Top Funds Report

Monthly Commentary

Global equity markets drop. Fall in Canadian dollar helps Canadian investors

Whoever said that April was the cruelest month likely didn't have any money invested in the global equity markets in May. Markets were hit particularly hard, with the MSCI EAFE Index dropping by more than 7% during the month. The S&P 500 lost 6% in U.S. dollar terms, while closer to home, the S&P/TSX Composite Index dropped by 6.1%.

Europe was again hit very hard as the MSCI Europe Index lost 12.1% as concerns over the debt crisis continue to mount. Investors focused their attention on Spanish banks which are in serious trouble after the country's property bubble burst in 2008. Many are on the verge of failure and without a bailout plan will go under, dragging the country with them. In Greece, a coalition government could not be formed, forcing the country back to the polls.

For Canadian investors, the drop in the Canadian dollar helped to mute overall losses. The dollar fell from $1.0117 to $0.9663, which had a noticeable affect returns. For example, the S&P 500 dropped by 6.0% in U.S. dollar terms, but once the impact of the falling dollar was taken into account it was a more modest 1.6% decline. The main reason for the dollar's drop was the selloff in commodities. With Europe in recession, China slowing down and lingering worries over the health of the U.S. economy, investors unloaded commodities as Brent crude was off by 14% and gold dropped by 6%.

The commodity selloff was also a big contributor to the drop in the Canadian equity markets. The S&P/TSX Diversified Mining Index was down nearly 17% and the energy index was off by nearly 11%. Real estate and REITs were the only bright spot, both posting a modest gain of 0.2% in the month.

Understandably, bonds, the traditional safe haven in times of uncertainty, were higher in the month. The DEX Universe Bond Index rose by more than 2.1%, with government bonds outperforming corporate bonds. Real return bonds were very strong, gaining more than 4.6% in the month.

Looking ahead, we expect more of the same. With Europe in the mess that it is, a solution, or rather a series of solutions has to be implemented before there can be any real improvement. Until that is fixed, investors will continue to focus more on the headline risks in the economy, rather than focusing on the strong corporate fundamentals.

From a portfolio positioning standpoint, our view hasn't changed from previous months. We are still suggesting that investor focus on Canadian and U.S. equities as we believe that there is still too much risk in Europe. We are also suggesting that investors focus on high quality companies that are generating attractive shareholder yields, which includes such things as strong free cash flows and attractive dividends.

For fixed income, interest rates will eventually be moving higher, but it appears that recent events have pushed that out a quarter or two from earlier estimates. We would expect that the Bank of Canada may move rates higher by 25 basis points by year end, but that likely won't happen until late into the fourth quarter, if not first quarter of next year. Within the fixed income portion of portfolios, again, our emphasis is on quality. We suggest that investors focus on high quality corporate bonds which will provide better downside protection when rates do move higher, but may also provide the potential for some better capital growth opportunities when compared to Government bonds.

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

Funds You Asked For

This month, we take a look at Mackenzie Universal Global Health Sciences, Dynamic Global Real Estate, Sentry Canadian Income and more!

Mackenzie Universal Global Health Sciences Fund - Ian Ainsworth took over the lead manager duties of the fund, after long serving manager Wendy Chua resigned from Mackenzie in January of this year. Mr. Ainsworth, an industry veteran, has more than 30 years of investment industry experience under his belt. He has been co-manager on this fund since 2005. Along with this fund, he is the Co-Lead of Mackenzie's Growth Team and manages other Mackenzie funds including the **Mackenzie Growth Fund** and the **Mackenzie Founders Fund**. He will be supported on this fund by the Mackenzie Growth Team

Mr. Ainsworth will use a fundamentally driven, bottom up, growth focused approach looking for companies that operate in the pharmaceutical, biotech, healthcare services, medical information and devices sectors. The portfolio is concentrated, holding between 25 and 35 names. The top 10 currently make up more than 60% of the fund. The portfolio turnover is modest, averaging 66% in the past five years.

