

Top Funds Report

Energy sinks Canadian equities

Volatility returns with a vengeance, as oil price plummet sinks equities, boosts bonds.

The past few months have certainly helped make 2014 a very interesting year. We saw the markets hit fresh highs amid some of the lowest volatility in recent memory, only to see it return with a vengeance. Equity markets, particularly the S&P/TSX Composite sold off heavily, losing more than 12% since September 1.

In Canada, most of the volatility can be attributed to two things. The first is the precipitous drop in the price of oil. Traders have become worried there is a significant oversupply of oil, given the weakening global economy and OPEC's refusal to cut production. The price of oil has dropped more than 40% in the year, and is down 46% from its peak in June. With energy making up a significant portion of the index, any drop in the sector will be felt by the entire index.

Another contributor to the recent volatility has been the roller coaster ride experienced by the financial sector. The financials experienced a 9% drop in September and October, recovering all the losses by the end of November. However, after a lackluster earnings season by the banks, the sector again dropped by another 8%. Financials are the largest component of the index, making up nearly a third.

Global equities have been largely mixed. The U.S. has been one of the better performing markets, gaining nearly 14% so far this year (to November 30). Europe, Japan, and the MSCI EAFE Index are down in U.S. dollar term, while most other major markets are higher. Some of the pain has been lessened for Canadian investors,

thanks to a falling Canadian dollar. To the end of November, the dollar is off nearly 8%, closing on December 12 at \$0.8666 US.

Perhaps the biggest surprise so far this year has been the resilience of the bond market. Many, had expected to see upward pressure on yields, which would make it difficult to see any real gains in bonds. We were wrong. With increasing market volatility and a less than stellar global economic recovery, the yield on the Government of Canada ten-year bond fell from 2.77% at the end of last year, to 1.74% on December 16. The broad market is up by nearly 9%, with long bonds nearly doubling that return.

My current investment outlook is:

	Under-weight	Neutral	Over-weight
Cash		X	
Bonds	X		
Government	X		
Corporate		X	
High Yield	X		
Global Bonds			X
Real Ret. 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 this year's winners and losers...

Bond Funds

Best – National Bank Long Term Bond Fund (NBC 486) – With bond yields moving substantially lower this year, it is not surprising to see that long term bonds outperform. At the end of November, the FTSE TMX Long Term Bond Index had gained more than 17%. That is why it is not really a shocker to see this National Bank offering as the top performing bond fund. It invests in a portfolio of bonds issued by Canadian governments and corporations that have a term to maturity of at least ten years. At the end of November, it held 42% in corporate bonds, 40% in provincial bonds, and 15% in government of Canada bonds. The duration is very high, coming in at 16.7 years, which is more than double the FTSE TMX Universe Bond Index, which is around 7 years.

Logically, there is no way this performance can be repeated going forward. While the Bank of Canada is likely to be on hold for a better part of next year, the U.S. Federal Reserve is widely expected to start moving policy rates higher sooner than later. With the duration significantly higher than the broader market, the interest rate sensitivity of this fund is off the charts. Any upward pressure on yields will result in a sharp selloff. If you hold this fund, or any other long bond fund, you may want to consider taking profits or selling your entire position and moving into something offering a shorter duration profile.

Worst – Dynamic Real Return Bond Fund (DYN 058) – When I first saw that this fund had lost 2.29% to the end of November, I honestly thought it was an error. I was surprised for a number of reasons. First, real return bonds tend often have very long time horizons, and at times trade much like a traditional long bond. Therefore, with yields dropping, one would

expect a positive return. Second, the real return bond index was up more than 14% so far this year, so a loss is pretty much inconceivable.

However, digging a little deeper I found the managers have sold Government of Canada bond futures to shorten the duration of the fund and hedge a portion of the interest rate risk. This was done to protect the fund against rising rates. If rates moved higher as everyone had expected, this would have been a positive for the fund, as the shorter duration profile would have helped preserve capital. However, when yields moved down, they got caught on the wrong side of the trade.

Looking forward, if we do see yields move higher in the New Year, the futures position would be expected to preserve capital for investors. However, I am still not convinced that it is a good time to have real return bonds in your portfolio, at least not as a standalone fund. Most of the more actively managed bond funds can add real return bonds when they feel it necessary. That said, if you want real return bond exposure, I would look at something like a **PIMCO Canadian Real Return Bond** or a **PH&N Inflation Linked Bond Fund**.

Canadian Equity Funds

Best – Mackenzie Canadian Growth Fund (MFC 650) – Please refer to the full fund profile on Page 6.

