

Top Funds Report

Volatile Third Quarter end with losses

Volatility expected to remain high in near term...

The ugliness and volatility that started in the summer continued through September, as most major indices finished in negative territory. The MSCI EAFE Index dropped by 5% in U.S. dollar terms, as weakness in Japan and Europe weighed. The S&P 500 lost 2.5%, but when the falling value of the Canadian dollar is considered, the loss was just over 1% in Canadian dollar terms.

Canadian equities struggled on a couple of fronts, dropping 3.7%. In September, oil dropped by more than 8%, closing at \$45.09. Energy shares followed suit, with the S&P/TSX Energy Index dropping by nearly 9%.

Another headwind was the pharmaceutical sector, which was under pressure as index heavyweight Valeant Pharmaceuticals faced U.S. regulatory scrutiny over its pricing policies. This started a big selloff in the stock, which lost nearly a third, bringing the sector and market with it.

Heading into the final quarter of the year, the near term focus is on corporate earnings. Forecasts are calling for a 5.3% drop in year over year earnings per share, marking the first decline since 2009.

Early into the reporting season, and things don't look particularly promising. A number of companies have missed their numbers and have provided downward guidance for future quarters. This is disheartening, given the already low bar that has been set. The most recent miss was Morgan Stanley, which missed badly, causing many to wonder if current valuations are justified.

Adding fuel to the worry is news that China's GDP growth slowed to 6.9% in the third quarter, its weakest rate since the global financial crisis, and below the government's 7% target. If there is a bright spot it is the results were stronger than many economists had predicted.

As I consider my investment outlook, I am keeping my broad asset exposure fairly neutral. I expect that the likelihood of elevated volatility in equity markets remains high in the near term. With continued speculation on if the U.S. Federal Reserve will start to move rates higher, I expect a higher level of potential volatility in the bond markets.

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 of Note

This month, we look at the offerings of Mawer and EdgePoint...

Earlier this month, an advisor emailed me asking about Mawer Funds. Below is my reply to him.

Mawer funds are some of the best available, bar none. Let's take a quick look at some of their funds

Mawer Canadian Bond Fund (MAW 100) - It's good, but it's certainly not my favourite bond fund. It looks a little too index like for my tastes, especially once we hit a patch of rising rates. The portfolio holds more than half in governments, and just over a third in corporates. It only invests in investment grade bonds, effectively limiting options. It's not bad, but there are better options available (**PH&N Total Return Bond Fund**, **TD Canadian Core Plus Bond Fund**, and **Dynamic Advantage Bond Fund** are my picks)

Mawer Balanced Fund (MAW 104) – Last year, I picked this as the one fund to own, if you could own only one. It invests in other Mawer managed funds and is as solid a balanced fund as you will find. Equities are selected using their fundamental, bottom up, GARP focused approach that looks for wealth creating companies that trade at a discount to what they believe it is worth.

Fixed income exposure is the Mawer Canadian Bond Fund, so that could be a weakness in the future as rates start moving higher. It will suffice for now. The asset mix is based on their macro call on which asset classes are likely to offer the best risk adjusted return. They don't move the mix much, and any changes are done very gradually. This remains one of the best balanced funds available.

Mawer U.S. Equity Fund (MAW 108) – This is managed using a fundamental, bottom up, GARP type approach that looks for wealth creating companies that trade at a discount to intrinsic value. They take a long term, patient approach. Their culture is very research focused, and all assumptions made in the investment process are put through a rigorous stress test and scenario analysis before any investment decision is made.

That said, I'm a little less enthused about this offering. Not because of Mawer or how the fund is managed, but rather, I'm not overly excited about U.S. equity funds in general. It is remarkably difficult to stand above the index in the U.S. equity space. That said, this is one of the stronger offerings in the category.

Mawer International Equity Fund (MAW 102) – You're going to have to look pretty hard to find a better international fund than this. The process used with all the funds is the same, the only difference is the geographic region and the name on the fund. You can also buy it as **Manulife World Investment Class (MMF 8521 – Front End Units, MMF 8421 – DSC Units)** if you are an advisor who is looking for full dealer compensation.

Mawer Global Small Cap Fund (MAW 150) – Ditto! I honestly haven't been able to find a better global small cap fund than this. This diversified portfolio holds around 80 names, with an overweight in technology, industrials, and consumer defensives. It is underweight cyclical.

