
Top Funds Report

Bond yields spike higher on Fed fears

Investors speculate that Fed will end quantitative easing program sooner than expected

Yields on the benchmark ten year government bonds rose on these rumblings, with the Canadian ten year moving from 1.69% to 2.06%, and the U.S. ten year rose to 2.16% from 1.87%. This caused a selloff in the bond markets, with the DEX Universe Bond Index falling by more than 1.5%. Long bonds and real return bonds, with their longer durations were hit the hardest, while shorter duration and corporate and high yield bonds held up relatively well.

While the timing of this bump in yields may have been a bit of a surprise, the fact that they did move higher shouldn't be. Still, even if yields move higher, we don't expect that the U.S. Federal Reserve or the Bank of Canada will move to raise rates anytime soon. While the economic fundamentals are improving in the U.S., they are stagnating in Canada, leaving the Bank of Canada little room to move. With this backdrop, we expect some continued short term volatility in the fixed income markets, and recommend that investors shorten the duration of their fixed income holdings and move out into the corporate bond space. The higher yields offered by corporate bonds will provide better downside protection when yields move.

We continue to favour equities, with the U.S. being our preferred region. Economic activity is improving and valuations are still reasonable. Those with higher risk tolerances may want to consider adding some European exposure to their portfolios, but we do expect the region to remain very volatile. We would suggest a high quality, actively managed global equity fund as a great way to access the space. Asia, particularly China is expected to remain very volatile, as questions continue to mount about the reliability of the economic statistics and the true level of growth in the country.

We believe that conditions remain quite challenging for investors and in this environment, we continue to favour actively managed funds over the indices.

IN MEMORIAM

By Gordon Pape

Shirley, my beloved wife of 51 years, passed away peacefully on June 2. I was with her along with our three children when she left us. Shirley was a strong, courageous, and loving wife, mother and grandmother. Although she was in weakened health in her latter years, she never lost her sense of humour, her infectious smile or her prodigious memory. She could recall in an instant events in our lives that had long slipped into the backwaters of my brain.

She leaves behind nine grandchildren, all of whom she adored. She loved being with them, listening to their stories and accomplishments, watching them grow and flourish, and marveling at the special talents and abilities each displayed.

And she loved life - the smell of fresh roses, a sip of fine wine, catching a trout at our fishing club, watching the Blue Jays, being with friends, gazing across the bay at our Florida home as the moon rose, and, above all, being with her grandchildren.

She wasn't ready to go. We weren't ready to lose her and we all miss her terribly. Be at peace, my love. Somewhere, some day, we'll be together again. All my love, Gordon.

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

Funds You Asked For

This month, we take a look at offerings from Invesco, Dynamic, Excel and more...

Correction – TD International Index Fund (TDB 964)

In our last edition, we mistakenly stated that the MER on this fund had been reduced from 1.38% to 0.51%. This was based on a report we received which contained an error, and was in fact referencing the e-Series of the fund, which has an MER of 0.51%. Regardless, we stand by the conclusion of our review that stated:

*“...it is our opinion that a high quality actively managed International Fund will do better than this offering over the long term, even with the lower MER going forward. We would suggest that investors looking for actively managed international exposure take a look at **Mawer International Equity, Renaissance International Equity or Invesco International Growth Class**. Each of those is a high quality fund that we expect should outpace the index fund over the long term.*

For those just looking for low cost exposure to International equities in a mutual fund, this would be our top pick.”

We apologize for any inconvenience this error may have caused.

Trimark Income Growth Fund (AIM 1543)

In the past several months, this Canadian focused balanced fund has experienced some meaningful manager turnover. A year ago, it was announced that equity manager Don Simpson had been replaced by Clayton Zacharias. More recently, longtime bond manager Rex Chong left the firm for personal reasons. Looking at the net impact of these moves, we view it to be a modest positive.

The equity portion of the fund will continue to be managed in the Trimark philosophy, which is business people buying businesses. Mr. Zacharias has a very respectable track record during his tenure with the Trimark Canadian Endeavour Fund. With that fund, he has been able to post top quartile performance. One key difference between that fund and this one is that the Endeavour fund is more mid cap focused, while this fund will lean more towards the large caps. Still, the investment process and philosophy will be identical.

While it was sad to hear of Mr. Chong's departure, we don't expect that it will have a significant impact on the management of the bond sleeve of this fund. It will continue to provide a volatility buffer for the equity holdings and generate some level of income. It is currently overweight in corporates given their level of valuation relative to governments.

