

Top Funds Report

Canadian Equities Modestly Lower

Global equities and bonds rally higher on central bank actions.

Both equities and bonds rallied higher in May, rewarding investors with positive returns. One notable exception were Canadian equities, which were weaker, dropping 0.3% in the month thanks to a selloff in the resource sector. With tensions between the Ukraine and Russia easing, many commodities sold off, bringing the energy and materials sectors with them. Fortunately the big banks posted a solid round of quarterly earnings, pushing share prices higher, tempering losses for the broader market.

Global equities were higher, with the S&P 500 gaining 1.1%, while the MSCI EAFE Index rose by 0.9%. Gains for Canadian investors would have been higher, were it not for the Canadian dollar, which rose by nearly 1 cent.

In Europe, markets were higher on speculation that Mario Draghi, the President of the European Central Bank would implement aggressive stimulus to help drive economic growth. He did not disappoint in June, taking the unprecedented step of taking policy interest rates negative.

This action has spurred a nice rally in European equities, and is expected to result in a short to mid-term rally. While I'm reluctant to suggest that Europe is out of the woods, there may be a decent opportunity for those who are comfortable taking on a bit more risk.

This ECB action, combined with the possibility of additional stimulus action from Central banks in China and Japan helped spur a rally in Asian stocks, with the MSCI Pacific Index rising 2.4%

in May. Expectations are for Asian equities to move higher in the short to medium term on central bank actions. Because of this, I am increasing my outlook for International equities from Underweight to Neutral.

A worldwide bond rally pushed yields to their lowest levels in a year. In Canada, it was the longer duration issues that outperformed, with government and investment grade corporate bonds lagging. High yield bonds saw spreads widen, muting gains. Still spreads remain at levels that cause some concern over valuation.

My investment outlook for the current environment is:

	Under-weight	Neutral	Over-weight
Cash		X	
Bonds	X		
Government	X		
Corporate		X	
High Yield		X↓	
Global Bonds			X
Real Return			
Bonds	X		
Equities			X
Canada			X
U.S.		X↓	
International		X↑	
Emerging Markets	X		

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

Funds You Asked For

This month, I take a look at some European equity funds, and offerings from Invesco and IA Clarington

Dynamic European Value (DYN 047 – Front End Units, DYN 055 – DSC Units) – If you have the stomach to handle fairly high levels of volatility, then this is one European equity fund you will want to take a look at. Managed by the team of Chuk Wong and Benjamin Zhan, this is a great fund to own when markets are rising. Coming out of the 2009 low, this was the top performer, a feat it repeated after the 2011 selloff in 2012, 2013, and so far this year. But be warned: when markets go south, so does this fund, often selling off hard. Part of this volatility can be explained by its exposure to small and mid-cap names, which make up more than half the portfolio. It is fairly concentrated, holding just under 60 names, with a strong overweight allocation to financials and industrials. I would expect that this fund will outperform if we see a continuation of the rally, but you have to be able to withstand the sharp drop when it sells off.

Mackenzie Ivy European Class (MFC 1565 – Front End Units, MFC 1808 – DSC Units) – While the Dynamic offering above has a bit of juice to it, this Ivy offering is the opposite, providing exposure to a conservative, concentrated portfolio of high quality, European based companies. It is managed using the same fundamentally driven, bottom up process that is used with all Ivy branded funds. It looks to win over the long term by not losing as much. The outcome of the process is evident in both the fund's overall level of volatility, which is well below its peer group, and its downside capture ratio. Historically, it has experienced less than 40% of the downside movement in the broader European equity markets. It holds under 20 names, and is heavily concentrated in consumer-focused companies, which make up nearly half

of the portfolio. Performance in any given year is very likely to be unimpressive, but the lower volatility profile has resulted in above average longer-term numbers. I would expect it to lag if we see a sharp rally in the near term, but I expect that it will continue to outperform over the long term.

Trimark Europlus Fund (AIM 1673 – Front End Units, AIM 1671 – DSC Units) – Managed by the team of Michael Hatcher and Matt Pedan, this fund is managed in a near identical fashion to other Trimark branded offerings. The managers have built a concentrated portfolio of what they believe to be best in class companies that are based in Europe. Companies they look for are typically leaders in their respective fields, with high defensible barriers to entry, sustainable competitive advantages, good management and strong long-term growth prospects. In addition, the company must be trading at a discount to their estimate of its intrinsic value, which they calculate using a proprietary fundamental process that relies heavily on a discounted cash flow model. It tends to hold under 30 names, most of which are larger, more established companies. It is defensively positioned, with an overweight in consumer staples and healthcare names, while it is significantly underweight financials. Performance has been above average every year since 2009 and overall volatility has been lower than its peers. The biggest knock on this fund is that its MER is 2.91%, which is above the category average. Still, I believe that this is one of the best European funds for all markets, particularly if you have a longer time horizon.