Despite having a go anywhere mandate and the ability to invest in companies of any size, the fund tends to be heavily weighted in U.S. mid cap stocks, which explains why this is one of the most volatile funds in the category. It also explains why many of the stocks held are not exactly household names, with Shire PLC, Catalyst Health Solutions and Onyx Pharmaceuticals being the top three holdings as of March 31.

The long term story for healthcare is a very compelling one, as an aging population, increased healthcare spending and new breakthrough drugs and medical products are creating exciting investment opportunities. But it is not without risks. There is an overhang of uncertainty in the sector, as we await the ruling by the U.S. Supreme Court on the constitutionality of "Obamacare". There are also worries that austerity measure, both in the U.S. and around the globe will curtail healthcare spending.

Healthcare tends to be a reasonably good defensive sector in periods of market volatility. Our biggest concerns with this fund are the recent change in the management team, the fund's emphasis on small and mid cap names, and the higher than average volatility. Instead, we prefer the **CI Global Health Sciences Fund** or the **TD Health Sciences Fund** to this offering.

Dynamic Global Real Estate Fund - This fund, which until December 2009 was known as the Dynamic Focus+ Real Estate Fund, is one of our favourite picks in the real estate category. Managed by the team of Oscar Belaiche and Tom Dicker, it invests in REITs and other companies that are actively involved in the real estate sector. They look for "best in class" businesses that have strong balance sheets, are industry leaders, and have management teams that hold a significant ownership stake in the business. The investment philosophy tilts towards value using their "Quality at a Reasonable Price" process.

The portfolio has a go anywhere mandate, but is heavily invested in North America at the moment. As of April 30, the fund's Canadian holdings were just under 63%, while the U.S. was 25%. It invests quite heavily in REITs, which made up 62% of the fund, while Canadian equities made up 21%. The portfolio is concentrated, holding approximately 60 names with the top 10 making up about half the fund. The manager has been very active in implementing their strategy of late, with portfolio turnover averaging well above 100% per year. The fund, with its 2.46% MER is one of the lowest in the category.

It has performed well, both on an absolute and relative basis. For the ten year period ending April 30, the fund has gained 8.45% per year, which has outpaced the Dow Jones Global Select Real Estate Index's 5.68% gain quite handily. The absolute numbers aren't as impressive for the past five year, gaining a mere 0.18%, which was much better than the loss of 5.4% that was posted by the benchmark.

Looking ahead, the managers have stated that they are fairly bullish on the Canadian real estate sector for the next year or so. They believe that the low interest rate environment, combined with investors' insatiable appetite for yield will help boost the sector. However, given real estate's reliance on financing, any fallout from Europe's debt crisis or a slowdown in China that slows credit availability in Canada has the potential to hurt this fund.

Its volatility profile is one of the lowest in the category, making it a good choice for investors who are looking for real estate exposure in their portfolio. Given the narrowness of the fund's mandate, we would suggest that investors keep their exposure modest, with 10% being our recommended maximum for high risk investors. More conservative investors should adjust this exposure down.

TD U.S. Blue Chip Equity Fund - As the name would suggest, the TD U.S. Blue Chip Equity Fund looks to provide long term growth by investing in medium and large sized "blue chip" companies that are located in the U.S. Managed by Larry Puglia of T. Rowe Price, the fund invests in stocks that have a market capitalization of at least $5 billion. Unlike other "blue chip" funds which tend to be somewhat value focused, this one is managed using a more growth oriented approach.

In building the portfolio, the T. Rowe Price team conducts a number of quantitative screens that look for companies that have exhibited high levels of revenue growth, are consistently growing earnings, and are generating strong levels of free cash flow. They then put the remaining companies through a qualitative review that considers such things as quality of management, brand recognition, and the soundness of the company's business plan. The final step is to conduct a valuation analysis, ensuring that the stock is not overvalued compared with its growth prospects.

