
Top Funds Report

Monthly Commentary

Concerns over the Fiscal Cliff will dominate market sentiment in the near term. Here's what you can do!

Despite data showing that U.S. manufacturing continued to expand pushing GDP growth higher than expected, reducing unemployment, it was concern over the impending "fiscal cliff" which weighed on U.S. markets in October and since the November election.

The fiscal cliff is the combination of the expiration of Bush era tax cuts and a slew of massive spending cuts that are slated to take effect in the new year. Unless a compromise is reached, many economists expect that the impact of this will be an increased tax burden of about \$3,500 per family. This will have devastating consequences for the U.S. economy, likely pushing it back into recession.

With Barrack Obama winning a second term in the White House, the Democrats controlling the Senate and the Republicans in charge of the House of Representatives, many fear that the political gridlock which crippled the president's first term is likely to continue. Given the ideological differences between the two parties coupled with their unwillingness to compromise, hope for a solution by year end is becoming increasingly unlikely.

Since the election, reaction from the investment markets has been less than favourable with the S&P 500 falling by more than 3% since the election (as of November 12). Bonds have been affected as investors pile into U.S. treasuries, bidding prices up and pushing yields lower. This has had an impact on currency as the U.S. dollar has rallied relative to the Canadian dollar, moving from \$0.9936 (USD/CDN) to \$1.0016 (USD/CAD) since the election.

While there are other concerns facing the markets, namely the European debt crisis and a slowdown in China, we expect that the short term focus will remain on the fiscal cliff. The fallout will be considerable and felt around the world, likely resulting in extreme volatility, affecting virtually all investors.

With such dire consequences, how can you protect your portfolio? There are a number of ways. The first is to get more defensive by increasing your allocation to bonds. If no deal is reached, equities will selloff very sharply. Should this happen, investors will flock to safe haven assets such as government bonds and to a lesser extent investment grade corporate bonds.

Another way to protect your portfolio would be to add another safe haven asset, namely gold. In periods of extreme uncertainty, gold tends to hold its value very well. For volatile times, you are historically better off holding bullion, rather than gold companies. Where possible, hold the currency hedged version to protect against the impact of currency.

And finally, for more aggressive investors who wish to have some U.S. equity exposure, we would suggest moving from high yielding dividend paying stocks to more growth oriented names. The rationale for this is that one of the tax increases that is expected to survive is with dividends. Currently, the top tax rate on dividends is 15% but is expected to rise to 40% under the new plan. This will likely result in a selloff of dividend payers and a surge in growth stocks as investors look to lessen their tax burden.

Of course, should a deal is reached before year end, it is likely that equities worldwide will enjoy a short term boost until attention returns to the overall condition of the economy and the European debt crisis.

Short of pulling all of your money out of the markets, none of these strategies will fully protect you from the unknown. But by taking a more defensive position in your portfolio, you may be able to help mitigate some of the potential damage.

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

Funds You Asked For

This month, we take a look at the Manulife Floating Rate Income Fund, Altamira High Yield Bond, CI Canadian Investment Fund and more.

Manulife Floating Rate Income Fund -

While the consensus is that interest rates are likely to remain low for the near term, there is little doubt that they will eventually be moving higher. One way to help reduce the risk associated with rising interest rates is to invest in a fund that invests in floating rate notes. This is one of those funds

It invests primarily in floating rate loans, but can also invest in other fixed income investments. Floating rate notes and loans (FRNs) will typically pay a rate of interest that will float with some well known interest rate benchmark like the Prime Rate of Interest or LIBOR. These notes are generally issued by corporations or governments.

Within this fund, the focus is primarily on corporate FRNs. They position this fund primarily on their expectations for interest rates. It is their intention to add exposure to FRN's when rates are low, hoping to capture gains as investor demand increases with likelihood of interest rate hikes. Performance to date looks promising, but there is not really sufficient track record on which to base a proper opinion. It has been more volatile than the other funds in the category.

There is a perception out there is these types of funds are relatively low risk. That is not necessarily the case. For example, looking at the FRN funds that were around in 2008, namely the **Trimark Floating Rate Income Fund** and the **BMO Guardian Floating Rate Income Fund**, both experienced significant losses that year. The BMO Guardian offering dropped 45% while Trimark lost 26%. When considering these funds, you need to remember that these are basically high yield bonds and can experience big drops when uncertainty hits.

