
Top Funds Report

Monthly Commentary

Aggressive Central Bank bond buying programs boosts gold, pushes equity markets higher.

As was widely expected, central banks in the U.S. and Europe stepped up to announce aggressive bond buying programs designed to inject much needed liquidity into the economy. Markets reacted positively showing gains in September, pushing all markets, except for Japan into positive territory for the third quarter.

After vowing to do “whatever it takes” to save the Euro back in July, European Central Bank President Mario Draghi announced plans for an unlimited bond buying program for distressed government bonds. The plan is to keep interest rates low, effectively buying more time for European governments to get a firm grasp on their debt issues. This plan will not solve the crisis, but it will provide a much needed safety net for bond investors. Because of this, the tail risk has effectively been removed from the European crisis. While volatility is expected to remain high while the crisis is sorted, the likelihood of a collapse is greatly reduced.

The U.S. Federal Reserve launched their third attempt at quantitative easing, announcing the much anticipated, if not originally named, QE3 program. Under this plan, the Fed will buy up to \$40 billion a month of agency mortgage backed securities. Unlike previous QE programs, there is no definitive end and they will continue to buy bonds until there is economic growth and an improved employment picture. They expect that short term interest rates will remain exceptionally low through at least 2015. This stability proved to be positive for bonds as the DEX Universe Bond Index was modestly higher by 0.67% in September.

During the month, gold gained more than 5%, closing at \$1,776 per ounce. Traders speculated that this continued influx of liquidity into the economic system will cause a marked increase in inflation. Gold has long been thought of as one of the best hedges

against inflation. Another factor that helped to push gold higher was the drop in the U.S. dollar, which saw the Canadian dollar end the month at \$1.0166 USD, up from \$1.0139 USD at the end of August.

Looking ahead, we remain cautious. While the ECB bond buying program has likely removed much of the risk of an outright collapse in the region, its debt crisis and economic picture are far from being fixed. The region remains mired in a severe recession that is having a negative affect global economic growth. More action needs to be taken and until that happens, considerable risk remains. China and the emerging markets find themselves mired deep in an economic slowdown, which is having a negative affect on global economic growth.

Closer to home, there is considerable uncertainty in the U.S. where worries over the election and the potential “fiscal cliff” of tax increases and spending cuts looms large. There are also concerns that we may see a bigger than expected slowdown in corporate earnings in the coming weeks.

Considering the above, our investment outlook remains defensive. We continue to emphasis actively managed funds that invest in high quality companies. In the fixed income space, we are looking to funds that allow the managers the flexibility to invest in a wide range of strategies that will help to increase returns and manage risk in a flat to rising rate environment. With equities, we are focusing on actively managed, large cap focused funds that invested in well managed, high quality companies that generate strong cash flows. We are still avoiding Europe and China in the short term, however, in the coming months we may begin to look at some specific opportunities. Instead, we continue to favour the U.S. and Canada.

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Funds You Asked For

This month, we take a look at Cundill Canadian Balanced, PH&N Total Return Bond, CIBC Canadian Real Estate and more.

CIBC Canadian Short Term Bond Index -

Interest rates are currently hovering near historic lows and will eventually have to move higher. When that does happen, one of the most effective ways of protecting the value of your fixed income investments is to shorten the duration. Duration is simply defined as the weighted average term to maturity of a bond, taking into account all coupon payments that are expected to be received.

It is also an estimate of how sensitive a particular investment is to changes in the rate of interest. The shorter the duration, the less sensitive the investment is to interest rate changes. For example, if the duration was 5 years, it is expected that for every 1% increase in rates, the value of the investment would fall by 5%.

This fund is a good way for investors to access short term bonds. It is designed to replicate the performance of the DEX Short Term Bond Index, net of fees. This index is made up of a wide range of investment grade bonds that will mature within one and five years. The bonds are issued by the government of Canada, the various provinces and corporations.

Along with the short term nature of the fund, it is also very high quality, with 56% of the index rated AAA, 20% AA, and 13% rated A. 52% of the fund has a maturity within three years, while 41% will mature within three and five years.

It has exhibited very low levels of volatility particularly when compared to a more traditional bond fund. Performance has been modest with a one year return of 2.0% as of July 31. It does provide great downside protection when included in a well-diversified portfolio because of its low correlation to the major equity indices.

For investors looking for a short term parking spot for their funds, but don't want to use a money market fund or invest in a GIC, this fund is a great alternative. The probability of loss is low, while the

expected return is higher than a money market fund.

