
Top Funds Report

Monthly Commentary

Deja Vu all over again - 2012 expected to continue 2011's wild ride in equity markets

After posting strong gains in 2009 and 2010, equity markets went on a wild ride in 2011 as global uncertainty was driven to new heights. Equity markets paid a price for this uncertainty with the S&P/TSX Composite Index dropping nearly 9% on the year. Most other markets, with the exception of the U.S., which rose by 5%, experienced similar losses.

Given the volatility experienced, it is not surprising that gold and fixed income investments performed very well in 2011. Investors flocked to safe haven investments with the DEX Universe Bond Index jumping by nearly 10% for the year. Gold also benefitted from the safe haven appeal, rising more than 10% in U.S. dollar terms.

Looking ahead, we expect that 2012 will be much like 2011. With no workable solution in place to deal with Europe's debt crisis, and the U.S. looking at another debt ceiling debate, we expect that uncertainty and volatility will remain at high levels for the near to medium term. We expect that in North America, the economies will continue to show modest levels of growth, while Europe will be hit with a potentially nasty recession.

From a portfolio construction perspective, we are following a number of key themes. They are:

Caution – Given the expectation that volatility is expected to remain elevated for the near term, we are exercising caution in our fund selection and portfolio positioning for the year. We do not expect to be making any big sector bets, or taking positions in high risk stocks. Instead, our focus will be on conservatively managed, high quality, low volatility funds.

Focus on Quality – In uncertain times, we expect that investors will seek out quality

investments over higher risk investments. This puts the investment focus on well capitalized, dividend paying, fundamentally strong companies located in financially and politically stable countries. In the fixed income space, we expect to focus on high quality corporate and Canadian government bonds, used primarily as a way to help protect invested capital in volatile markets.

Active over Passive – While we understand and acknowledge the appeal of a passive investment process, we believe that in uncertain markets an active strategy implemented by a high quality investment manager will beat a passive strategy. However, not all active managers are created equally and a focus on quality should be paramount in the fund selection process.

Underweight Europe – Given the debt situation in Europe, it is our opinion that there is far too much volatility risk at the moment. As the situation comes closer to finding a viable solution, we may begin to add to our European holdings, but not until a clear solution has been devised.

Diversification – The best way to protect against volatile markets, while still providing the potential for some level of investment return is to have exposure to a wide range of asset classes located in a number of different geographic locations. The asset mix should be dependent on your investment objectives and risk tolerance.

While nobody can predict the future with accuracy, we believe that by building well diversified, high quality portfolios you can help mitigate the impact of the uncertainties in the markets.

Please send your comments to feedback@paterson-associates.ca.

Funds You Asked For

Readers ask about RBC Canadian Dividend, Fidelity Canadian Asset Allocation and more!

RBC Canadian Dividend Fund - With assets of just under \$13 billion, the RBC Canadian Dividend Fund is one of the largest funds in the country. Given the monumental task of managing this behemoth is the duo of Stuart Kedwell and Doug Raymond who took over the fund in April 2007.

The team uses a quantitative screening process that examines a number of factors, eliminating stocks that do not meet the criteria. Typically, they are looking for companies that have a history of providing consistent and reliable gains for shareholders. They like companies with high margins and above average returns on capital that are reasonably valued relative to their potential growth prospects.

Given the dividend mandate, it's not surprising to see the portfolio is filled with your usual suspects, namely the banks, pipelines, and utility companies. The top five holdings are the big five banks which make up more than one quarter of the portfolio. The top 10 names make up just under 42% of the portfolio. The fund pays a quarterly distribution, which has ranged between \$0.14 and \$0.15 per quarter in the past year. This works out to a yield of approximately 1.4% based on recent fund prices. The fund is very focused in Canada, and can invest no more than 25% of its assets in foreign securities.

Performance has lagged the S&P/TSX Composite Index in all time periods and the fund has landed mostly in the third quartile during the past four years. Volatility is lower than the broader market, and is in line with the Canadian Dividend and Income Equity category average.

The costs for this fund are reasonable with MER of 1.77%, which is well below the category median of 2.2%.

Based on all of the above factors, it is our opinion that there are better options available for investors interested in a Canadian dividend fund offering.

Fidelity Canadian Asset Allocation Fund - After the March and April departures of long-time managers Bob Swanson and Brandon Snow, the management team of the Fidelity Canadian Asset Allocation Fund underwent a significant restructuring. Geoffrey Stein and Derek Young stepped into the lead managerial role and took the responsibility of leading Fidelity's fixed income and equity teams.