While we are encouraged by this fund, we would likely favour the Trimark Floating Rate Income Fund over this one for a couple of reasons. First is its lower MER, second is its lower volatility and third is that the same management team has

been with the fund since its inception, including 2008 when the fund held up relatively well.

Altamira High Yield Bond Fund - With interest rates hovering near historic lows, many investors are turning to high yield bonds as a way to generate additional return while rates remain stable, and to provide better downside protection when interest rates begin to move higher.

This high yield offering from National Bank invests in high yield bonds of both Canadian and global issuers. As of September 30, it was heavily tilted towards U.S. issuers, which make up more than two thirds of the fund. Canadian issuers make up 17%.

The yield is higher than traditional bonds, coming in at 7.6%, while the duration is relatively short at 4.4 years. The credit quality is neutral to its benchmark, holding an underweight position in BB bonds with a slight overweight in bonds rated CCC or lower.

The managers are fairly patient in managing the fund. Portfolio turnover has averaged approximately 40% for the past five years. In looking at the current environment, the manager does not anticipate any major changes in the portfolio's positioning, and expect that it will remain relatively conservative. That said, they are looking to replace bonds in the portfolio that are fully valued with other issues that they believe to be more attractive and less vulnerable to any market turmoil. In reviewing the current environment, they believe that high yield bonds will need to see some level of sustainable economic turnaround if they are to gain any ground

Historically, this has been one of the most volatile funds in the category, outperforming in up markets and underperforming in down markets. In 2008, it was hit particularly hard, dropping 24%, which was worse than many of its peers. In the time since, performance has been very strong, 10.4% for the three years ending September 30,

putting it well into the top half of the high yield category.

While the recent performance has undoubtedly been strong, it is our opinion that the overall volatility may be too high for most investors. While this may be suited for more aggressive investors, it is our opinion that there are other choices available which offer a comparable return profile with considerably less risk.

O'Leary U.S. Strategic Yield Fund - While this is officially classified as a global balanced fund, it is in fact, one of the few U.S. focused balanced funds that are available to investors. Launched in June 2011, it invests in equity and debt securities of U.S. issuers. It is available in a version which hedges the currency exposure and a version which does not.

The well diversified portfolio is very actively managed with turnover that was more than 140% in 2011. Within the equity sleeve, it can invest in companies of any size, and looks for those that pay a dividend. For the fixed income portion, the emphasis is on corporate bonds, floating rate notes and high yield issues.

In managing the fund, they use a combination top down, bottom up approach. The top down analysis is used to identify the most attractive sectors and asset classes. Once they are identified, bottom up, fundamentally driven, value tilted approach is used to find companies that are trading at less than their intrinsic value.

The portfolio is fairly neutral in its positioning, holding approximately 48% in U.S. equities and 47% in U.S. corporate bonds. The equities are currently focused on large cap names as they believe that they will provide better downside protection in the event of any market pullback. It also has a significant exposure to REITs for their yield contribution to the portfolio. This is important since it pays a monthly distribution of \$0.042, which at current prices works out to a yield of approximately 5.3%.

Given that the fund is just over a year old, it is far too early to make a definitive call on its

performance, but the early indications are not particularly favourable. The longer term numbers are disappointing, while short term things have improved.

Based on our analysis, we believe that with its emphasis on high yield debt that it has the potential to be very volatile, given that should we experience periods of high volatility, the high yield holdings will not provide the same backstop that you would get from government or even investment grade corporate bonds.

It is also very expensive and quite small. Assets in the fund were approximately \$10 million. O'Leary has chosen to absorb a significant portion of the operating costs of the fund. If they were to not do this, the MER would be well north of 5%. If the fund does not achieve big growth, there is a high probability it will be merged with another fund or closed down as it will be unprofitable to keep in operation.

CI Canadian Investment Fund - The CI Canadian Investment Fund follows a very simple investment approach where manager Daniel Bubus looks to buy out of favour companies that are trading at a discounted valuation, often due to a controversy. Using their fundamentally driven, bottom up, value focused approach, they look to determine if the reason it is out of favour is permanent or temporary in nature and how likely the value of the company is to return to normal. To do this, they develop a very clear investment thesis on each company they review.

The portfolio is fairly concentrated holding between 25 and 45 names, with the top ten making up around a third of the fund. Sector weights are largely the by-product of the stock selection process and individual names are capped at 10% of the fund.