The end portfolio is deceptively concentrated, holding around 140 names with the top 10 making up more than 35% of the fund. It is also very concentrated in technology and consumer cyclical names, which combined represent nearly 60% of the fund. Top holdings include such well known brands as Apple, Google and Amazon.com. Typically, they do not hedge any of the currency exposure. Mr. Puglia is fairly patient in managing the fund, with a portfolio turnover rate that has averaged just over 46% per year since 2006.

Performance, particularly for a growth oriented fund has been strong, gaining 12.5% in the past three years, finishing in the first quartile and narrowly under performing the S&P 500 Index's 12.9% gain. Given its growth nature, it is more volatile than both the index and the peer group. It also is likely to be hit harder in market downturns. In 2008, it dropped nearly 30% compared with the index's decline of 23%, and in 2002, it dropped 26%, compared with the 23% fall in the index. But it also has the potential to bounce back nicely, gaining 18.6% in 2009, doubling the return of the index.

For investors who are looking for a growth oriented U.S. equity fund, this is one to consider. It is best suited for those with a medium to high risk tolerance and a long term time horizon. We are increasing its rating to $$$. The level of volatility and the higher than average MER of 2.55% prevent us from giving it a $$$$ rating.

Sentry Canadian Income Fund - For investors who are looking for a regular distribution and the potential for some capital gains, it doesn't get a whole lot better than this fund. Each month, investors are paid a distribution of $0.0775 per unit, which as of May 31 works out to an annualized yield of 5.8%. In addition to the decent distribution yield, the fund has the potential for strong levels of capital growth. In 2011, it gained 6.1% while the S&P/TSX Composite Index lost 8.7%. It has finished in the first quartile in every year, except for 2006, where its 4.4% gain landed it in the bottom quartile.

Michael Simpson and Aubrey Hearn have been increasing the U.S. exposure of late. They believe that the U.S. market is playing catch up from a down and out scenario and they are finding many investment opportunities there that just aren't available in Canada. The maximum foreign exposure is 30%, and as of April 30, it was sitting at 24%. Their outlook for Canada is positive, but more muted than for the U.S. Much of Canada's growth will be dependent on the demand for commodities coming out of Asia and the U.S., which is likely to be a question mark for the rest of the year.

Regardless, the team remains committed to their strategy. They believe that companies that increase dividends over time tend to outperform those that don't. They refuse to chase quick returns and remain focused on quality companies that offer diversification with good valuations and a history of dividend growth.

We are reaffirming our $$$$ rating on the Fund.

IA Clarington Canadian Conservative Equity Fund - The Fund has been managed by George Frazer and his team at Leon Frazer & Associates Investment Counsel since 1950 using a very value focused approach. They look for companies with a demonstrated history of growing dividends paid to investors over time based on their belief that "dividend increases drive growth in both income and capital and offer capital protection in volatile markets." The team also looks for a history of strong earnings, cash flows, and quality management. Valuation is a key focus of their strategy and the team focuses only on the stocks that they feel are reasonably priced based on their estimate of value and the growth prospects.

Performance for the fund has been decent, gaining 4.1% since last October, handily outpacing the S&P/TSX Composite which gained 1.8% during the same time period. While this level of outperformance is respectable, it placed the fund in the third quartile.

This has not changed the management team's process. They have no intention of making any major tactical shifts in the short term and will continue to take a long term view and focus on high quality Canadian dividend paying companies.

They remain optimistic for 2012 given the dividend growth that has been exhibited by the fund's holdings in the past year or so. Many of the fund's holdings have increased dividend payouts in the past year, but the market has yet to reward them through increased share prices. Historically, the markets tend to pay for dividend increases over time, and they expect that this time will be no different, and recent dividend increases will be rewarded.

