
Top Funds Report

Canadian Markets Shine on Gold Rebound

Political tensions push gold and commodities higher, Canadian equities benefit.

With political tensions heightened after Russia's annexation of the Crimean peninsula, gold and other safe haven assets experienced a rise in the first quarter of the year. This certainly helped the Canadian equity markets, which saw the S&P/TSX Composite Index rise by more than 6%. Small and mid-caps were even stronger, gaining nearly 8%.

Global markets were also largely higher, although the majority of the gains in the quarter were the result of a drop in the Canadian dollar. With signs of a stronger U.S. economy, the Canadian dollar lost ground to the greenback, falling nearly \$0.04 over the quarter.

Bond markets were higher, with longer dated and corporate issues continuing to outperform. Despite little evidence of a re-emergence of inflation, real return bonds were the strongest performers, with the DEX Real Return Bond Index gaining more than 6%.

Looking ahead, the Russia / Ukraine situation is once again in the spotlight as tensions have risen as pro-Russian forces launched an attack in Kiev. Many believe that the Ukraine is on the verge of a civil war. Tensions are likely to remain high, which will likely drive investors towards the more traditional safe haven investments such as bonds and gold.

From an investment standpoint, I am concerned we may see further volatility in the global equity markets. Investor uncertainty around the standoff, combined with mixed economic signals out of China are expected to weigh on investor confidence. In the U.S., I expect that markets will grind higher in the near term, on improving economic numbers. I expect that the S&P/TSX should outperform, given the significant exposure to gold and materials. Fixed income markets should again hold their value relatively well over the near term as investors seek safe haven.

The recent rally in gold has become a hot topic of late. Some believe this signals the start of a new gold rally, while others, myself included believe that it is a temporary opportunity that will subside as the geopolitical tensions in the Ukraine ease.

People invest in gold for two reasons; it has traditionally been viewed as a safe haven investment in periods of uncertainty, and it has long been viewed as a hedge against the threat of inflation.

I don't view inflation to be a meaningful threat in the short to mid-term. Economic growth, particularly in the U.S. has not been strong enough to spur any meaningful job growth.

In early May, the U.S. Bureau of Labor Statistics released the March numbers that showed that the economy created 192,000 jobs. This was substantially below the forecast, which was between 200,000 and 225,000. Even at the forecasted rate, job growth would not be high enough to make a meaningful dent in the unemployment rate. While the official unemployment rate sits around 6.7%, there are several hundred thousand Americans who have given up looking for work, or are underemployed. Until they find work, the pressure on wages will remain well contained, making it tough to see much in the way of price gains.

Further, while corporate profitability has been strong, revenue growth has been fairly weak. We need to see a meaningful increase in revenue growth, otherwise the economy will continue to merely chug along.

Given this, I don't believe that there is a strong case for holding gold, other than as a short term trading opportunity.

Please send your comments to

feedback@paterson-associates.ca.

Funds You Asked For

This month, I take a look at some SRI funds, as well as offerings from Dynamic, Fidelity & Manulife.

PH&N Community Values Bond (RBF 1610)

– This quality focused fund is managed in a very similar manner to the highly regarded **PH&N Bond Fund**. The portfolio is roughly split between government and corporate bonds. It is all investment grade, making it highly sensitive to movements in interest rates. While this is the best SRI bond fund available, I believe that most investors would be better off with a fund that is more focused on corporate and high yield issues, which are expected to hold up better should rates start moving higher.

Meritas Growth Portfolio (SRI 010) – Investing in a mix of other Meritas funds, this portfolio is heavily tilted towards equities. The target mix is 20% fixed income, 35% Canadian equity, and 25% U.S. equity with the balance in international equities. Even with such a high equity weighting, the portfolio's volatility has been well below the benchmark and the peer group. This is a very respectable SRI offering, particularly for those looking for a well-diversified, one ticket solution.