In the simplest terms, this fund is essentially a fund of funds, where the lead managers will set the asset allocation by adjusting the mix of a number of sub portfolios. The managers use a tactical approach to asset allocation and invest in a mix of Canadian equity, fixed income and money market securities. They also invest tactically in foreign securities to take advantage of market opportunities as they arise. The neutral asset mix of the fund is 65% in equities, 30% bonds, with the balance in cash. Based on market conditions, the managers will adjust the asset allocation to provide the mix which they feel will generate the best risk-adjusted return for investors. Typically, the asset mix changes are done on a gradual basis, rather than suddenly.

It is much too early to make any type of definitive judgment on the performance of the new management team. Since taking over, performance has been in the middle of the pack, finishing second or third quartile. For the six-month period ended November 30, the fund lost 4.9% while the index dropped 6.4%. The longer-term numbers are considerably more encouraging with performance being in the top two quartiles dating back to 2002. However, whether the new management team is able to repeat this level performance remains to be seen. The volatility of the fund is higher than both the benchmark and the category average.

Costs for the fund are reasonable ranging between 2.25% for the front end version to 2.46% for the DSC version.

Given the recent change in management, we would be reluctant to recommend this fund at this point in time. It is our opinion that there are better options available in the Canadian balanced category for most investors.

CIBC Monthly Income Fund - Like the name suggests, this Canadian balanced fund pays investors a monthly income of \$0.06 per unit per month. Based on the December 31 price of \$12.78 per unit, this works out to an annual distribution yield of approximately 5.6%. While this yield certainly looks attractive, one has to wonder how sustainable it is going forward, given the low interest rate environment and the dividend yield on stocks within the portfolio.

David Graham took over the lead manager role in December 2007 after the departure of long time manager Stephen Gerring. Mr. Graham uses a top down, macro economic analysis to set the broader asset mix of the fund, and then employs a bottom up security selection process. In selecting stocks for the portfolio, Mr. Graham tends to favour attractively valued large cap names. For the fixed income portion of the fund, the CIBC fixed income team makes the calls.

Performance since Mr. Graham took over has been middle of the pack, finishing second or third quartile in most time frames with the exception of 2010, when the fund finished in the first quartile. 2009 was not a good year as the manager was heavily weighted in fixed income, missing out on a good portion of the equity rally that began in March of that year. The fund is conservatively managed, boasting a level of volatility that is below both the index and category average.

Currently, the fund is just over 60% in equity, 20% in corporate bonds and 9% in Canadian government bonds. The equity exposure, much like the Canadian market, is heavily concentrated in financial services, energy and materials. Combined, those three sectors make up more than three quarters of the equity sleeve of the fund. Given this mix, we would expect that volatility may trend a bit higher going forward.

Costs for the fund are reasonable, with an MER of 1.48%, well below the category average, and in line with other monthly income funds offered by the other banks.

Dynamic American Value Fund - Manager David Fingold takes a fundamentally driven, bottom up value focused approach to securities selection, buying stocks trading at a significant discount to their intrinsic value and selling when they become fully priced. The portfolio is quite concentrated, typically holding about 30 names, and he places large bets on stocks he likes. The top 10 holdings make up more than 42% of the total portfolio.

The manager has a flexible cap structure, meaning that he can invest in any size company – small caps, mid caps, or large caps – wherever the best opportunities for the fund lies. The fund is still small enough at \$595 million where the manager can still take a meaningful position in a small or mid cap stock. However, for all practical purposes, the focus of the fund will be in the large cap names. Currency is tactically managed to help protect against the impact of a rising Canadian dollar.

Long term performance numbers have been very strong, outpacing the S&P 500 by 2.7 percentage points per year for the past five year period. As of November 30, the fund had posted an annual compound return of 0.2% while the index was down an average of 2.43% per year in the same time period. Short term, the performance hasn't been as strong, posting a 2.3% loss versus a gain of 3.4% for the index.

The manager does a stellar job in managing volatility, delivering a level of volatility that is significantly below the category average and roughly in line with the benchmark.

