

Top Funds Report

Second Quarter Starts Strong

With energy and commodities on the rebound, global markets rally off February bottoms...

After a rough start to the year, it looks like the global equity markets have found some solid footing. Since mid-February they have been moving higher, thanks in large part to a sustained rally in the price of oil. On February 10, oil hit a year to date low, closing at \$26.21. Since then, it has rebounded nicely, hitting a 2016 high of \$42.74, a rise of more than 63%.

The S&P/TSX Composite finished the first quarter higher by more than 4.5%, thanks in large part to a strong gain in March. It is up another 3% or so in April so far, and is more than 15% off the February lows.

A drawback to this rebound in oil has been a recovery in the Canadian dollar, which closed at \$0.79 U.S. on April 20, up more than 15% from its low this year. Many are worried that this bump will hurt our already weak manufacturing and export sectors. However, putting it in perspective, it is still trading at the low end of the ten year range versus the U.S. dollar, keeping us as competitive as we've been in a decade. While I have some concerns, they are more than offset by the continued recovery in the U.S.

In the U.S. economic growth continues to chug along at a positive, yet almost anemic pace. There are however some signs of life, with auto sales looking very strong and consumer spending looking to be on the upswing.

Elsewhere, Europe and Asia continue to struggle, despite significant central bank moves. Many regions are now experiencing negative interest rates. Still, the outlook remains cloudy.

In the emerging markets, with commodities looking to have regained something resembling a solid footing, we may see a short term rebound. Still, I would be quite cautious for the near term.

With bonds, barring a sharp rebound in inflation or significant uptick in global economic growth, I don't see a catalyst to move rates meaningfully higher. With this backdrop, I continue to favour high quality, higher yielding investment grade corporate bonds over governments.

For equities, I remain neutral in most developed markets, but would favour the U.S. and Canada over Europe and Asian near term.

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.

Trudeau Budget Surprises Fund Industry

Many shocked as corporate class funds lose key advantage and Labour Sponsored funds make return...

The Trudeau government released their inaugural budget last month, forecasting a head shaking deficit of \$29.4 billion this year, and significant deficits for the next few years. I'll reserve my opinion on this for another time.

Also contained in budget were two items that are sure to effect many Canadian investors – the loss of the ability to switch between funds in a corporate class mutual fund structure without incurring a taxable event, and the bringing back the Labour Sponsored Venture Capital tax credit.

On the surface, the loss of ability to switch between corporate class mutual funds without it being a disposition for tax purposes appears to be a huge loss for investors. While it may be for some, I'm not so sure it's as significant as it appears, for most investors.

First, as a refresher, in a corporate class structure, investors had the ability to switch between funds that were part of the same corporate class structure without triggering a disposition for tax purposes. This made it really handy to re-allocate your portfolio between funds, to move to a different fund, or to simply rebalance your portfolio without the worry of taxes. Under the proposed changes, this will no longer be the case effective September of this year.

While this was a useful feature, it was best used for portfolios that were held at a single fund company. This provided the most flexibility, allowing investors to easily switch on a tax free basis. However, for non-registered portfolios that used a "best in breed" type approach, where many different fund companies were used, the importance of this feature was less pronounced.

I am certainly a proponent of the best in breed portfolio approach because I believe in the majority of cases, it results in a better portfolio for the investor, when all aspects are considered,

including risk adjusted return, volatility, and even after tax return. As the industry becomes more focused on fee based planning, one fund company portfolios will become even less prominent.

While I strongly disagree with this decision, I don't see it as the end of corporate class funds. At least not yet. Corporate class funds still allow all forms of income and expenses to be spread over all the funds in the corporation, which reduces the likelihood of large taxable distributions. Also, interest and foreign income are taxed at the corporate level, meaning any distributions an investor is likely to receive will be in the form of Canadian dividends and capital gains, which are taxed at a more favourable rate.

The other move the Trudeau government made was to reinstitute the tax credit on Labour Sponsored Venture Capital Funds. My only thought on this is why? Granted, I am biased, and have not been a fan of these funds since I became aware of them in the mid-nineties. I see these as a tax product only. They have a dismal track record of providing any meaningful return to investors, and there are a number of them that are currently in trouble, having frozen redemptions, making it impossible for investors to get their money out.

Further, in many cases, these funds have been marketed as being suitable for everyone. Nothing could be further from the truth. They are designed to invest in high risk start-up companies. That carries a very high degree of total risk and the likelihood of profit, particularly under a very rigorous funding schedule that these funds are subject to, is very low.

Apart from the tax break, there is nothing appealing about the majority of these products, and this is one investment I would have been happy to see die on the vine.