NEI Ethical Select Growth Portfolio (NWT 020) – Similar to the Meritas offering discussed above, this is set up as a fund of funds portfolio that invests in a well-diversified mix of NEI funds. It is heavily tilted towards equities, which make up approximately three quarters of the fund. Performance has been more than respectable, gaining an annualized 6.3% for the three years ending February 28, handily outpacing the S&P/TSX Composite Index and many of its peers. Volatility has also been firmly in check, making this a very solid SRI offering.

iShares Jantzi Social Index ETF (TSX: XEN)

– This is one of only three SRI ETFs available in Canada and it is designed to track the Jantzi Social Index, which looks to invest in the large Canadian companies that have passed various screens for environmental, social, and governance factors. The index excludes any companies that are involved in nuclear power, military weapons, and tobacco.

Despite the low level of assets, currently at a paltry \$25 million, there are a couple of reasons to like this ETF. The cost is very reasonable with an MER of 0.55%. Performance has also been strong, posting an annualized five year gain of 15.2%, outpacing the index and the majority of its peer group.

RBC Jantzi Canadian Equity Fund (RBF 302)

– This fund invest only in Canadian companies that have strong corporate governance policies, stellar environmental records, and exemplary human rights practices. It avoids companies that are involved in weapons, tobacco, or nuclear power. The result is a well-diversified portfolio that has modestly outpaced the broader market on a one and three year basis, with comparable volatility. The biggest downside is the portfolio looks very similar to the S&P/TSX Composite. Investors may be better off investing in the iShares Jantzi Social Index ETF, which offers a comparable portfolio at a much lower cost.

NEI Ethical Canadian Equity Fund (NWT 072)

– Being one of the largest equity focused SRI funds in Canada, it is also one of the more attractive offerings. It is managed by Calgary based QV Investors who invest in companies with above average returns on equity capital, but whose shares trade below market valuations. Performance has been strong, with a three year gain of 8.4%, handily outpacing both the index and its competition. Volatility has also been kept well in check. Considering the management team at the helm and the process used, I expect this to continue to be a very solid Canadian equity offering, SRI or other.

NEI Ethical Special Equity Fund (NWT 067) -

Managed by Joe Jugovic and Ian Cooke of Calgary based QV Investors, this small cap fund is virtually identical to the **IA Clarington Canadian Small Cap Fund**. The biggest difference between the two is the management team submits investment ideas to Ethical Funds who put the prospective company through their rigorous environmental, social and governance screens. Assuming it passes, it is allowed

into the fund. Performance, particularly on a risk-adjusted basis, has been impressive, although, this fund has begun to lag the Clarington offering. Still, with its value approach, I expect performance to lag in a sharply rising market, but will hold up nicely in periods of high volatility and in down markets, making it one of my top small cap picks.

NEI Ethical Global Dividend (NWT 084) –

This go anywhere fund managed by KC Parker of Beutel Goodman looks for high quality, profitable companies that generate high levels of free cash flow that is either reinvested back into the business, or returned to shareholders through share buybacks or a dividends. Ethical is a very active shareholder and encourages companies to improve their environmental, social and governance practices through dialogue, shareholder resolutions and proxy voting. They are not afraid to take action if a company does not want to play ball. My biggest concern with this fund is its volatility, which has been above the benchmark and the category average. For investors who can stomach the higher volatility, this is a great fund to consider.

Dynamic Power Balanced Fund (DYN 001) –

Alex Lane took over the equity portion of this fund last May, after longtime manager Rohit Sehgal stepped down to focus on managing hedge funds.

The fund has a target asset mix of 50% equity and 50% fixed income. At the end of January, it had approximately 30% invested in bonds, 36% in Canadian equities, 22% in U.S. equities, and the rest in cash. Most of the U.S. exposure is through a holding in the **Dynamic Power American Growth Fund**, which has posted very strong returns of late.

The equity component is managed using an active growth focused strategy. It is a mix of top down macro analysis and bottom up fundamental research. It is concentrated, but flexible. About a third of the equity sleeve is invested in mid and small cap names.

The bond sleeve is managed by Michal McHugh, and is heavily tilted towards corporate bonds. The average bond quality is listed as BBB, which is at the lower end of the investment grade scale, which should provide better returns than a portfolio of only government bonds.

Performance for the past year has been strong, with a gain of 14.3%, outpacing both the benchmark and most of its peer group. A major contributor to that performance was the U.S. equity exposure.

Like other Power branded funds, this contains a bit of kick. The volatility is significantly above average. It has a level of volatility that is roughly in line with U.S. equities. It tends to outperform when markets move higher, but it has historically been hit much harder when markets fall. Even with the new manager at the helm, I expect this trend to continue.