Performance has been excellent, and has consistently outpaced both the index and its peers. But even more impressive is this has been done at a level of volatility that is significantly lower than the benchmark or peers. Downside protection has been very strong, experiencing approximately 40% of the downside movement of the MSCI World Small Cap Index, while realizing almost all the upside.

This mandate is capped institutionally, so it is possible it may be capped to retail investors at some point in the future.

For advisors, this fund is also available as the **Manulife Global Small Cap Fund (MMF 4505 – Front End Units, MMF 4405 – DSC Units)**, which includes a full trailer fee. There is also an F class version available with an MER of 1.26%, which is cheaper than the Mawer version of the fund.

Mawer Global Equity Fund (MAW 120) – I’m really starting to feel like a broken record here, but this has been one of the strongest global equity funds around. It has consistently been in the top quartile, gaining an annualized 16.3% for the five years ending September 30.

It is managed by Paul Moroz and Jim Hall, using the firm’s disciplined, rigorous, bottom up, GARP process. It holds just under 70 names, from 17 different countries, with the U.S. making up 43% of the fund. The sector mix is largely the byproduct of the stock selection process, and at the end of September, financials, industrials, and healthcare were the largest sector exposures. Combined, they represent just over half the portfolio.

Volatility has been well below the category average, and downside protection has been

excellent. With an MER of 1.41%, this is a great core holding for most investors.

Mawer New Canada Fund (MAW 107) – Here’s a shocker – this has been one of my favourite Canadian small cap funds for as long as I can remember. Unfortunately, it has also been capped for several years, as the mandate was getting too large, and the firm thought it was in the best interest of all unitholders to cap the fund. It’s tough to disagree with that.

Another potential drawback is longtime manager Martin Ferguson will be retiring at the end of the year. Jeff Mo, who has been with the firm since 2008 and co-manager of the fund since 2012 will assume the lead manager duties.

Mr. Mo has a number of years with the firm and the fund, and he is well versed in the fund’s investment process. I am cautiously optimistic he will continue to deliver, but will be watching closely in the coming year to see if there is any meaningful erosion in the risk reward metrics of the fund.

I recently received an email from an advisor on EdgePoint. It read:

I was reading the latest Wealth Professional magazine that leads with advisors rating their providers. I noticed a company Edge Point was high on many survey items but scored a perfect 5 out of 5 on fees. Their rate of returns seem to be very favorable, especially 2008 where their worst return was +2%. Have you looked at them? If so, what are your thoughts?

Answer - I do cover Edgepoint. They have basically four mandates – **EdgePoint Canadian Portfolio** (Canadian Equity), **EdgePoint Canadian Growth & Income Portfolio** (Cdn Equity Balanced), **EdgePoint Global Portfolio**

(Global Equity), and **EdgePoint Global Growth & Income Portfolio** (Global Equity Balanced).

While they call the funds “portfolios”, they are not fund of funds or WRAPs, but instead are single mandate funds.

The Funds all tend to be fairly well rated. In my August report, they rated as follows:

Canadian Portfolio – A (ranked 21 out of 120)

Canadian Growth & Income Portfolio – A (ranked 28 out of 150)

Global Portfolio – B (ranked 1 out of 111)

Global Growth & Income Portfolio – B (ranked 4 out of 122)

The investment process is very much like the old school Trimark approach – business people buying businesses. They run concentrated portfolios of high quality, well managed businesses that offer strong competitive positions, generate high levels of free cash flow, have high barriers to entry, and excellent long term growth prospects. They look to buy these companies at prices that are below what EdgePoint believes they are worth. They take a long term investment outlook, typically in excess of five years, and are patient. Portfolios are built on a bottom up basis, and the sector mix is nothing like the benchmarks. They use an “all cap” approach, with good exposure to companies of all sizes.

The balanced mandates will have fixed income allocations that will range between 20% and 60%, and will be dependent on valuation. If they see opportunity in fixed income, the weighting will be higher, and if valuations are stretched, they will be near the lower end of the range, as they are at the moment. The bond exposure is pretty much all corporate, and they will invest in a mix of investment grade and high yield.

Performance, particularly over the long term has been excellent across the board. Don’t get too excited about the 2008 numbers they posted, since the funds didn’t launch until November, which missed the majority of the downfall. So really, the posted numbers are a bit misleading. In my opinion they should be removed from the website, or additional disclaimers or clarification added to emphasize the results are only for a month or two.