The fund is positioned for growth with an overweight position in equities. It holds 42% in Canadian equity, 22% in U.S. equity, and 23% in fixed income with the balance in cash.

The level of portfolio turnover has been modest, averaging around 50% a year. It was noticeably higher in 2012, but that is not unexpected given the manager change. We would expect that it will move back down towards the longer term numbers going forward.

Performance has been decent, but unspectacular. For the five years ending May 31, it gained 2.7%, outpacing its benchmark, which gained 1.7% during the same period. Shorter term numbers are stronger, with a one year gain of 16.7%, compared to a 10.4% rise in the benchmark. Volatility has been above average, but given the higher equity component, this is not unexpected.

Looking forward, we are cautiously optimistic that with Mr. Zacharias managing the equity portion that we will see a sustained improvement in overall returns. Still, it is our opinion that there are better balanced fund options available to investors.

Dynamic Blue Chip Equity Fund (DYN 204)

Formerly known as the Dynamic Focus+ Equity Fund, this go anywhere equity fund is managed with the underlying philosophy that they are not simply investing in a stock, but are instead buying into a company. The manager looks for strong, well-managed businesses with a demonstrated history of generating attractive returns on invested capital. They seek out high quality businesses that have pricing power and attractive growth opportunities. Valuation is also a key consideration, as they do not want to overpay.

The portfolio is concentrated, holding between 30 and 40 individual companies. The top ten currently makeup approximately 36% of the fund and is filled with household names like Microsoft, Coca Cola and Citigroup. It is well diversified across sectors, and has about 60% of the fund invested in U.S. based companies.

Despite the concentration, one of the key objectives of the fund is capital preservation. They have done a very respectable job in protecting investors' money. In 2008 when the S&P/TSX Composite Index dropped by 33%, this fund was down by only 20%. Unfortunately, with its emphasis on quality, it will also lag in a sharply rising market. In 2009, coming off the market lows, it gained only 21%, dramatically underperforming the 35% rise in the broader market.

We love the philosophy of the fund, but thus far have been underwhelmed with its execution. For the three years ending May 31, the fund was up an annualized 5.4% while the Fundata North American Equity Index was up more than double that.

While we don't believe that this fund will hurt you too badly over the long term, we also don't expect any surprises to the upside. Considering the above, it is our view that there are more attractive opportunities in both the Canadian and global equity categories that can better serve the needs of investors.

NEI Ethical Global Equity Fund (NEI 069)

For some, investing is more than just making money. They want to know that they can make a difference by investing only in companies that are helping make the world a better place. Ethical Funds were one of the first companies offering to Canadian investors, and this fund is their global equity offering.

It is an all cap, go anywhere global equity fund that is managed almost like a fund of funds. Manning Napier has three distinct investment strategies that it allocates to based on their outlook of the world. The first strategy is their strategic profile, which is focused on identifying undervalued companies that they believe are positioned for strong growth.

The "hurdler rate" strategy looks for companies that are operating in sectors experiencing trouble, but are strong enough to survive and likely to lead the rebound when things turn around. This strategy is usually how they play in the cyclical space.

The "bankable deal" strategy is very similar to traditional value investing, where they look for companies that are trading at significant values to what the managers believe to be the company's true value. They are typically looking for companies that are 40% to 50% below their true value.

Along with traditional stock selection, Ethical Funds are very active shareholders and often engage company management to make positive changes within their firms.

The portfolio is very well-diversified holding nearly 100 names. It is an all cap mandate, but the majority of the companies in the portfolio are larger, more recognized names. Because of the unique investment process uses, the portfolio looks much different from its benchmark. It is significantly underweight in financials and utilities, and overweight in technology.

Performance has been largely uninspiring. As of May 31, it has an annualized five-year return of 1.2%, which is less than half the gain in the Dow Jones Global Total Return Index. A big reason for this underperformance is the high cost of the fund, which carries an MER of 2.71%, which is well above the category average. Volatility has been higher than the index.

Despite the above, this is one of the best SRI options available in the global equity category. It is our opinion that investors looking for SRI exposure might want to consider looking at the **NEI Ethical Global Dividend Fund**, which is managed by KC Parker of Beutel Goodman. It offers a slightly more favourable risk reward profile and a lower cost.

Excel China Fund (EXL 103)

There is little doubt that the growth story out of China has been quite impressive for the past several years. It has largely been responsible for the boom in demand for commodities that has buoyed many developed markets, including Canada. While many are calling for this remarkable growth story to continue, it is not without its risks.

