TOP FUNDS REPORT

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MONTHLY COMMENTARY

September was not a kind month to investors as concerns over the European sovereign debt crisis and a slowing global economy fuelled investor fears, causing a selloff in the global equity markets for the fifth month in a row. Adding to the unease is the level of uncertainty that markets are showing, swinging wildly from one day to the next and reacting quickly and swiftly to any hint of negative news. Further, equity markets appear to be moving almost in tandem.

All of this volatility appears to be wearing down investor sentiment. After showing positive monthly sales from January to August, the Canadian mutual fund industry was hit with net redemptions to the tune of $205 million for the month of September. It was equity funds which took the biggest hit, with net redemptions of $1.6 billion. Investors poured more than $1 billion into the safe haven of fixed income funds. Given the big market drops and the continuing uncertainty the fact that investors pulled some money off the table is not surprising.

Portfolio funds, which are also known as fund of funds showed strong sales momentum during September. While stand alone mutual funds saw net redemptions of more than $1 billion, fund of funds saw new inflows of nearly $840 million during the month. The popularity of these funds has never been greater. With markets as challenging as they are, investors and advisors alike are letting the portfolio managers make the asset allocation decisions for them.

Another surprising aspect of the recent industry statistics is the resilience of the Canadian ETF industry. The Canadian ETF Association announced that during the third quarter net creations (net new money being invested in ETFs) were $2.8 billion. During the same period, mutual funds saw net inflows of $566 million, a fraction of the money flowing into ETFs. Perhaps even more surprising was the fact that it was equity related ETFs which saw the bulk of the new inflows. Should this trend continue, mutual funds may be forced to make some changes to help maintain their asset base and attract new money.

But despite the doom and gloom of the third quarter, October was a very strong month for equity markets. The S&P/TSX Composite Index rose by 5.6%, while the S&P 500 jumped by more than 10% in U.S. dollar terms.

It is our expectation that high levels of volatility will remain for the near to medium term and that investors should be defensively positioned. The focus should be on high quality, high yielding investments both in fixed income and equities.

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

FUNDS YOU ASKED FOR

TD Canadian Bond Fund (TDB 162): A reader notes that the MER in the TD Canadian Bond Fund has risen steadily to 1.11% over the couple of years from 1.05%. We contacted TD Mutual Funds on this issue and were told that this increase is attributable solely to the implementation of the HST which became effective July 1, 2010. Prior to this date, funds were only required to pay the 5% GST on the management fees and operating expenses of the funds.

The HST has hit other funds including one of our long time favourites, the **PH&N Bond Fund (PHN 110)**, which has had its MER pushed to 0.61% from 0.59%. In fact, the increase has hit all mutual funds in Canada, with the higher MER funds showing a more visible hit.

At 1.11%, the TD Canadian Bond Fund is still below the category average, but is above many of the other bond funds which we recommend including the PH&N Canadian Bond Fund, the **PH&N Total Return Bond Fund (PHN 340)** and the **Beutel Goodman Income Class (BTG 771)**.

Even with the higher MER, we recommend the TD Canadian Bond Fund for investors looking for exposure to bonds in their portfolios. The fund is well managed and in our opinion well positioned for the current fixed income environment. The fund holds approximately 60% in corporate bonds, which should provide better protection when interest rates start to rise, and with their higher yield, should provide a better gains in a low interest rate environment.

The fund has a very high quality portfolio with nearly 85% of the fund invested in bonds that are rated “A” or higher. The yield on the bonds held in the fund is higher than the yield on the DEX Universe Bond Index, and has duration (weighted average term to maturity) that is lower. The lower duration indicates that the fund is defensively positioned relative to its benchmark.

However, if fees are a concern, then you may want to consider moving to one of the other bond funds we recommend.

Mackenzie Saxon Small Cap (MFC 4155): This is a Canadian small cap fund that is managed by Scott Carscallen and William Aldridge. Mr. Carscallen has been co-manager on this fund since 2005, and was named lead manager of the fund when Robert Tattersall gave up his investment management duties in 2009.

Performance of this fund has been disappointing of late. It has lagged not only the benchmark, but also its peer group, posting third and fourth quartile results as of September 30. The fund has also been very volatile, exhibiting a level of volatility that is significantly higher than the broader index

We have some concerns regarding this fund. First - the managers have taken on significantly more risk yet investors have not been rewarded for that additional risk. Secondly, we have some concerns regarding the turnover within Howson Tattersall, the firm that manages the fund. Robert Tattersall and Richard Howson, the founders of the firm and the team that was largely responsible for the fund's early successes, are no longer part of the investment management team. Also, Suzann Pennington left the firm in May.