IA Clarington Global Dividend Fund (CCM 1850 – Front End Units, CCM 1860 – DSC Units) – On June 11, it was announced that Joe Jugovic and the QV Investor team would take over the management duties of the **IA Clarington Global Dividend Fund** starting in July. The fund will be renamed the **IA Clarington Global Equity Fund**.

The fund will have a mid-cap to large cap mandate, investing in companies that have a market cap of at least \$1 billion. The team uses a bottom up investment process that looks for financially strong companies with proven track records, excellent management teams, and competitive products and services that have the ability to earn a sustainable return. Another critical factor considered is the ability to pay and increase dividends over time.

It is expected that the portfolio will be made up of between 25 and 40 companies, and is expected to be well diversified across most sectors. Looking at their other mandates, I would expect that the top ten would be in the 40% to 45% range.

Another positive of this change is IA Clarington expects that the MER will drop from the current 2.83% to a more reasonable 2.59%.

QV has elected to take the portfolio in cash, meaning that they should have their portfolio up and running within a very short period of time. Whenever there is significant turnover in a portfolio, there is the potential that significant capital gains may be triggered. In speaking with IA Clarington, they mentioned that there are significant loss carry forwards, which will offset any capital gains triggered, reducing the possibility of a taxable distribution for investors. Also, given QV's relatively low turnover style, I wouldn't expect significant trading gains to be generated in the near term, making this a relatively tax efficient option for non-registered accounts.

I am told that this fund will be managed in a near identical way to a global equity pooled fund managed by QV. I dug up the return data on that fund, adjusted it for the difference in costs, and ran some analytics on it. Based on my review, I estimate that for the five years ending May 31, the fund would have earned an annualized 13% with QV at the helm. This lags the 15% rise in the MSCI World Index over the same period. One of the hallmarks of QV is their low volatility style, and this fund is no different. For the past five years, their volatility was lower than both the index and its peer group. Taking this into account, the risk adjusted returns would have been well above average.

Having been a fan of QV for more than a decade, knowing their investment process, and management team, I see this as a positive change for the fund. However, given the uncertainty that a change this significant can have on the fund, I would be likely to hold off a few months to make sure that the transition goes smoothly, and that they can continue to manage as they have in the past. I will revisit this fund in early 2015 to follow up on the progress.

BMO Global Energy Class (GGF 70236 – No Load Units, GGF 87236 – Front End Units, GGF 85236 – DSC Units) – A reader recently asked my opinion on this energy focused offering from BMO. It's not hard to see why given the strong outperformance it has shown. For the five years ending May 31, it has gained 20.8%, handily outpacing its peer group. Even more impressive is the one year gain of 55%.

While these numbers are no doubt impressive, one key factor to consider is there was a manager change in May of last year. Longtime manager Robert Taylor left BMO to join Canoe Funds. After his departure, the team of Mark Serdan and Kyle Hunter took the reins.

One concern that I have with the new management team is that Mr. Serdan, while a very experienced fund manager, has focused

almost exclusively on the materials and gold sector, and has little direct experience in the energy sector. On the other hand, Mr. Hunter has been actively involved in the sector since 2007, first as a research associate with Wellington West Capital, and then joining BMO Investments in September 2010.

In the year since they took over the management duties of the fund, performance has been spectacular, gaining a mind blowing 55%, second only to the **Sprott Energy Fund**. As impressive as this is, I would still exercise caution for a number of reasons, the biggest of which is that we cannot say for certain how much of this performance can be directly attributed to the new managers. Another concern is they have only been managing the fund for a year. Ideally I like to see a minimum of 36 months on a mandate before making a definitive call on the fund.

Given their excellent start, I will continue to follow the fund, and in the coming months will be doing a much deeper dive into the managers and their investment process to get a sense of how they stack up to their competition.

TD Science & Technology Fund (TDB 645 – No Load Units, TDB 322 –Front End Units, TDB 352 – DSC Units) – Science and technology funds have been on a tear recently, and this has been one of the best performers in the category. For the year ending May 31, it has gained 44%, and was up an annualized 22.4% for the past five years.

