
Top Funds Report

Monthly Commentary

Encouraging comments from ECB President and China rate cuts boost sentiment.

Global markets got a boost following the July 26 comments made by the European Central Bank's president Mario Draghi. In his remarks, Mr. Draghi stated that the ECB would "do whatever it takes" to ensure that the Euro remained intact. Investors took this as a sign that the ECB would take immediate stimulative action in an effort to shore up the European economies, bidding stock prices higher.

These comments boosted investor confidence, resulting in a modest 1.1% gain in the MSCI EAFE Index in U.S. dollar terms while the S&P 500 gained 1.4%. Unfortunately for Canadian investors these gains were muted, as the Canadian dollar rose against other currencies. The dollar gained 1.76% against the greenback, rising from \$0.9813 to end the month at \$0.9986. Once the currency affect was taken into account, gains were much reduced, with the S&P 500 rising a more modest 0.03% and the MSCI EAFE losing 0.61% in the month.

One sector that did see a boost was resources, which saw a 3% rise in gold and a 7% jump in the price of oil. These gains were partly attributable to Mr. Draghi's comments, but also to news that both European and Chinese central banks cut interest rates and were committed to further stimulus action. This boosted hopes that China would be able to rebound out of their slowdown more quickly which would boost demand for oil.

In Canada, the S&P/TSX Composite Index gained 0.80%. Not surprisingly, it was energy leading the charge higher, gaining 4.4%, followed by telecom and industrials, who posted gains of 2.8% and 2.4% respectively. Laggards included technology, which was dragged lower by the continued fall of Blackberry maker Research in Motion. Small Caps outpaced their large cap brethren, with the S&P/TSX Small Cap Index gaining 2.5%.

Canadian bonds were positive, with the DEX Bond Universe gaining 0.66% on the month. Corporate bonds outpaced governments and yields remain near historic lows. While there is no doubt that rates will be moving higher, the question remains when will that rise begin. Considering comments from Bank of Canada governor Mark Carney, and the yield curve, it is our view that rates are now likely on hold until at least early 2013.

While Mr. Draghi's statement was encouraging, there is still much more that needs to be done before the European debt crisis is solved and the future of the Euro more certain. Despite central bank easing, China continues to show signs of a slowdown that will no doubt have an impact on the Canadian economy, particularly those sectors that are tied to energy and commodities. The U.S. is showing some signs of economic life, but growth is not yet at a pace that will provide significant support for the equity markets.

Based on this view, our investment outlook remains unchanged. We continue to focus on quality, both in equities and fixed income. With an overhang of issues weighing on the markets in Europe, and slowing growth in the emerging markets, we continue to favour North America. For equities, we favour well managed, conservatively positioned funds that invest in large cap, dividend paying companies.

Within fixed income, our focus is on actively managed funds that can invest in a mix of government and high quality bonds. We also like funds that offer higher yields and shorter durations than the benchmarks. This will serve two purposes – provide the potential for better returns while rates are flat, and better downside protection when rates move higher.

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Funds You Asked For

This month, we take a look at Mackenzie Sentinel Income, Mawer International Equity and provide an update on the PH&N High Yield Bond Fund.

Mackenzie Sentinel Income Fund - We were a bit concerned about this fund after the retirement of Bill Proctor and the resignation of Chris Kesic back in the summer of 2010. As it turns out, most of our fears were unwarranted as the new team of Steve Locke and Norman Raschkowan have done a good job keeping the fund on track.

While performance may have lagged the benchmark since they took over, it has outpaced most of its peer group, finishing in the upper half of the category. They have done a good job at keeping volatility in check, keeping it in the lower half of the balanced fund category.

The investment process uses a top down macro view to help set the asset mix and sector selection, while a fundamentally driven, bottom up research process helps identify suitable investment candidates.

Within the fixed income portion of the fund, they tend to focus on investment grade corporate bonds, but can shift between government bonds, corporates and securitized debt. On the equity side of the fund, they focus on the big dividend paying companies. To ensure this happens, they will only look at companies that have a market capitalization of at least \$1 billion and have a dividend yield of at least 1%. They are also looking for companies that have good management and sustainable earnings growth.

Currently, the fund is conservatively positioned, holding 58% in bonds, 7% in cash and 34% in equity. The asset mix of the fund doesn't move around a lot, helping to provide some level of consistency in the fund.

It provides investors with a monthly distribution, which is dependent on the series. Our preference is for the Series B units, which pay a monthly distribution of \$0.033 per unit, which works out to an annualized yield of just under 5%.