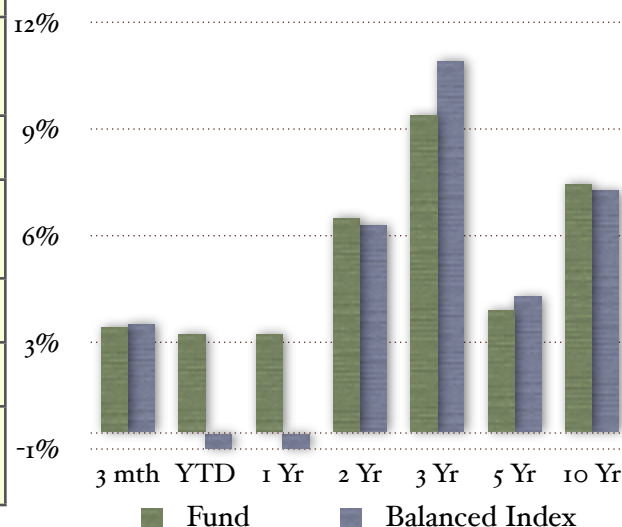
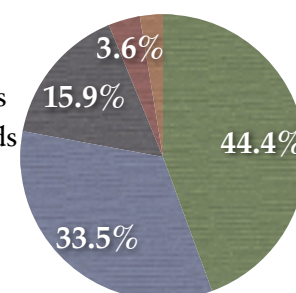
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RBC Monthly Income Fund

Fund Company	RBC Global Asset Management
Fund Type	Canadian Neutral Balanced
Rating	\$\$\$\$
Style	Conservative
Risk Level	Low to Medium
Load Status	No Load
RRSP/RRIF Suitability	Not Available
TFSA Suitability	Not Available
Manager	Jennifer McClelland since 2007 Suzanne Gaynor since 2007
MER	1.18%
Fund Code	RBF 448
Minimum Investment	\$500

Asset Mix

- Cdn Equity
- Cdn Gov Bonds
- Cdn Corp Bonds
- Cash
- Other



ANALYSIS:

At just under \$8 billion in assets, the RBC Monthly Income Fund ranks as one of the largest funds in the country. Despite its hulking size, the fund continues to reward investors with steady, stable performance. Volatility has been below both the fund's benchmark and the broader category average. Even during the credit crisis of 2007 - 2009, the fund dropped by 19%, while the benchmark fell by more than 28%.

This is a conservatively managed Canadian balanced fund that has a target asset mix of 55% fixed income, 40% Canadian equity and 5% cash. The asset mix decisions are made by the RBC Investment Policy Committee, while the individual security selection calls are made by the lead managers: Jennifer McClelland who focuses on Canadian equities, and Suzanne Gaynor who manages the fund's bond sleeve.

As of November 30, the fund held 50% fixed income and 46% in equities. Given the higher exposure to equities, investors may face slightly elevated levels of

volatility. Within the equity component, the focus is on high quality, dividend paying large caps and REITs. Not surprisingly, the equity sleeve is heavily weighted towards financials, which currently make up 41% of the stocks. Given the conservative nature of this fund, combined with its size, we don't envision the managers making any dramatic shifts to the asset mix. Most changes will likely occur at a very deliberate pace.

The fund pays a monthly distribution of \$0.0475. At current prices, this works out to be a distribution yield of approximately 4.5%. Given the current level of bond yields and the dividend yield of the fund, it is a possibility that there may be some capital erosion if the managers are unable to deliver any capital gains on the investment portfolio.

The Fund is our top pick for investors with a medium risk tolerance who are seeking a mix of capital growth and a modest income distribution from their investment.

The Fund is not available in registered plans such as RRSPs, RRIFs, or TFSAs.

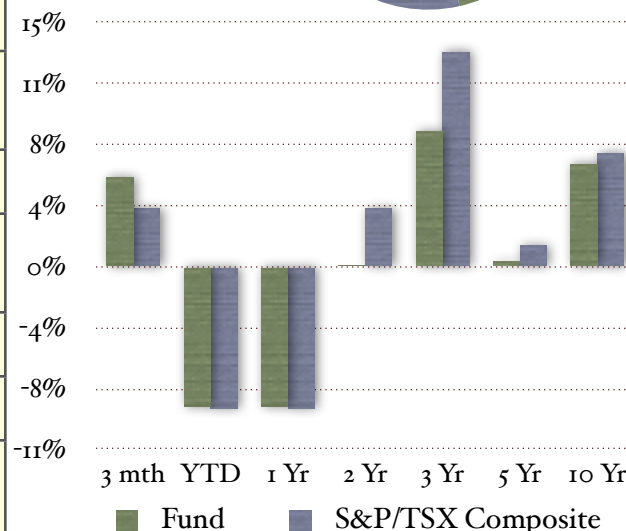
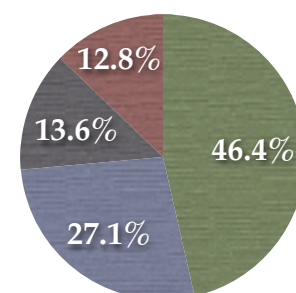
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CI Harbour Fund

