
Top Funds Report

Third quarter starts off strong

Calmer heads prevail as economic numbers continue to improve.

The third quarter started off well with gains in both stocks and bonds. Worries over higher interest rates took a back seat to improving economic fundamentals both at home and abroad.

In Canada, the S&P/TSX Composite Index rose by 3.2%, led by strong gains in gold companies, consumer staples and financials. Gold rallied by more than 7.3% on expectations that the low interest rate environment may fuel future inflation. I don't expect that this gold rally is sustainable given that there are no meaningful signs of inflation on the horizon.

U.S. and global equities also showed strong gains, with the S&P 500 rallying 5% in U.S. dollar terms, while the MSCI EAFE gained 5.3%. For Canadian investors, a falling U.S. dollar muted those gains. Investors celebrated stronger than expected economic growth, improving job numbers, benign inflation and strong consumer demand. Many were also encouraged by comments made by Ben Bernanke, the Chairman of the U.S. Federal Reserve reinforcing that tapering does not mean tightening. He reiterated that while bond buying would slow or stop, interest rates would not move higher until certain employment and inflation thresholds were breached. Given the current outlook, it may be many months before that happens.

In Europe, investors rejoiced on news that the troubled region had finally emerged from recession. While this is positive news, there is still much uncertainty about the pace of economic growth. With the austerity measures and debt controls that are in place, it is highly unlikely that we will see a return to the spectacular pace of growth experienced before the global credit crisis. Still, there is no denying the region is in much better shape than it was a year ago, and is definitely on the right path.

As we enter into the dog days of summer, my investment outlook remains consistent. I favour equities over fixed income. While I don't expect that we will see big jumps in bond yields, I expect that we will see higher levels of volatility as investors speculate on when the Fed will begin raising rates.

While it may be tempting to sell all your bond holdings in this environment, I would strongly advise against that. Fixed income, even in a heightened risk environment can be a cornerstone of any portfolio. You will want to focus on shortening duration and increasing yield, while monitoring your overall risk exposure. Some good ways to do this include short-term bonds, floating rate notes, and global bonds.

Within equities, I favour the U.S. over Canada and Europe because it offers stronger fundamentals. Corporate profitability remains strong. There may be some opportunities in Europe, but I would not recommend the region as a core holding. Instead, I would suggest you consider gaining exposure through a high quality, actively managed global equity fund that can provide exposure to the region. Investors with higher risk appetites may want to consider a European equity fund, but remember it can be volatile.

Canadian equities remain a concern. Our market is heavily focused on commodities which are expected to be under pressure for the near to mid-term. Another worry is the affect a slowdown in the housing market will have on our banks. Fortunately signs are pointing to a soft landing in housing, but still the risk remains. I would avoid index funds, and instead look for a high quality, actively managed fund that looks much different than the S&P/TSX Composite Index.

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

Funds You Asked For

This month, I highlight a fund of funds from Renaissance and as a number of quick hits.

Renaissance Optimal Income Port. (ATL 048)

Despite being made up of a mix of middle of the road funds, this is a portfolio that really punches above its weight. It offers investors decent risk adjusted returns and cash flow all at a reasonable price.

It is a fairly static mix of a number of Renaissance funds including the **Renaissance Canadian Bond Fund**, **Renaissance Canadian Dividend Fund**, **Renaissance Global Infrastructure Fund**, and the **Renaissance High Yield Bond Fund**. The asset mix stays pretty consistent over time, with portfolio turnover averaging 3% a year for the past five years.

Launched in late 2007, the timing for this fund could not have been worse. Still, its performance has been respectable with very modest volatility. It has shown strong downside protection with decent upside participation. In other words, while you will lose money in this fund when the markets are down, on average, you can expect to lose much less, without sacrificing a lot of the upside.

It pays a monthly distribution that is set at \$0.033 per unit. At current prices, it is an annualized yield of around 4%. If you need higher levels of cash flow, there are T-6 and T-8 versions available that offer yields of 6% and 8% respectively. A word of caution with the higher distributions is that you will likely experience some erosion of your capital over time. That is not necessarily a bad thing, but it is something you need to be aware of.