We like this fund as a core balanced fund for low to medium risk investors. We also like it as a good way to generate cash flow for investors through the distributions.

Mawer International Equity Fund - Until recently, this fund was known as the Mawer World Investment Fund. To be honest, we always had a bit of an issue with the name as it implied that it had a true global mandate, when in reality, the fund was always non North American in its focus. That is why we were happy to see the name changed to the Mawer International Equity Fund, which we believe to be considerably more appropriate.

Despite our issues with the fund's previous name, it has always been a fund that we have held in high regard. Managed in the Mawer growth at a reasonable price approach, they look for wealth creating companies that are trading at discounts to their estimate of intrinsic value. A typical company will have excellent management teams, improving business fundamentals and a history of generating high returns on equity.

Like other Mawer funds, this one is well diversified, typically holding between 50 and 60 names. It is relatively conservatively positioned, with the top ten holdings making up about 30% of the fund. They tend to be long term, patient investors, and portfolio turnover tends to be relatively low.

Performance has consistently been in the upper half of the category, with the notable exception being 2003 when its 9.7% gain placed it well behind other international equity funds. Volatility has been in line with the index and the category average, resulting in very strong risk adjusted returns.

The cost of the fund is reasonable, with an MER of 1.57%. Because this is a no load fund, that number does not include any advisor compensation.

Perhaps the biggest drawback to this fund is that it has a \$5,000 minimum, which puts it out of reach for many smaller investors. But for those investors who can meet that minimum, this is a great way to get non North American equity exposure. It offers a high quality management team, a proven process, reasonable cost and a great track record.

PH&N High Yield Bond Fund - Having been closed to new investors since November 2010, if you don't already own units of this great fund, then you are out of luck. After seeing a big jump in assets, management decided to cap the fund to protect existing unitholders. Despite not being open for new investment, we felt that an update was warranted.

The fund is a bit of a different animal than many other high yield funds, focusing on higher quality issues in the high yield space. It focuses on medium quality corporate bonds, convertibles, preferreds and some government debt. Historically, about half of the fund has been invested in bonds that were rated BB or better.

The manager sets the sector mix of the fund based on their relative attractiveness based on the outcome of their macro analysis. Once the sector mix is determined, the managers conduct a fundamental analysis on a number of

companies, looking at their free cash flow, and interest coverage ratios to determine quality.

Given the fund's size, management sought and was granted a slight change to the mandate last year, removing the fund's cap on foreign holdings, giving it free reign. In reality, given the manager's strengths, it is unlikely that we will see much of a change to the fund in the near term. As of June 30, it held 49% in the U.S., 4% in other developed countries with the balance in Canada.

It is conservatively positioned with a yield to maturity of 4.9%. Management is focusing on bonds from high quality issuers in non cyclical industries. While the credit quality of the portfolio may be higher than a more traditional bond fund, risk is mitigated through a shorter duration. As of June 30, the fund's duration was 2.5 years, compared to the DEX Universe, which is closer to 7 years. This means that when rates do move higher, this fund is expected to hold up better than the broader index.

Given the more conservative nature of the fund, its performance can be a bit of a mixed bag. Longer term, results have been very strong, handily outpacing the DEX Bond Universe and Global High Yield universe over the past 10 years. Volatility is also the lowest in the category. Another bonus is that it carries a rock bottom MER of 0.89%.

This has long been one of our favourites in the fixed income space and we expect it to be for the foreseeable future. We see this as a great way for investors to gain corporate bond exposure in their portfolio while at the same time adding some high yield, without taking on huge risk.

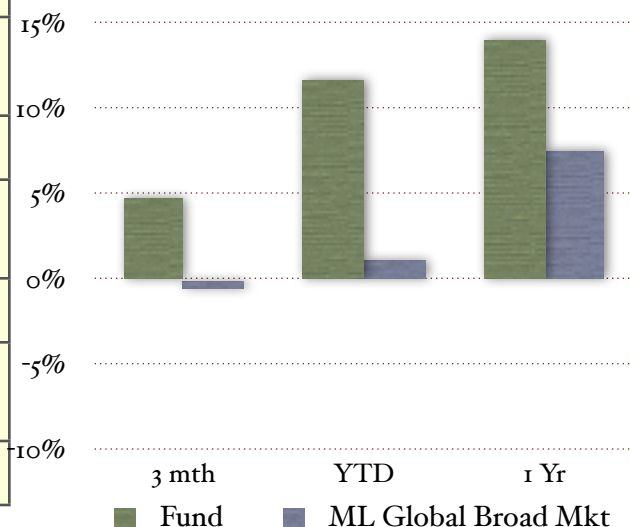
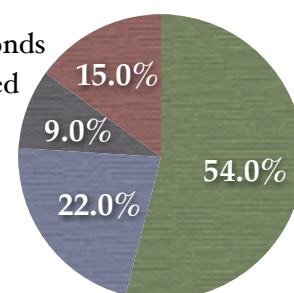
Is there a fund you would like us to review?? Please send any requests for fund reviews to feedback@paterson-associates.ca.