Funds of Note

This month, I provide a quick overview of the Chorus II Portfolios from Desjardins, and more...

Desjardins Chorus II Portfolios – Recently, a reader asked for more information on the **Desjardins Chorus II Portfolios**. The Chorus II portfolios are a series of dynamically managed portfolios that invest in mutual funds offered by Desjardins Investments. There are six portfolios available, ranging from Conservative to Maximum Growth, and everything in between.

For the Conservative Portfolio, the target fixed income weight is 72%, with 28% in equity and other growth focused investments. The most aggressive portfolio; Maximum Growth, is focused on equities, with 83% targeted for equities and 17% in fixed income. The other portfolios range between these extremes, and are focused more on balanced investors.

The portfolios are available in both trust version and corporate class versions. The corporate class versions were designed for non-registered accounts, with the corporate class structure allowing for tax free switching between funds, making the tactical nature of these funds rather appealing. However, with the Federal government's move to eliminate this feature, it becomes less attractive. Further, the asset mixes of the Corporate Class versions have a touch more exposure to equities, making them slightly more risky than the trust options.

The minimum investment is set at \$100,000. Costs are not outrageous, particularly for a fund of fund program, ranging from 1.61% at the low end to 2.30% at the high end.

The portfolios invest in a mix of Desjardins offered funds, as well as some ETFs. Some of

the Desjardins funds included in the portfolios are **Desjardins Canadian Bond**, **Desjardins Enhanced Bond**, **Desjardins Canadian Equity Value**, **Desjardins Global Equity Growth**, **Desjardins Emerging Markets**, and **Desjardins Global Small Cap Equity**.

The portfolios are well diversified, perhaps too diversified, holding between 15 and 20 underlying funds. According to Morningstar, the number of individual holdings in these portfolios is above 5,000.

The equity sleeve provides a mix of Canadian, U.S., and international equities. The focus is very much on large caps, with just modest exposure to small and mid-cap names. Further, the focus is on developed markets, with very modest emerging markets exposure. This is not unexpected in this type of program.

On the fixed income side, the portfolios are also well diversified. While the focus is on investment grade, there is some exposure to high yield offerings, which will help to enhance yield and reduce interest rate sensitivity.

Putting it all together, the portfolios are okay at best. The reality is that fund companies tend to do well in only a couple of areas, and lag in others. So when a portfolio is built using only one company's products, the net result is middle of the road performance, more often than not. Further, these portfolios are, at least in my opinion, way too diversified, with exposure to far too many securities. In the end, they look a lot like the index, making it difficult to post above average performance.

If I had to pick, I like the Trust versions of the less risky options, with Balanced Income, and Conservative, being your best bets. Both are very conservatively positioned, with a target of 72% bonds for the Conservative Portfolio and 62% for the Balanced Income Portfolio.

Performance for both has been middle of the pack compared with their peers, although both have lagged their benchmarks. Volatility is in the low end of the peer group, and modestly below the benchmark. On a risk adjusted basis, both look fairly good compared to their peers and benchmarks.

If you're looking for a one ticket solution, these may be an okay option. However, if you are willing to put a bit of time into it, you can create your own portfolio that will be expected to be much stronger than these offerings.

Westwood Emerging Markets Fund (NBC 269 – No Load Units, NBC 469 – Front End Units, NBC 569 – DSC Units) – The emerging markets space has been a tough slog for many of late, and this fund is no exception. For the year ending March 31, it was down 12%, lagging both the index and much of its competition.

It has been managed by a team headed up by Patricia Perez-Coutts since August 2012. You may recall Ms. Perez-Coutts had tremendous success previously at AGF. Unfortunately, a repeat of this success has thus far been elusive, but there are signs things are turning around.

The process and team are nearly identical from when she was with AGF. The process uses a number of fundamental quantitative screens to identify potential investment candidates, followed up by rigorous bottom up analysis that looks for sustainable competitive advantages, growth drivers, and the potential for continued free cash flow generation. Any investment must also have a strong financial outlook.

The portfolio typically holds between 70 and 90 names, most of which are large caps. The process also leads the team to invest in higher quality companies. The bottom up focus results in a fund that is dramatically different than the benchmark.

One of the biggest drawbacks to this fund is it is extremely expensive. It had a management fee of 2.50% and fixed costs of 0.22%, bringing the total MER to 3.07% after all taxes. Fortunately, National has recognized this to be an issue and has cut both the management fee and administration fees. The new management fee is 2.30% and the admin fees are 0.19%, bringing the MER to an estimated 2.84%. It's still pricey, but more in line with some of its peers.