I expect with the interest rate sensitivity in the portfolio that it will be difficult to deliver the levels of absolute returns that it has in the past. Still, I do expect that it has the potential to continue to deliver above average levels of return.

It is a well-diversified portfolio offered at a very reasonable cost. All in all, this is a fund you may want to consider if you are looking for a diversified portfolio that will deliver modest risk adjusted returns and good cash flow.

CI Cambridge Canadian Growth Companies (CIG 11108)

Since its September 2012, this Brandon Snow managed small cap offering has handily outpaced both the benchmark and its peer group. For the year ending June 30, it gained a staggering 44%, while the BMO Canadian Small Cap Index was down 1%. While this outperformance is impressive, it is not sustainable, and I expect that over time, we'll see it return to a more normalized level.

Like all Cambridge funds, it is managed using a fundamentally driven, bottom up approach. They look for companies that have management that is aligned with shareholders, have a demonstrated history of being strong capital allocators, and have a strong competitive advantage.

It has a flexible mandate that allows the managers to diversify across a wide range of asset classes and geographies. As a result, it will likely be actively managed and is benchmark agnostic. Portfolio turnover since inception has averaged more than 300% a year. It is fairly concentrated, holding 36 names with the top ten making up 36% of the fund. I expect that over the long term, this fund will be more volatile than many other small cap offerings.

Currently, it is defensively positioned, holding an overweight in consumer defensives, healthcare and utilities. It is also positioned for modest economic growth, with a significant overweight in both industrial and technology focused names. It has very little exposure to commodity driven names.

I like the management team and their process, but clearly, the recent outperformance, is not sustainable going forward. Realistically, I would expect this fund to outpace most of its peers, but to do so with higher levels of volatility. Because of this, I would approach this fund with caution, and I would only suggest you consider it if you have an above average appetite for risk.

Dynamic American Value Fund (DYN 041)

After a great deal of thought and analysis, I reluctantly came to the decision to drop the fund from the Recommended List. I really like the process and approach that David Fingold uses when looking at stocks. He has a unique view and has historically done a great job at protecting investors' capital in down markets. Despite that, something isn't working. He has consistently lagged the index, and his peer group since mid-2011. In the past 12 months, the fund has only outperformed the S&P 500 one time, and in the past 24 months, has only outperformed five times. In the past 24 months, the fund has only participated in 30% of the upside movement of the market, and 70% of the downside. Considering the above, I really have no other choice but to remove the fund from the Recommended List.

RBC Global Precious Metals Fund (RBF 468)

To say that gold and gold companies have struggled of late would be a bit of an understatement. As of June 30, the S&P/TSX Global Gold Index had plummeted by more than 43% on the year, and the outlook does not look any better. Gold has long been thought of as a hedge against inflation, but with yields moving higher, the outlook for inflation becomes even more muted. Factor in worries about demand in India, the world's largest consumer of gold, combined with gold mining companies taking more than \$17 billion in write downs so far this year and more expected, the picture becomes pretty glum.

Some are even expecting gold to trade as low as \$1,000 by the end of the year. With this as the backdrop, my view on the RBC Global Precious Metals Fund and gold funds in general, has become even more bearish. I still believe that gold can be a good hedge against inflation, and portfolios can benefit from some exposure over the long term, but at the moment, I believe that the risks far outweigh the benefits. I will continue to monitor the situation and make the appropriate suggestions when the time.

RBC Global Corporate Bond Fund (RBF 580)

Of all the funds on my Recommended List, this was the one I was most disappointed with in the past quarter. With its emphasis on higher yielding corporates and shorter duration bonds, I expected it

to hold up better than it did. Based on a recent manager commentary, it appears that they were burned by long term bond exposure. I believe that the worst is behind us for now, and as things settle, we will see the fund return to producing above average returns. In July, it significantly outpaced both the benchmark and its peer group with a gain of 0.9%.

