

Top Funds Report

U.S. Fed May Move Rates in June

Inflation worries more troubling than the prospect of lower global growth...

Earlier this week, the U.S. Federal Reserve Board released the minutes from their late April policy meeting, signaling to traders that a June interest rate increase is not out of the question, if economic data supports it. Citing stronger growth numbers, the Fed said they were more concerned about inflation than they were a meaningful slowdown in global economic growth.

Traders took this to indicate that rates may be moving higher sooner than many had predicted. On Monday and Tuesday, interest rate futures were pricing in about a four percent probability that the Fed would move rates in June. On Wednesday, this jumped to a nearly 30% probability being reflected.

So how does this change my investment outlook? Simply put, it doesn't. These minutes do not mean a rate increase in June is a sure thing. And even if rates do move higher, nothing changes. I have been somewhat bearish on bonds for a while, and this doesn't change that view. I continue to favour equities over fixed income.

Another factor to consider is the Bank of Canada will still likely hold the line on rates for the near term. Economic growth at home is not strong enough to support any rise in rates, and the full impact of the Fort McMurray fires has yet to be felt in the oil patch. Until we see sustained stability in the price of oil, the Bank of Canada is somewhat challenged.

Within fixed income, I continue to favour high quality, actively managed bond portfolios over the indices. While some rate volatility is

expected, I remain comfortable with the index like duration calls of **PH&N Total Return Bond**, and **TD Canadian Core Plus Bond Fund** over more conservatively positioned options.

With equities, I continue to favour concentrated, high conviction, quality focused portfolios that look much different than their respective benchmarks. As investors once again try to outguess the Fed, I expect we will see periods of above average volatility, taking us on a wild ride. With the prospect of higher rates happening sooner than expected, we should see upward pressure on the U.S. dollar, which will be a tailwind for unhedged foreign currency exposure.

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, I take a look at some of the funds on my Recommended List...

IA Clarington Canadian Conservative Equity (CCM 1300 – Front End Units, CCM 1400 – DSC Units) – This is a fund I have struggled with for a few quarters now. I originally like it because of its conservative nature, decent returns, and lower than average levels of volatility. To do this, the managers focus on well-managed, high quality Canadian companies that pay an above average dividend that is not only sustainable, but also growing. One of the risks of this strategy was over time, it became fairly concentrated in energy. More specifically, it invested heavily in energy infrastructure such as pipelines - the types of names that historically exhibited much less commodity sensitivity. However, when the energy swoon hit last year, investors sold off anything related to energy, including many of the names held in this fund. The result was a significant increase in volatility and levels of downside participation that were uncharacteristic for this fund.

I had numerous conversations with management, who remained consistent in their approach and continued to believe in these high quality, “backbone” type companies. Their belief was that as the energy markets normalized, so too would the risk reward profile of the fund. I felt comfortable with this, and continued to keep the fund on the list.

In February, IA Clarington made a change to the management team, bringing Terry Thib into the co-manager role alongside long-time manager Doug Kee. The fund was also given more flexibility in its mandate, allowing for some

exposure to smaller companies, and also some foreign holdings.

In a meeting with Mr. Thib, he reiterated that the fund’s positioning is likely to remain consistent for the near term. The focus will remain on high quality, well managed companies that deliver high levels of sustainable cash flow. In fact, he underscored that under his leadership, the fund will once again emphasize the conservative. He expects, the concentration in energy will be lessened as many of the names rebound and are sold as they approach full valuation.

I am strongly encouraged by the changes and what I heard from Mr. Thib. I believe that if successful in executing its strategy, it will return to its former self. That said, these changes are in fact significant, and I have some concerns on how the new managers will work together and how the changes may be executed in real time. Until that is determined, I feel it prudent to monitor it closely.

Mackenzie U.S. Large Cap Class (MFC 1022 – Front End Units, MFC 1172 – DSC Units) – Over the past few quarters, I have noticed an uptick in the valuation levels in the portfolio, which has corresponded with higher volatility and an overall erosion in the risk reward metrics of the fund. The managers use an approach that is a mix of top down thematic with bottom up security selection, which gives it a bit of a growth tilt that has strongly outperformed over the past few years. However, as the market leadership looks to be shifting towards more value names, I expect this fund may be due for

some slowdown in growth or potentially a bit of profit taking. Given the outlook, the valuation levels, and erosion of the risk reward metrics, I am removing it from the Recommended List.