PIMCO Monthly Income Fund

Fund Company	PIMCO Canada
Fund Type	Global Fixed Income
Rating	\$\$\$
Style	Tactical
Risk Level	Low - Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Dan Ivascyn since January 2011 Alfred Murata since January 2011
MER	1.38%
Fund Code	PMO 005 - Front End Units PMO 105 - Low Load Units
Minimum Investment	\$1,000

Asset Mix

- Government Bonds
- Mortgage Backed
- Emerging Mkt.
- Other



ANALYSIS:

PIMCO is one of the leaders in the global fixed income investing space. While the firm has a long track record, they are relatively new in Canada, launching a family of mutual funds in the Canadian market.

One of those funds is the PIMCO Monthly Income Fund, a tactically managed global fixed income fund that looks to generate a high and consistent stream of income for investors. In the past year, the fund has paid monthly distributions to investors that have ranged between \$0.041 and \$0.046 per unit, equating to an annualized yield of approximately 3.85%.

The fund is managed using PIMCO's proven investment philosophy and process that uses a mix of top down and bottom up analysis to build the portfolio. The top down macro view is used to set the funds duration, yield curve positioning and sector exposure, while the bottom up research looks to identify the most attractive non Canadian securities that meet the funds broader asset mix.

Performance has blown the competition out of the water and done so with very little volatility. Its one year return was 14.0%, nearly doubling the benchmark BoA ML Global Bond Market Index return of 7.6%.

It is conservatively positioned at the moment, holding 54% in Government bonds, 22% in mortgage backed securities and 10% in emerging market debt. It has a low duration of 3.8 years, meaning it won't be hit as hard as a traditional bond fund when interest rates move up.

While returns to date have been strong, we believe that the fund has the potential to be much more volatile than it has been. This is because the fund can engage in a number of non traditional strategies including investing up to 50% of the fund in high yield bonds, investing in credit default swaps, it can invest up to 10% of the fund in gold or silver bullion, and it may also invest in leveraged and inverse ETFs.

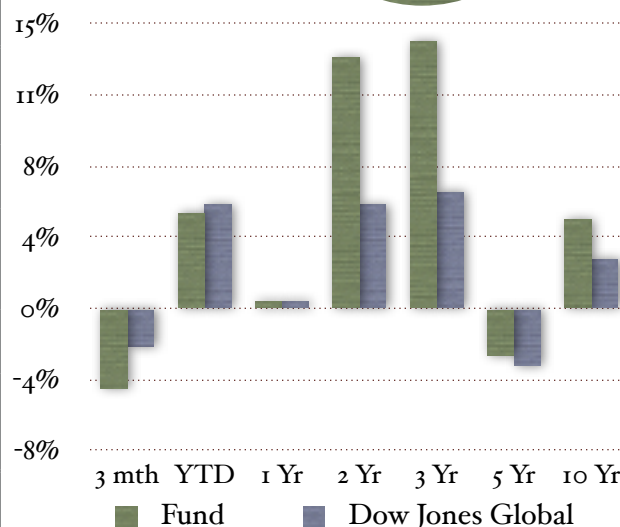
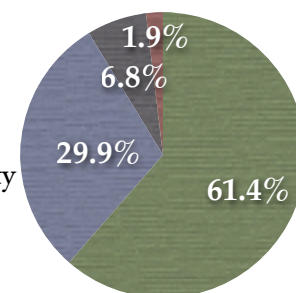
We are initiating coverage of this fund with a \$\$\$ rating. The only thing preventing us from giving it a \$\$\$\$ rating is that it only has a year and a half of track record in Canada, which dampens our enthusiasm a touch.

Trimark Global Endeavour Fund

Fund Company	Invesco Canada
Fund Type	Global Small / Mid Cap Equity
Rating	\$\$\$
Style	Value
Risk Level	High
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Jeff Hyrich since October 2001 Erin Greenfield since Dec 2008
MER	2.69%
Fund Code	AIM 1593 - Front End Units AIM 1591 - DSC Units
Minimum Investment	\$500

Asset Mix

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



ANALYSIS:

Like other funds that carry the Trimark name, the Trimark Global Endeavour Fund is managed with a common sense approach of buying high quality businesses when they are temporarily out of favour. Management scours the globe looking for well managed, small and mid cap companies that have strong management, high quality balance sheets, low debt, and demonstrated growth potential that are trading at a discount to their prospective earnings growth and cash flow. They like to see this margin of safety between the stock's market value and its intrinsic value as it provides a buffer against permanent loss of capital for the investors.