The biggest issue that I have with this fund is that it is far too volatile. It is supposed to be a balanced fund, but carries the same level of risk as a diversified large cap equity fund. Considering the above, it is my view that there are better balanced funds available for those looking for a more traditional balanced fund offering.

Fidelity Northstar Fund (FID 253) –

After struggling to find their footing with the fund since taking it over in 2011, Joel Tillinghast and Daniel Dupont have really turned things around. They scour the globe looking for companies of any size, in any industry, located anywhere in the world.

They take a medium to long term outlook, and are looking to find high quality, attractively valued stocks that offer what they consider to be an attractive risk reward profile. It is well diversified across company size, with exposure to mega caps, micro caps and everything in between.

The portfolio has a value bent to it. It is underweight materials, financials and real estate, with overweights the defensive names, particularly consumer and healthcare.

Historically the portfolio turnover has been very high, averaging above 100% per year, but with the new managers in place, I expect that it will decline over time.

Performance certainly looks like it has turned the corner, with a one year gain of 35%, handily outpacing the benchmark and its peer group. Even with the all cap mandate, volatility has been well contained.

I'm encouraged by the turnaround, and have very strong confidence in Daniel Dupont as a manager.

My expectation is that we will see a continued improvement in performance, although I doubt the 46% gain of 2013 will be repeated this year. Still, it should continue to outpace most of its peers and do so with less volatility.

Manulife Monthly High Income Fund (MMF 383) –Managed by the team of Alan Wicks and Jonathan Popper, this fund invests in a mix of Canadian fixed-income and large-cap equity securities. It has dual investment objectives; to preserve capital and maintain a regular distribution. The distribution is currently set at \$0.06 per unit per month, which at current prices works out to an annualized yield of around 5%.

At the end of March, the asset mix was nearly 20% cash, 20% bonds, and the rest in equities, which were pretty much equally split between Canada and the U.S. The fixed income sleeve is invested entirely in investment grade bonds. To better position the fund for higher rates, it is carrying a fairly high level of cash. This will help protect against rising rates, but may drag returns while rates remain flat.

The stock selection process is a fundamentally driven, bottom up approach. It also has a bit of a value tilt to it, where the managers are looking for companies that are undervalued, relative to their estimate of growth potential.

They also pay a great deal of attention to the potential downside of a stock, and try to build the portfolio to maximize the upside, while minimizing the downside. This process seems to have worked. The fund has consistently seen more upside than downside. It also has a standard deviation that is below the category average.

Performance has been very strong, with a five year annualized return of 12.3%, which has outpaced the benchmark and most of its peer group.

I like this fund. It offers a decent risk reward profile. It has delivered above average returns with below average risk. However, with its focus on income, it is likely to be fairly sensitive to movements in interest rates. I believe it is unlikely that it will be able to deliver the same type of returns as we move into a rising rate environment. Still, over the long term, I

expect that it will continue to deliver above average returns with below average risk.

IA Clarington Global Opportunities Fund (CCM 340) –Veteran manager Brad Radin took over the management duties of this concentrated, all-cap global equity fund back in late 2011. It struggled in 2012, trailing its peer group, but started to turn things around in 2013 with a respectable 37.5% gain. In the past two years, the fund has gained an annualized 17.6%, which has lagged the MSCI World Small Cap Index.

To be fair, I don't believe that two years is a long enough period on which to judge Mr. Radin's track record. His value focused investment process takes a much longer outlook, typically three to five years. Ideally, he is looking to buy well managed, cash flow generating companies at the point of maximum pessimism. If you look at his longer term numbers with his old fund, the **Templeton Global Smaller Companies Fund**, you will see that he was able to consistently generate strong returns, with below average volatility. With no changes to his investment process, I see no reason why he won't be able to deliver that over the course of a typical market cycle.

He is currently following a few key themes. He is actively taking profits in those companies where he believes the market price now fully reflects its value. He has identified a few names in Europe that he has or will soon be trimming. He is also underweight in the U.S. and he expects to remain so in the near term. Currently, most of his U.S. exposure is in financials, which have been very strong contributors to performance in the past year. Despite the dire headlines coming out of China, he is finding a few very compelling investment opportunities. This exemplifies his buy at the point of maximum pessimism discipline.