The funds have been slightly less volatile than the broader markets and their peers, but over time, because of the concentrated nature, all cap exposure, I would expect volatility to pick up a bit. This, combined with the much different sector mix, make it highly likely there will be periods where performance is out of step with the broader markets. Over the long term however, I would expect above average returns on both an absolute and risk adjusted basis, with above average volatility.

Costs are reasonable, but certainly not anything earth shattering. In the Canadian equity category, the MER is 2.16%, compared with the category average of around 2.24%. In the global space, they are more competitive, with a 2.14% MER compared with an average of 2.50%.

Bottom line is EdgePoint is an excellent shop. The biggest risk to them would be a big influx of capital that may start to negatively affect their ability to continue to manage the funds in the same way they have been since 2008. This is particularly true in the Canadian equity space. A detailed review of their Global Portfolio is found on page seven of this report.

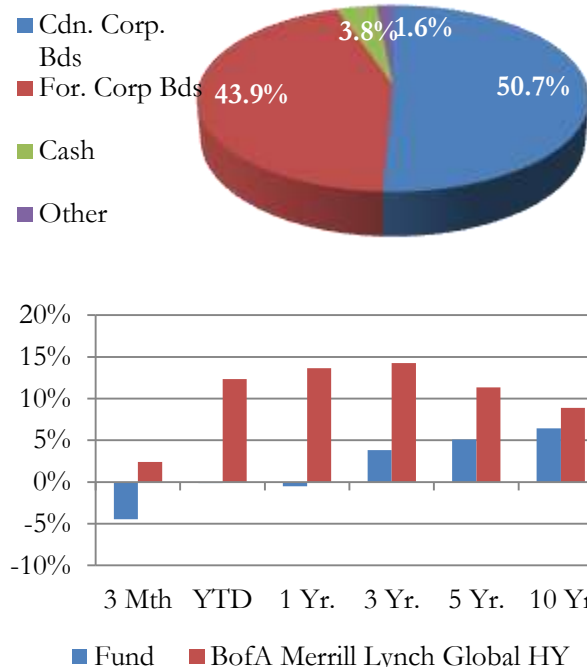
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca

PH&N High Yield Bond Fund

Fund Company	RBC Global Asset Management
Fund Type	High Yield Fixed Income
Rating	B
Style	Active Credit Analysis
Risk Level	Low - Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Hanif Mamdani since July 2000
MER	1.45% Advisor Series 0.87% DIY Series
Fund Code	RBF 1280 – No Load Units RBF 6280 – Front End Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Recently, this fund has hit a rough patch, with the advisor sold units falling 4.6% in the past three months. During the same period, the Barclays Global High Yield Index lost 3.1% in U.S. dollar terms, and the category average is down 1.8%. It has been four months of losses in the high yield market, something PH&N notes hasn't happened in more than 20 years.

Part of the reason the fund was hit so hard was its higher weighting to more illiquid Canadian high yield names. Canadian issues were harder hit than many of their U.S. traded brethren. Another detractor would be the exposure to energy, which has struggled in the face of volatility in the oil market.

In a recent commentary, PH&N noted that "This sharp decline in high yield bond prices occurred due to an almost perfect storm of factors including: concerns over slowing global growth, a potential Fed rate hike, a potential hard landing in China's economy, troubles in many emerging markets, a collapse of most commodity prices and a string of specific and unrelated corporate setbacks across the aerospace, telecom/satellite, wireless, media, healthcare and pipeline sectors."

With prices taking a beating, yields have risen sharply, and now sit at roughly 8%. This represents a spread of 675 to 700 basis points above what a comparable government bond would yield. This is also about 300 basis points higher than they were recently.

If you want to have high yield exposure in your portfolios, I believe this is one of the best funds available for that. It has an excellent manager and team behind it, using a disciplined, and repeatable process. While it may not always keep pace with its peers on an absolute basis, it's lower levels of volatility, and better downside protection make it a great way to get high yield exposure, in a more risk managed way.

Another positive is its current positioning. It has a duration of 3.5 years, which is less than half that of the broader Canadian bond market. It also has an underlying yield to maturity of approximately 8%, which is excellent. Even if things just stabilize from here, it would not be unrealistic to expect a modest positive return given the underlying yield.

