in Net Assets Attributable to Holders of Redeemable Units. The Fund endeavours to invest its subscriptions received in appropriate investments while maintaining sufficient liquidity to meet redemptions.

#### **15. NOTICE OF FILING EXEMPTION**

The Fund is considered a non-reporting issuer and as such is exempt from the filing requirements of Section 2.1 of National Instrument 81-106. Consequently, these financial statements have not been filed with the Ontario Securities Commissions.

#### **16. FUTURE ACCOUNTING CHANGES**

Standards issued but not yet effective up to the date of issuance of the Fund's financial statements are listed below. The Fund will adopt any applicable standards when they become effective.

##### **Financial Instruments - Classification and Measurement ("IFRS 9")**

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments, bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 introduces a logical, single classification and measurement approach for financial assets that reflects the business model in which they are managed and their cash flow characteristics. Built upon this is a forward-looking expected credit loss model, that will result in more timely recognition of loan losses and is a single model that is applicable to all financial instruments subject to impairment accounting. In addition, IFRS 9 also removes the volatility in profit or loss that was caused by changes in the credit risk of liabilities elected to be measured at fair value, such that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. IFRS 9 also includes an improved hedge accounting model to better link the economics of risk management with its accounting treatment. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. In addition, the own credit changes can be early applied in isolation without otherwise changing the accounting for financial instruments. The Fund is in the process of assessing the impact of IFRS 9.

#### **17. COMPARATIVE FIGURES**

Certain figures were reclassified to conform with the current year's presentation.

**Davis-Rea Enhanced Income Fund**  
**Notes to Financial Statements**  
**December 31, 2017 and 2016**  
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**18. STATEMENT OF PORTFOLIO TRANSACTION**

A statement of portfolio transactions for the year ended December 31, 2017 will be provided without charge by writing to:

Davis-Rea Ltd.  
Investment Counsel  
79 Wellington Street West  
Suite 3535, P.O. Box 239  
Toronto, Ontario M5K 1J3