

Top Funds Report

Bank of Canada Shocks Markets

Surprise 25 basis point cut surprises everyone. More cuts expected

Last month, Bank of Canada governor Stephen Poloz shocked everyone by cutting its key overnight lending rate by 25 basis points. In a statement, Mr. Poloz cited the potential economic damage caused by falling oil prices as the main reason for the cut.

Most of the expected damage will come in the form of lower oil revenues, and increased unemployment as many oil companies move in to stop the bleeding by shutting down rigs, and lay off workers. According to the Canadian Association of Oilrig Drilling Contractors, less than half the 800 oil rigs were in operation in Canada, compared with nearly 70% a year ago. The longer oil prices stay low, the more rigs are likely to be shuttered and more jobs to be lost.

However, it's not all bad. In other parts of the country, for example, Ontario and Quebec, the lower oil prices will put more money in the pockets of consumers, helping to spur demand.

In speaking with a couple of bond managers, they believe that another reason the Bank of Canada may have cut rates was to lower the dollar, in an effort to help spur exports, which may help offset some of the impact.

Regardless of the reason, it is now almost a certainty that another 25 basis point cut is coming soon, and another one or two are possible.

This has definitely changed the investment landscape. While I still believe that equities will outperform bonds this year, the potential returns from Canadian fixed income investments have

been adjusted upwards. With downward pressure on yields expected, I am moving my fixed income allocation to neutral from underweight. I am also moving out the duration exposures slightly. In the past, I had been calling for shorter duration, but am now moving more towards a neutral stance of approximately 7 years.

For equity investments, my outlook remains fairly stable, with the U.S. expected to once again lead the way, while Canada, Europe and Asia struggle. I continue to favour managers that use a disciplined, active approach, and have portfolios that are much different than their benchmarks.

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 some of the funds on my Recommended List...

Dynamic Advantage Bond Fund (DYN 258 – Front End Units, DYN 688 – DSC Units) –

When it had appeared that interest rates in Canada were likely going to rise, the defensive positioning of this fund resulted in it being my top bond fund pick. With a shorter duration and more conservative asset mix, it was well positioned to withstand the increased volatility in the bond market, and was expected to hold up better when yields started to rise. That all changed a few weeks ago when the Bank of Canada surprised everyone and cut its overnight lending rate by 25 basis points to 0.75%, with many expecting more cuts to follow. In an environment where it is more likely that yields will fall or remain flat, this fund will likely lag those funds that have a more neutral positioning. I still believe this is a great bond fund for the long term, and expect it to hold up well when yields are moving higher. Until then, my focus will shift to funds that have a higher duration exposure such as the **PH&N Total Return Bond Fund**, or the **TD Canadian Core Plus Bond Fund**.

PH&N Total Return Bond Fund (RBF 6340 – Front End Units, RBF 4340 – DSC Units) –

With more cuts to interest rates expected from the Bank of Canada, this high quality bond fund becomes my top pick. At the end of December, it had a duration of 7.3 years, which is slightly less than the 7.6 years of the FTSE TMX Canadian Universe Bond Index. The fund itself is very much like the stalwart **PH&N Bond Fund**, except the managers have a little more flexibility which allows them to invest a modest portion of the fund in non-traditional strategies such as high yield, mortgages and derivatives. A little more than half is invested in government

bonds, the majority of which are higher yielding provincial bonds. Approximately 40% is invested in corporate bonds. Within the corporate sleeve, they have focused more on higher quality issues, and have remained underweight bonds in more cyclical sectors, namely energy. Looking ahead, I expect the management team to continue to do what it has done since the fund's launch in 2000 – use its rigorous, highly disciplined investment process to opportunistically position the portfolio in a way they believe will best benefit the portfolio, while paying particular attention to managing risk.