While the investment approach may make intuitive sense, the results have been somewhat disappointing, lagging both the index and the peer group. Volatility has been roughly in line with the index.

All in all this isn't a bad fund however we do believe that there are better options available. Within the CI family, it is our opinion that **Harbour** or **CI Signature Select Canadian** offer a more favourable risk reward profile for investors.

AGF Canadian Growth Equity Class - What makes this fund interesting is that it invests about two thirds of the fund into large and mid sized companies, with the remaining third invested in small caps. In selecting investments, the managers use a bottom up investment process that looks for companies with strong long term growth potential. They look for strong management, above average growth potential, financial strength and a reasonable level of valuation. The end result is a very well diversified portfolio holding more than 200 names with the top 10 making up about 25% of the fund.

The managers believe that the current slow growth environment is likely to continue in the near term. They remain positive on energy and materials in general, and are very bullish on gold. It is their premise that central bank actions, in the form of easing measures and the actual buying of bullion will continue to support the gold price. Combined, the resource sectors make up more than half of the fund. It is also currently overweight in technology and underweight in financials. Given the capitalization breakdown of the fund, this is to be expected.

Management is looking to use any market volatility as an opportunity to add attractive names to the portfolio at reasonable levels of valuation.

It is a highly volatile fund and tends to take on more risk than comparable funds. Performance has been largely disappointing, and has lagged both the category and the benchmark of late. No doubt a contributing factor to that is that it carries an MER of 3.02%, which is more than 60 basis points higher than the category average. This high cost will continue to weigh on the performance of the fund.

In reviewing the above, we would be very reluctant to recommend the fund at the moment. It is our opinion that there are more attractive options

available that can provide mid cap exposure with less volatility, better returns and lower cost.

Mackenzie Universal Precious Metals Fund - Many believe that with all the liquidity that central banks have pumped into the economic system, the outlook for precious metals, and gold in particular remains quite strong. Precious metals funds are a good way for investors to access this sector.

One such fund is the Mackenzie Universal Precious Metals Fund which can invest in a wide range of companies involved in the precious metals sector including the junior, early stage exploration companies to the very senior production companies. The focus is in Canada, but can invest up to 49% in global equities. In evaluating companies, a couple of the traits they look for include a low cost structure and a very sound balance sheet.

Looking at the current environment, management sees significant support for gold and believes that the opportunity cost for holding it is quite low at the moment. It is their opinion that quality gold companies should match the performance of gold bullion going forward. They are looking for companies that can add incremental value over and above the basic appreciation in the price of gold. One particular area where they are finding such opportunities is in the precious metals royalty companies which they believe are well positioned for a new growth cycle as they offer alternative funding sources to mining companies.

While the investment strategy seems sound, performance has been largely disappointing. The fund has failed to keep up with the category, particularly in 2008 and 2010 when it lagged the category by a wide margin.

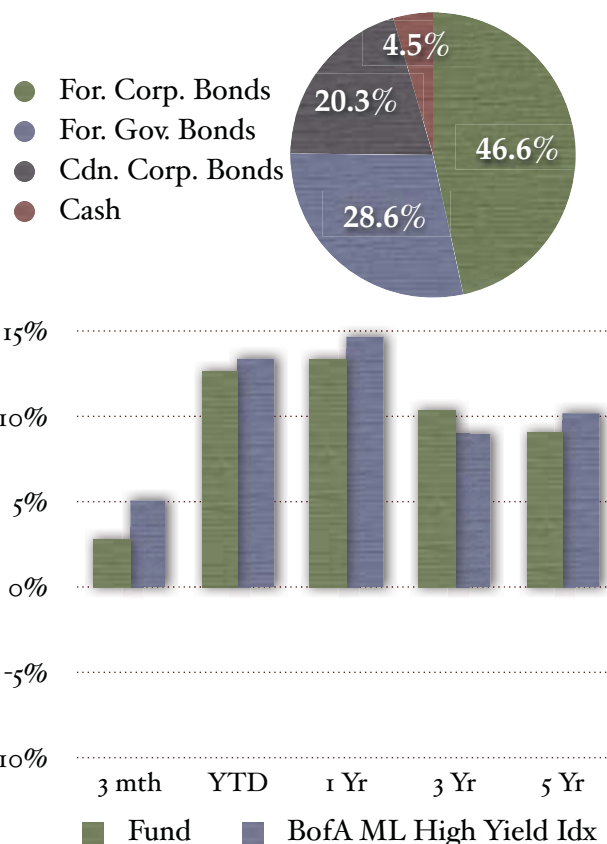
Quite frankly, we believe that there are better options available in the precious metals category including **Sentry Precious Metals Growth** and **RBC Global Precious Metals**.