This fund looks to capitalize on that impressive growth story by investing in companies that are located in China, Hong Kong and Taiwan. It is managed by Barings International Investment Limited, which was one of the first companies to invest in Chinese equities. Today, they are one of the largest teams investing in China and Hong Kong equities.

In managing the fund, they use a very active management style. For the past five years, portfolio turnover has averaged more than 100%. The portfolio is fairly concentrated, with 45 holdings. The top ten make up 44% of the fund. Financial services make up 30% of the fund, followed by industrials at 13%, technology at 12% and energy at 11%.

In a recent commentary, the managers said that they believe that the market has been overly pessimistic on the economic growth in the region. This is why stocks are trading below their historical range. They are using this weakness as an opportunity to improve the quality of the portfolio. Specifically, they are finding attractive options in Chinese property stocks, cement companies and select retail brands.

Not surprisingly, performance of this fund has been extremely volatile. The monthly volatility has been higher than its peer group and significantly higher than the broader market. Despite the big growth story in China, performance has been largely disappointing. For the five years ending May 31, it lost an average of 5.4% per year, while the MSCI China Index lost 1.6% during the same period.

Another issue with this fund is its cost. It has an MER of 3.54%, which is the highest in the category by a significant margin. This high level of fees will continue to drag performance of the fund.

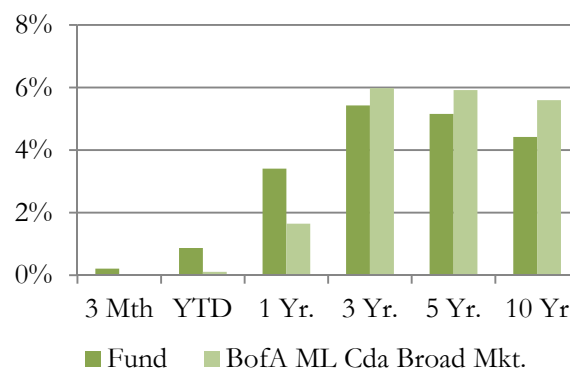
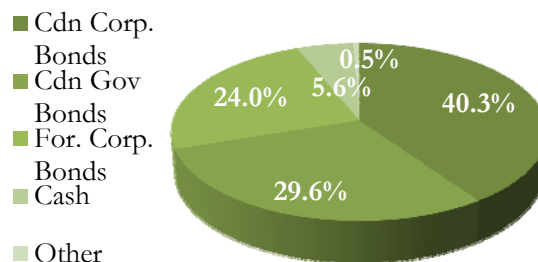
While we acknowledge that there are opportunities investing in China, we don't think that this is the fund to do that. We believe that there are other, less aggressive, and less costly funds that would do the job better. There is significant risk in the region and only those with a very high tolerance for risk should consider investing.

If there is a fund that you would like reviewed, please email it to us at feedback@paterson-associates.ca.

Dynamic Advantage Bond Fund

Fund Company	Dynamic Funds
Fund Type	Canadian Fixed Income
Rating	Not Rated
Style	Duration Management
Risk Level	Low
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Michael McHugh since July 06 Domenic Bellissimo since 2012
MER	1.55%
Fund Code	DYN 258 – Front End DYN 688 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Managed by the team of Michael McHugh and Dominic Bellissimo, we believe this fund is well positioned for the current interest rate environment. First, it is heavily weighted to corporate bonds, with some exposure to high yield. This will increase the yield generated by the portfolio, allowing for higher returns in a flat rate environment and better downside protection when rates move higher. Second, approximately 10% of the fund is in investment grade foreign bonds, which will lower the sensitivity to Canadian interest rates. Third, the manager is actively working to control duration by using a number of strategies including selling long bonds, selling bond futures short and the use of floating rate notes.

Using these strategies, the fund has set itself up to provide better downside protection when rates rise. In reviewing the historic upside and downside capture ratios over the past five years, we found that it captured about 75% of the upside of the DEX

Universe Bond Index, yet only experienced a third of the losses.

Another thing that we like about this offering is that it is one of the few remaining bond funds that is available in a corporate class version, which means that investors in non registered accounts can better manage their tax burden. On an after tax basis, the returns have more than offset its higher costs when compared to a comparable ETF.