Trimark Floating Rate Income Fund (AIM 1233)

When I last talked about floating rate funds, I said they would be a good way to help protect against rising rates. Fast forward a quarter and we see that this fund did exactly what I expected it to do. While most other fixed income funds were down, even the "low risk" short term bond funds, this one managed to eke out a small gain. I expect that to continue in the current environment. While you may be encouraged by its performance, it is not a core fund. It carries a higher level of risk than you might think, and should only be used as a portion of your overall fixed income exposure.

Fidelity Canadian Balanced Fund (FID 282)

One of the key factors that attracts me to this fund, namely the relatively static asset mix of 50% bonds, 50% equity, may end up being its detriment as we move forward. While not an immediate concern, it may become one as the fixed income space becomes more volatile. With the managers effectively handcuffed to a 50% fixed income allocation, they may not be in as strong a position to protect capital as those that have more flexibility around their asset mix.

IA Clarington Canadian Conservative Equity Fund (CCM 1300)

When the fund is heavily concentrated in interest rate sensitive sectors like pipelines, utilities and communications, it shouldn't be a big surprise that it struggled during a quarter when interest rates shot higher. While I believe that the worst is likely over, there may be a bit more volatility with this fund over the next little while until the interest rate picture settles. I still believe that this can be a good core fund over the medium to long term for most investors.

Sentry REIT Fund (NCE 705)

Real estate and REITs in particular have been very hard hit since interest rates have shot higher. Despite the short term selloff, I believe that the longer term outlook, particularly in Canada remains strong. There is significant institutional demand for high quality properties which will help to provide some support for prices. Still, I do expect more volatility in the short term. While I think that there is a bit more downside in the near term, you may want to start looking at adding to your REIT exposure on the drawdowns, particularly if you have an above average risk tolerance and a long term time horizon.

Templeton Global Smaller Companies Fund (TML 707)

The process that manager Martin Cobb uses on this fund is very sound. It is a value focused, bottom up approach that looks to identify names that are undervalued relative to their assets or earnings. Yet when I look at the results since he took over, they are well below average. There has been a turnaround in the past year, and it had a very strong second quarter. Volatility however, has been on the upswing, and is now above the category average. I am encouraged by this turnaround, but still cannot give it my full recommendation until I get a better sense if the recent turnaround is for real or just a blip.

Mackenzie Cundill Recovery Fund (MFC 742)

The mandate of the fund is to invest in companies that are undergoing some sort of recovery. This has always been an interesting mandate, and that hasn't changed. However, I am increasingly concerned with two things – volatility and the overweight exposure to China, particularly in real estate. With the exposure to the floundering China real estate market, I expect that volatility will move even higher, with no guarantee of increasing returns. Considering the above, I would suggest that investors approach this fund with caution.

AGF Emerging Markets Fund (AGF 791)

While I have been impressed with the job that the management team led by Stephen Way have been doing with this fund, I am becoming increasingly

concerned about the emerging market sector in general. We continue to see many cracks in the story, particularly in China. Under former manager Patricia Perez-Coutts' management, the fund did a stellar job in preserving investors' capital compared to its peers, particularly in down markets. I am watching its performance closely during this period of heightened volatility to see how it holds up. That will hopefully give me the comfort surrounding the new management team's ability to effectively manage the fund going forward.

PH&N Canadian Equity Fund (PHN 130)

Like other PH&N equity offerings, it follows the PH&N philosophy of "quality growth". The managers look for companies that offer an attractive yield combined with strong management, high levels of profitability, a sound financial position, strong earnings and dividend growth. Valuation is also a key component to the process, since they don't want to overpay.

It is diversified, holding more than 90 names, with the top ten making up more than 40% of the fund. From a sector standpoint, it looks a lot like its benchmark, with financials, energy and materials representing the bulk of it. Still, it is slightly underweight in materials, which has certainly helped boost its shorter term returns when compared to the S&P/TSX Composite Index.