Fund Company	CI Investments
Fund Type	Canadian Focused Equity
Rating	\$\$\$\$
Style	Value
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Gerald Coleman since 1997 Stephen Jenkins since 1997
MER	2.43%
Fund Code	CIG 690 - Front End Units
Minimum Investment	\$500

Asset Mix

- Cdn Equity
- U.S. Equity
- Cash
- Int'l Equity



ANALYSIS:

Despite struggling in 2010, the CI Harbour Fund, managed since its launch by Gerry Coleman and Stephen Jenkins, is back. In 2010, the fund lagged the S&P/TSX Composite by a significant margin, as the higher beta, more cyclically driven names drove the index higher. Given the managers' somewhat more conservative, value focused approach, this underperformance, while disappointing to investors, was not unexpected.

The fund is managed with a value tilt and the manager focuses on quality companies that have strong balance sheets, strong management teams, and leadership within their respective industries. The manager is patient with portfolio turnover that is very low.

While the fund has the ability to invest in mid cap stocks, don't expect to see many because of its large asset base. The fund holds 40 names with the top 10 holdings making up 40% of the fund.

The fund currently holds 50% in Canadian equities, 25% in U.S. equities and 12% in international equities.

The portfolio is heavily weighted towards energy, financials and materials. Combined, those three sectors make up 53% of the portfolio.

For the year, the fund delivered second quartile performance for investors. The longer term numbers are more impressive, with strong relative returns in all time periods, with the exception of 2003. Given the manager's focus on quality and conservative nature, this fund will likely lag in sharply rising markets.

There is some key person risk with this fund given that Gerry Coleman has been largely responsible for the performance of the fund. It should be pointed out that Stephen Jenkins has worked with Mr. Coleman on this fund since its inception. However, when Mr. Coleman does step down, we will review the new management team and how it intends to continue to manage the fund.

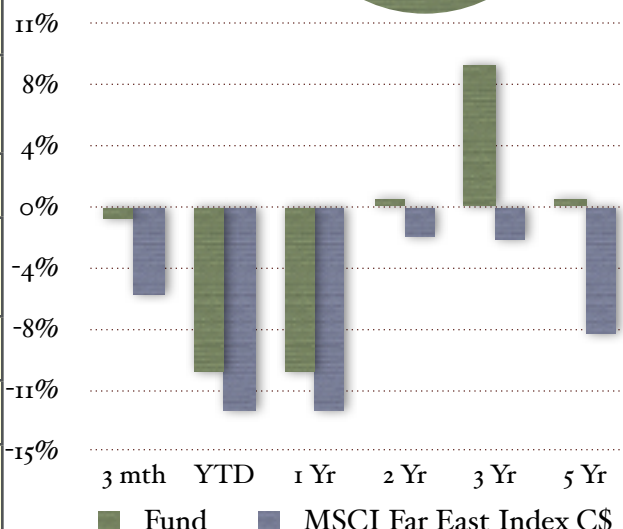
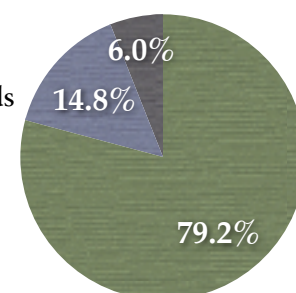
In the near to medium term, given our expectations that market volatility will remain high, the CI Harbour Fund will likely continue to be a solid choice for long term, patient investors.

BMO Gdn Asian Growth & Income Fund

Asset Mix

Fund Company	BMO Guardian Funds
Fund Type	Asia Pacific Equity
Rating	\$\$\$\$
Style	GARP
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Robert Horricks since 2009 Jesper Madsen since 2011
MER	2.86%
Fund Code	GGF 620 - Front End Units
Minimum Investment	\$500

- Int'l Equity
- For. Corp Bonds
- Cash



ANALYSIS:

Clearly one of the hottest investing stories in the past decade has been the emergence of Asia, and particularly China as a global economic powerhouse. While the story has its appeal, the investing climate can be a very daunting and intimidating place, fraught with risk, volatility and uncertainty.

But for those wanting exposure to the region while still looking to keep a lid on volatility, the BMO Guardian Asian Growth and Income Fund is a great way to do just that. The fund, while technically classified as an Asia Pacific Equity Fund is actually more of a balanced fund. As of November 30, the fund held 83% stocks, 14% bonds and 3% in cash.

