
Top Funds Report

The Best of 2013

With 2013 now just a memory, let's take a look at the highlights of the year that was.

Health Care Equity

In the past two years, healthcare has risen by more than 80%. While there are a number of reasons to remain positive on the sector, the recent run-up causes me some concern and I would expect that we will likely see some sort of correction soon. If you have held health care in your portfolio for any length of time, you may want to consider taking some profits, to protect against any potential selloff. My favourite fund in the category remains of the **CI Global Health Sciences Fund (CIG 201)**.

U.S. Small / Mid Cap Equity

I was a bit surprised to see small caps lead the way in 2013. As we enter 2014, I see a similar market environment to what we experienced last year. While I do not expect another 40% year out of U.S. small caps, I think it likely that we will see another strong year. In the category, my favourite would be the **Fidelity Small-Cap America fund (FID 261)**, managed by Steve MacMillan. Since taking over this fund, he has done a great job focusing it on high quality names, and investors have been rewarded.

U.S. Equity

With signs that a sustained improvement in economic conditions is underway, U.S. equities responded favourably with their best year since 1997. For Canadian investors, the gains were even more impressive, thanks to a 7% drop in the Canadian dollar. This year, I expect we will see further signs that the economy is on the right track. The Federal Reserve's tapering of their bond purchases that started in January is likely to continue over the course of the year. Still, it is very unlikely that the Fed will move overnight rates higher until at least 2015. U.S. equities

should have another strong year, although I doubt that they can repeat the strong gains of 2013. The U.S. is always one of those markets where it is very difficult for any manager to consistently outperform. As a result, I would favour a low costs U.S. focused ETF or index fund over an actively managed fund.

Japanese Equities

Investors celebrated the economic reforms brought forward by Prime Minister Abe by pushing the Nikkei up by 57%. Many are expecting a continuation of 2013, with both economic and earnings growth rising. Still, I remain very cautious on Japan. I am not currently recommending any Japanese equity funds. If you would like exposure to the region, your best bet is to invest in a more diversified Asia-Pacific equity fund. My pick in the category would be the **BMO Asian Growth and Income Fund (GGF 620)**, which is a more conservative way to play the region.

Global Small / Mid Cap Equity

Global small caps had a very strong year gaining 32.3% compared with the 29.9% rise of their large-cap brethren. This year should be quite similar to last, providing the potential for another strong showing for global equities, both small and large cap. In the small cap space, my pick would be the **Trimark Global Endeavour Fund (AIM 1593)**. It is a concentrated portfolio of high quality names that trade at a discount to the manager's estimate of intrinsic value. It is very different from its benchmark, which may cause it to perform much differently than the index at any given time. Over the long term, risk adjusted returns should be above average.

Please send your comments to

feedback@paterson-associates.ca.

Funds You Asked For

This month, I take a look at some funds from Beutel Goodman, CI, Dynamic and Fidelity.

CI Cambridge Canadian Growth Companies Fund (CIG 11108)

Last week, CI announced that they would be closing this fund to new investors effective at 4 PM on March 3. Investors who have holdings in the fund can add to them. The reason that this is being done is the fund has grown too quickly and capping it will help maintain the manager's ability to effectively manage the fund. I believe that this is a great move that will definitely benefit the existing investors.

Beutel Goodman American Equity Fund (BTG 774)

The Beutel Goodman American Equity Fund is managed using a highly disciplined, bottom up value approach that places emphasis on capital preservation, with a focus on delivering absolute returns and managing risks. To achieve this, the managers look to identify high quality, well managed, dividend paying companies that have a history of generating stable cash flows and have earned a level of return that is greater than the company's cost of capital.

Given the value bias used, any company considered for inclusion in the portfolio must not only be undervalued, but have the potential to grow their share price closer to its intrinsic value within a three year period. When evaluating a company, they pay particular attention to the price to earnings, price to cash flow and price to book ratios in the context of not only the company's historical numbers, but also compared to the market and what the management believes to be the company's sustainable earnings growth rate.