Mawer Canadian Equity Fund

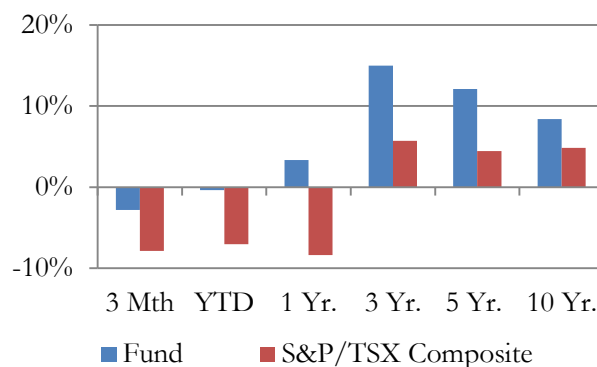
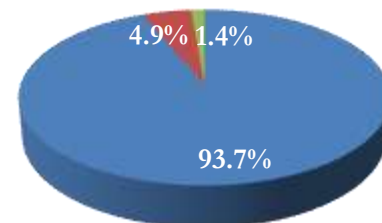
Fund Company	Mawer Investment Mgmt. Ltd.
Fund Type	Canadian Equity
Rating	A
Style	GARP
Risk Level	Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
Manager	Jim Hall since December 1999 Vijay Viswanathan since 09/11
MER	1.21%
Fund Code	MAW 106 – No Load Units
Minimum Investment	\$5,000

Asset Mix

■ Cdn Equity

■ Cash

■ U.S. Equity



ANALYSIS: Consistently ranked as one of the best Canadian equity funds in the country, Mawer's disciplined, research driven approach is the main reason why.

The investment process is a fundamental, bottom up, GARP type approach that looks for wealth creating companies that trade at a discount to intrinsic. They take a very long term, patient approach. Their culture is very research focused, and all assumptions made in the investment process are put through a rigorous stress test and scenario analysis before any investment decision is made.

They are benchmark agnostic, with the sector mix being the result of the stock selection process. The fund will often look much different than the S&P/TSX Composite, and at the end of June was underweight energy, materials and financials. It is also fairly well-diversified, holding just over 40 names, with the top ten making up just under 40% of the fund. They also hold a reasonable part of the portfolio in small and mid-cap names.

Performance across all time periods has been excellent, with a five year annualized return of 12.1% to the end of September, while the S&P/TSX Composite Index has returned 4.5%. Even in the past year, the fund gained 3.3%, while the index lost 8.4%. The fund lagged its peers in 2009 and 2010, but has outperformed each year since.

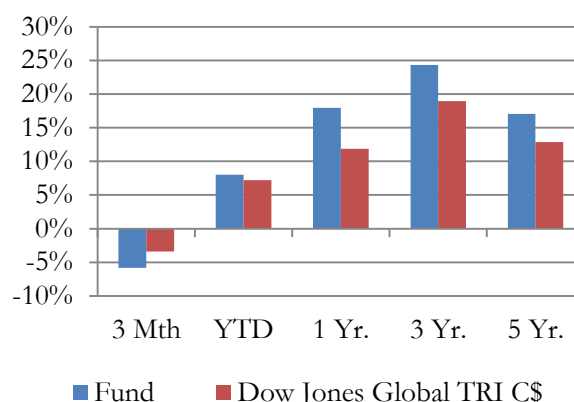
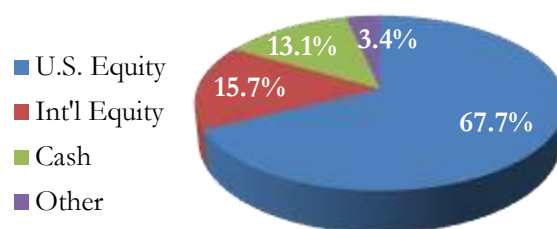
The fund's volatility has been below both the index and the peer group over the past three, five and ten year periods. In my view, the most impressive aspect has been the funds downside protection. According to Morningstar, the downside capture ratio for the past three years was 23% and 35% over the past five years. This means that on average, the fund experience much less downside than the index. Further, the upside capture is close to 100%, meaning the fund experienced most of the gains of the index.