Worst – Red Sky Canadian Equity Corporate Class (CIG 2577) – With a year to date loss of 3.6% (at November 30), this fund has lagged the 11% rise in the S&P/TSX Composite by a considerable margin. What a difference a year makes, as last year, it gained more than 27% and was one of the stronger Canadian focused equity funds out there. Things started to go bad for this

fund in September and it never really regained its footing. Much of that can be attributed to its overweight exposure to energy and financials, which have both been hit in the past few months. It also holds a significant overweight in tech.

It is an all cap equity fund, managed using a high conviction, high turnover, opportunistic approach that blends bottom up fundamental security selection and top down macro analysis.

It was recently announced that the fund's manager, Red Sky Capital has resigned from the fund effective January 9, 2015, and the fund would be closed to new investors at the end of the year. Brandon Snow of Cambridge Global Asset Management will take over the reins. Mr. Snow has an excellent track record, and is one of my favourite managers at the moment. While nothing has been announced, it is my expectation that the fund will be merged into one of Cambridge's other funds. Regardless, with Mr. Snow at the helm, I expect the fund's risk reward profile will improve dramatically.

U.S. Equity Funds

Best – CIBC NASDAQ Index Fund (CIB 520) - Please refer to the full fund profile on Page 8.

Worst – RBC O'Shaughnessy U.S. Value Fund (RBF 776) – You know a category is having a good year when the worst performing fund posts a gain of 10.5%. That is the case here.

The fund is managed using a quantitatively driven approach that rates and ranks stocks on a number of quality, valuation and yield factors. While over the long term, the model tends to deliver strong returns, but, there can be periods where it underperforms, sometimes dramatically. This has definitely been one of those times.

Another factor adding to the underperformance is the fund's currency exposure, which is fully hedged. This will help to boost returns when the Canadian dollar is rising, but will hurt when the Canadian dollar is falling, as has been the case

this year. In U.S. dollar terms, the S&P 500 is up 14%, compared with a 22% rise in Canadian dollar terms.

Despite the recent underperformance, this remains one of my favourite U.S. equity funds, and I expect that over the long term, it will continue to deliver strong relative returns to investors. One caveat is it can be a touch more volatile than other U.S. equity funds. But if you're comfortable with that, you should be rewarded over the long term.

Foreign Equity Funds

Best – RBC QUBE Low Volatility Global Equity Fund (RBF 717) – Low volatility funds are one of those investing concepts that seems too good to be true. Not only are you likely to earn as good, or even better return, but you can do it with a lower level of risk. Naturally, I was a little skeptical.

That is why I am somewhat impressed with the performance of the majority of the low volatility funds this year. With all the volatility experienced, they did exactly what they were supposed to do, and helped protect investors' capital. During the September 1 to October 15 period, the MSCI World Index dropped by nearly 7%, yet this fund was off by 6.1%.

Perhaps even more impressive, to the end of November, it has gained 19.4%, outpacing the 15.2% rise in the benchmark. While these results are indeed encouraging, I am still reluctant to recommend it until there is at least a three year audited track record.

Worst – Beutel Goodman International Equity Fund (BTG 798) – Beutel Goodman follows a very disciplined bottom up, value focused approach, that is heavy on risk management. The managers are given a lot of flexibility, which results in a concentrated portfolio that often looks much different from the benchmark. In addition to having sector weights that are different, the funds will also typically have exposure to more

small and mid-cap names than a number of their peers.

In certain mandates, for example Canadian equity, this process has produced stellar results, with funds that typically outperform their peers more often than not.

Unfortunately this process has not translated into the same sort of success with their global and international mandates, which have struggled to keep pace. In 2014, their international fund has been the worst performing foreign equity fund that I follow.

A big reason for this underperformance is the fund has about 85% invested in Europe, which has disappointed this year, thanks to a nonexistent economic recovery. That said, when Europe turns around, this fund is well positioned for a nice rebound.

Still, I'm not waiting around for that to happen. There are definitely stronger international and global equity options available. If you want to invest with Beutel, I would suggest you stick to their Canadian equity mandates where they really shine.

Balanced Funds

Best – Mackenzie Canadian Growth Balanced Fund (MFC 724) - Please refer to the full fund profile on Page 5.

Worst – AGF Inflation Focus Fund (AGF 4074) – In May 2012, AGF launched this very interesting balanced fund that is designed to mitigate the impact of inflation. It invests in an actively managed basket of AGF funds with underlying exposure to inflation adjusted fixed income, resource and commodity stocks. The target asset mix is set at 60% **AGF Inflation Plus Bond Fund**, 20% **AGF Global Resources Class**, and 20% **AGF Precious Metals Fund**. At November 30, it was underweight both bonds and precious metals, with an overweight to resources. Looking at that asset mix, it's not hard to see

why this was the worst performing balanced fund this year.