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

RBC Global High Yield Bond Fund

Asset Mix

Fund Company	RBC Global Asset Management
Fund Type	High Yield Fixed Income
Rating	\$\$\$\$
Style	Credit Analysis
Risk Level	Medium
Load Status	No Load / Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Frank Gambino since July 2003 Jane Lesslie since July 2003
MER	1.77%
Fund Code	RBF 591 - No load units RBF 762 - Front End Units
Minimum Investment	\$500



ANALYSIS:

For those looking for a well managed fund that invests in high yielding corporate and government bonds around the world, this is a great place to start. While the focus is on developed markets, it can also invest in emerging market debt. As of September 30, the fund had 38% exposure to emerging markets.

Performance has been strong, providing index like returns on the upside, with better downside protection. This has resulted in a five year return of 9.8%, putting it well into the upper half of the category. Volatility has been reasonable and is in line with the category average. It held up reasonably well in 2008, losing 10.3%.

The managers employ a very active style and have levels of portfolio turnover that has averaged 100% for the past five years. Of note, management is more active in periods of uncertainty, as turnover rates have been on the decline since 2007 and 2008.

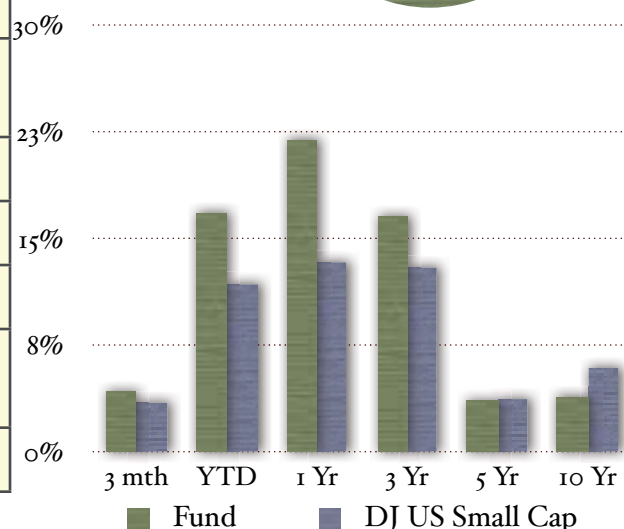
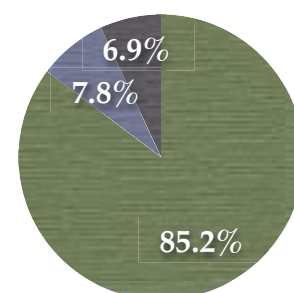
In the current environment, they have become more positive on U.S. high yield bonds over emerging market debt and have been taking action to increase the credit quality. In the past quarter, they have been reducing their exposure to BB bonds and increasing exposure to the BBB bonds. They like the U.S. and believe that it offers good relative value with low default prospects and feel that corporate fundamentals are the best they have seen in years. In reaction, they have increased the duration of the U.S. exposure, at the same time shortening the EM exposure.

Considering our review, we believe that this is a great high yield bond fund for most investors. It offers a strong management team, good performance, a reasonable 1.77% MER, and reasonable levels of volatility. For investors looking for high yield exposure, this is a great pick. A word of caution – given the risks associated with high yield bonds, portfolio exposure should be limited to 10% to 20% of the portfolio, based on the risk tolerance of the investor.

Fidelity Small Cap America Fund

Asset Mix

- U.S. Equity
- Cdn Equity
- Cash



Fund Company	Fidelity Investments Canada
Fund Type	U.S. Small / Mid Cap Equity
Rating	\$\$\$\$
Style	Growth
Risk Level	Medium High
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Steve MacMillan since May 2011
MER	2.54% Sr. A, 2.33% Sr. B
Fund Code	FID 261 - Front End Units FID 561 - DSC Units
Minimum Investment	\$500

ANALYSIS:

Since taking over the fund in May 2011, Steve MacMillan has done a good job for investors, gaining 18.6% to September 30, outpacing not only the benchmark, but also most of his peer group. During his tenure, he has made a few changes, most notably reducing the number of holdings from nearly 200 to a more manageable 40. He also increased the average market cap of the holdings, pushing it much closer to the mid cap space. This did two things; it improved the quality of the investments in the fund, and lowered the volatility profile.