It is managed by T. Rowe Price using a fundamentally driven, bottom up, and proprietary research process that is both quantitative and qualitative in nature. Within the team, it is very much a collaborative approach, where analysts and portfolio managers share ideas and knowledge across industry sectors and geographies.

They are looking for medium to large technology companies located anywhere in the world. At the end of May, more than 70% was invested in the U.S., 16% in Europe, 10% in Asia, with the rest in cash. Their focus is on well managed companies with strong or increasing market share, and product pipelines that appear to put the company in a position for long-term growth. The investment process is predominately growth focused, however, the managers do pay attention to valuation to ensure they are not overpaying for growth. One way they do that is to focus on earnings and other valuation multiples, to make sure they are reasonable compared with the company's history, its peer group, and the broader market.

At the end of May, it held 56 companies with the top ten making up about half the fund. It is very actively managed, with portfolio turnover averaging more than 100% per year.

As mentioned above, performance has been very strong, consistently outpacing its rivals in the tech space. A drawback is that volatility has been higher than the category average, and given the narrow focus of the mandate, it is likely to have periods where volatility is well above average. Because of this, it is definitely not a core holding, and should only be considered by those who are comfortable taking on a higher level of risk.

While some exposure in a portfolio may help to boost returns, it may also add to the overall volatility of your portfolio because it is highly correlated to the S&P 500. Another concern I have is the cost, with an MER of 2.82% it is more expensive than many of its peers. Given that, I'd limit the exposure to between 5% and 10% for most growth focused investors.

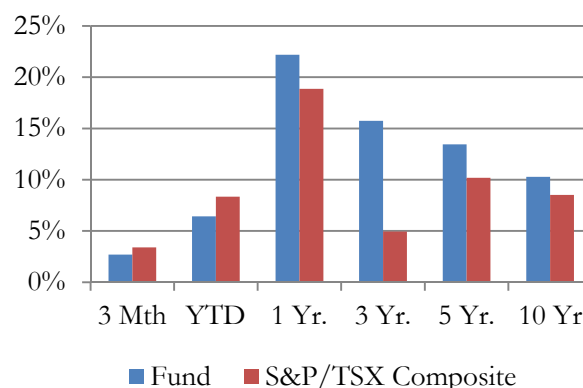
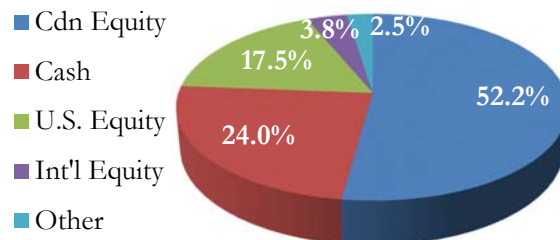
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca

National Bank Canadian All Cap Equity

Fund Company	National Bank Securities
Fund Type	Canadian Focused Equity
Rating	A
Style	Mid Cap Growth
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Brandon Snow since June 2011 Alan Radlo since June 2009
MER	2.51%
Fund Code	NBC 485 – Front End Units NBC 585 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: At first glance, this looks very similar to the **CI Cambridge Canadian Equity**. But dig a little deeper and you will notice some significant differences.

Perhaps the biggest similarity is both funds are managed by the same manager, using a near identical process. Manager Brandon Snow looks for companies that have a defensive business model, a history of intelligent capital allocation, and a management team whose interests are aligned with the shareholders. The bottom up approach is more growth focused, but valuation is a consideration. It can invest up to 30% of the fund outside of Canada.

The process is very active, with portfolio turnover well north of 100% per year. Further, Mr. Snow is not afraid to use periods of higher volatility as an opportunity to improve the portfolio. Turnover tends to increase with volatility, allowing him to pick up quality names at more attractive prices.

There are some very important differences between the funds. This fund tends to be more mixed across company size, holding significantly more small and

mid-cap names than the CI offering. Because of this, the portfolios are somewhat different. This has more exposure to energy, industrials, and consumer names, while holding less in financial services and real estate.