The AGF Asset Allocation Committee conducts formal reviews on a quarterly basis, also manages the asset mix. It determines the outlook for each asset class and region, and then optimizes the portfolio by return, yield and volatility.

The idea for this fund is very interesting, but the timing of its launch really couldn't have been worse. While the longer-term outlook for inflation may be positive, it is muted in the near term. Add in a relatively calm geopolitical environment, and it's not hard to see why it has struggled. For the past year, the only fund of the three that has been positive was the AGF Global Resources, but it was only marginally in the black. AGF Precious Metals has been pummeled, dropping 43% in the past year.

Understandably, with this backdrop, the fund has performed rather poorly. It is down 5.4% since its launch and was down 3.8% so far this year. This lagged both the benchmark and the peer group by a substantial margin. That doesn't necessarily mean that this is a bad fund. Looking at the current environment, the performance, while poor, isn't out of line with expectations for inflation focused funds. The underlying funds are all decent on their own, but combining them into one balanced fund has been disastrous compared with other balanced funds that don't have the inflation focus mandate.

Considering the outlook, I don't expect there to be much of a change in the short term. Longer term however, with all the liquidity that has been injected into the global economy, there is likely to be increasing pressure on prices. Considering that, I would avoid this fund in the short term. But it might be something to take a look at down the road.

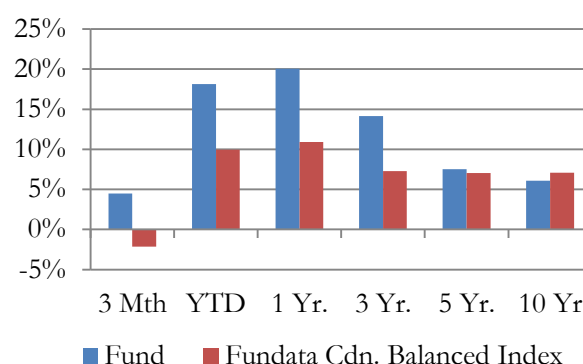
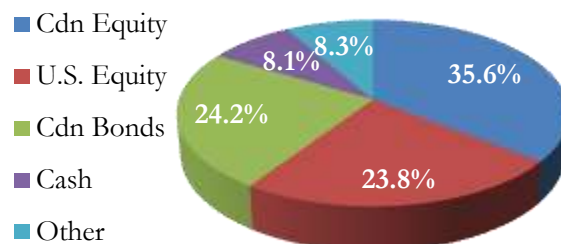
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca

Mackenzie Canadian Growth Balanced Fd

Fund Company	Mackenzie Investments
Fund Type	Canadian Neutral Balanced
Rating	B
Style	Growth
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Dennis Starritt since Nov. 96 Steve Locke since January 2010
MER	2.51%
Fund Code	MFC 724 – Front End Units MFC 824 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This balanced fund is managed almost like a fund of funds, with Dennis Starritt, Dina DeGeer, and David Arpin managing the equity component, while Steve Locke and the Mackenzie Fixed Income Team taking care of the fixed income sleeve. The top level asset mix decision is now in the hands of Mackenzie's Asset Mix Team, which is headed up by. Alain Bergeron.

The equity sleeve looks almost identical to the **Mackenzie Canadian Growth Fund** (please see page 6 for a more detailed review). It holds a mix of companies of all sizes, with more than half invested in small and mid-sized names. They also have nearly 40% invested in the U.S. The portfolio looks a lot different than the S&P/TSX Composite Index, with a significant underweight in energy, materials and financials, and a big overweight in technology.

The fixed income portion is overweight in corporate bonds and those rated BBB. It also has some exposure to high yields. In a recent commentary, the manager hinted the that the recent selloff in high yield was

overdone, and "...expect the strong fundamentals to continue and the default rate to remain near record lows and also continued volatility through the end of the year, driven by geopolitical uncertainties and fears of rising interest rates that will create tactical opportunities for investors."

The fund's asset mix will lean towards equities, which are expected to range between 60% and 90%. At the end of November, it held about a third of the fund in fixed income, 40% in Canadian equities, 20% in U.S. equities and the rest in cash.