The result is a concentrated portfolio of U.S. based large cap companies that are leaders in their field. As of September 30, it held 29 stocks with a top ten making up 48% of the fund. At the end of October, they viewed U.S. equities as attractive, supported by a stable economy, and sound balance sheets.

They are seeing value in the technology sector, and have added to their holdings in the past few months. They also believe that financials look attractive given their expectation of a stable economic environment. It has minimal exposure to commodities and deep cyclical, high beta stocks.

They are patient in implementing their process, with portfolio turnover averaging 33% for the past five years. That said, they are not afraid to use periods of heightened volatility as an opportunity to improve the quality of the portfolio. This happened in 2008 and again in the first half of 2012 when several new names were added to the portfolio including Halliburton, and JP Morgan Chase.

Performance has been decent, gaining an annualized return of 13.3% for the past five years, slightly trailing both the S&P 500 and the category average. It also has decent downside protection, holding up well in 2008, losing less than half of the index's 23% drop. Volatility has been lower than the category average, but has matched the broader market.

Another positive is the relatively low MER of 1.49%, which is well below many of its competitors.

The risk reward characteristics have been eroding when compared to the peer group. This has been a bit of a concern. Still, on balance, this is a very solid U.S. equity offering that I believe will deliver above average returns with below average risk over the long term.

CI Harbour Fund (CIG 690)

Until December 2012, this fund had been managed by respected veteran, Gerry Coleman, when he handed over the reins to longtime associate, Stephen Jenkins. Despite the change in manager, there hasn't been any major changes to the investment process used in the fund.

It is still managed using a patient, bottom up and research intensive approach that invests in concentrated portfolio of 30 to 40 names. They look

for industry leading companies with strong balance sheets and sustainable competitive advantages that can generate significant free cash flows. They look for good management teams who have proven that they are good allocators of capital with an eye for creating shareholder value. Once they find these opportunities, they must be trading at an attractive discount to their estimate of intrinsic value, so there is a margin of safety for investors. Ideally, they are looking for a discount of at least 50%.

Cash will still be used tactically when no investment opportunities that meet the manager's criteria are available. At the end of November, it held 15% in cash. This will act as a buffer in volatile markets, but will drag performance when markets are rising.

Traditionally, the portfolio has been focused on quality, and that is still the case, however under Mr. Jenkins' watch, valuation has become a slightly more important factor. This may result in it trailing its peers in a sharply rising market. Over the long term, this should not have a negative effect on performance.

At the end of the year, longer term numbers remained quite strong, however shorter term, it has underperformed. It gained 12.3% in 2013, slightly lagging the S&P/TSX Composite, but trailing its competition by a significant margin.

This fund remains on my Rec list for now, but the shorter term performance has become a bit of a concern. I will continue to watch it closely for any further erosion in the risk reward metrics of the fund.

Dynamic Canadian Dividend Fund (DYN 1040)

This is a fund that has undergone some pretty big changes in the past few years. In 2011, David Fingold took the lead after the departure of David Taylor. With Mr. Fingold at the helm, the fund has focused more on high quality companies that can pay and grow dividends that are trading at deep discounts to their true value.

With this approach, I expect that we will see the downside protection increase dramatically, a trait that is quite common with other funds managed by Mr. Fingold. An unfortunate drawback to his style is that it is also quite likely that the upside participation will

also drop dramatically. We are seeing signs that this is happening.

Under Mr. Taylor, the fund tended to be quite volatile, particularly for a dividend focused fund. That has come down under Mr. Fingold, and I expect that to continue.

The portfolio itself is very focused in the large cap names, and the top ten is filled with familiar names including Power Corp, Bank of Nova Scotia, and EnCana. It pays a monthly distribution of \$0.05, which works out to an annualized yield of about 4.4%.