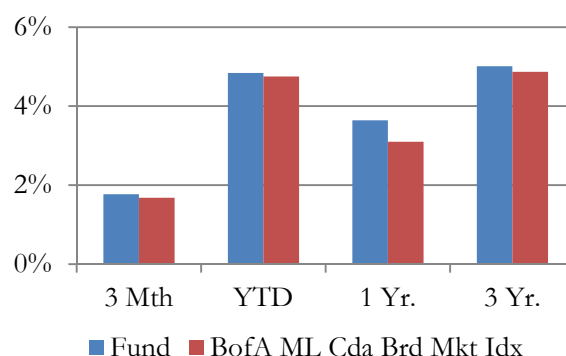
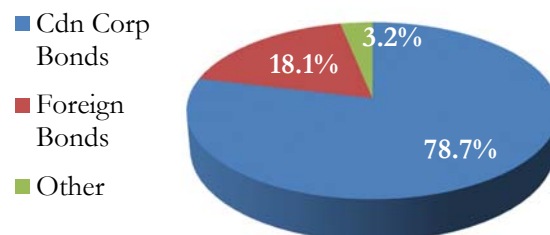
Performance has been strong, handily outpacing the index and peer group since Mr. Snow took the reins. The volatility profile of the fund is equally impressive showing much less variability than the index or peer group. It has outperformed in a rising market, and experienced a fraction of the downside in falling markets. While the absolute level of returns is likely unsustainable going forward, I expect it to be able to deliver above average risk adjusted returns in the near to medium term.

As far as which of the two funds is better really boils down to your situation. Costs are similar, although the CI offering is seven basis points cheaper. If you are looking for more large cap exposure, Cambridge Canadian Equity is the better option, but if you want more mixed cap exposure, this is the better choice.

Fidelity Corporate Bond Fund

Fund Company	Fidelity Investments Canada
Fund Type	Canadian Fixed Income
Rating	A
Style	Credit Analysis
Risk Level	Low
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Brian Miron since Sept. 2010 Catriona Martin since July 2012
MER	1.69%
Fund Code	FID 1634 – Front End Units FID 1631 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: In today's challenging fixed income environment, one way to enjoy above average returns is to invest in higher yielding investment corporate bonds. One of the stronger funds in that space has been the Fidelity Corporate Bond Fund. It invests predominantly in Canadian corporate bonds, which make up nearly 80% of the portfolio. The balance is invested in a mix of global and high yield bonds.

Rather than try to guess which way interest rates will move, the managers conduct detailed credit analysis that looks for high quality bonds that are attractively priced based on the outlook. As a starting point, manager Brian Miron analyzes the bonds included in the DEX Universe All Corporate Bond Index.

The high yield exposure in the fund is obtained by investing in the **Fidelity American High Yield Bond Fund**, which is approximately 10% of the portfolio. The managers are keeping the portfolio highly liquid so they can take advantage of any buying opportunities resulting from increased volatility. The

portfolio is diversified, holding more than 160 bonds, with the top ten making up about 17% of the fund.

Performance has been very strong, handily outpacing the majority of its peer group. For the three years ending May 31, it has gained an annualized 5.0%, beating the category average by 110 basis points. Volatility has been in line with the broader market.

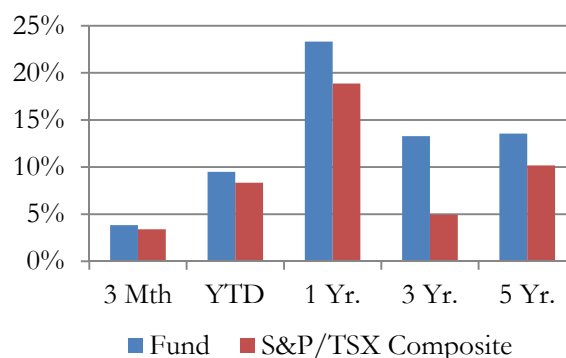
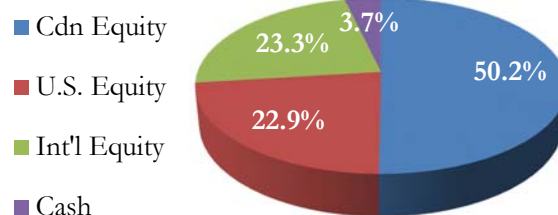
The portfolio is well positioned for the current, and a rising rate environment, but it will still be hit should we see a bump in rates. Its duration is 5.88 years, which is below the broader Canadian market duration of approximately 7. This means that for every 1% rise in rates, it is expected that this fund will drop by 6%.

With the focus on investment grade bonds, I believe that this is suitable as a core bond holding for most investors. Still you must be aware that if we see a period of extreme flight to safety, this will be hit more than a fund that holds more government bond exposure. That said, I expect that it will continue to outperform in normal market environments.

Steadyhand Equity Fund

Fund Company	Steadyhand Investment Funds
Fund Type	Canadian Focused Equity
Rating	A
Style	GARP
Risk Level	Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
Manager	CGOV Asset Management
MER	1.42%
Fund Code	SIF 130 – No Load Units
Minimum Investment	\$10,000

Asset Mix



ANALYSIS: The **Steadyhand Equity Fund** has blossomed into one of the better Canadian focused equity funds available today. It is managed by CGOV Asset Management using a fundamentally driven, benchmark agnostic, approach that strives to deliver investors absolute returns in all market conditions.