I will continue to watch this fund, but am not ready to jump on the bandwagon yet. Recent performance has been strong, and I will look for a continuation of this trend. Stay tuned...

Franklin Mutual U.S. Shares Fund (TML 213 – Front End Units, TML 313 – DSC Units) – This fund has struggled in 2014 and 2015, but has recently shown signs of a turnaround. For the year ending March 31, it was down by 5.6%, compared to the 4% gain in the S&P 500, while year to date it outperformed, gaining 1.1% while the index was lower by 5.6%.

It is primarily a value focused equity fund, but can also invest in merger arbitrage opportunities and distressed securities. The manager can also tactically hedge currency.

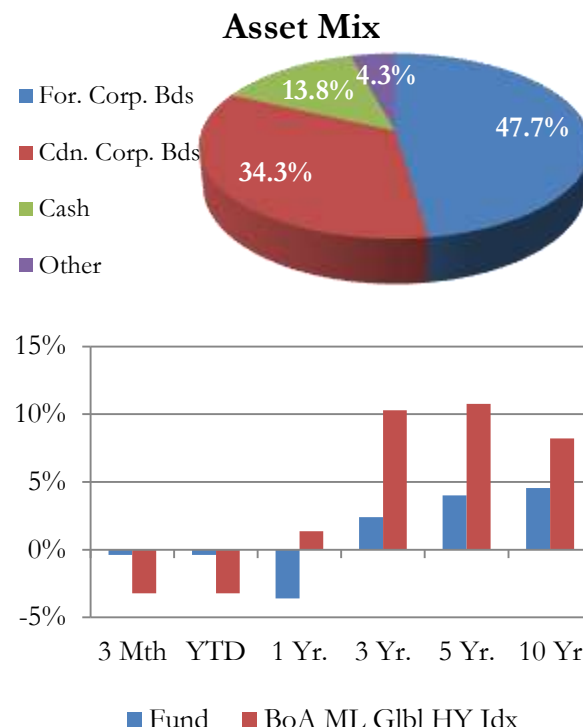
I like the process and management team, but think that for the long-term, you would be better off looking at the global version, **Franklin Mutual Global Discovery** over this offering. The U.S. equity market is a tough one to beat.

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

feedback@paterson-associates.ca.

CI Signature Corporate Bond Fund

Fund Company	CI Investments
Fund Type	High Yield Fixed Income
Rating	D
Style	Blend
Risk Level	Low to Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Geoff Marshall since Jan. 2006 John Shaw since January 2006
MER	2.11%
Fund Code	CIG 9010 – Front End Units CIG 9060 – DSC Units
Minimum Investment	\$500



ANALYSIS: Given the somewhat unique mandate of this fund, it's a tough one to classify. It invests in a diversified portfolio of bonds, right across the credit spectrum, ranging from AAA rated government bonds to high yield.

The investment process is a blend of top down macro analysis, which helps the team set the mix of investment grade and high yield, and fundamentally driven, bottom up credit analysis that helps evaluate the individual securities. They use a relative value type approach, looking for securities that are trading below what the teams believes they are truly worth.

There is no minimum or maximum exposure to high yield in the fund, and it will range based on the opportunity set. At the end of March, it held approximately 11% in cash, 47% in high yield, and 41% in investment grade bonds.

Even with a significant portion of the portfolio invested in high yield, the managers will look to

preserve capital, rather than chase yield for the sake of yield. This results in a more defensively positioned portfolio than you may see from other high yield offerings. The upside is you get potentially lower volatility, but the downside is you will likely lag when the high yield markets are rallying.

Performance on an absolute basis has been somewhat mediocre, gaining an annualized 4% over the past five years. However, factoring in the lower volatility the fund has experienced, and performance is well above average, on a risk adjusted basis.

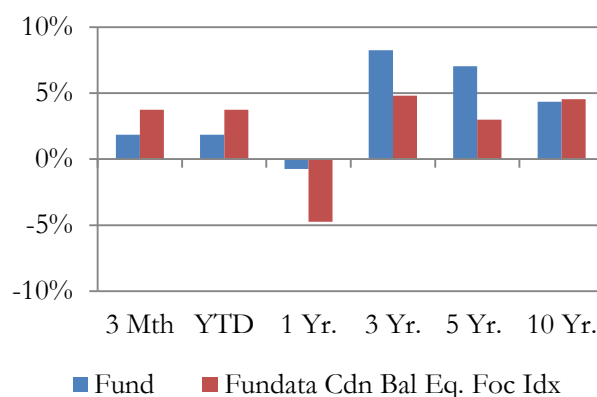
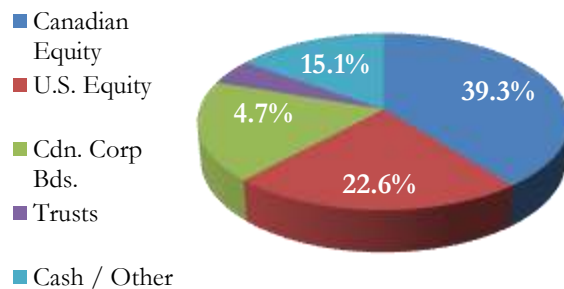
If there is a drawback to the fund, it is its cost. With an MER of 2.11% it is a bit pricey when compared with other quality high yield and global bond offerings.