Performance has really lagged in the past few years. For the three years ending December 31, it generated an annualized return of 1.9%, while the index did 3.4%. It trailed its competition by an even more substantial margin. Going forward, I don't see much on the horizon that leads me to believe that there will be a significant improvement in performance. I definitely think that there are better dividend focused options available. Within the Dynamic family, I'd prefer the **Dynamic Dividend Fund (DYN 048)**, managed by Oscar Belaiche and Jason Gibbs over this offering.

Fidelity Canadian Asset Allocation Fund (FID 281)

This is a fund that I really want to like, but it just hasn't been able to come back to what it once was. Despite some small glimmers here and there, it just hasn't been the same since Alan Radlo left Fidelity in 2009.

Today, it is set up like a fund of funds where Geoffrey Stein & Derek Young invest in various sub portfolios managed by other Fidelity managers. They can be quite tactical in their approach and the asset mix is based on their view of the market conditions. The target asset mix of the fund is set at 65% equity, 30% bonds, and 5% in cash. At the end of November, it held 64% in equity, 30% in bonds, and 6% in cash.

Geographically the focus is in Canada, where 71% of the portfolio is held, while 23% is invested in the U.S. The equities tend to be focused on some pretty well-known names including TD Bank, Royal Bank, and Shoppers Drug Mart.

Within the fixed income sleeve, most of the emphasis is on investment grade bonds, with some exposure to high yield. It is tilted towards corporate bonds, with only 40% of the bond allocation invested in government bonds. This should help to reduce the duration risk of the portfolio.

Performance has been disappointing, and has underperformed since 2010. For the three years ending December 31, it has an annualized return of 2.3%, which is less than half the return of the benchmark and the peer group. Volatility has been in line with both the benchmark and the peer group.

Sadly, I don't expect to see this fund return to its former glory any time soon. In my opinion, there are many better options available, and within the Fidelity family, my pick would be the **Fidelity Monthly Income Fund (FID 269)**.

Invesco Select Canadian Equity Fund (AIM 1583)

This Canadian focused equity fund follows the same investment process that is used on all the Trimark branded funds: business people buying businesses. The fund itself invests in a concentrated portfolio of high-quality, well managed businesses that are trading below their estimate of its true worth. The managers take a long-term, patient approach, and look for financially sound companies that are industry leaders, are likely to provide long term growth, and have a strong management team at the helm.

Heather Hunter managed this fund from 1999 to the end of last year, when she retired. She was replaced by the team of Ian Hardacre, Jason Whiting, and Alan Mannik. While there is not likely to be any change in the investment philosophy or process, there will likely be some turnover within the portfolio. This is to be expected anytime there is a change in management.

Of late, performance under the previous management team had been improving, and had been outpacing both the index and the peer group. Under the new management team, I expect that this trend will continue.

Still, given the change, I'd be a bit hesitant to recommend the fund. I would like to see at least a couple of quarters with the new team at the helm to get a better sense of how the team operates with this specific mandate. I will be monitoring the situation closely.

Manulife Growth Opportunities Fund (MMF 388)

Managed by Ted Whitehead, this fund invests primarily in small and mid-cap companies located in Canada. At December 31, it had 73% invested in Canada, 16% in the U.S. and the balance in Europe.

Stocks are selected using a mix of quantitative screening and bottom up fundamental analysis. The first step is to rank the selection universe based on the manager's proprietary model. They then will conduct more detailed fundamental analysis on the top ranked names. Companies that tend to find their way into the portfolio generally are well managed, industry leaders that are trading at attractive prices.

There is strong risk management culture, with a dedicated risk management team that monitors the various risk factors in the fund. While this looks good from a process standpoint, I'm not sure how effective it's been in practice, given that volatility is slightly above average, and the downside capture has been more than 100% for the past three, five and ten year periods.

The portfolio is fairly well diversified, holding more than 70 names, with the top ten making up over a quarter of the fund. Portfolio turnover has averaged about 55% for the past five years.

Probably the best way to describe this fund is average. It has delivered average return with average volatility. There is nothing special about it. You will likely do okay with it, but there are funds that are better than this.