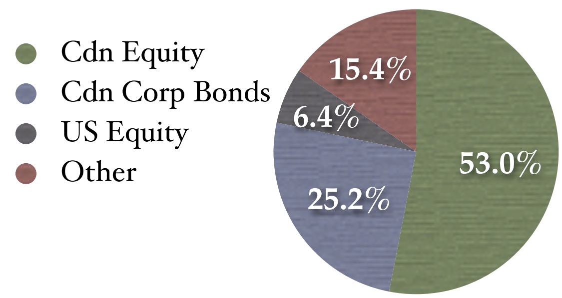
We are reaffirming our $$$ rating on the fund. We expect that it will lag in "hot" markets, but should provide strong risk adjusted returns over the long term, with lower than category volatility.

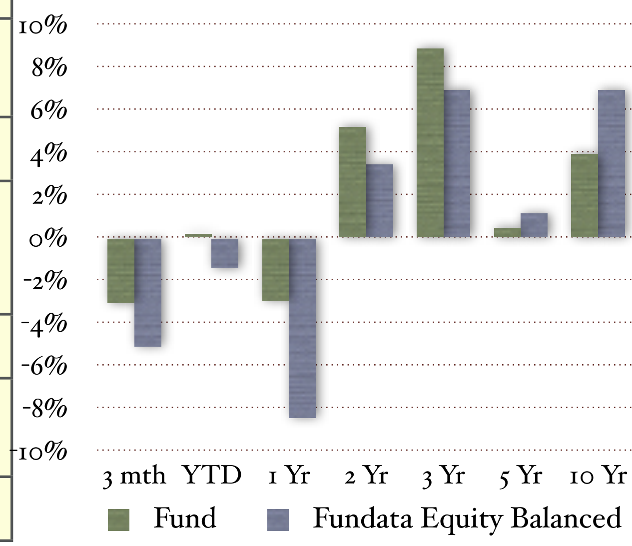
Is there a fund you would like us to review?? Please send any requests for fund reviews to feedback@paterson-associates.ca**.**

TD Monthly Income Fund

Fund Company	TD Asset Management
Fund Type	Canadian Equity Balanced
Rating	$$$$
Style	Large Cap Blend
Risk Level	Medium
Load Status	No Load / Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Doug Warwick since June 1989 Michael Lough since July 2005 Geoff Wilson since January 2010
MER	1.48%
Fund Code	TDB 622 - No Load Units TDB 821 - Front End Units
Minimum Investment	$500

Asset Mix





ANALYSIS:

We believe that this is a great core fund for most investors and it is only likely to get better given the recent changes to the bond component of the fund. Until early 2010, the bond exposure was predominantly high yield bonds. While this may have provided the potential for return, it also raised the volatility profile of the fund, increasing the total risk profile. When Geoff Wilson took over the bond sleeve of the fund in January 2010, it began to look at lot more like the **TD Canadian Core Plus Bond Fund**, which has long been one of our favourites.

Managing the equity component is the team of Doug Warwick and Michael Lough, who focus high quality, dividend paying stocks that have a history of earnings growth. The end result is a portfolio of 60 to 80 large cap stocks. Given the focus on dividends, it is not surprising to see that it is heavily overweight in financials, utilities and energy, with virtually no exposure to materials or technology.

The broader asset mix is determined by Mr. Warwick. In managing the fund, he is very patient, with very low levels of portfolio turnover that have been averaging around 10% per year. It was higher in 2009 and 2010 largely because of the change in the bond manager. It is our belief that the changes should help provide better downside protection in periods of market volatility.

Performance has been very strong on both an absolute and relative basis, finishing in the upper half of the category in every year since 2002. The one exception was 2008, where the high yield exposure dragged performance, pushing it into the fourth quartile.