While we do like this fund, it is our opinion that those with more than \$5,000 to invest in short term bonds consider the **PH&N Short Term Bond & Mortgage Fund** instead. It offers a broader portfolio, high quality active management and a lower MER, all of which make it a more attractive option.

Mackenzie Cundill Canadian Balanced

Fund - This fund is managed using the same deep value style that has become synonymous with Cundill. The approach is almost contrarian, buying stocks when they are most hated by the markets. Over the long term, this has provided strong returns for investors with modest levels of risk. However, during shorter periods of time, it has the potential to experience higher levels of volatility which can lead to periods of underperformance.

Like other Cundill funds, this one is very concentrated, holding less than 30 equity names and less than 30 fixed income investments. The top ten holdings make up 45% of the fund. In constructing the portfolio, the managers use a bottom up approach that looks to invest when the security is trading at a significant discount to their estimate of its intrinsic value.

The managers will actively manage the asset mix of the fund, but it does have a neutral mix of 60% equities and 40% fixed income. As of July 31, the fund was roughly 65% equity and 35% bonds.

The fixed income portion of the fund can invest in government bonds, corporate bonds and high yield bonds. They will focus the portfolio on the sectors that are offering the most attractive risk reward characteristic. Currently, they are conservatively positioned, holding short duration bonds to protect against rising rates. They believe that long term rates offer very little incentive to take on the additional duration risk.

Within the equity side of the fund, a bottom up, deep value, contrarian stock selection process is used. Like with other Cundill funds, they are not afraid to hold significant cash balances if no suitable investment opportunities are found.

While the longer term performance has been strong, volatility has been high compared to other funds in the category. The volatility is comparable to a well managed Canadian dividend fund. This higher volatility can come from two main sources; the manager's deep value style, and their high conviction, concentrated portfolios.

Any investor considering this fund should have a long term time horizon and at least a medium risk tolerance. While we like the fund, we believe that there are better options available for most investors.

CIBC Canadian Real Estate Fund - Many view real estate as an attractive asset class that can provide diversification within a portfolio due to its relatively low correlation to the equity markets. With real estate funds however, the diversification benefits may not be quite as high as many expect given that most will have significant holdings in REITs, which are often traded on the equity markets. Because of this, the correlation benefits may not be as high as investors may anticipate.

One such fund in the CIBC Canadian Real Estate Fund which invests in a mix of REITs and real estate operating companies. Managed by Charles Dillingham of Morguard Investments since 1997, the fund invests in undervalued securities. The process is very much a bottom up approach that analyzes the quality of the properties and the track record of management.

It is heavily invested in REITs. As of June 30, 63% was held in REITs, 15% in operating companies, and 8% in cash, with the balance in other equities. The portfolio is concentrated, holding 43 names with the top ten making up more than half of the fund. It is also very Canada focused, with only 21% invested outside our borders.

Performance has been strong, gaining an annualized 9.85% for the 10 years ending July 31, outpacing broader equities by a significant margin. Many believe that real estate is less volatile than the markets, and while in some cases that may be true, it is not with this fund, which has shown a level of volatility that is in line with the broader market. The historic argument for real estate was that it was countercyclical to equities. While this may be true for standalone real estate, it is not the case with this fund. During the 2008 crisis, it lost nearly 40%, a larger drop than the S&P/TSX Composite, which lost 33%.

Unlike many other real estate funds, this one does not pay a regular monthly distribution. It is also very expensive, with an MER of 2.96%, which is well above the category average and most Canadian equity funds.

We believe that this fund is a good option for investors looking for exposure to the real estate sector in Canada. Despite this, it is not our top pick in the real estate category. Despite the stronger absolute performance, we favour the **Sentry REIT Fund**. We like its manager, the higher yield of the underlying portfolio and its lower cost.

PH&N Total Return Bond Fund - Despite the threat of rising interest rates, fixed income investments should form the cornerstone of most investment portfolios. Rates have been hovering near historic lows and many are expecting them to begin moving higher in 2013. When this happens, the value of fixed income investments will fall.

While some decline is inevitable, not all fixed income funds are created equally. For example, those funds with more exposure to corporate bonds are expected to hold their value better. This is because corporate bonds typically pay a higher rate of interest than government bonds, which reduces their sensitivity to rising rates. Also, funds that have a shorter term to maturity are also expected to hold their value better when rates move higher.