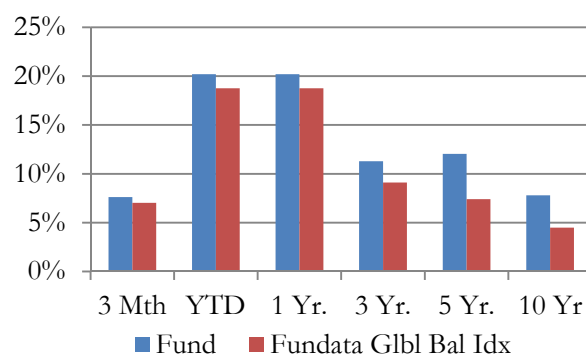
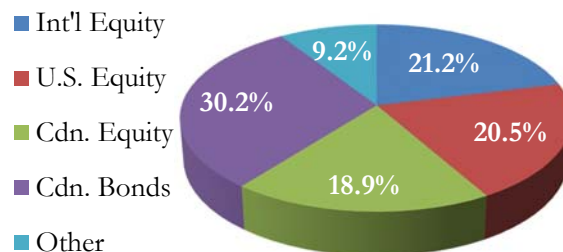
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca

Mawer Balanced Fund

Fund Company	Mawer Investment Management
Fund Type	Global Neutral Balanced
Rating	A
Style	Blend
Risk Level	Low - Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
Manager	Greg Peterson since June 2006
MER	0.95%
Fund Code	MAW 104 – No Load Units
Minimum Investment	\$5,000

Asset Mix



ANALYSIS: In a recent article, I picked the **Mawer Balanced Fund (MAW 104)** as the fund I would want to own in 2014, if I could only pick one fund. This fund of fund offering from Calgary based Mawer Investment Management gives you a bit of everything. It invests in other Mawer offered funds. At the end of November, it held just under 10% in cash, 29% in bonds, with the remaining 60% split pretty evenly between Canadian, U.S. and International equities.

Each of the underlying Mawer funds are top notch, except for maybe the U.S. equity fund, which has struggled to differentiate itself from the pack. Another potential drawback is that **Mawer Canadian Bond Fund** looks quite similar to its index. While not necessarily a deal breaker, it only has about 40% in corporate bonds, which may cause some underperformance in a flat or rising yield environment, compared with a fund that has higher corporate bond exposure.

On balance, this is a really good looking portfolio. Each of the underlying funds are managed using Mawer's disciplined, research driven, bottom up process that looks to find well managed, wealth creating companies that are trading at less than they are worth.

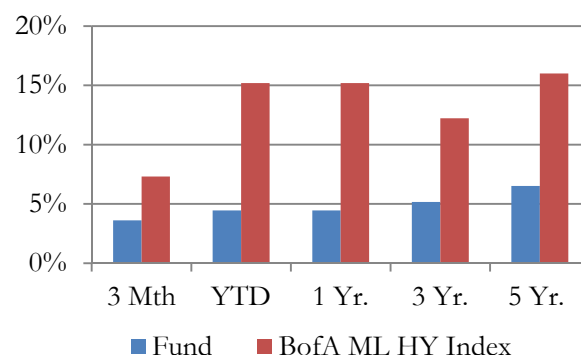
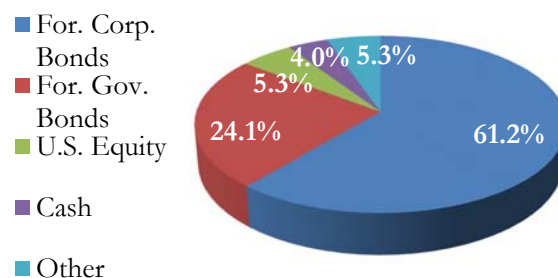
The results speak for themselves. Performance has consistently been above its benchmark and peer group for two main reasons. The first is the disciplined process that is used by the managers in the underlying funds. The second reason is cost. With an MER of 0.98%, it is one of the lowest priced balanced funds available.