Given Mr. Radin's track record, I am cautiously optimistic on this fund. I cannot give it a full recommendation yet, but will be continuing to monitor it closely.

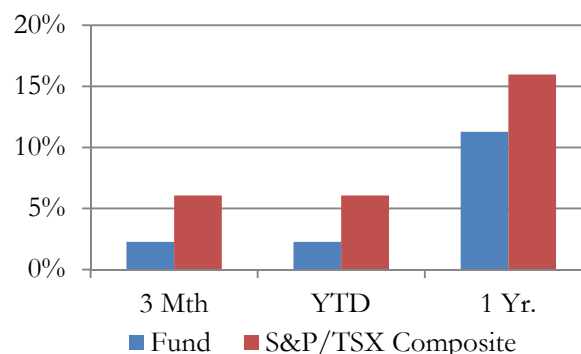
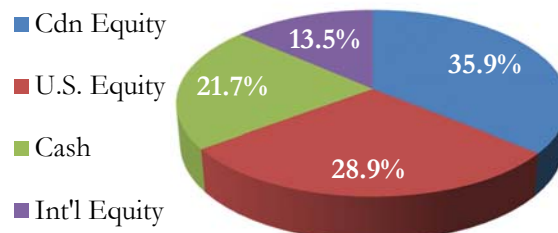
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca.

Sprott Enhanced Equity Class

Fund Company	Sprott Asset Management
Fund Type	Canadian Focused Equity
Rating	Not Rated
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	John Wilson since Apr. 2012
MER	2.44%
Fund Code	SPR 430 – Front End Units SPR 433 – Low Load Units
Minimum Investment	\$1,000

Asset Mix



ANALYSIS: The Fund is managed using the basic premise that investors can win over the long term simply by not losing. It takes on an absolute return focus where veteran manager John Wilson uses a well-defined process that involves both loss limits and a strict sell discipline, combined with a number of conservative option overlay strategies. I look at it as a “hedge fund light”.

The portfolio is concentrated, holding 25 to 30 high quality companies with a history of generating free cash flow, and a high degree of earnings predictability, that are trading at a discount to its long-term value. Mr. Wilson is constantly comparing a stock’s upside to its downside, and will only invest in those stocks where his analysis shows the upside far outweighs the downside. If no such opportunities exist, he will hold cash.

To help preserve capital, he uses an option strategy that involves put options to protect against downside, call options to provide increased upside participation, and covered call options to increase the income the fund generates.

He is benchmark agnostic, meaning the portfolio will look nothing like its benchmark. He is very defensively positioned, with no exposure to Canadian banks and minimal exposure to the highly volatile commodity sectors.

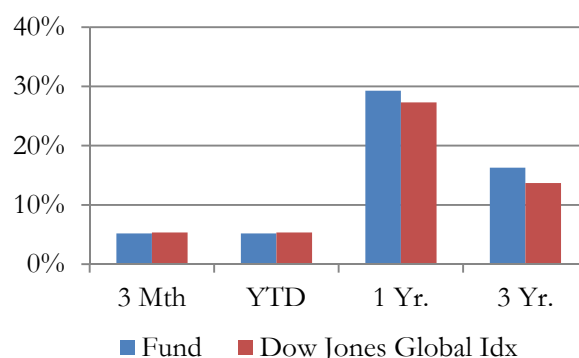
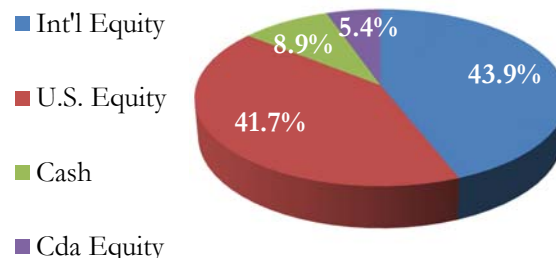
Performance has been decent, gaining nearly 11% since its launch. More impressive has been that the volatility has been about half that of the index and the downside protection has been very strong.