AGF Monthly High Income Fund (AGF 766 – Front End Units, AGF 689 – DSC Units) –

With two thirds of the fund invested in equities, combined with an overweight allocation to energy and materials, it is not hard to see why this was the worst performing balanced fund on our list in the fourth quarter. It lost 5%, while each of the other picks on the list were in positive territory. While the equity sleeve was aggressively positioned with a cyclical bent, the fixed income sleeve was somewhat defensive, with a duration slightly lower than the index, and a yield that was higher. Approximately 50% of the U.S. dollar currency exposure was hedged against currency movements, which dampened gains in the quarter. In December, they increased the hedge from 50% to 75%, which may be a further headwind in the face of the prospect of a falling Canadian dollar. With the benefit of hindsight, we can see that they got the positioning wrong for the short term. Understandably, I will continue to monitor this fund, and it's positioning closely. I expect it to

remain the most volatile of the balanced picks, but anticipate it will do well over the long term.

CI Signature High Income Fund (CIG 686 – Front End Units, CIG 786 – DSC Units) – Despite a modest 0.6% gain in the final quarter, the fund still posted a respectable 8.6% rise for 2014. Over the year, the managers had taken profits in many of their energy names, and built up a significant cash reserve. At the end of December, it had about 20% in cash and cash like investments. They have done this for two reasons. The first is to help boost the defensive positioning of the fund, helping it to better withstand any near term volatility. The second reason is for some “dry powder”, which will allow the managers to step in and pick up some high quality names trading at very attractive valuations.

I continue to like this fund and believe it to be one of the best balanced funds out there. I expect it to continue to deliver very strong levels of risk adjusted returns, with volatility levels that are well below average.

IA Clarington Conservative Canadian Equity Fund (CCM 1300 – Front End Units, CCM 1400 – DSC Units) – For me, the big appeal of this fund is its conservative profile, which has allowed it to post decent returns over the long term, with significantly less downside than the market, and its peers. Historically, it has delivered about 70% of the upside of the market, yet only experienced between half to two thirds of the down-side. This helps to explain why I was so disappointed with its recent performance when it dropped lockstep with the market.

I had the chance to speak with Ryan Bushell, one of the managers of the fund recently, and the main reason for this underperformance was the indiscriminate selloff of any stock that was related to energy. If you look at the fund, it has about a third invested in energy. Yet digging

deeper, we see that many of these energy names are high quality, cash flow generating, conservative plays, such as pipelines and companies more focused on natural gas. This includes names such as Enbridge, TransCanada, and AltaGas. Historically, when oil sold off, these names held up much better. Unfortunately this time around, that didn't happen, and these stocks were punished with the same veracity as their oil focused brethren.

As we move forward, Mr. Bushell believes that much of the selloff in many of the fund's holdings was unwarranted, leaving a significant amount of upside in the portfolio. They will continue to build the portfolio on a bottom up, fundamentally driven approach that looks for companies with strong management teams and excellent balance sheets that will allow them to withstand any market cycle. They will not deviate from the same process that has worked for them since 1950. I will continue to follow the fund closely.

RBC O'Shaughnessy U.S. Value Fund (RBF 776 - Front End Units, RBF 134 – Low Load Units) – If you look at the quarterly performance of this fund compared to the other U.S. equity funds, you might be wondering what happened with it, posting a very modest 2.1% rise, while the others were all significantly higher. Well since you asked, I'll tell you what happened -currency happened. Over the quarter, the Canadian dollar dropped by nearly 4%. The RBC O'Shaughnessy U.S. Value Fund hedges its currency exposure, while the other U.S. equity funds on the list are largely unhedged. When a fund is unhedged and the Canadian dollar drops in value, the U.S. dollar assets will see a rise in value because of the falling currency. For example, the **TD U.S. Blue Chip Fund** rose by 3.7% in U.S. dollar terms. When the returns were converted into Canadian dollars, the gain was nearly double, coming in at 7.3%. With the U.S. Federal Reserve likely to

start moving rates higher in the U.S. and the Bank of Canada expected to cut rates at home, it is highly likely we will see a further drop in the value of the Canadian dollar. At the very least, I would expect that currency volatility will be on the upswing in the near term. For this fund, or any other that hedges a significant portion of its U.S. dollar exposure, it may result in underperformance when compared with funds that do not hedge their currency. That said, I still believe this to be an excellent U.S. equity fund for those who can stomach a bit higher level of volatility in their portfolio.