Given the above, we would not recommend the Mackenzie Saxon Small Cap Fund at this point in time. In our opinion, there are better small cap options available to investors. One which is on our Recommended List is the **Beutel Goodman Small Cap Fund (BTG 799)**.

RBC Global Precious Metals (RBF 468): There is little doubt that there is a tremendous amount of investor interest in gold at the moment. With the continued uncertainty and high levels of volatility in the markets, it is no wonder that investors are seeking out the safe haven refuge of the yellow metal. These days, investors have a wide range of options to provide exposure to gold including traditional precious metals funds, which invest in gold mining and exploration companies, and bullion funds which provide exposure to the metal either through gold bullion or gold certificates.

It is important to point out that while precious metals funds are influenced by the price of gold, they do not always move in lock step with the price of the metal. The value of precious metals funds move more based on the profitability of the underlying gold miners held in the portfolio, which can be influenced by a number of factors such as mining costs, reserve levels, and of course the price of gold.

One of our favourite precious metals funds is the **RBC Global Precious Metals Fund** which is managed by Chris Beers and Brahm Spilfogel. The fund invests in companies that are involved in the exploration, mining and production of gold, silver and platinum. The fund may also invest in gold bullion and gold certificates up to a maximum of 20% of the fund.

The fund's performance over the long term has been strong on both an absolute and risk adjusted basis. It has lagged recently given the fund's focus on small and mid cap funds which have underperformed their large cap brethren. The fund has also underperformed gold bullion recently, as investors have preferred to hold the bullion rather than the companies. While this trend may continue in the short term, gold companies will soon show increasing profitability, which should drive gold company prices higher resulting in out performance relative the metal.

For investors who are looking to add some exposure to gold companies in their portfolio, the RBC Global Precious Metals would be one of our choices. Given the significant volatility risk associated with such an investment, investors should limit their exposure to a small amount of their portfolio.

NOVEMBER'S TOP FUNDS

Dynamic Power American Growth

Fund Company	Dynamic Mutual Funds
Fund Type	U.S. Equity
Rating	$$$$
Style	Growth – Large Cap
Risk Level	High
Load Status	Optional front or back load
RRSP/RRIF Suitability	Good
TFSA Suitability	Poor
Manager	Noah Blackstein - since inception (July 1998)
MER	3.61% (including performance fee)
Code	DYN 004 – Front End
Minimum Investment	$500

Analysis: Like most of the other funds launched under the Power banner, this is not a fund for the faint of heart. Manager Noah Blackstein uses a very concentrated, growth oriented approach in managing this fund. Because of this, the fund tends to be considerably more volatile than other global equity funds, with a level of volatility more than 1.5 times the S&P 500 Index.

The first step in the stock selection process is a quantitative screen which looks to identify companies which are showing strong earnings momentum and have a history of upside earnings surprises. Once these companies are identified, the manager conducts a detailed fundamental review focusing on cash flows, management, and the company's competitive environment.

The result is a very concentrated portfolio. Typically the manager will hold 20 to 30 names in the portfolio. As of July 31, the top 10 stocks in the fund accounted for more than 70% of the fund. There is also typically significant concentration with respect to sector exposure, with half the fund invested in technology stocks. The manager is also very active in managing the portfolio, with portfolio turnover averaging more than 300% in the past five years.

This is not a cheap fund to own. The management fee is 2.0%, but there is also a performance fee for this fund, which when included in the total costs, pushes the MER up to 3.61%. While the total costs may be high, the performance has been strong, significantly outperforming the S&P 500 over the past five and ten year periods.

Despite the strong returns generated by this fund, we would be reluctant to suggest it be used as a core U.S. equity fund. The volatility of the fund is far too high for most investors. Rather, we would suggest that this fund be used by investors with a strong appetite for risk who are looking for a little high octane in their portfolios. (October 26, 2011)

BMO Guardian Monthly High Income II

Fund Company	BMO Guardian Funds
Fund Type	Canadian Dividend & Equity Income
Rating	$$$
Style	Blend – Mid Cap
Risk Level	Medium
Load Status	Optional front or back load
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	John Priestman - since inception (October 2002) Kevin Hall - since inception (October 2002) Michelle Robitaille – since June 2003 Ted Macklin – since July 2008
MER	2.40%
Code	GGF 619
Minimum Investment	$500

Analysis: This Canadian Dividend and Equity Income fund used to be an Income Trust focused fund. Many income trusts were forced to convert back to corporations which resulted in the focus of this fund also shifting. The fund now invests predominantly in high yielding equities and real estate investment trusts (REITs).