The PH&N Total Return Bond Fund both of those covered. It has significant exposure to corporate bonds, holding nearly 49% of the fund in corporate bonds and 6% in Government of Canada bonds. The fund also has a healthy 32% exposure to provincial bonds, which offer high yields than Canada's and should outperform in a rising rate environment. It has a shorter average term to maturity than the benchmark DEX Bond Universe, and nearly half the fund is in bonds with maturities of less than 5 years. It is a very high quality portfolio, with nearly 85% rated "A" or better.

The fund is managed in a very similar fashion to the PH&N Bond Fund, but can use a few nontraditional strategies including the use of high yield bonds, mortgages and derivative strategies. As a result, it has outpaced the PH&N Bond Fund recently and we expect that trend to continue in the near to medium term. This opinion is based on two key factors. First, the managers have a number of different strategies in their toolbox that will allow them additional flexibility to add yield and protect capital. Second, it has a smaller asset base, which allows the managers to be more nimble.

We believe that this fund is a great core holding for most investors. It exhibits relatively low levels of volatility and has shown low to negative correlation to the equity asset classes. This will allow it to help reduce the overall volatility of your portfolio and help provide better downside protection in volatile markets.

Scotia Canadian Growth Fund - Shortly after Scotia acquired Dundee, they replaced the managers on this fund with Rohit Sehgal, who manages the growth focused Dynamic Power Canadian Growth Fund. Unfortunately Mr. Sehgal's style did not turn things around with the fund and he was replaced in early 2012 by Alex Lane.

Mr. Lane uses a bit more of a balanced approach to growth, that uses a combination of top down analysis to help identify what he expects to be the most attractive sectors for the next three to five years. He then conducts a fundamentally driven,

bottom up research that looks to identify high quality businesses with sustainable growth.

To help manage volatility, he combines both core and cyclical elements in his portfolios. Core holdings are typically growth companies that have strong fundamental businesses that are likely to be less sensitive to the economy as well as having demonstrated the ability to grow dividends over time. The cyclical portion of the portfolio is made up of economically sensitive names that generate most of their returns through capital appreciation.

The portfolio tends to be concentrated, holding around 40 names. As of August 31, it held 42, with the top ten making up 37% of the fund. He can invest in companies of any size, but the current focus is on large caps, which make up about two-thirds of the fund. The sector exposure is similar to the S&P/TSX Composite Index, as energy, financials and industrials make up 57% of the fund.

Since Mr. Lane took over, returns have definitely improved on both an absolute and relative basis. On a year to date basis, the fund is up 4.5%, handily outpacing the index and peer group. While the period is much too short to make a sound judgment, we are cautiously optimistic about the fund.

Another positive factor is that the MER is 2.17% for the no load version, which is well below the category average.

Our biggest concern with this fund is the level of volatility. Without exception, Power branded funds tend to be more volatile than other funds with a similar mandate. Given that this fund is managed in the same way, we would expect that its volatility will also be higher.

We are taking a wait and see approach with this fund. The manager's short tenure and our expectation of higher volatility are preventing us from upping our rating at the moment.

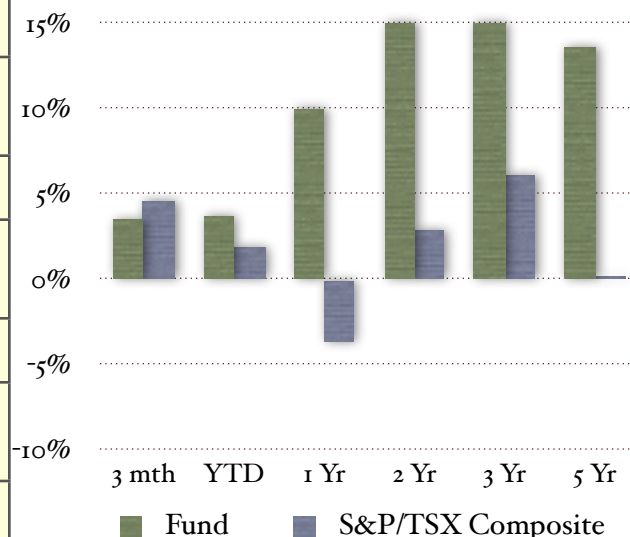
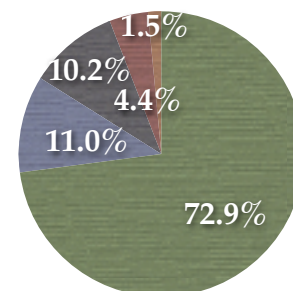
Is there a fund you would like us to review?? Please send any requests for fund reviews to feedback@paterson-associates.ca.