The longer term numbers have been middle of the pack with the Series D units finishing just above the median for the category, while the Advisor series came in just below the median. This is the result of the cost structure, which is still fairly attractive with an MER of 1.30% for the Series D units and 2.04% for the advisor sold units.

While this isn't a bad option, I would likely lean more towards the **PH&N Dividend Income Fund** over this offering. It has generated comparable returns, and has done so with less volatility.

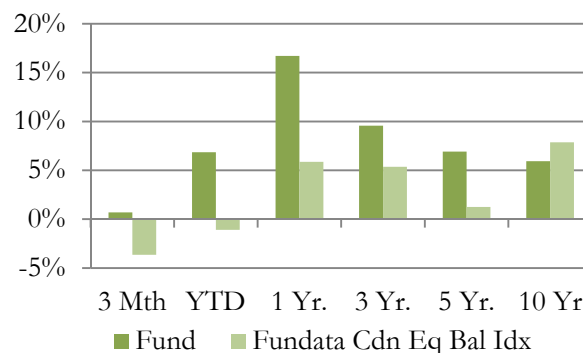
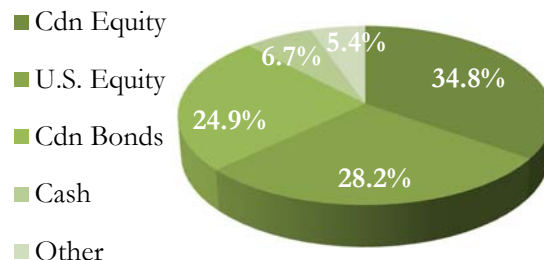
If there is a fund that you would like reviewed, please email it to us at

feedback@paterson-associates.ca.

Cundill Canadian Balanced Fund

Fund Company	Mackenzie Investments
Fund Type	Canadian Equity Balanced
Rating	B
Style	Value
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Lawrence Chin since April 2009
MER	2.53%
Fund Code	MFC 740 – Front End Units MFC 840 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Manager Lawrence Chin uses the same deep value style that has become synonymous with the Cundill name. 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.

The asset mix is actively managed, but it does have a neutral mix of 60% equities and 40% fixed income. As of June 30, it was roughly 65% equity, 28% bonds with the balance in cash.

True to their style, the managers have begun to kick the tires on some opportunities in the materials sector. Currently the portfolio is underweight the sector, with no direct holdings in any mining companies. With many names in the sector off more than 80% from

their highs, they believe it warrants some serious consideration. Making any move into this sector has the potential to push the volatility of the fund even higher.

While the longer-term performance has been strong, volatility has been high compared with 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 managers' deep value style and their high-conviction, concentrated portfolios.

It has had a particularly good run in the past few years, and if you have held it, I would suggest that you consider rebalancing your portfolio to take some profits. Over the long term, I expect that it can deliver above average returns with above average risk. Any investor considering this fund should have a long-term time horizon and at least a medium risk-tolerance.

Leith Wheeler Canadian Equity

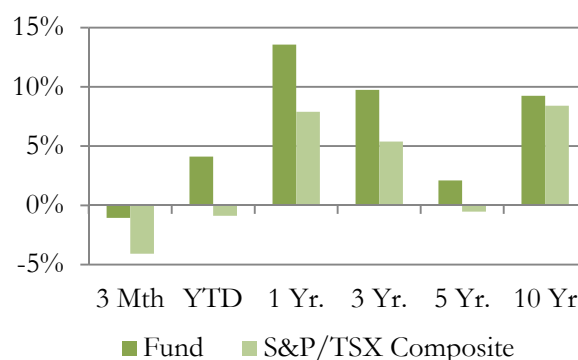
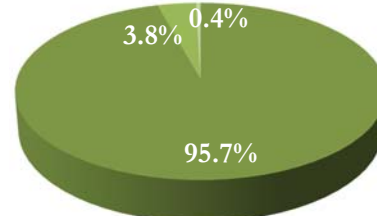
Fund Company	Leith Wheeler Investment Counsel
Fund Type	Canadian Equity
Rating	B
Style	Value
Risk Level	Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
Manager	Leith Canadian Equity Team
MER	1.56%
Fund Code	LWF 002 – No Load Units
Minimum Investment	\$5,000