The fund is benchmark agnostic, and looks for well managed companies with good franchises that dominate their markets. Fidelity has implemented a risk control which limits sector exposure to +/- 10% of the index weights. The bottom up stock selection approach relies heavily on Fidelity's extensive research team to help identify investment ideas. Once a company is selected as a buy candidate, he meets with the management to confirm the fundamental findings. He will look to be patient and will generally take a 3 to 5 year investment view. Based on

this, it is expected that portfolio turnover will be lower than 50% going forward.

The portfolio has been pretty stable with healthcare, consumer discretionary and technology being the key sectors. Combined, they make up 57% of the fund. From a sector point of view, this positioning will make it a nice compliment to a typical Canadian equity fund, which tend to be very light on those sectors.

The manager expects that the U.S. is likely to experience a prolonged period of muted economic growth, but still feels that it will be a safe haven in the current environment. The portfolio is filled with companies they believe are not dependent on a strong economic or cyclical environment.

Costs are reasonable, with an MER that is just below the category average. For investors looking for exposure to U.S. small caps, this fund is a great way to do just that. The biggest drawback is that the manager has a somewhat limited track record on the fund. We will continue to monitor the fund closely.

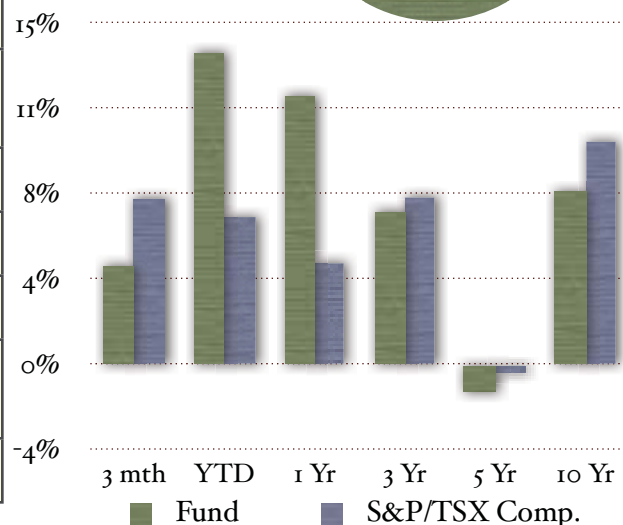
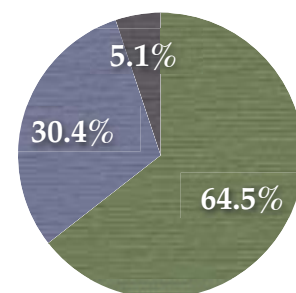
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Dynamic Dividend Advantage Fund

Asset Mix

Fund Company	Dynamic Funds
Fund Type	Canadian Focused Equity
Rating	\$\$\$
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Cecilia Mo since October 2011
MER	1.57%
Fund Code	DYN 054 - Front End Units DYN 056 - DSC Units
Minimum Investment	\$500

- Cdn Equity
- Trusts
- US Equity



ANALYSIS:

After longtime manager David Taylor left Dynamic in October 2011 the reins of this fund were handed over to Cecilia Mo. Along with the new manager, it also got a new name, when it was renamed the **Dynamic Dividend Advantage Fund**, losing its old moniker, the **Dynamic Dividend Value Fund**.

This is a fund whose mandate is right in the wheelhouse of Cecilia Mo in that it focuses on dividend paying stocks including high yielding commons stocks, REITs and Trusts. In selecting the investments for the fund, she uses a fundamentally driven, bottom up approach that considers both the long term growth factors of a company with the current macro environment.

The portfolio is fairly diversified, holding around 50 names with the top 10 making up about 40% of the fund. While the focus is on dividend paying stocks, four of the top ten names were REITs on September 30. The two biggest sectors are financials and energy, which combined

make up 60% of the fund. Most of that financial exposure is REITs, rather than financial services.