RBC Canadian Income Equity

Asset Mix

Fund Company	RBC Global Asset Management
Fund Type	Cdn Dividend & Income Equity
Rating	\$\$\$
Style	Blend
Risk Level	Medium
Load Status	No Load / Optional
RRSP/RRIF Suitability	Excellent
TFSA Suitability	Excellent
Manager	Jennifer McClelland since July 06 Braham Spilfogel since April 2007
MER	2.09%
Fund Code	RBF 591 - No load units RBF 762 - Front End Units
Minimum Investment	\$500

- Cdn Equity
- US Equity
- Trusts
- Cash
- Other



ANALYSIS:

This fund used to be known as the **RBC Canadian Diversified Income Trust Fund**, until July 2009 when its mandate was broadened to include other equity securities. Today, the management team scours the universe of investible securities using RBC's "3D" model which scores and ranks stocks based on fundamental, technical and qualitative factors. They are looking for stocks that have exhibited positive rates of change on their ranking scores.

The process is very active, with portfolio turnover averaging 370% in the past five years. They are also not afraid to be even more active in periods of increased volatility. In 2008 and 2009 turnover spiked to more than 500%, as they bought and sold a number of positions to take advantage of the volatility. They view volatility as an opportunity to buy attractive names at good valuations. The fund will also look nothing like its benchmark. Rather it is a well diversified portfolio, holding around 115 names.

There is little doubt that this process has worked, posting an annualized five year return of 13% while the

broader S&P/TSX Composite lost a 0.6% per year during the same period. Volatility has been comparable to the benchmark. Where this fund has really shined is with its downside protection. In 2008, the broader market was down 33%, while this fund lost 19%.

Despite this impressive track record, we do have some concerns. Assets levels have grown substantially. As of July 31, the fund had assets under management of nearly \$1.8 billion. In 2009, assets in the fund were only \$70 million. This will likely impact the fund in a couple of ways. First, historically they would invest in a number of small and mid cap names. With the higher asset base, they will likely have to move into some larger names if they want to continue to trade as actively as they have previously. Second, they may have to curtail their trading activity given the liquidity that may be available with some of the names in the fund.

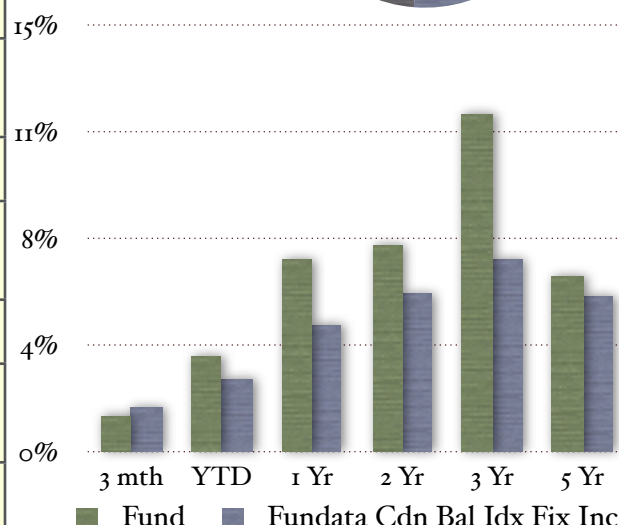
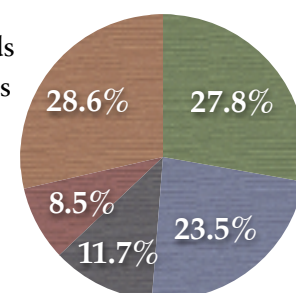
We like the fund, but we don't believe that the past levels of absolute performance are likely to be repeated. Still, we believe that it will do better than the average Dividend & Income Equity Fund for the near to medium term and can be considered a good core holding for most investors.

Fidelity Income Allocation Fund

Asset Mix

Fund Company	Fidelity Investments Canada
Fund Type	Cdn Fixed Income Balanced
Rating	\$\$\$\$
Style	Tactical
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Geoffrey Stein since April 2011 Derek Young since April 2011
MER	1.99% Sr. A, 1.78% Sr. B
Fund Code	FID 294 - Front End Units FID 594 - DSC Units
Minimum Investment	\$500

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



ANALYSIS:

Before July 2010, this fund was known as the **Fidelity Monthly High Income Fund**, which invested primarily in income trusts. Since then, it has been renamed and now has a target asset mix of 70% fixed income and 30% equity. Lead managers Geoffrey Stein and Derek Young have the flexibility to be fairly active around this target asset mix.