PH&N Monthly Income (RBF 1660 – No Load Units, RBF 6660 – Front End Units, RBF 4660 – Low Load Units) – With some level of stability returning to the energy markets, this Canadian neutral balanced fund rebounded nicely in the first quarter. The advisor sold units gained an impressive 3.25%, outpacing its benchmark and peer group. While this is encouraging, it is not enough for me to keep it on the Recommended List. While the bond portion is solid, the equities have been merely average. Returns have disappointed and volatility has been on the rise. I will continue to monitor the fund for any meaningful improvement in the outlook.

Fidelity Canadian Large Cap Fund (FID 231 – Front End Units, FID 531 – DSC Units) – Despite lagging the S&P/TSX Composite Index, the fund still managed to outpace most of its peers in the first quarter. Much of this outperformance happened in January and February, when its underweight exposure to energy names and foreign holdings helped. However in March, with energy on the rebound and the Canadian dollar rising against the U.S. greenback, the fund lagged its peers.

The portfolio continues to look much different than the benchmark and its peers, with a substantial underweight in financials, real estate, materials and energy. It is overweight in the more defensive sectors such as consumer, healthcare, and utilities. It is also well represented in the technology space.

Despite being managed using a value focused style, the portfolio does not appear to be cheap, with valuation levels looking stretched. If you have held it for a while and have realized some solid gains, you may want to consider rebalancing and taking some profits off the table. Still, for the long term, this continues to be one of my favourite Canadian equity funds.

IA Clarington Canadian Small Cap Fund (CCM 520 – Front End Units, CCM 521 – DSC Units) – With a top quartile gain of 5.25%, the fund continues to deliver above average returns, with lower than average volatility. The managers use a fundamentally driven, bottom up investment process that looks for high quality businesses, run by strong management teams that are trading at attractive valuations.

Because the managers pay very little attention to the benchmark, it looks nothing like it. It is significantly underweight in materials, which created a bit of a headwind in the first quarter, as gold and silver shot significantly higher. It is overweight in consumer focused names, with a modest overweight in energy and industrials.

Valuation is key to the management team, and that is reflected by the portfolio which is trading at significantly lower multiples than the benchmark or its peer group. They also tend to favour companies that offer not only a dividend, but the ability to maintain and grow that dividend over time. The portfolio yield is 2.9%.

Looking ahead, the managers believe we are in a low return environment and have continued to place an emphasis on capital preservation. Volatility has historically been lower than the benchmark and peers, and downside protection has been excellent.

I believe this to be one of the best small cap funds available to investors. If you're looking for a fund that will shoot the lights out, you might want to keep looking. But, if you're looking for a well-managed, high quality fund that has the potential to deliver above average returns and below average volatility over the long-term, this is definitely one to consider.

Trimark U.S. Small Companies Class (AIM 5523 – Front End Units, AIM 5521 – DSC Units) – With an average 23% cash weighting, the fund was able to outpace both its benchmark and peers in the first quarter. With U.S. small cap names selling off, the high cash balance helped to provide a buffer to this downside.

The managers continue to express concern about the high level of valuation in the small cap space. That had led them to raise a significant amount of cash in the fund. But with the year starting out as it did, with high levels of volatility and some decent selloffs, the team was able to find a few high quality candidates and put some cash to work. Over the quarter, they added a new tech name, Liberty Broadband, and added to some existing positions that had become even more attractively valued. At the end of the quarter, the cash balance was still high, sitting at 17%. While this is high, it is because the managers remain disciplined, and would rather hold cash than invest in an idea that does not meet their quality and valuation standards. They are committed to using periods of market volatility to step in and pick up attractively priced names as appropriate.

Over the long term, the fund tends to be less volatile than its peers or index, and offers excellent downside protection. However, given

the high cash balance, I would expect it to lag in a rising market. Still, if you are looking for U.S. small cap exposure that is much different than the index, this is definitely worth looking at.

CI Signature High Income Fund (CIG 686 – Front End Units, CIG 786 – DSC Units) – In April, it was announced that Ryan Fitzgerald, co-manager of the fund had moved over to the Harbour Team, where he was appointed lead manager of the **CI Harbour Fund, CI Harbour Global Equity, and CI Harbour Voyageur.**

A manager change is a significant event that often leads to a fund being removed from the Recommended List. In this case however, the fund will remain on the list. There are a couple of reasons for this.