Ultimately, I believe the emphasis on quality and capital preservation will help investors looking for conservative access to high yield offerings. It is certainly not a core holding, but rather a compliment to your otherwise well diversified fixed income sleeve.

Trimark Income Growth Fund

Fund Company	Invesco Canada Ltd.
Fund Type	Canadian Equity Balanced
Rating	A
Style	Large Cap Blend
Risk Level	Low to Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Clayton Zacharias since June 12 Jennifer Hartviksen since Sep 13
MER	1.80% SC Units, 2.53% A Units
Fund Code	AIM 1543 – SC Units AIM 6543 – Front End Units AIM 1541 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: The last time I reviewed this fund was April 2013, shortly after Clayton Zacharias had taken over the management of the equity portion of the fund. At the time I said I was "...cautiously optimistic that with Mr. Zacharias managing the equity portion that we will see a sustained improvement in overall returns." Turns out I was right.

Performance has definitely improved, with the fund boasting an annualized five year gain of 7.1%, handily outpacing its rivals and its benchmark.

In managing the equity sleeve, the team has built a concentrated portfolio of high quality Canadian companies that are trading at attractive valuations. It will typically hold between 25 and 35 names, and they are not afraid to raise cash when no suitable opportunities are available. At the end of March, they held around 5% in cash after putting some cash to work.

The fixed income sleeve is managed by a team headed up by Jennifer Hartviksen. They are currently overweight in corporate bonds and are very defensively

positioned. At the end of March, the duration was listed at 3.84 years, which is about half that of the FTSE/TMX Canadian Universe Bond Index. This will certainly help in periods of rising yields and bond market volatility. The yield to maturity is also above the benchmark, which will help drive returns in a flat rate environment.

The asset mix is 5% cash, 22% bonds, and the balance in Canadian and U.S. equities.

The fund's volatility has been above average, but given that it tends to carry a higher equity weight than a lot of its peers, this is not unexpected.

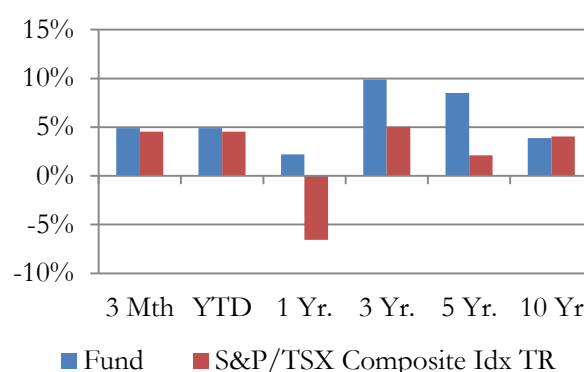
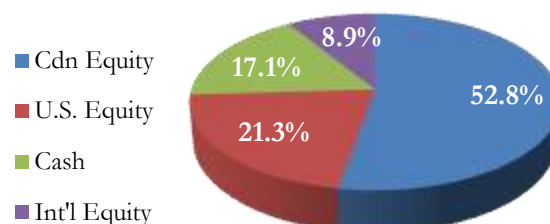
While performance has definitely improved, the conservative positioning and contrarian nature will likely lead it to underperform in rising markets, but hold up well in falling markets and volatile times.

I prefer the SC units over the Series A units because they carry a lower cost. Still, I think this can be a great core balanced fund for those looking for a concentrated, Canadian focused balanced fund.

Mackenzie Ivy Canadian Fund

Fund Company	Mackenzie Investments
Fund Type	Canadian Focused Equity
Rating	A
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Paul Musson since January 2009 Matt Moody since July 2012
MER	2.48%
Fund Code	MFC 083 – Front End Units MFC 613 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: When long-time manager Jerry Javasky stepped down in 2009, the reins of the fund were handed over to Paul Musson. When Mr. Javasky ran the fund, its stellar capital protection was legendary. Unfortunately, it was also known for its lackluster performance in up markets.