They took over the fund last year after the departure of Bob Swanson and have since done a good job. They are up about 7%, which has outpaced both the index and the peer group. Equally impressive, they have been able to keep volatility in check on both an absolute and relative basis.

Like other Fidelity balanced funds, it is managed much like a fund of funds with the lead managers taking responsibility for the broader asset mix and sub managers looking after the underlying funds. As of August 31, it was conservatively positioned, holding 10% in cash, 51% in Canadian bonds, 14% in foreign bonds and 22% in equities.

The fixed income sleeve is very diversified. The managers can invest in any type of fixed income they feel best, based on their view of the current environment. They

can invest up to 49% of the fund outside of Canada. Generally, all the U.S. fixed income exposure will be hedged back to Canadian dollars, to help manage currency risk.

Portfolio turnover has been modest, averaging 28% for the past five years. There was a spike higher in 2011, but given the management change, this was to be expected. It pays a variable monthly distribution that has ranged between \$0.014 and \$0.026, which works out to a modest yield of around 2%.

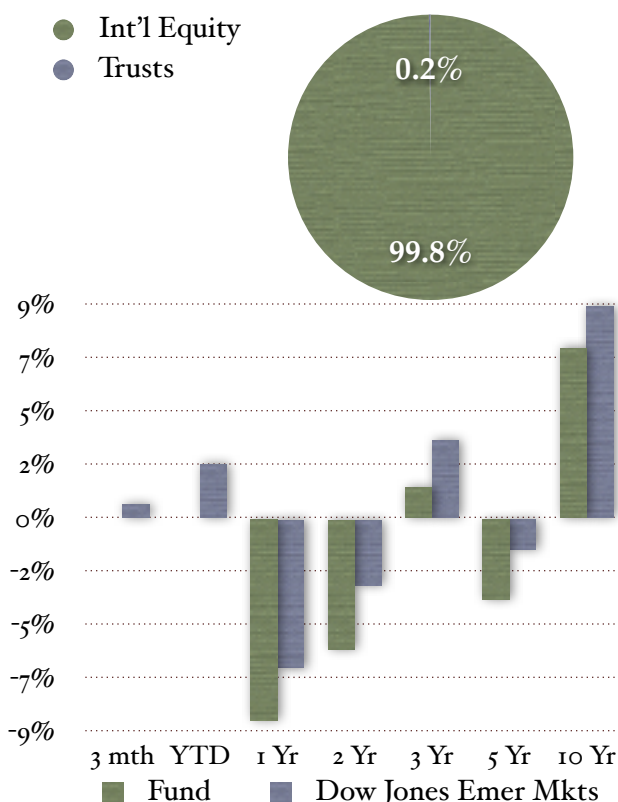
While the performance numbers have been strong, we do not expect that they will be repeated going forward. With the change to the fund's mandate, it has a greater emphasis on fixed income which we expect will result in both lower return and volatility from here.

For those looking for a relatively conservative balanced fund, this is one they may want to consider. It may also be a good choice for those moderate or higher risk investors who are looking for a fixed income alternative for a rising rate environment. We would expect that it will outperform a traditional bond fund in both a flat and rising interest rate scenario.

Templeton Emerging Markets Fund

Fund Company	Franklin Templeton Investments
Fund Type	Emerging Markets Equity
Rating	\$\$\$
Style	Large Cap Value
Risk Level	High
Load Status	Optional
RRSP/RRIF Suitability	Poor
TFSA Suitability	Poor
Manager	Mark Mobius since 1991
MER	2.95%
Fund Code	TML 730 - Front End Units TML 731 - DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS:

Since Patricia Perez-Coutts bolted from AGF, we have been reviewing many of the other emerging market funds available. One that has come up on our radar is the **Templeton Emerging Markets Fund** which is managed by Mark Mobius, who is considered to be one of the pioneers of emerging market investing and the firm remains one of the key players in the emerging market space globally.

The fund is managed using a value oriented process that looks for companies with healthy balance sheets and strong earnings growth that are trading at an attractive valuation. Investment candidates are identified using a range of quantitative screens that weed out the undesirable companies. The team then conducts detailed analysis on the potential buy candidates, often meeting with management to gain a stronger insight into the company, the industry and the region in which it operates.

The selection universe is limited to companies that are located in, or make at least 50% of their revenues in the emerging markets. Being bottom up, they pay little attention to the benchmark weightings and sector and country exposures are a result of stock selection. Sector allocations

are capped at 25% of the fund, while individual holdings are capped at 10%.