First, the replacement is Eric Bushell, who is the CIO of the Signature Group, and is very well versed in the Signature house process, given that he was instrumental in its development.

Second, Mr. Bushell has managed this fund on a couple of other occasions, so is extremely familiar with it.

Third, given the size of the team, and the team approach used by the Signature group, this departure is less impactful than it would be with a less well-resourced team.

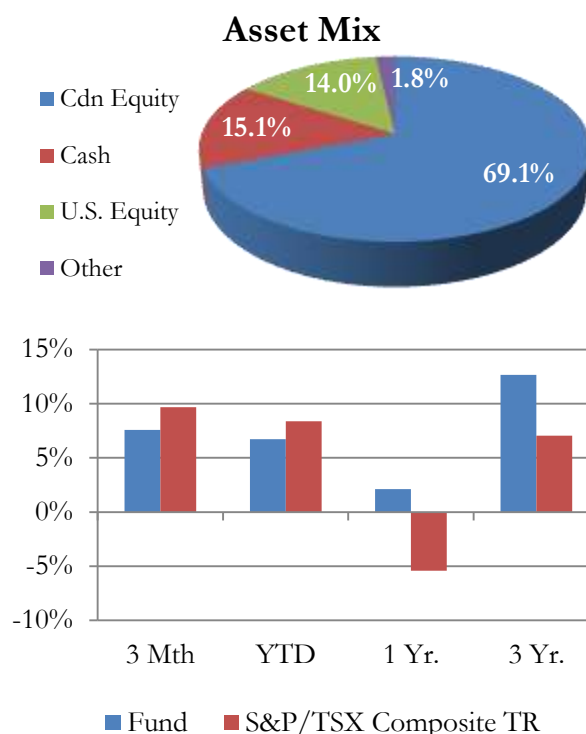
Combined, these factors lead us to remain very comfortable with the CI Signature High Income Fund as a well-managed, global balanced fund offering for the long-term.

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

feedback@paterson-associates.ca

Manulife Dividend Income Fund

Fund Company	Manulife Investments
Fund Type	Cdn Dividend & Equity Income
Rating	A
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Alan Wicks since March 2012 Conrad Dabiet since March '12
MER	2.29%
Fund Code	MMF 4529 – Front End Units MMF 4429 – DSC Units
Minimum Investment	\$500



ANALYSIS: Managed by the team of Alan Wicks, Conrad Dabiet, and Jonathan Popper, using a bottom up, fundamentally driven process that seeks out businesses of any size that have high returns on invested capital. Each potential investment candidate is scored on a number of factors, including stability and level of their earnings power, managerial skill and ownership, and financial leverage. A deeper due diligence review is conducted on the most attractive opportunities. This includes meetings with management and generating an estimate of fair value. They also determine buy and sell prices. Once a company is in the port-folio, they actively manage position sizes based on real time valuation levels. The closer a name is to its buy price, the greater the weight it has in the fund. Surprisingly, turnover levels have been modest, averaging around 70% for the past three years.

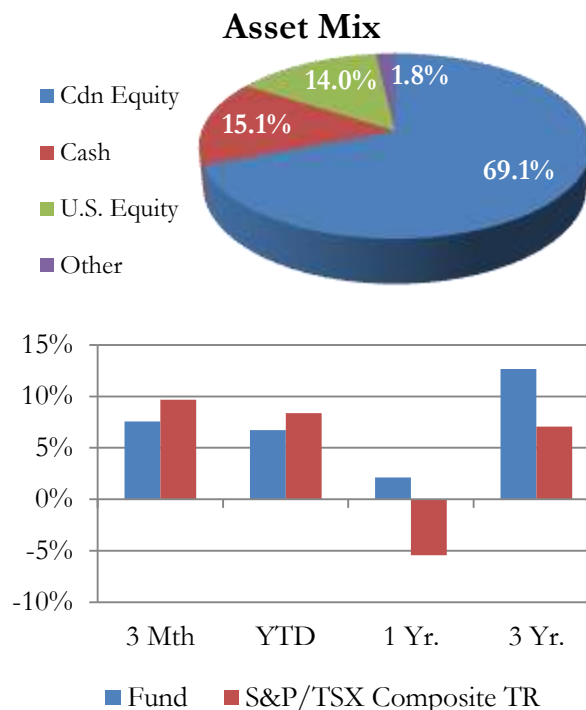
It is much different than many other dividend mandates, with an underweight in energy and financials. It can invest outside of Canada, and has about 30% in the U.S. at the moment. They will also hedge part of their currency exposure.