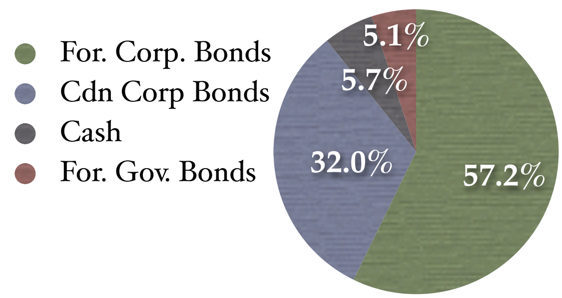
We like the lower volatility bond component of this fund and expect that it will result in better risk adjusted returns for investors going forward. Despite the monthly distribution of $0.031 per unit, we see this fund more as a good core bond holding for low to medium risk investors rather than a meaningful source of income.

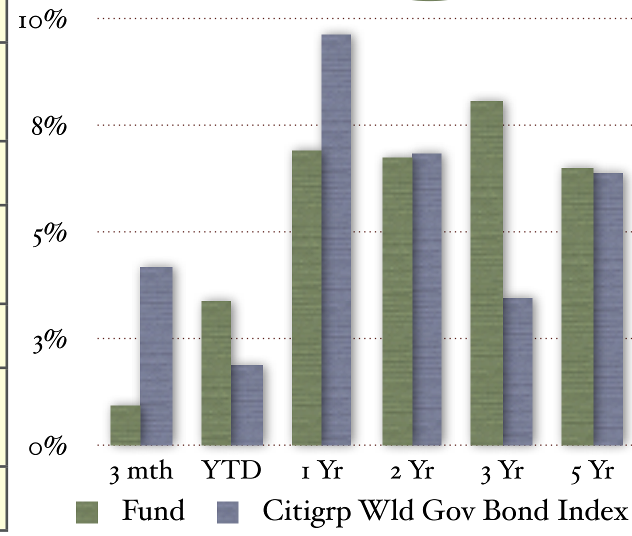
Given the above, we are reaffirming our $$$$ rating.

RBC Global Corporate Bond Fund

Fund Company	RBC Global Asset Management
Fund Type	Global Fixed Income
Rating	$$$$
Style	Credit Analysis
Risk Level	Low / Medium
Load Status	No Load or Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Frank Gambino since Aug. 04 Marty Balch since June 09
MER	1.74%
Fund Code	RBF 580 - No Load Units RBF 753 - Front End Units
Minimum Investment	$500

Asset Mix





ANALYSIS:

With interest rates hovering near historic lows, fixed income investments have never looked so risky. As interest rates rise, bond prices will be pushed lower, eroding the value of your investment. There are a couple things you can do to protect yourself. One is to invest in shorter term bonds, which aren't affected as much by changes in interest rates. Another option is to invest in high quality corporate bonds which offer higher yields than traditional government bonds.

The RBC Global Corporate Bond Fund is a great way to access to the corporate bond sector. Managed by Frank Gambino and his team, they look to build a portfolio of high quality corporate bonds that are issued by companies that have stable or improving credit profiles and that are trading at a discount to their real worth.

As the name suggests, this fund is very global in nature. As of April 30, 47% was in the U.S., 29% in Canada, 17% in international bonds, and just under 8% in emerging market bonds. The credit quality is strong, with nearly 70% invested in bonds that are rated BBB or higher. It can also invest up to 30% in high yield and emerging market bonds. The portfolio is well diversified, holding more than 500 positions with the top 10 making up a mere 7.1% of the fund.

Looking ahead, the manager has a favourable outlook on corporate bonds given the strong health of many U.S. and Canadian corporations. Other factors that are supporting corporate bonds include valuation and investors' need for yield, which cannot be satisfied with Government bonds.