The portfolio tends to be very concentrated, typically holding no more than 25 companies. As of July 31, more than half of the fund was made up of the top ten holdings. It is very consumer focused with 32% of the fund invested in consumer discretionary names and 15% in consumer staples. A very patient approach is used when managing the fund, with portfolio turnover averaging about 25% per year.

Performance has been strong of late, finishing first quartile every year since 2009. Despite this strong relative

performance, its distinct management style can result in periods of underperformance. For example, in 2007 and 2008, the fund lagged the index and the category, only to bounce back sharply in 2008 and 2009.

The managers believe that equities are offering a more compelling risk reward tradeoff when compared to bonds. Their rationale is that the spread between earnings yield on equities and treasury bills at its widest peak since the mid 1970s. They are also embracing the recent market volatility and have used it as an opportunity to find some high quality names trading at reasonably compelling valuations.

We like this fund as a way for medium or high risk investors to gain exposure to high quality global small and mid cap stocks. However, investors need to be aware that it can be a very volatile fund. Further, from a valuation standpoint, large caps appear to be more attractively valued than small and mid cap stocks. As such, we would suggest some level of caution with the fund at the moment, and would suggest limiting exposure in a portfolio to between 5% and 10% depending on the investor.

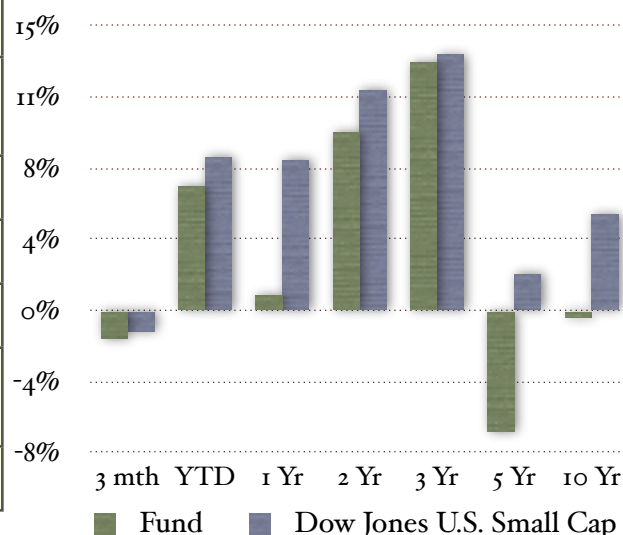
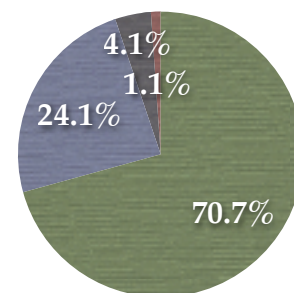
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IA Clarington Sarbit U.S. Equity

Asset Mix

Fund Company	IA Clarington Investments Inc
Fund Type	U.S. Small / Mid Cap Equity
Rating	\$\$\$
Style	Value
Risk Level	Medium - High
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Larry Sarbit since June 2009
MER	2.68%
Fund Code	CCM 150 - Front End Units CCM 151 - DSC Units
Minimum Investment	\$500

- U.S. Equity
- Cash
- Income Trust
- Int'l Equity



ANALYSIS:

Since June 2009, this fund has been managed by Larry Sarbit using a Warren Buffet inspired, high conviction, bottom up, value driven investment process. His process is a tough one to classify as it really is a mix of both a growth and value style.

Basically, Larry is looking for what he calls "terrific businesses." These are companies that have a strong franchise, very high barriers to entry, operate in an expanding market, and are generating high levels of free cash flow for investors. He also prefers businesses which operate using a very simple, easy to understand business model. He likes companies that can be explained in about thirty-seconds. "I look for businesses that any idiot can run, because sooner or later, some idiot will."

Valuation is an important part of the process but only after all the other factors have been considered. There are many companies that are cheap, but not necessarily terrific companies. He looks for companies that have a high margin of safety.

The fund is a high conviction portfolio, holding 17 names with the top 10 making up more than 70% of the

fund. It can invest in companies of any size, but at the moment Larry is finding a number of opportunities in the mid cap space. The fund is overweight in consumer cyclical, consumer defensive and communication while very underweight in technology, industrials and healthcare.