Trimark Global Endeavour Fund (AIM 1593 – Front End Units, AIM 1591 – DSC Units) - While I have this fund in the Global Small and Mid-Cap Equity category on the Recommended List, it is really much more of an all cap mandate. Managers Jeff Hyrich and Erin Greenfield have built a concentrated portfolio of high quality names, with sustainable competitive advantages that trade at a discount to their estimate of intrinsic value. Their fundamentally driven, bottom up approach has resulted in a portfolio that looks nothing like its benchmark. They are very disciplined when it comes to valuation, and as a result, cash balances can run quite high. For example, at the end of September, cash was sitting at 14%. Over the course of the quarter, they used market weakness as an opportunity to chip away at a few opportunities, adding a couple of new names to the portfolio, and adding to existing names. This brought the cash down to around 11% at the end of the year. They continue to be patient, waiting for high quality names to trade at values they like. They are also starting to find some ideas in the emerging markets. This remains a great global mid cap pick for those investors who can be comfortable with a performance stream that is much different than the index.

Brandes Emerging Markets (BIP 171 – Front End Units, BIP 271 – DSC Units) – The fourth quarter was a tough one for the fund, amid a precipitous drop in the price of oil, major currency devaluations (especially the Russian Ruble), and political instability in Brazil, Argentina and other EM nations. With its overweight position in both Russia and Brazil, the fund was hit particularly hard, dropping 9.3% in Canadian dollar terms. It was even worse in U.S. dollar terms, with the fund dropping 12.6%. In a recent commentary, the managers stated they remain committed to their thesis on Russia. They believe “...it can offer some of the most potentially undervalued businesses in the world right now. On a macro level, valuations in that nation are about half those of the next closest country, China.”

At the end of December, the fund had 8.4% invested in Russia. It also had 18% in Brazil. It is important to note that the portfolio is constructed using a bottom up process, meaning the country allocations are a byproduct of their stock selection process. Emerging markets have historically been more volatile than more developed markets, and that has certainly been the case of late. I don't see anything near term that will change that. If you are uncomfortable with high levels of volatility, you should not be invested in an emerging market fund. Over the long term, I believe Brandes will reward investors with solid gains. However, you need to be comfortable with potential underperformance. If not, you should look elsewhere. I am monitoring both the fund and sector closely.

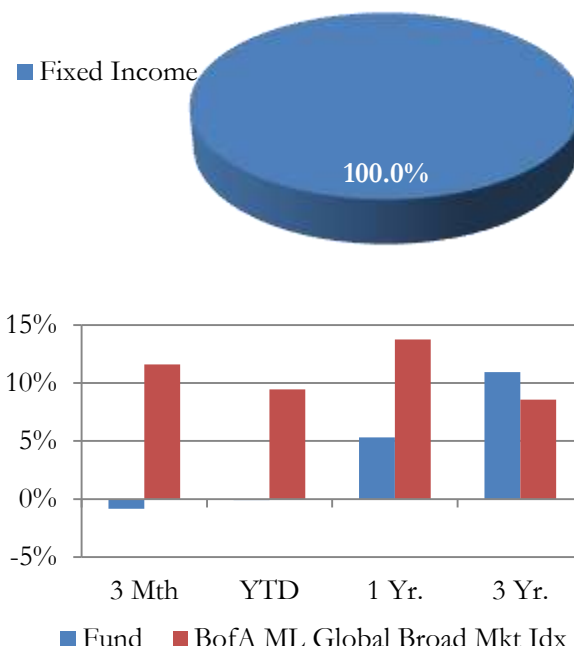
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca

PIMCO Monthly Income Fund

Fund Company	PIMCO Canada
Fund Type	Global Fixed Income
Rating	A
Style	Income Focus
Risk Level	Low – Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Alfred Murata since January '11 Dan Ivascyn since Sept. 2014
MER	1.38%
Fund Code	PMO 005 – Front End Units PMO 105 – Low Load Units
Minimum Investment	\$1,000

Asset Mix



ANALYSIS: After coming out of the gate very strongly in 2011 and 2012, performance of this global bond fund has certainly moderated to more sustainable levels. For the year ending January 31, it gained 5.3%, lagging both its index and peer group.

Despite this slowdown in performance, this remains one of the strongest global bond funds available. It is very actively managed and invests in non-Canadian dollar denominated fixed income investments. It is managed using a process that is a mix of top down and bottom up analysis to build the portfolio. The top down macro view is used to set the fund's duration, yield curve positioning and sector exposure, while the bottom up research looks to identify the most attractive non-Canadian securities that meet the its broader asset mix objectives.

The portfolio is managed using a bit of a barbell approach, with higher yielding, growth dependent issues on one end, and higher quality, defensive issues on the other.

The fund remains conservatively positioned, with a duration of 2.83 years, which is well below the index. They are currently focusing on mortgages and government bonds in the quality bucket, and high yield and emerging market debt in the higher yielding bucket.

The managers believe that global growth will pick up this year, helped largely by the drop in oil prices. While they still expect the U.S. to start raising rates, the easing policies of other central banks are expected to limit how far the Fed can move.

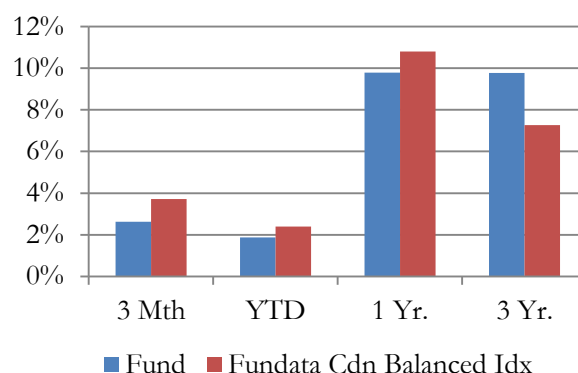
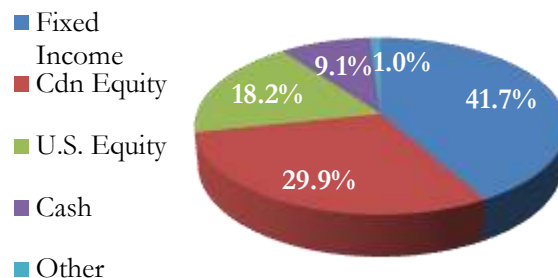
To benefit from this, they are keeping duration short and are focusing on debt that is more senior in the capital structure. The portfolio remains well diversified and they continue to focus on the income levels generated by the underlying issues.

As I have said in the past, I like this fund, but it is a bit riskier than historic volatility will have you believe. It is a great compliment to an otherwise well diversified portfolio, and is expected to continue to deliver decent cash flow to investors.

Sentry Conservative Balanced Income Fund

Fund Company	Sentry Investments
Fund Type	Canadian Neutral Balanced
Rating	A
Style	Large Cap Blend
Risk Level	Low - Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Michael Simpson since Jan 2012 James Dutkiewicz since May 12
MER	2.23%
Fund Code	NCE 734 – Front End Units NCE 334 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This conservatively managed balanced fund has been run by the team of Michael Simpson and James Dutkiewicz since 2012, and performance, particularly on a risk adjusted basis has been strong. For the three years ending January 31, it gained 10%, outpacing its peer group. However, factor in the fund's volatility, which has been well below average, you get a Sharpe Ratio that is nearly double the category average.