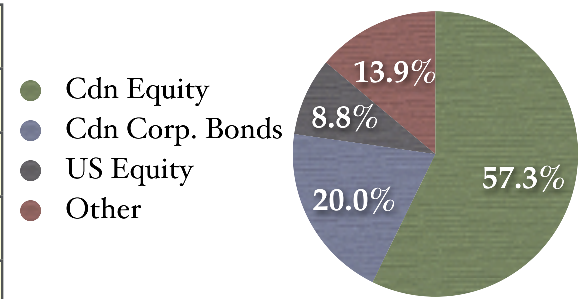
Given this outlook, they intend to maintain an overweight position in quality high yield bonds, and will look to take advantage of a number of European investment grade corporate bonds as the opportunities arise.

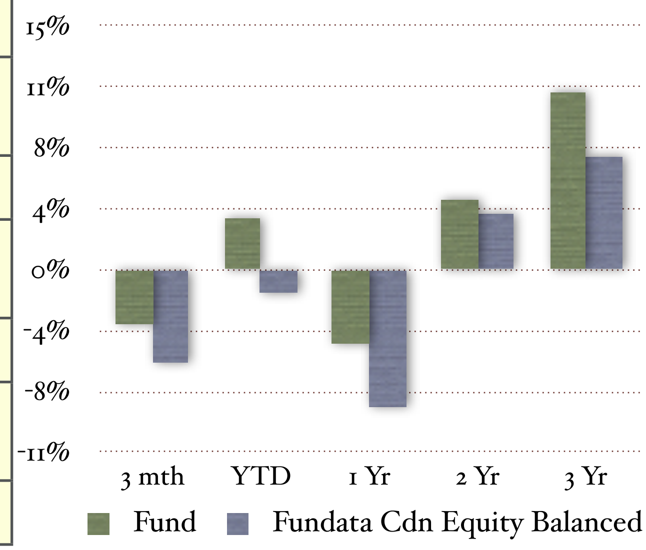
While corporate bonds have the potential to provide better downside protection in a rising rate environment, they can also be more volatile than a traditional government bond. Because of this, you should exercise caution when bringing corporate bonds into your portfolio. We would suggest that this fund make up no more than half of the fixed income weighting in your portfolio.

Edgepoint Cdn Growth & Income

Fund Company	EdgePoint Wealth Management
Fund Type	Canadian Equity Balanced
Rating	$$$$
Style	Bottom Up Value
Risk Level	Medium High
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Tye Bousada since November 08 Geoff MacDonald since Nov. 08
MER	2.14%
Fund Code	EDG 188 – Front End Units EDG 388 – Low Load Units
Minimum Investment	$15,000

Asset Mix





ANALYSIS:

The **EdgePoint Canadian Growth & Income Portfolio** is EdgePoint's Canadian balanced offering. It has grown to nearly half a billion in assets since its 2008 launch.

Like all EdgePoint offerings, it is managed using an investment philosophy is conceptually very simple – they are long term investors looking to buy an ownership stake in a small number of high quality business at prices that are trading below their estimate of its true value. For the equity sleeve of the fund, they employ a fundamentally driven, bottom up investment process that is based on the old Trimark approach.

For the fixed income portion of the fund, they look for securities that will provide an attractive total return through coupon payments and capital appreciation while focusing on the issuer's ability to pay. They can invest in any type of fixed income security, but it is expected that the fund will be heavily weighted towards credits as they have more confidence in their ability to conduct a thorough credit analysis on a company or government, rather than trying to predict the direction of interest rates or the shape of the yield curve. They will invest in investment grade or high yield bonds, depending on their relative attractiveness.

The asset mix can vary widely, depending on the risk reward profiles of the various asset classes. For example, the fixed income exposure can range from a low of 25% of the fund to a maximum of 60%. In setting the asset mix, the managers want to ensure that they are properly compensated for the risk they accept. With interest rates at near record lows, it makes sense the fixed income exposure is at the low end of the target range.