The fund is managed by a team led by John Priestman, one of the most highly regarded managers in the former income trust space. Shortly after the announcement regarding the implementation of trust taxation, the management team welcomed large cap equity expert Ted Macklin into the fold in 2008. Since Ted's arrival, the fund has begun adding larger cap holdings into the funds such as TD Bank and TELUS. While there may be some more traditional dividend stocks in the fund, the managers have said that they don't intend to become just another dividend fund. They intend to deliver high income yields to investors by investing in a wide range of income producing equity securities including common stock and REITs.

The portfolio is fairly well diversified holding between 40 and 50 names with the top 10 holdings making up approximately 45% of the fund. Performance has been strong, outpacing the S&P/TSX Composite Index in addition to posting first quartile performance. The fund pays a monthly distribution of $0.06 per unit per month, which works out to be a yield of approximately 5.5% at current prices. Given yield on the underlying investments in the portfolio, combined with the longer term return profile of the fund, it is likely that this level of distribution appears to be sustainable for the near to medium term. The volatility of the fund is reasonable, and roughly in line with the broader market.

The fund is a bit expensive relative to other Canadian Dividend & Equity Income Funds. The MER of the fund is 2.35%, while the median MER of other funds in the category is 2.19%. (October 31, 2011)

Beutel Goodman Small Cap Fund

Fund Company	Beutel Goodman & Company Ltd.
Fund Type	Canadian Small / Mid Cap Equity
Rating	$$$$
Style	Value
Risk Level	Medium
Load Status	Front End
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Stephen Arpin - since January 1995 William Otton - since January 2007
MER	1.49%
Code	BTG 799
Minimum Investment	$5,000

Analysis: This has long been one of our favourite small cap funds available to investors today. The fund has consistency of management, having been managed by Stephen Arpin since 1995. Today, with the addition of William Otton, there is a solid management team in place.

In managing the fund, the managers follow a fundamentally driven, bottom up, value focused process. The team looks for undervalued companies, with quality management teams in place. The portfolio will hold between 30 to 60 individual securities with the top 10 names making up nearly 60% of the fund.

As the assets in the fund have risen, so too has the average market capitalization that the managers hold in the fund. Previously, the focus was on small cap stocks, however in recent years, the focus has shifted more towards the mid cap segment.

Performance has been strong, outpacing both the BMO Nesbitt Burns Small Cap Index and its peer group over the past ten year period. Volatility is high, with a level of volatility that is slightly above the broader market. Given the focus on small and mid cap stocks, this is not surprising.

Costs are very reasonable for this fund, with an MER of 1.49%, much lower than the 2.69% median for the category.

In our opinion, this fund is a great choice for investors seeking exposure to small and mid cap companies in their portfolio. However, with the high levels of volatility and uncertainty in the markets, investors will focus on high quality, dividend paying stocks, which may result in this fund struggling in the near to medium term. (November 1, 2011)

Trimark Fund

Fund Company	Invesco Canada
Fund Type	Global Equity
Rating	$$$
Style	Value
Risk Level	Medium
Load Status	Optional front or back load
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Dana Love – since May 2004 Jeff Feng – since April 2011 Michael Hatcher – since April 2011 Darren McKiernan – since April 2008
MER	1.66% (SC units)
Code	AIM 1513
Minimum Investment	$500

Analysis: To say that Trimark has gone through some tough times in the past few years is like saying there are some concerns about Greece's outstanding debt. The company has struggled with retaining managers and has been experiencing significant net outflows for years. The Trimark Fund is not that different, having been through a number of managers in the past few years. Current lead manager, Dana Love has been working on the fund since 2004. In August of this year, after the departure of Heather Pierce, the team of Jeff Feng, Michael Hatcher and Darren McKiernan joined Mr. Love on the fund.

Despite the turnover, the one thing that has remained constant with this fund is the stock picking discipline, which in simple terms is "business people buying businesses". They use a value focused, bottom up approach and look for a concentrated portfolio of high quality businesses. Obviously, the downside of this approach is that there will be periods of time where the market does not reward quality and the fund will underperform.

However, there will also be periods of time when the market will focus on quality. Given the high levels of uncertainty combined with the significant level of volatility, the Trimark Fund is well positioned to benefit. The managers have built a portfolio of high quality companies that they feel are very attractively valued. In fact, Dana Love has stated that this is the highest quality portfolio he's ever seen during his time with the fund.

And the markets are starting to recognize this quality. The fund has been delivering first or second quartile performance as of late, and has outpaced the MSCI World Index over the past 10 years. Given the current environment, we expect that the Trimark Fund will continue to deliver better than peer group performance for the near to medium term. (November 3, 2011)