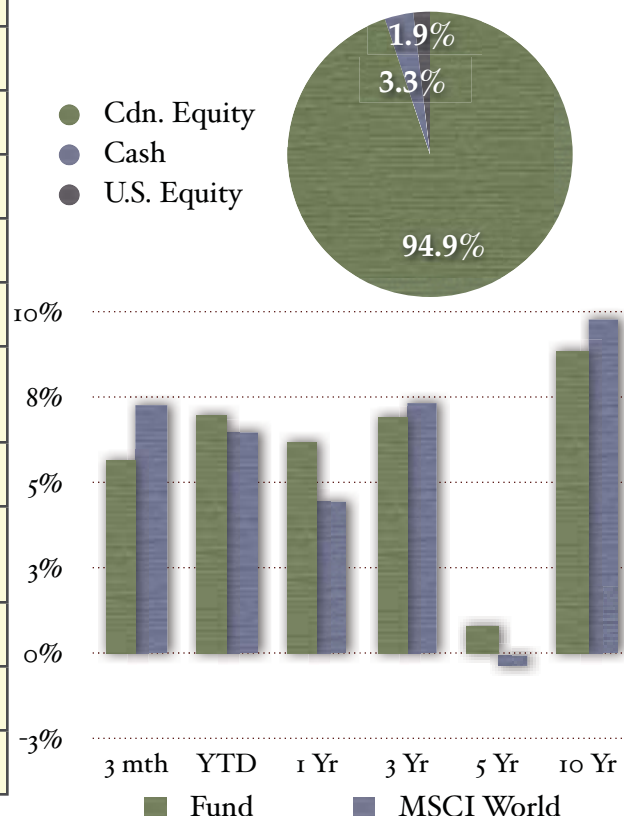
Performance since she took over has been strong, gaining 11.8%, outpacing both the index and the category by a wide margin. Since taking over, she has made some changes to the fund. For example, the average market capitalization of the fund has dropped, but the number of names in the fund has increased. Considering this, we expect that volatility will remain similar to what it was under David Taylor's tenure.

It pays a variable quarterly distribution, but the yield is very low, which limits its effectiveness as a reliable source of income. For those looking to receive regular cash flow, it is available in a T-Series which will pay out monthly distributions which will approximate a yield of 8%. Costs are also very reasonable, with one of the lowest MERs in the category, coming in a 1.57%. All things considered, this is a great fund for investor looking for a portfolio of companies that offer an attractive underlying yield without taking on significant volatility risk.

Beutel Goodman Canadian Equity

Asset Mix

Fund Company	Beutel Goodman Company Ltd.
Fund Type	Canadian Equity
Rating	\$\$\$\$
Style	Value
Risk Level	Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
TFSA Suitability	Excellent
Manager	Mark Thomson since June 1999 Pat Palozzi since August 2007
MER	1.43%
Fund Code	BTG 770 - No Load Units
Minimum Investment	\$5,000



ANALYSIS:

This fund is a high conviction portfolio that will typically hold between 35 and 45 names. It is a pure Canadian equity fund that has no exposure outside of Canada. The investment process is highly disciplined with a great emphasis on capital preservation and a focus on delivering absolute returns while managing risk. The focus is on well managed, large cap companies that are leaders in their respective fields. A small portion is invested in the Beutel Goodman Small Cap Fund, which provides exposure to small and medium sized companies that have the potential to become leaders in their respective fields.

The bottom up stock selection process has a definitive value bias to it. Any potential investment candidate must be trading at a discount of at least 33% to their estimate of intrinsic value, and have the ability to grow within the next three years. It is this margin of safety which helps to provide downside protection when markets become volatile. The approach is also quite patient. Portfolio turnover has averaged less than 20% for the past five years.

There is evidence that this approach works. For example, in 2008 the S&P/TSX Composite Index plummeted by 35%, yet this fund held up much better, losing only 22%. The flip side is that it will likely lag in a sharply rising market. This was indeed the case in 2009, when it failed to keep pace with the 33% jump in the index.

Looking ahead, it is very conservatively positioned with significant underweight holdings in both the energy and materials sector. It has no exposure to REITs or utilities because they believe that the valuations look rich and there is not enough margin of safety at current levels. Still, they remain fully invested and are using market volatility as an opportunity to add new names to the fund at compelling valuations.

We expect that it will provide good downside protection in volatile markets, but will likely lag in a sharply rising market. All in all, this is a great core Canadian equity fund for most investors.