Given the relatively short track record of this fund, it is too early to make a definitive call on it. But the early results are definitely promising. I expect that this is the type of fund that will provide long term returns that are in the middle to upper half of the category, but with much less volatility than its peers. It should hold up well in periods of extreme market volatility, but will likely lag when markets take off. This could be a nice compliment to a more index focused fund, or could serve as a great core equity holding for those investors looking for equity exposure but aren’t comfortable with the volatility.

Manulife Global Equity Class

Fund Company	Manulife Mutual Funds
Fund Type	Global Equity
Rating	A
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Paul Moroz since Nov. 2009 James Hall since Nov. 2009
MER	2.75%
Fund Code	MMF 4506 –Front End Units MMF 4406 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This Manulife offering is a virtual copy of the highly regarded **Mawer Global Equity Fund**. The main differences would be that it has a \$500 minimum, compared with \$5,000 for the Mawer offering, and it carries an MER that is 130 basis points higher. Even with the higher cost, this still rates as one of the better global equity funds around.

Like its Mawer counterpart, it is managed by the team of Jim Hall and Paul Moroz. It has a go anywhere mandate, and looks for wealth-creating businesses with competent management and long-term competitive advantages that are trading at a reasonable price. They use a very patient, long term focused, research-driven, bottom-up security selection process.

The portfolio is nearly identical to Mawer, holding approximately 70 stocks. It is overweight in industrials and financials, and significantly underweight in consumer focused names.

They tend to take a longer term outlook when looking at a company. This is reflected in the fund's very low

level of portfolio turnover. It has averaged less than 20% per year since its launch.

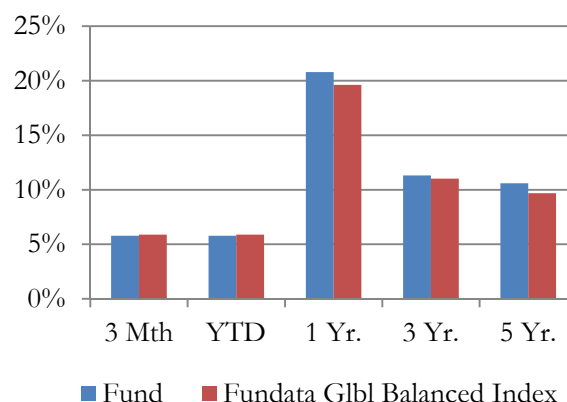
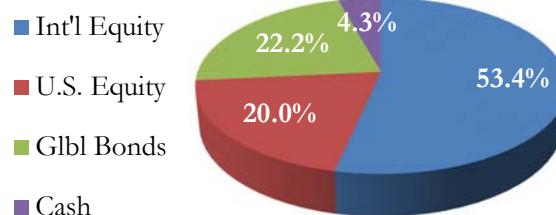
Performance has been very strong, but not surprisingly, with the higher cost, has lagged the Mawer offering. For the three years ending March 31, the fund has gained an annualized 16.3%, compared with 17.8% for Mawer. Both the fund's volatility and downside protection numbers are much better than its peer group.

The fund is also part of Manulife's corporate class structure, which may make it more attractive in taxable accounts. Still, my preference would be to buy the Mawer fund directly, this is a great substitute for those who are unable to do so. With its go anywhere mandate and bottom up portfolio construction approach, there may be periods of time where performance lags the peer group and benchmark. However, given the strength, reputation and process of the manager, I would expect that this fund will continue to deliver above average returns with below average risk for investors over the long term. .

Templeton Global Balanced Fund

Fund Company	Franklin Templeton Investments
Fund Type	Tactical Balanced
Rating	B
Style	Value
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Lisa Myers since Dec. 2005 Michael Hasenstab since Aug 06
MER	2.48%
Fund Code	TML 3240 – Front End Units TML 3242 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This fund really struggled in the first few years after it was launched in Canada, trailing most other global balanced funds between 2009 and 2011. However, in mid-2012, performance turned the corner, and since then, this has been one of the strongest performing global balanced funds available.

The equities are managed by Lisa Myers using Templeton's trademark value focused stock selection process. She and the global equity team scour the equity universe looking for well-managed, high quality companies that are out of favour and are trading below their estimate of its true worth.

The fixed income sleeve is managed by Michael Hasenstab and the Templeton global bond team. They analyze interest rates, currencies and yield spreads to help identify the right bond mix for the investing climate. The portfolio is heavily tilted towards corporate bonds. They remain cautious given the current rate outlook, and do not believe that investors are being adequately compensated for the additional risk of moving further out the yield curve.