Recently, the portfolio has been positioned to benefit from two main themes; consumers and commodities. They believe that as per capita incomes continue to rise, so too will the demand for consumer goods. With commodities, they believe that global commodity demand will outstrip supply, and continued weakness in the U.S. dollar will help to support commodity prices.

Portfolio turnover has been modest, averaging 27% for the past five years. The MER of the fund is high, coming in at 3.13% in 2011. Thus far in 2012, the company has opted to eat many of the operating expenses, reducing the MER down to 2.95%.

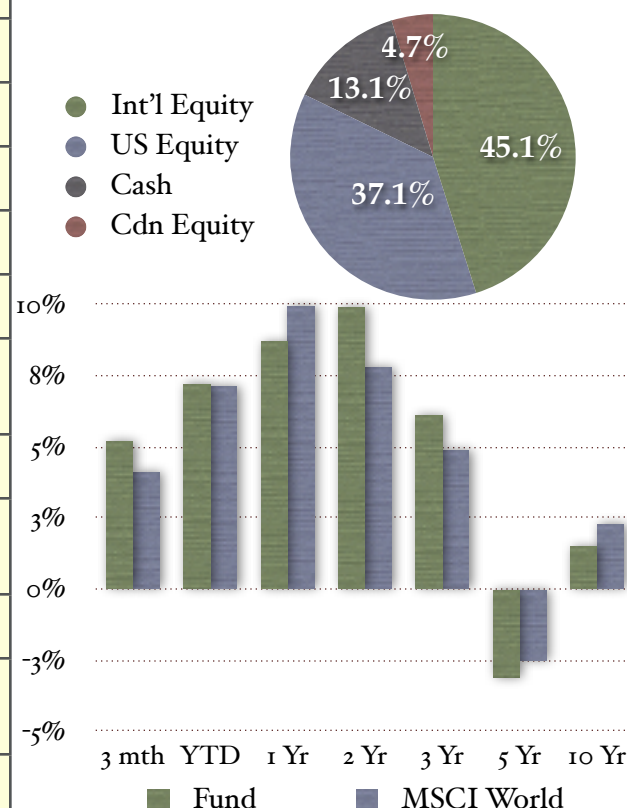
We have a couple of concerns. First is cost. With an MER of 2.95%, it is well above the category average. Our second concern is that the sector makeup of the fund is very similar to the Canadian market, which may limit its effectiveness as a diversifier in a Canadian focused portfolio. Should Franklin Templeton continue to reduce costs for this fund, it will definitely become a more attractive option for investors seeking EM exposure.

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CI Harbour Foreign Equity Fund

Fund Company	CI Investments
Fund Type	Global Equity
Rating	\$\$\$\$
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Stephen Jenkins since Dec 01 Gerry Coleman since Dec 01
MER	2.44%
Fund Code	CIG 14139 - Front End Units CIG 14039 - DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS:

Like all Harbour branded funds, the **CI Harbour Foreign Equity Fund** is managed using a bottom up process that looks for best of breed companies that are run by strong management teams, with sound balance sheets and the ability to generate superior cash flow. They also like companies that have some level of pricing power and have the ability to grow. Dividends and share buybacks are also factors that are considered when conducting their fundamental review. The result is a concentrated portfolio that will hold between 30 and 40 names.

Performance has been strong, gaining 8.7% for the three years ending August 31, handily outpacing the MSCI World Index which rose by 4.8% during the same time. The fund has had its share of problems. Between May 2007 and February 2009, it dropped by more than 53% while the index was down 42%. Since then, the fund has risen moved higher, gaining more than 75% off the lows, outpacing the index by a wide margin. This has been largely responsible for the uptick in the fund's volatility numbers.

They believe that the current environment is very supportive for equities based on a number of factors. These include the strong pace of growth in corporate profitability, particularly with higher quality companies, the low interest rate environment and the overall level of valuations of the equities relative to other asset classes.

As of August 31, the fund held 15% cash, 44% international equity, 32% U.S. equity and 9% in Canadian equities. The managers are content with the makeup of the fund, and haven't been making many changes recently.

Despite the blip in 2008, it is our opinion that this is a great core global equity fund for most investors. We expect that volatility within the fund will settle down in the coming months when compared to the broader market. Apart from the higher volatility that the fund has experienced of late, the other potential knock on the fund is that with a significant cash balance, it may lag the broader market in a market rally. Long term however, we believe that the fund will deliver strong relative returns to investors.

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