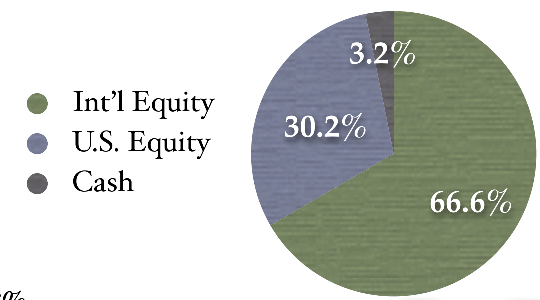
Performance has been strong on both an absolute and relative basis, finishing first or second quartile in each year since its launch. The volatility of the fund has been in line with the category average. The MER of 2.14% for the front end version, which is well below the category median of 2.33%.

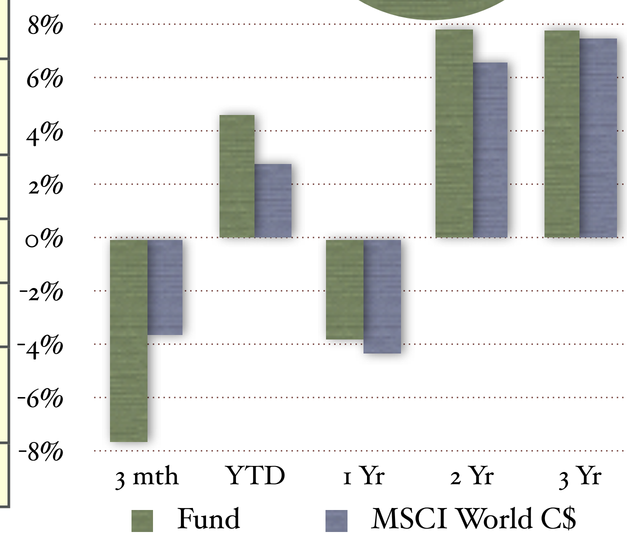
We are initiating coverage of this fund with a $$$$ rating. It is a good core balanced fund for investors who have a medium to high risk tolerance and a long term time horizon

Ethical Global Dividend Fund

Fund Company	NEI Investments
Fund Type	Global Equity
Rating	$$$
Style	SRI Value
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	KC Parker since November 2007
MER	2.10%
Fund Code	NWT 084 - Front End Units NWT 184 - Low Load Units
Minimum Investment	$500

Asset Mix





ANALYSIS:

For some investors, building a portfolio involves more than just earning a decent return on their investments. They want to do the right thing and invest only in companies that take an active stand on such things as human rights and the environment. While the feel good factor has always been good with Socially Responsible Investing (SRI), it has had mixed results when it comes to investment performance.

One fund which has thus far bucked that trend is the Ethical Global Dividend Fund, which is managed by KC Parker of Beutel Goodman. This fund, with a go anywhere mandate looks for high quality, profitable companies that generate high levels of free cash flow that is either reinvested back into the business, or returned to shareholders through share buybacks or a growing stream of dividends.

Performance has been strong when compared to not only its peer group, but also the benchmark. As of May 31, the three year return was 7.8%, outpacing the MSCI World Index by nearly 30 basis points, and finishing in the top quartile. The portfolio is concentrated, holding around 30 names, with the top 10 making up more than two-thirds of the fund. Not surprisingly, this has resulted in a level of volatility that is in the upper half of the category, a rare occurrence for a value focused fund.

Ethical are very active shareholders and encourage companies to improve their environmental, social and governance practices through dialogue, shareholder resolutions and proxy voting. They are not afraid to take action if a company does not want to play ball. For example, they recently turfed Great-West Life from the portfolio because they didn't want to address or discuss the risk of climate change to its insurance business.

Looking ahead, the manager is cautiously optimistic on equities, and believes that the risk reward profile looks attractive, particularly when compared to fixed income. The focus in the near term will be in the more defensive and cyclical sectors of the market, with overweight positions in industrials and health care.

Our biggest concern with this fund is its volatility, which has been above the benchmark and the category average. However, for investors who can stomach a bit more volatility in return for knowing they are investing in companies with a well defined ethical stance, this is a great fund to consider.