As we enter 2014, I think that this fund will be a great fund to own for the year. While it may not shoot the lights out, I expect that it will deliver above average returns and still allow you to sleep comfortably at night.

Manulife Strategic Income Fund

Fund Company	Manulife Mutual Funds
Fund Type	Global Fixed Income
Rating	B
Style	Tactical
Risk Level	Low - Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Dan Janis since August 2010 Tom Goggins since Aug. 2010
MER	2.06%
Fund Code	MMF 559 – Front End Units MMF 459 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Because of the very active way that this fund is managed, it is a tough one to classify. Most consider it to be a high yield bond fund, but in my view, it is more of a tactically managed global bond fund.

While there is some high yield exposure in the portfolio, it invests in a wide range of fixed income investments including high yield bonds, investment grade corporate bonds, global emerging market debt, U.S. treasuries, and Government of Canada bonds. In addition, it has a dynamic currency overlay that is designed to protect against adverse currency movements.

At the end of November, the fund held approximately 16% in emerging market debt, and nearly two-thirds was invested in corporate bonds. Quality was relatively high, with an average credit rating of BBB. The managers set the fund's sector weights based on their top down business cycle analysis that considers such things as yield spreads, and economic growth. Once the sector mix is set, bottom-up analysis is done to find

the securities they feel are best position to benefit from their macro view, with an emphasis on yield generation.

This process is very active. There have been some fairly significant shifts in the sector allocation over the past several years to take advantage of some of the major trends. For example, and 2009 they dramatically increased their exposure to high yield bonds, moving it for more than 10% to nearly 40% of the fund by the end of the year.

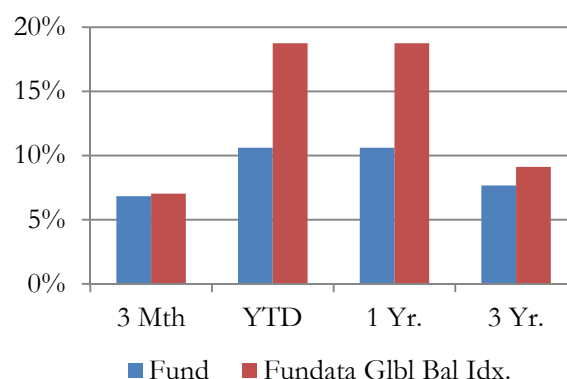
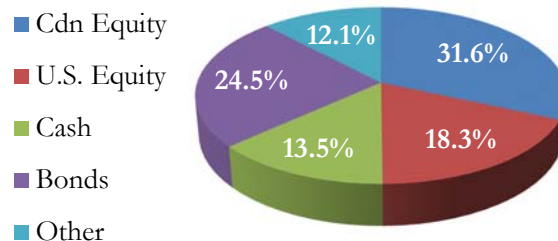
Performance has been decent, gaining 4.5% in 2013. For the past five years, it has gained an annualized return of 6.5%. While this may have lagged many of the high yield funds, it has handily outpaced many of the global bond funds.

Looking at the portfolio, I believe that the managers are well positioned for the current fixed income environment. Still, I do not believe that this is a core bond fund. Instead, it is a smaller piece of your overall fixed income allocation.

Dynamic Strategic Yield Fund

Fund Company	Dynamic Funds
Fund Type	Global Neutral Balanced
Rating	A
Style	Blend
Risk Level	Low - Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Oscar Belaiche since March '09 Michael McHugh since Mar. '09
MER	2.30%
Fund Code	DYN 1560 – Front End Units DYN 1562 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This is a relatively new balanced fund that is managed by the team of Oscar Belaiche and Michael McHugh. It invests in a mix of stocks and bonds with the objective of generating a total return that is a mix of yield and long term capital growth. It pays investors a monthly distribution of \$0.0584 a unit, which works out to an annualized yield of about 4.8%

This truly has a “go anywhere” mandate and can invest in companies of any size, operating in any industry sector, that are located anywhere in the world. Like other funds managed by Mr. Belaiche, it looks for companies which fit into their “quality at a reasonable price” criteria. These types of companies typically generate strong levels of cash flow, have sound balance sheets and sustainable and growing dividends.