While I doubt that this level of outperformance can be sustained over the long term, I still expect that the fund can modestly outperform on both an absolute and risk adjusted basis. This remains a top pick for in the Canadian equity category

EdgePoint Global Portfolio

Fund Company	EdgePoint Wealth Management
Fund Type	Global Equity
Rating	B
Style	All Cap Blend
Risk Level	Medium / High
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	EdgePoint Management Team
MER	2.14% Front End 2.41% - Low Load Units
Fund Code	EDG 100 – Front End Units EDG 300 – Low Load Units
Minimum Investment	\$15,000

Asset Mix



ANALYSIS: EdgePoint was launched in late 2008 after Geoff MacDonald and Tye Bousada left Invesco Trimark. Using what they learned there, they launched four core funds at EdgePoint.

This is their global equity offering that invests in companies of any size, located anywhere in the world that have strong competitive positions, excellent long-term growth prospectus, and strong management teams. Valuation is a key component, as they look to buy these companies at prices that are below what they believe it is worth.

The portfolio is built purely on a stock by stock basis, with country and sector weights being the byproduct of the stock selection process. The result is a portfolio that looks nothing like the index. To help ensure proper diversification, they look to diversify across business ideas.

It is a concentrated portfolio, typically holding around 40 names, with the top ten representing just under 45% of the fund. Their time horizon is longer term,

typically five or more years, and they are rather patient, allowing their investment thesis to play out. Portfolio turnover has been very modest, averaging around 30% for the past five years. They will typically sell a company for a couple reasons. First is the investment thesis is no longer valid, and second, they are able to find a better idea for the portfolio. They are constantly looking to upgrade the portfolio and will sell when one becomes available.

Performance has been excellent, on both an absolute and risk adjusted basis. For the past five years, it's gained an annualized 17.1%, outpacing the index and peer group. Volatility has been above average, which is not surprising given the all cap nature and concentrated portfolio.

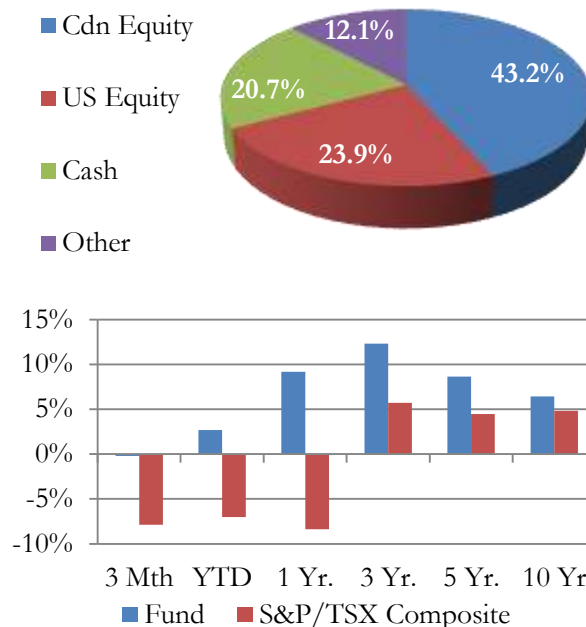
Costs are also quite competitive, with an MER of 2.14% for the front end units, which is well below average.

This is a great core global equity offering, for those who can stomach the potential for higher volatility.

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	Stephen Groff since July 2015
MER	2.41%
Fund Code	CIG 11112 – Front End Units CIG 11162 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: Portfolio manager Stephen Groff officially took the reins of this fund in July 2015. Mr. Groff took over from Brandon Snow and Bob Swanson who had been running the fund since late 2013. Given the way the Cambridge teams works together, this transition is not a concern.

Since taking it over, the Cambridge team has 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, in this concentrated portfolio. 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.

In the category, the managers can hold up to 30% outside of Canada. They will take advantage of this, and at the end of September had just under 24% abroad.

As with most Cambridge mandates, portfolio turnover is fairly high. For the year ending March 31, turnover

was about 160%. They can be quite active, making shorter term tactical investments where opportunities exist. They will also use market volatility as a way to upgrade the portfolio by picking up high quality names at a cheaper price.

Cash is dependent on the available investment opportunities. The higher the cash, the fewer opportunities that meet their criteria. At the end of September, they held 21% in cash.

Performance has been strong, gaining 9.2% for the past year, while the S&P/TSX Composite lost more than 8% and the category is down nearly 7%. Given that Cambridge has been at the helm for a little under two years, we can't really measure the volatility, however early indications are positive, holding up well in volatile periods.

I don't believe this level of outperformance is sustainable, but I do expect that this fund has the potential to deliver above average returns with below average volatility over the long-term.