In building the portfolio, the managers utilize a fundamentally driven, bottom up GARP investment process that considers both the current fundamentals and the long term growth prospects for the company. The managers focus the portfolio on dividend paying shares and U.S. dollar denominated convertible bonds. The focus on dividends is a key element to the manager's approach in managing overall portfolio volatility.

Performance for the fund has been strong, outpacing both the index and the fund's peer group by a significant margin. But even more impressive is that this has been accomplished with a level of volatility that is significantly lower than the peer group.

We were concerned in March when long time manager Andrew Foster left the firm. However, since his departure, the fund has not missed a beat. Performance continues to tick along and we have not noticed any meaningful increase in portfolio volatility.

The cost of the fund is a touch on the high side, with an MER of 2.86%. The fund pays a quarterly distribution which varies from one quarter to another. From an income yield point of view, this distribution is somewhat negligible, coming in at approximately 0.5%.

This is definitely not to be considered a core fund. Instead, it should be regarded as a fund which can add some incremental return to the portfolio, but also can help to reduce overall portfolio volatility.

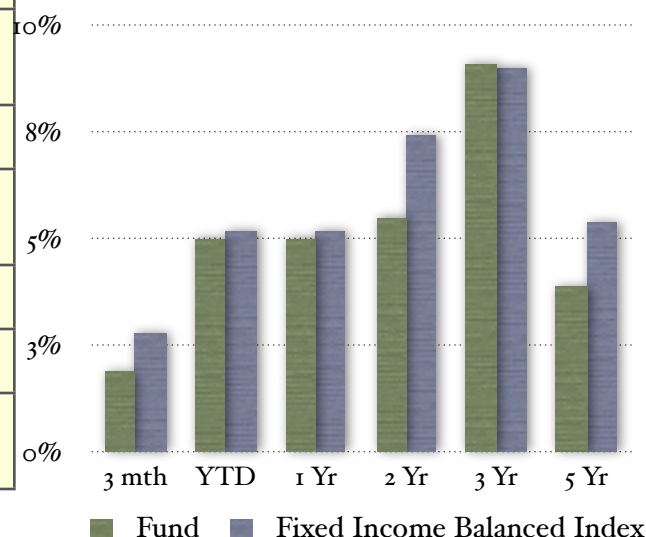
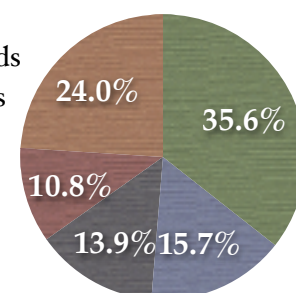
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TD Income Advantage Portfolio

Fund Company	TD Asset Management
Fund Type	Canadian Fixed Income Balanced
Rating	\$\$\$
Style	Fund of Fund
Risk Level	Low - Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	TD Asset Management Fixed Income Management Team
MER	1.66%
Fund Code	TDB 963 - No Load Units
Minimum Investment	\$2,000

Asset Mix

- Cdn Corp. Bonds
- Cdn Gov. Bonds
- Cdn Equity
- Mortgages
- Other



ANALYSIS:

The TD Income Advantage Fund is a balanced fund that invests in income focused mutual funds offered by TD. It provides exposure to a wide range of income producing funds including the **TD Canadian Bond Fund, TD Dividend Income Fund, TD Short Term Bond Fund, TD Mortgage Fund** and **TD High Yield Bond Fund**.

The fund emphasizes income and provides some potential for capital growth. In managing the fund, the manager uses a strategic asset allocation process with an asset mix that will be at least 80% invested in fixed income investments, and no more than 20% invested in equity investments. The managers will shift the asset mix of the fund when they feel it prudent, based on their market expectations.

Costs are reasonable with an MER of 1.66%, which is in the lower half of the category. The fund pays out a monthly distribution, which is currently set at \$0.0214 per unit. Based on recent prices, this translates into an annual distribution yield of approximately 2.3%. If you are looking at this fund as a source of regular cash flow, there are better options available.

Currently, the fund is 77% bonds, 14% equities and 7% in cash. Performance has been respectable, but an investor would have done better in an all fixed income portfolio. Over the past couple of years, the equity component has pushed up the overall volatility while not adding significantly to the return. Further, it was the equity and high yield exposure of the fund which hurt performance in 2008.

Looking ahead, taking into account the outlook for interest rates, we would expect that this fund will likely outperform the TD Canadian Bond Fund over the medium to long term, but with a higher level of volatility.