The asset mix is pretty close to balanced, with 49% equity, 44% bonds, and 7% in cash.

It is heavily weighted towards corporate bonds, which make up more than half of the fixed income sleeve. While the focus is on investment grade, about one quarter is invested in high yield bonds. On a whole, the bond sleeve offers investors a higher yield than the FTSE/TMX Universe Bond Index with a lower duration. This positioning may help explain some of the fund's recent underperformance, where longer dated bond issues have rallied higher after the Bank of Canada's surprise rate cut in January.

The equity portion is managed in a similar way to the highly regarded Sentry Canadian Income Fund, although this fund's smaller size allows it to take more of an all cap approach. It is also able to invest outside of Canada, and currently has about 20% foreign exposure, with the bulk of that coming in the form of U.S. equities.

It is also a decent option for those looking for cash flow. It pays a monthly distribution of \$0.0375 per unit, which works out to an annualized yield of 3.5% at current prices. The MER is 2.23%, which is above the average Canadian Neutral Balanced Fund.

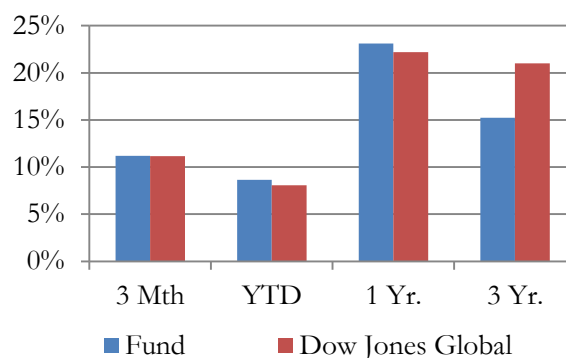
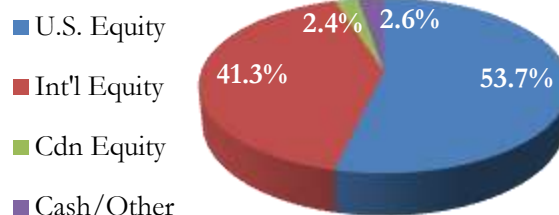
There are two things about this fund which cause me some shorter term concern. The first is the fixed income portfolio, which is better suited to a flat or rising yield environment, which is in doubt, particularly in Canada. The other concern is its overweight energy exposure. While a lot of the selloff was overdone, it may result in higher volatility levels going forward.

Still, I feel this is one of the stronger balanced offerings available, and a good option for risk averse investors.

Guardian Global Dividend Growth Fund

Fund Company	Guardian Capital LP
Fund Type	Global Equity
Rating	C
Style	Blend
Risk Level	Medium
Load Status	Front End Load
RRSP/RRIF Suitability	Excellent
Manager	Sri Iyer since May 2011 Fiona Wilson since May 2011
MER	2.32%
Fund Code	GCG 570 – Front End Units
Minimum Investment	\$5,000

Asset Mix



ANALYSIS: This go anywhere, global dividend fund is managed by Sri Iyer and his team at Guardian Capital, using a proprietary, multi factor quantitative model that screens the global equity universe looking for positive rates of change in the fundamentals of companies. These factors include growth, payout ratios, efficiency, valuation, and investor sentiment. Further, the team will conduct a fundamental review to validate any of the potential buy candidates to ensure the rating is appropriate.

The result is a well-diversified portfolio that holds between 70 and 100 names, holding just under 90 stocks at the end of December. The sector and country mix is the byproduct of the stock selection process.

Nearly 55% is invested in U.S. equities, with European names making up most of the rest. The fund is conservatively positioned - overweight the more defensive sectors such as consumer defensives, communications, and utilities. It is underweight financials, consumer cyclicals, and material. This would be expected to hold up well in periods of higher volatility.