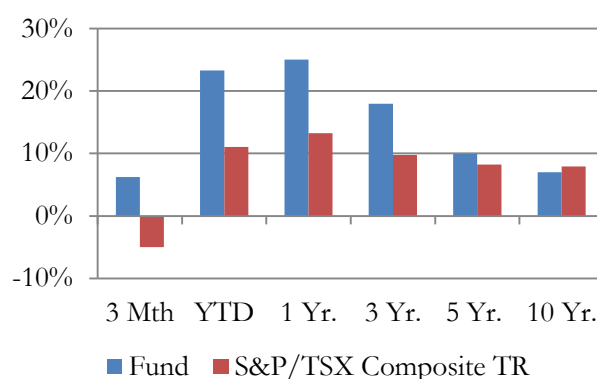
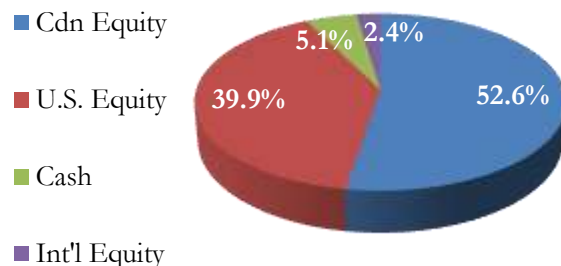
Recent performance has been strong, thanks largely to the U.S. equity holdings, and the underweight in energy and materials.

It offers a solid equity component, complimented by a strong fixed income team. The biggest question mark will be how much additional value, if any, having an asset mix manager will add to the fund. While not a bad balanced fund, I do believe that there are other balanced funds that offer a more compelling risk reward profile.

Mackenzie Canadian Growth Fund

Fund Company	Mackenzie Investments
Fund Type	Canadian Focused Equity
Rating	A
Style	Large Cap Growth
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Dennis Starritt since August '95 Dina DeGeer since August '95 David Arpin since January '13
MER	2.51%
Fund Code	MFC 650 – Front End Units MFC 640 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Year to date, this has been the best performing Canadian equity fund, gaining more than 22%, handily outpacing its peer group and the index. Longer term numbers are also impressive, gaining an annualized 18% for the most recent three year period.

To do this, the team uses a bottom up, fundamentally drive approach that looks for companies with strong management, good growth prospects and a solid financial position. While their process is definitely not a value focused one, they do pay attention to make sure they don't over pay for expected growth.

They look for companies of any size, and at the end of November, about half the fund was invested in small and mid-cap names. It is a Canadian focused fund, meaning they can invest up to half outside our borders. Currently, about 40% is invested in the U.S., which has definitely helped to boost recent performance, particularly since currency is generally not hedged.

Given their approach, it is not surprising to see a portfolio that looks nothing like its benchmark,

significantly underweight energy, materials, and financials. It is overweight in healthcare and technology, which have helped the recent performance.

For their domestic holdings, they have been focusing on names that generate a significant amount of their revenues outside of Canada.

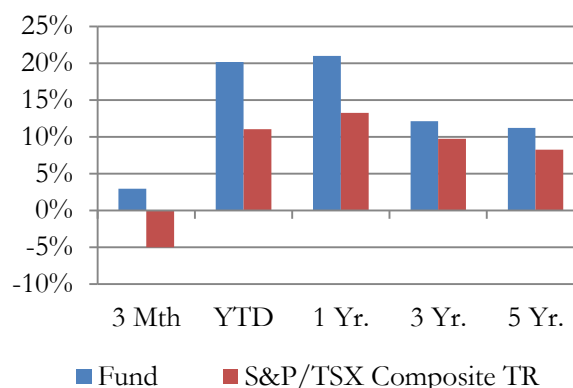
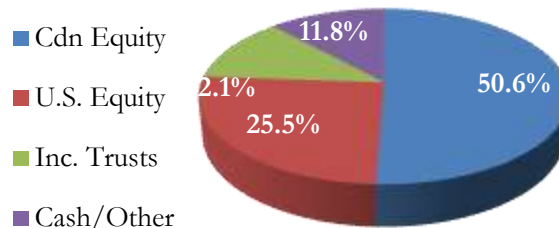
Despite the growth focus, they have done an excellent job in keeping volatility in check. Volatility has remained well below the index and peer group. However, given the growth focus, combined with the concentrated portfolio, there is a risk that volatility may be higher than average in certain periods.

This is a very solid Canadian focused equity fund. It offers a concentrated portfolio that looks dramatically different than the index. Costs are a touch on the high side, with an MER of 2.51%. While I don't expect the recent performance to be repeatable, I still expect this to remain a very solid fund going forward, delivering decent risk adjusted returns to investors

CI Cambridge Canadian Dividend Fund

Fund Company	CI Investments
Fund Type	Cdn Dividend & Income Equity
Rating	A
Style	Mid Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Brandon Snow since Dec. 2013 Bob Swanson since Dec. 2013
MER	2.40%
Fund Code	CIG 11112 – Front End Units CIG 11162 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Since Cambridge took this fund over a little more than a year ago, they have definitely put their mark on it. This is not your typical dividend fund. It is significantly underweight in financials, and in fact, there is not a Canadian bank to be found. It is also underweight energy, because most of the energy names they like don't typically pay dividends, which would exclude them from this fund. Another differentiator is it has more mid-cap names than most. The portfolio is relatively concentrated, holding less than 30 positions.