The asset mix is based on where the most attractive opportunities are being found. They have a great deal of flexibility and can have between 25% and 75% of the fund invested in either equities or fixed income at any time. The current mix heavily favours equities, which make up two-thirds of the fund.

Recent performance has been stellar, delivering twice the returns of the average tactical balanced fund in 2012 and 2013. For the five years ending March 31, it posted an impressive 10.6% annualized gain, which handily outpaced the majority of its peers.

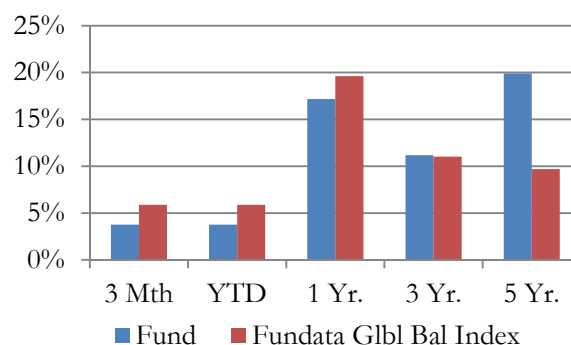
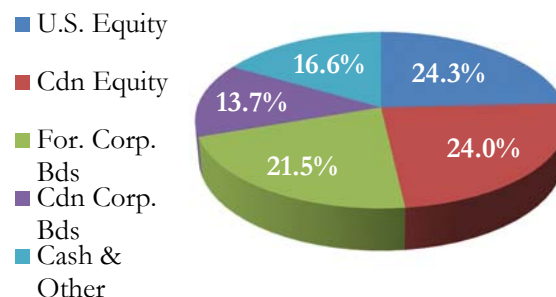
The fund's volatility has been significantly higher than the benchmark and its peer group. Its standard deviation is only slightly lower than the MSCI World Index, making this one of the higher risk balanced funds offerings out there.

If you can stomach the higher risk, are patient, and have a longer term time horizon, I believe you will see an above average return with this fund.

Aston Hill Growth & Income Fund

Fund Company	Aston Hill Financial
Fund Type	Global Neutral Balanced
Rating	A
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Andrew Hamlin since Sep/10 Vivian Lo since November 2011
MER	Capped at 2.35% for 2014
Fund Code	AHF 400 – Front End Units AHF 420 – Low Load Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This is a global balanced fund that has an income focused, go anywhere mandate. It pays investors a monthly distribution of \$0.03 per unit, which works out to an annualized yield of 4.75% at current prices. The fund has a nearly \$30 million in tax loss carry forwards, which mean that any income paid out to investors is likely to be treated as return of capital for tax loss purposes. This makes it very tax efficient in a non-registered account.

The managers use the fund's relatively small size to its advantage, taking a more opportunistic approach. They are very active in their process, with portfolio turnover averaging well above 100%. In addition to buying stocks and bonds, they will also use options, a bit of short selling, and the tactical use of cash to help manage both volatility and downside risk. Results in this front have been mixed, as volatility has been higher than a global neutral balanced benchmark.

On the equity side of the portfolio, it holds approximately 80 names, with a heavy emphasis on cyclical names. It is significantly overweight financials, real estate and consumer cyclical names,

while being underweight energy, industrials and technology. They to focus on, undervalued companies that have the highest potential for cash flow growth.

The bond sleeve of the portfolio is heavily concentrated on Canadian and U.S. high yield offerings, with no exposure to investment grade bonds. This strategy lowers the fund's sensitivity to rising interest rates, and increases the income stream, which will allow it to outperform in a flat or rising interest rate environment. A drawback is that it increases the credit risk in the portfolio, and if we see any disruption in the high yield market, this fund is likely to be hit harder than those funds where the bond component is in higher quality offerings. Still, Aston Hill has very strong reputation in the high yield space.

The MER has been capped for 2014 at 2.35%, which is competitive for its peer group. This is a pretty solid balanced fund offering, but is more risky than it appears. If you are a risk averse investor, you may want to look elsewhere. But if you can stomach a bit of risk for the potential of above average returns, this is a great balanced fund to consider.