Asset Mix

■ Cdn Equity

■ Int'l Equity

■ Other



ANALYSIS: When it comes to Canadian equity funds, it doesn't get a whole lot better than this. It is a simple, no nonsense, consistent fund that does what you expect it to do: deliver above average returns more often than not.

The management team looks at each investment opportunity as if they were buying the whole company. They are looking to find high quality, conservatively financed companies that generate attractive returns on capital, that are trading below what they believe it to be worth. They like to buy companies after a big drop in price, since they believe that it only adds to their margin of safety, reducing the likelihood of big drawdowns.

They work from the philosophy that to beat the benchmark, you must look different from the benchmark. As of June 30, held less than 1% in cash, and was significantly overweight financials and industrials, which combined make up more than half the portfolio. It is underweight in the more volatile energy and materials.

They are not afraid to take meaningful positions in companies they buy. The top ten represents more than half of the fund. It holds a lot of household names

including the big five banks, Canadian National Railway and Canadian Tire.

Portfolio turnover has averaged about 35% a year for the past five years, which shows they are fairly patient in implementing their investment process. This indicates that they will typically hold a stock for about three years.

While their longer term outlook means they are not driven by short term performance, they have still managed to deliver decent absolute and risk adjusted returns for investors. As of June 30, the five year annualized return on the fund was 2.1%, handily outpacing the 0.5% loss of the index. The three year number is even more impressive at 9.7%, compared to the 5.4% rise in the index during the same period. Volatility has been in line with the index.

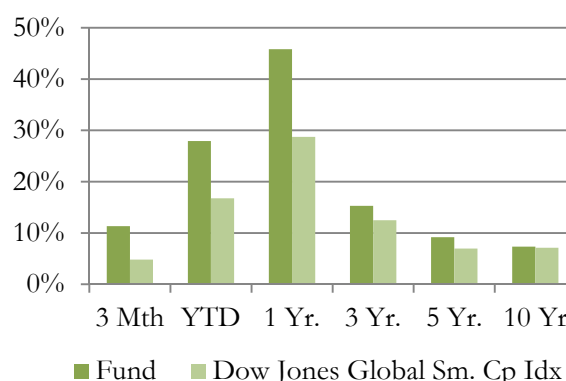
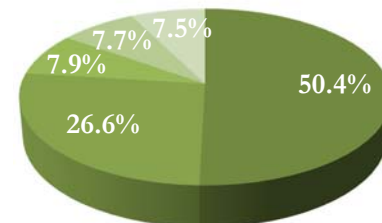
There are a number of reasons to like this fund. It offers a very solid management team following a disciplined, repeatable process. It also has a very reasonable 1.56% MER, which is much lower than many advisor sold offerings. For longer term investors, you can't really go too far wrong with this fund.

Chou Associates Fund

Fund Company	Chou Associates Management
Fund Type	Global Small / Mid Cap Equity
Rating	B
Style	Value
Risk Level	Medium
Load Status	Front End
RRSP/RRIF Suitability	Fair
Manager	Francis Chou since October 86
MER	1.86%
Fund Code	CHO 100
Minimum Investment	\$5,000

Asset Mix

- U.S. Equity
- Cash
- Int'l Equity
- Cdn Equity
- Other



ANALYSIS: This all cap, go anywhere, global equity fund is managed using his high conviction, deep value approach. The process is fundamentally driven, and focuses on balance sheet strength, cash flows, management and future growth potential. Valuation is critical; Mr. Chou won't even consider adding a position unless it is trading at a discount of at least 40% to his estimate of its intrinsic value.