Portfolio turnover has been high since they took over, but that is to be expected given the portfolio transition. Cambridge generally tends to run higher turnover portfolios. They can be quite active, making shorter term tactical investments where opportunities exist. They will also use market volatile as a way to upgrade the portfolio by picking up high quality names at a cheaper price.

From here, I would expect that portfolio turnover will settle somewhere in the 150% to 200% range, which

is comparable to other Canadian equity mandates managed by Cambridge.

Cash will also be dependent on the available investment opportunities. They will let it grow when they don't see much in the way of suitable investments. At the end of November, they held 11.5% in cash, which was down from 17% at the end of September.

Performance has been excellent, gaining more than 20% so far this year. Going forward, I would expect to see performance remain strong and volatility remain well below average.

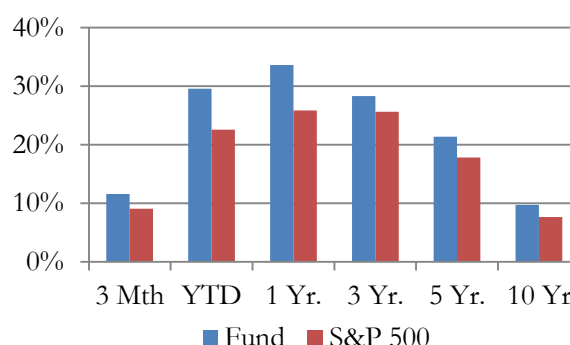
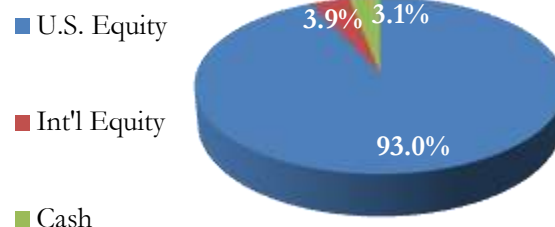
It pays a monthly distribution, which is currently set at \$0.03 per unit. At current prices, this works out to an annualized yield of 1.75%.

Costs are higher than the average Canadian dividend fund. However, all things considered, this is a very solid fund, and can easily be considered a core Canadian equity holding for most investors.

CIBC NASDAQ Index Fund

Fund Company	CIBC Asset Management
Fund Type	U.S. Equity
Rating	A
Style	Large Cap Growth
Risk Level	Medium to High
Load Status	No Load
RRSP/RRIF Suitability	Fair
Manager	Patrick Thillou since August '05
MER	1.26%
Fund Code	CIB 520 – No Load Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: U.S. growth stocks have definitely been the big winners over the past couple of years. This fund provides exposure to them by replicating the NASDAQ 100 Index, which is made up of the 100 largest non-financial companies that trade on the NASDAQ. It includes NASDAQ's largest companies across major industry groups, including computer hardware and software, telecommunications, retail/wholesale trade, and biotechnology.

At the end of November, it had nearly 60% invested in technology, 20% in consumer names, 15% in healthcare, and the rest in industrials and communications. It had zero exposure to energy, financials, materials or utilities, which could make this a very nice compliment to the S&P/TSX Composite Index, which is heavy in those sectors. The top holdings are littered with household tech names including Apple, Microsoft, Google, and Facebook.

Because it is an index fund, it has very low levels of turnover. It is rebalanced and reconstituted on an annual basis. Last year, turnover was approximately 17%.

The index is cap weighted, meaning that the bigger the company, the higher the weighting in the fund.

Despite having a higher MER than the NASDAQ index funds offered by TD or Scotia, this version has slightly outperformed over the past ten year period.

The fund does not hedge currency exposure, which has definitely helped to boost returns when compared to the TD version, which does hedge.

Recent volatility has been lower than average, but given the concentrated nature of the portfolio, I expect volatility to be higher, over the long term. While it was the top performer this year, it is not inconceivable that it could be near the bottom of performance, if tech hits a rough patch.

Given that, I would be very reluctant to recommend it as a core U.S. equity holding for most investors, given this potential for above average volatility. Instead, I see it as a compliment to a more traditional U.S. equity fund. It could serve as a core holding for those with an above average appetite for risk.