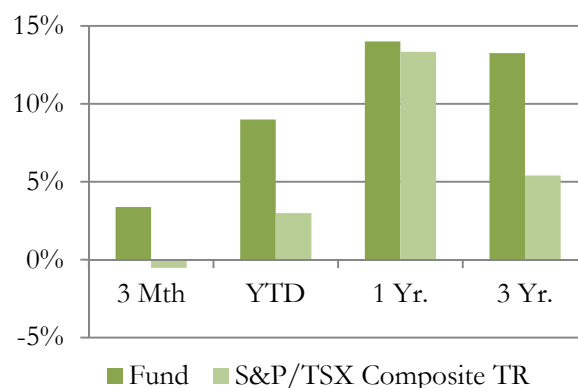
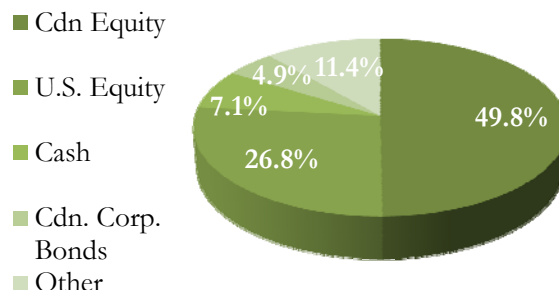
Looking at the performance during May, the process is definitely working. The DEX Bond Universe Index dropped by nearly 1.5%, while this fund, with its defensive positioning was lower by 1.0%.

Despite posting a loss during May, it is our opinion that this fund remains one of the best bond fund picks for very conservative investors. We believe that the defensive positioning will protect investors when yields are pushed higher.

Sentry Growth and Income Fund

Fund Company	Sentry Investments
Fund Type	Cdn Dividend & Income Equity
Rating	A
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
TFSA Suitability	Excellent
Manager	James Dutkiewicz since May 12 Michael Simpson since Aug 08
MER	2.80%
Fund Code	NCE 727 – Front End Units NCE 327 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This Canadian dividend focused offering has posted stellar risk adjusted returns with an annualized return of 12.2% for the three years ending May 31. This outpaced the S&P/TSX Composite Index by more than 800 basis points per year. Even more impressive, the level of volatility has been well below both the category average and the broader market.

To do this, the managers have built a diversified portfolio of well-managed companies with strong balance sheets that are generating high returns on equity, and are paying healthy and growing dividends. While the focus is on Canadian based companies, they can invest up to 30% in global securities. As of April 30, approximately 27% was abroad.

Along with dividend paying equities, the fund will invest in corporate, high yield and government bonds. Currently, about 10% is in fixed income, of which the majority is invested in corporate bonds.

The fund's equity holdings are significantly underweight in materials, which made up just 6% of the fund as of March 31. This has helped considering the recent collapse in commodity prices. They have been increasing their exposure to industrial names, where they have been finding a number of very attractive opportunities. They expect that economic growth will slow both at home and in the U.S.

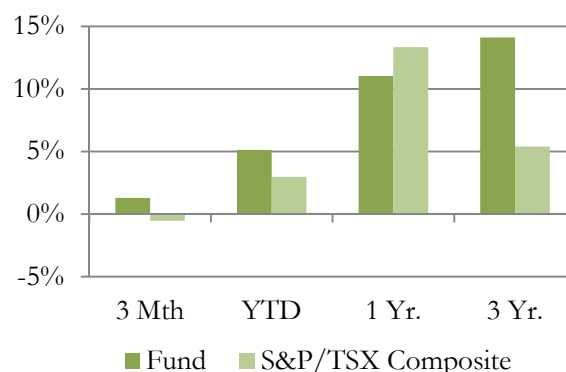
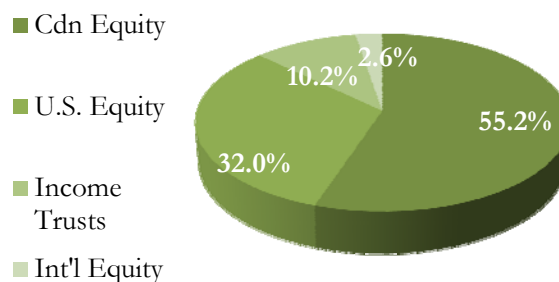
It pays investors a monthly distribution of \$0.067 per unit, which at current prices works out to a yield of more than 8%. Looking at the yield of the underlying investments, it is unlikely that the fund can sustain the distribution without there being an erosion of capital.

Our biggest knock on this fund is that it is not cheap, with an MER of 2.75%, which is well above the category average. Still, with its focus on both yield and growth, we expect that the fund can continue to deliver strong risk adjusted returns, compared with its peer group.