Today, with Mr. Musson running the show, the emphasis on downside protection remains firmly in focus, but now it does a much better job at providing decent gains when the markets are rising. For investors this means the potential for stronger overall risk adjusted returns over the long-term.

To do this, the managers have built a concentrated portfolio of around 40 Canadian and global names, that are all leaders in their industry. They use a fundamentally driven, bottom up process that looks for well-managed, high quality, financially sound companies that are trading at prices that make them attractive for the long-term.

The process is benchmark agnostic, and as a result, the portfolio looks quite different from its benchmark. It is

underweight financials, and materials, but is significantly overweight in consumer focused names, healthcare and industrials.

Performance has improved, gaining an annualized 9.9% for the past three years, compared with a 5.0% rise in the S&P/TSX Composite. There are a couple of factors that helped this outperformance including an underweight to the hard hit energy sector, and a healthy exposure of non-Canadian stocks, which were helped by a falling Canadian dollar.

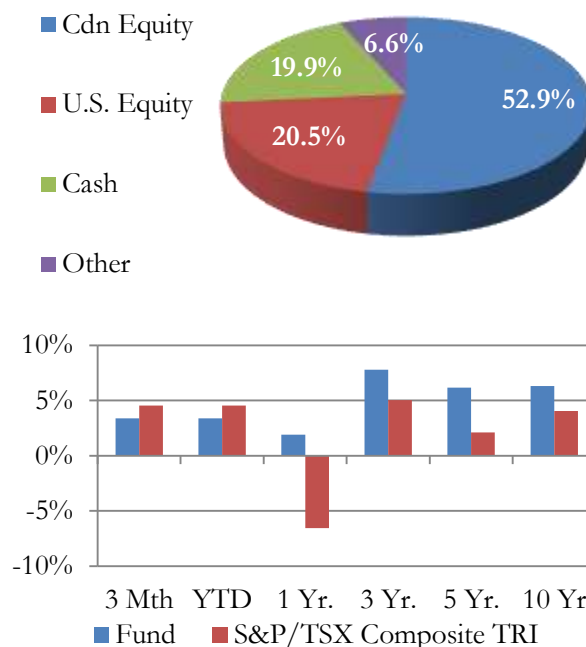
Volatility remains well below the index and the peer group. What is more impressive however is the improvement in the upside participation. According to Morningstar, the fund participated in more than 80% of the upside of the market, compared with only 50% over the past ten years.

I am really warming up to this fund and can see it being a great core holding for more conservative investors looking for Canadian equity exposure. I don't expect it to shoot the lights out, but it shouldn't hurt you when things get rough.

Fidelity Dividend Fund

Fund Company	Fidelity Investments Canada
Fund Type	Cdn Dividend & Income Equity
Rating	A
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Geoffrey Stein since April 2011 David Wolf since March 2014
MER	2.13%-B Units, 2.34%-A Units
Fund Code	FID 221 – Front End Units FID 521 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: As investors continue their hunt for yield, dividend funds remain a popular choice, and this Fidelity offering is one of the best in the category.

Managed by the team of Geoff Stein and David Wolf, who run the fund much like a fund of funds, making allocations to underlying funds managed by asset class specialists. They try to keep a fairly static asset mix that is in line with the fund's benchmark, 95% equity and 5% in bonds.

The bond allocation is through buying units in the **Fidelity Canadian Bond Fund**, which is a core offering that looks somewhat like its index. At the end of March, it had an overweight allocation to corporate bonds, and carried a duration of 7.5 years, which is slightly above the index. It had a yield to maturity of 2.4%, which is above the index.

The equity sleeve is managed by Don Newman who follows a "Growth at a Reasonable Price" philosophy. Using a fundamentally driven, bottom up investment process, he looks for high quality companies that have the potential to maintain and grow their dividends

over time. He seeks out companies with strong balance sheets and solid growth prospects that trade below their estimate of its true value. Some factors he considers include the company's ability to generate free cash flow and evidence of improving earnings.

The equity sleeve is well diversified, typically holding between 60 and 90 names. Given the dividend focus, it will look to have an average yield that is at least 1.5 times that of S&P/TSX Equity Index.

Performance, particularly over the medium term has been excellent, gaining 7.8% annualized for the past three years, compared with just over 5% for the broader Canadian market. More impressive is this has been done with a level of volatility that is well below both the index and the peer group.

It is defensively positioned, and the manager has been reducing exposure to cyclical names in light of expectations of lower economic growth.

I believe this is a great core holding for most investors. I expect it to deliver above average risk adjusted returns over the long term.