Another aspect of the high conviction style is Larry's willingness to hold large amounts of cash when there are no suitable investment candidates available. He did this while at the helm of the AIC American Value Fund, which at one point was 81% cash and held only three stocks, causing concern among more traditional investors.

Performance since Larry took over the fund has been first quartile, with a three year gain of 13.1%. Given the concentrated portfolio and mid cap focus of the fund, it is likely to be more volatile than other funds in the category. For example, in 2010, the fund nearly doubled the performance of the index, yet in 2011, it lagged both the index and the category.

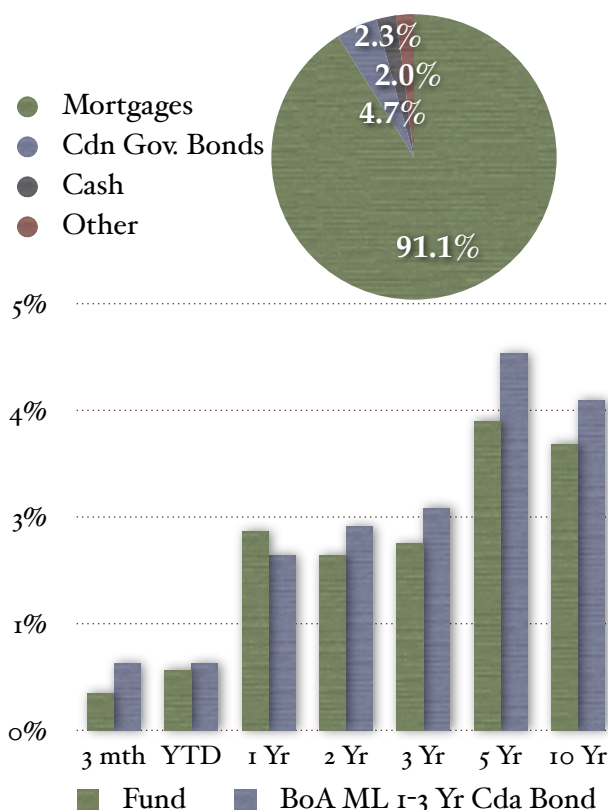
Given this, we believe that this is a good fund for investors who have the patience to remain invested over the long term as it may be prone to periods of high volatility and underperformance.

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TD Mortgage Fund

Fund Company	TD Mutual Funds
Fund Type	Cdn Short Term Fixed Income
Rating	\$\$\$
Style	N/A
Risk Level	Low
Load Status	No Load / Optional
RRSP/RRIF Suitability	Excellent
TFSA Suitability	Excellent
Manager	David McCulla since Jan 2004 Olga Bylaard since January 2009
MER	1.82%
Fund Code	TDB 621 - No Load Units TDB 2010 - Front End Units
Minimum Investment	\$100

Asset Mix



ANALYSIS:

In many cases, simple is good. With the TD Mortgage Fund, that is definitely the case. It is a very simple fund, investing in a portfolio of high quality Canadian residential mortgages that it buys from TD Bank. It can also invest in uninsured conventional mortgages, National Housing Act insured mortgages and mortgage backed securities.

The goal of the fund is to provide investors with a steady stream of income. To do this, it pays out a variable monthly distribution, which in the past year has ranged between \$0.095 and \$0.181 per unit. This works out to an annualized yield of about 2.6%.

The portfolio is very well diversified, holding nearly 12,000 individual securities. 92% is invested in mortgages, 5% in bonds with the balance in cash. It is very high quality, with more than 95% of the fund being rated AAA. It is also very conservatively positioned with a duration that is lower than the index, while having a yield that is higher. This will help to better protect investors' assets when interest rates begin to move higher.

Given the conservative nature of this fund, we view it as a pretty good parking spot for shorter term funds. For example, it has a level of volatility that is half that of a traditional bond fund and it has never lost money over a 12 month period. It provides a level of return that is higher than what you could earn in a money market fund or high interest savings account, and is comparable to a GIC. That said, unlike a GIC, this fund does have the potential to lose money in the short term.

It also has low correlation to the major asset classes, including bonds, so it will be a good in a portfolio as part of your fixed income weighting.

Performance has been middle of the pack for the Canadian Short Term Fixed Income category, but volatility is in the lower half of the category. While we like this fund for most investors, those with more than \$5,000 to invest in short term instruments may want to consider the **PH&N Short Term Bond & Mortgage Fund** instead as it offers a slightly better risk reward profile and a lower cost.