He is not afraid to hold significant cash balances if no suitable investment opportunities are available or he feels that volatility is too high. He is not afraid to take big bets on stocks he feels are cheap. For example, in March, his largest holding was Berkshire Hathaway, which made up more than 10% of the fund. The next largest holdings, Dell and Sears, both had weightings well above 7%, and the top ten made up nearly 60% of the fund. When evaluating a stock, he takes a long term view, putting less emphasis on shorter term market factors. As a result, portfolio turnover tends to be low. For the most recent five year period, turnover has been less than 20%.

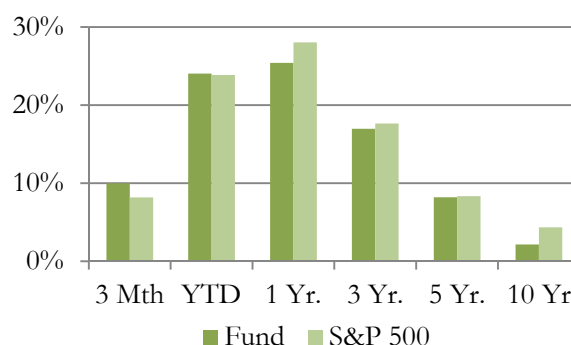
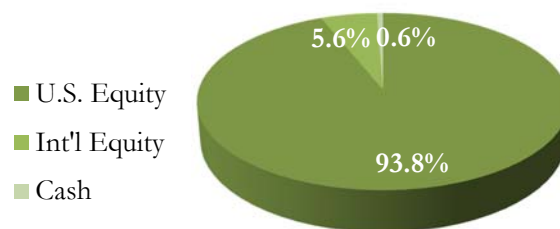
There are risks with this fund. Along with the volatility, nearly one quarter of the fund is held by Fairfax Financial. If they were to redeem their holdings, the manager would have to raise cash in a less than opportune environment, which could hurt the fund. Further, this is largely a one man show. If anything were to happen to Francis Chou, the fund would be negatively affected until a suitable replacement were found.

I like this fund but would be reluctant to recommend it as a core holding. In my opinion, it is best used as a small portion of a well-diversified portfolio. My reason is based on two factors. First is the key person risk. Second is the deep value style that is employed. While I believe that investors will be rewarded over the long term, there is a good chance of higher than average volatility in the short term. It is not highly correlated to the major indices, so it may zig when other funds zag. Still, over the long term, I believe that it has the potential to deliver above average returns with above average volatility.

Trimark U.S. Companies Fund

Fund Company	Invesco Canada Ltd.
Fund Type	U.S. Equity
Rating	C
Style	Growth at a Reasonable Price
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Jim Young since October 1999 Ashley Misquitta since Feb 2012
MER	2.98%
Fund Code	AIM 1743 – Front End Units AIM 1741 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Manager Jim Young has built a concentrated portfolio of U.S. based businesses that have strong management, distinct proprietary advantages, and a history of generating long term cash flows. Where this fund differs from other Trimark funds is the manager pays particular attention to companies that have a proven ability to profit from technological advances, and who have invested significantly to gain their competitive advantages.

The investment process is fairly patient, with a level of portfolio turnover that has averaged around 50% per year. This indicates that the implied holding period for each stock in the fund is approximately two years. It is nearly fully invested, holding less than 1% in cash.

Performance has been decent, gaining 8.2% annually for the past five years. Despite lagging the index, it

finished in the top quartile, handily outpacing its peer group. The volatility is roughly in line with the broader market.

The fund is not cheap, with an MER of 2.98%. This is well above the category median of 2.45%.

The manager remains positive on U.S. equities and believes that they are better positioned to withstand any macroeconomic headwinds than many other countries. He is also quite positive on the potential manufacturing renaissance that could occur in the U.S. as a result of previously inaccessible natural gas deposits as a cheap form of energy.

It is our opinion that this fund may be a good core U.S. equity holding for investors who have at least a medium risk tolerance and a long term time horizon.