First Asset Canadian Dividend Opportunities

Fund Company	First Asset Funds
Fund Type	Cdn Dividend & Income Equity
Rating	A
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
TFSA Suitability	Excellent
Manager	John Stephenson since April 10
MER	2.28%
Fund Code	FAF 6103 – Front End Units FAF 6100 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: John Stephenson and his team pore over mounds of economic data, constantly trying to get an accurate picture of where we are in the business cycle. With this knowledge, they determine the sectors they believe will outperform. They then conduct fundamental research on companies operating in those sectors looking for well managed companies that offer not only an attractive dividend yield, but is also sustainable and likely to grow.

The result is a portfolio of 40 names, typically concentrated in only a handful of market sectors. Currently, it is heavily weighted in energy, financials and utilities. It can invest up to 30% of the fund globally, and are currently at the maximum. All the exposure is the U.S., which they believe is on the upswing with a rebounding housing market and strong economic fundamentals.

They are quite tactical in their approach, not afraid to raise cash significantly when they believe trouble is on the horizon. For example, in September 2011, they

moved cash up to more than 50% of the fund, which helped protect investors from a large loss in the latter half of the year. The fund gained 11% that year, while the index dropped by nearly 9%.

As impressive as the returns have been, the volatility numbers have been even better. Since its launch, the fund has been about half as volatile as the broader equity markets, and has been well below its peer group.

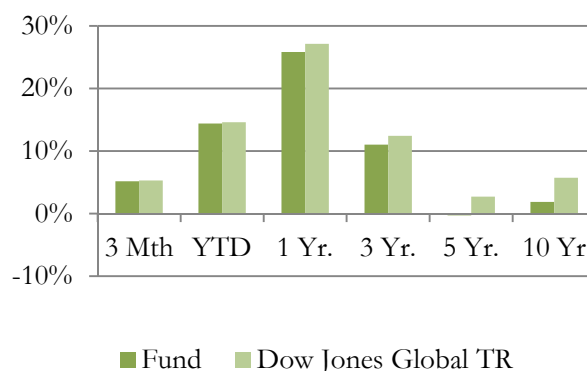
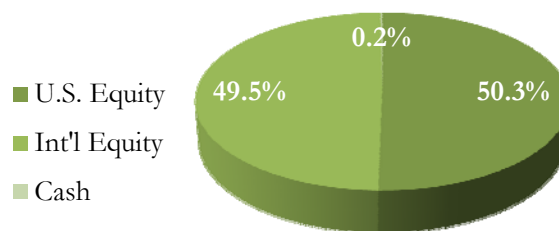
Considering the above, we like this fund. Historically, it has offered a very compelling risk reward profile for investors. One risk is that the concentrated approach, both to sector allocation and security selection could work against you if they are in the wrong sectors, or if they are sitting on a high cash balance in a market rally.

Still, it is our opinion that this fund can be a good option for those looking for actively managed, income producing Canadian equity exposure.

National Bank Global Equity

Fund Company	National Bank Securities
Fund Type	Global Equity
Rating	UNDER REVIEW
Style	Growth
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
TFSA Suitability	Good
Manager	Nadim Rizk since April 2012 Andrew Chan since April 2012
MER	2.62%
Fund Code	NBC 867 – No Load Units NBC 467 – Front End Units NBC 567 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Since the new management team of Nadim Rizk and Andrew Chan of Fiera Capital took over this fund a little more than a year ago, the performance has definitely turned around. It had previously been a laggard, and was perennially in the bottom half of the category, while lately it has been firmly in the upper half of the category.

It is an all cap, go anywhere mandate that relies on basic screens to help identify potential investment candidates. Once identified, they conduct a detailed fundamental analysis focusing on both company and industry factors that help them determine their estimate of the intrinsic value of the company. Once that is known, they look for companies that offer a minimum return of at least 50% over the next three years. They are benchmark agnostic and the country

and sector weights are a byproduct of their stock selection process.

The portfolio is a concentrated, yet diversified portfolio that will typically hold between 40 and 60 names. At the end of May, it held 44 positions with the top ten making up 30% of the fund.

We definitely like the direction that this fund is headed. While one year is far too short of a history on which to judge performance, the manager in fact has a much longer track record. He has been managing global equities since 2006. When we reviewed his global equity composite track record for the past five years, adjusting for the cost differential of the fund and the composite, we found that it would have ranked in the top ten of all global equity funds in our coverage universe. This is definitely a fund to watch.