The concentrated portfolio looks nothing like its benchmark. It has a significant overweight position in consumer defensive, industrial and healthcare names. It has virtually no exposure to real estate and is about half the index weight in financials. This results in a portfolio that is expected to behave much differently than the benchmark.

Judging by the fund's performance history that is indeed the case. For the past three years returns have been stellar, gaining an annualized 13.3%, leaving the index and most of its competition in the dust. A lot of that outperformance can be attributed to its foreign holdings, which have significantly outperformed Canadian equities. The portfolio's concentration was also a factor, as the focus on strong, cash flow generating businesses paid off with outsized returns.

The fund's volatility has been significantly below average, outperforming in both rising and falling markets. The focus on quality has certainly helped in falling markets, as the fund has experienced less than half the drop of the S&P/TSX Composite Index over the past three years.

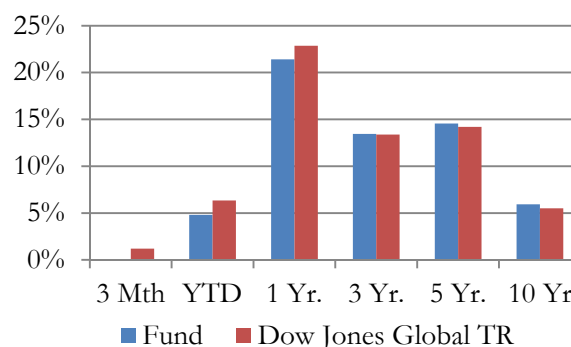
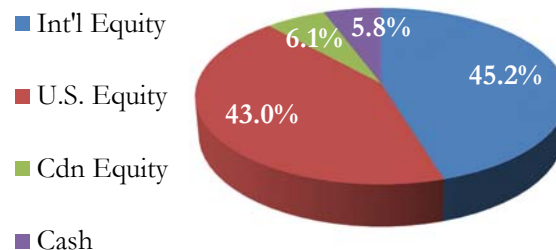
With just \$60 million in the fund, the managers can be very flexible in managing the fund, and can continue to take meaningful positions in mid cap names, if the investment opportunity is there.

While I don't expect that the three year number will be repeated, I do believe that the fund can continue to deliver above average returns with below average risk, making it a solid core holding for most investors. The emphasis on downside protection and margin of safety will go a long way in helping the cause, especially in volatile markets. Investors in this fund must be in it for the long term, because it is very likely to experience periods where performance lags significantly. I would expect this to happen more in a sharply rising market.

Capital International Global Equity Fund

Fund Company	Capital International Asst Mgmt
Fund Type	Global Equity
Rating	B
Style	Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Multi Manager
MER	2.11%
Fund Code	CIF 843 – Front End Units CIF 863 – Low Load Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This global equity fund is managed using a unique, multi-manager approach with different managers responsible for portions of the fund, independent of each other. Running the show are Carl Kawaja, Dina Perry, and Galen Hoskin. Also contributing to the fund is a team of 30 analysts who are responsible for about a quarter of the names. The total portfolio will have about 200 names.

The overall portfolio is monitored by Mr. Kawaja who ensures there is no undue concentration. To help with this, there are a number of controls in place including a maximum weight of any position of 5%, with a maximum sector weight of 25%.

Each manager has a unique, yet complimentary investment approach, including contrarian value, growth and a more tactical, opportunistic style. Regardless of the style, the research process is strictly bottom up, fundamentally driven. The process is patient and long term focused. A significant portion of the manager's pay cheque is based on their performance over an eight year period, allowing the

managers to focus on the big picture drivers of equity returns, rather than short term noise.

The sector mix and geographic allocation is the byproduct of stock selection process. It is overweight consumer cyclicals and technology, and underweight financials, real estate and utilities. While the process is largely bottom up, many of the companies in the fund are benefitting from a number of macro themes, including the emergence of affluent consumers in developing countries, the popularity of mobile computing, and healthcare innovation.

Performance has been strong. For the five years ending May 31, it gained an annualized 14.6%, outpacing much of its competition, but lagging the MSCI World Index. Volatility has been in line with the broader market.

On balance, this is a great core global equity fund for most investors. It has a very strong team behind it, a proven process, and a reasonable cost. I would expect that it will continue to consistently be one of the better performing global equity funds over time.