Michael McHugh is responsible for the bond sleeve of the fund. True to his style, it is conservatively

managed and focused on corporate bonds, both Canadian and global.

The overall asset mix is based on their expectations for the economic and market conditions. They will position the fund in a way that will allow them to focus on the most attractive investment opportunities. At the end of November, it held 13% cash, 25% bonds, and 55% in equities.

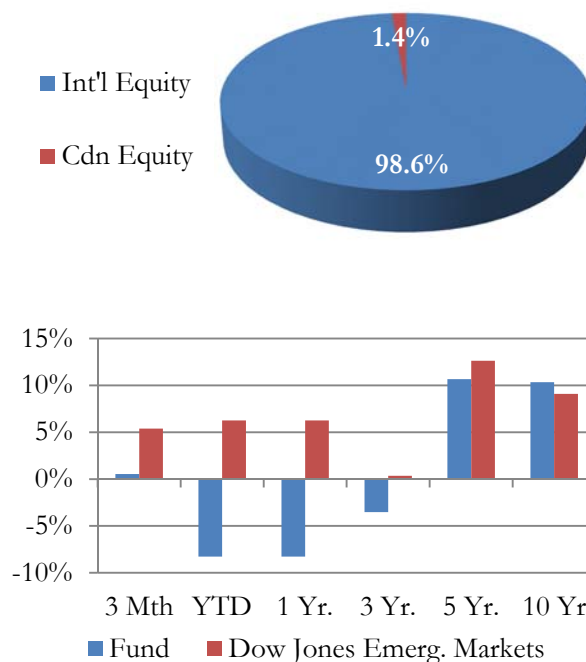
One big drawback to this fund is that its underlying portfolio is fairly interest rate sensitive. While the longer term returns have been quite strong, it has struggled recently. With the current rate environment, I expect that it will continue to struggle in the near term. Still, the managers have done a great job at keeping volatility well contained.

Over the long term, I expect that this fund should do well. Shorter term however, I believe that returns will be closer to that of its peers, but with below average volatility.

AGF Emerging Markets Fund

Fund Company	AGF Investments
Fund Type	Emerging Markets Equity
Rating	B
Style	Blend
Risk Level	Medium - High
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Stephen Way since May 2012 Alpha Ba since May 2012
MER	3.11%
Fund Code	AGF 791 – Front End Units AGF 691 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Until the May 2012 departure of manager Patricia Perez-Coutts, this was hands down my favourite emerging markets fund. Over most time periods, it had outperformed both its index and its competition, and done so with much less volatility. If there was a drawback to its performance, it was that it tended to lag in rising markets, but more than made up for it when things got rocky.

Under the management team of Stephen Way and Alpha Ba, things don't appear to have changed much. They are following the very same investment process that starts with a screening process that scans the universe for companies that meet various market cap, trading volume and economic profit screens. Companies must also generate positive economic profit, have a strong business franchise, above average cash flow generation, consistent earnings growth and the ability or the potential to pay dividends to investors. They conduct fundamental, bottom up due

diligence on companies that meet their screens. The portfolio tends to hold about 70 names, with the top ten making up about 20% of the fund.

Because of the consistency in process, there really hasn't been a significant erosion of the risk reward characteristics of the fund.

The biggest knock on this fund is its cost. The MER is now sitting at 3.11%, which is well above the category average.

If you have held the AGF fund and are happy with it, there is no real compelling reason to sell it. I don't expect that we will see a big erosion in the risk reward profile, and it should continue to deliver better than average long term returns with much less volatility. If you are looking for more upside when markets are moving higher, and are comfortable taking on a higher level of risk then you may want to consider the **Brandes Emerging Markets Fund**, which has been another one of my favourites in the category.