I really like the investment process used by the managers. It is disciplined and repeatable. It focuses more on rates of change rather than the absolute values which can help identify trends sooner. I like that it takes a lot of the emotion out of the process, yet has the fundamental oversight of the investment team for verification. It is not a black box strategy.

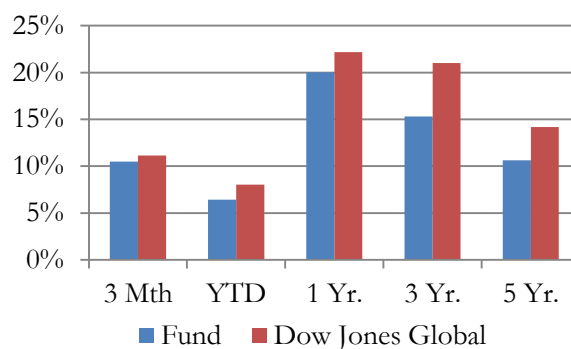
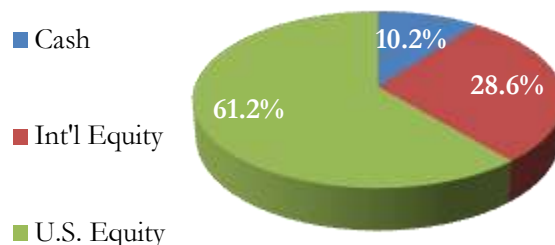
I would expect this fund to deliver average to above average returns, with lower than average volatility. It is also quite different than its benchmark. This of course can be a double edged sword, and could potentially result in periods where it underperforms for an extended period of time. Still, I believe it can be a great core global equity holding for most investors.

If you are unable to purchase this fund through your advisor, you could invest in the **BMO Global Dividend Fund (GGF 70725)**, which is virtually identical, except for a slightly higher MER – 2.48% vs. 2.32%. If you prefer an ETF, you could look at the **Horizons Active Global Dividend ETF (TSX: HAZ)**.

IA Clarington Global Equity Fund

Fund Company	IA Clarington Investments
Fund Type	Global Equity
Rating	C
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Joe Jugovic since July 2014
MER	2.72%
Fund Code	CCM 3071 – Front End Units CCM 3072 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Last July, Joe Jugovic of Calgary based QV Investors took over the management duties of this fund. QV is a shop known for their focus on finding high quality companies trading at attractive valuations.

While their track record on this fund is very short, QV has been running this mandate as a pooled fund since January 2007 with great success. This fund is identical to the pooled fund, except that it carries an MER of 2.72%. Yes, this is high, but even with the additional cost, it would have still able to outpace most of its peers over the past five years on a risk adjusted basis. Adjusting for the higher cost, this would have been the number 3 ranked global equity fund in my coverage universe at the end of the year.

The fund is managed using the same disciplined, bottom up process that is used with other QV funds. It looks for high quality, invested management that has delivered strong growth in equity, earnings, sales and cash flows. The company must be generating a level of free cash flow that will allow it to increase dividends over time, and the balance sheet cannot be

over levered. Finally, it must be trading at a level of valuation that is well below current market levels, while providing return on equity that is above average.

The portfolio is fairly concentrated, holding roughly 35 names. The sector mix and geographic allocation is a byproduct of the stock selection process. At the end of December, it was overweight communication services, financials and consumer defensive, and underweight utilities and real estate. The fund also has exposure to companies of all sizes, although more than 60% is invested in larger firms.

Looking at the historic track record of the pooled fund, combined with the other QV mandates I follow, I expect this fund to deliver above average returns over the long term. With their focus on higher quality names, it is expected to lag in a sharply rising market, however, it will more than hold its own when markets sell off. The emphasis on yield and cash flow will also help to mitigate overall volatility. The biggest drawback is its higher MER. Still, I see this as a great core global equity fund for most investors.