Performance has been excellent, but more impressive is the volatility has been significantly lower than the broader market and its peer group. Further, it has done an excellent job of protecting capital in falling markets. While the retail version of this fund is only a few years old, it has been operating as an institutional mandate since June 2004 with similar risk reward metrics.

I don't see the absolute levels of return likely to be repeated, but I expect that it will be able to produce above average returns with less risk. I see this as a great core holding for investors looking for core Canadian equity exposure.

Manulife U.S. Equity Fund

Fund Company	Manulife Investments
Fund Type	U.S. Equity
Rating	F
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Grayson Witcher since June '08
MER	2.48%
Fund Code	MMF 4504 – Front End Units MMF 4404 – DSC Units
Minimum Investment	\$500



ANALYSIS: The U.S. market is one of the toughest to beat on a consistent basis, which is why I tend to favour low cost ETFs for my U.S. equity expo-sure. However, if you are looking for a well-managed, high quality, mutual fund that will give you a shot at outperforming the S&P 500 once in a while, then this fund, which mirrors the **Mawer U.S. Equity Fund (MAW 108)** is definitely worth considering.

Mawer has built a strong reputation with their multi-layer, disciplined, research driven investment process that looks for well-managed, high quality companies with sustainable competitive advantages that are trading well below what Mawer believes it to be worth. To find potential investment candidates, the managers screen for companies with high returns on equity that are trading at attractive valuations. Once identified, a more thorough fundamental review is conducted that includes a discounted

cash flow analysis and the firm's arduous scenario analysis and stress testing to get a better understanding of the stocks potential upside and downside.

Performance and volatility numbers have been respectable. While the fund has lagged the S&P 500, it has still managed to post above average results every year since 2011.

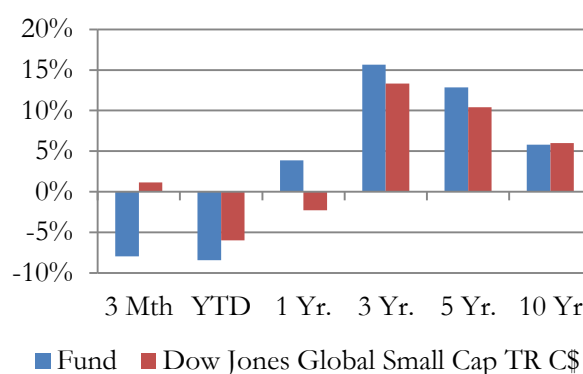
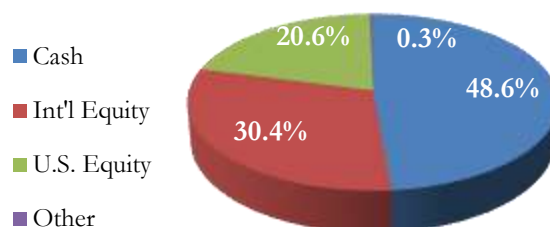
If you are using a fee based account, or are a do-it-yourself investor, I would suggest that you look at the Mawer offering directly because it offers a lower MER than even the F-Class version of this fund. The MER of the A series is a bit rich at 2.48%, the F-Class is 1.26%, and the Mawer offering comes in at a very reasonable 1.18%.

While I don't see this fund significantly outperforming the S&P 500 on a consistent basis, it is a good option for those looking for a high quality U.S. equity mutual fund.

Fidelity Northstar Fund

Fund Company	Fidelity Investments
Fund Type	Global Small / Mid Cap Equity
Rating	A
Style	Mid Cap Value
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Daniel Dupont since Oct. 2011 Joel Tillinghast since Jan. 2012
MER	2.36%
Fund Code	FID 253 – Front End Units FID 553 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This go anywhere, all cap fund is managed by the team of Joel Tillinghast and Daniel Dupont. Both managers use their unique individual bottom up stock selection process.

Mr. Tillinghast looks for well-managed, high margin companies with little or no debt that are growing faster than their peers. There also must be sustainable competitive advantages and high levels of free cash flow. He tends to be very well diversified, typically holding between 400 and 500 names.

Mr. Dupont, on the other hand runs a more concentrated book, typically in the 20 to 50 stock range. He uses more of a value focused process that looks for stocks that are significantly undervalued. He likes strong companies with unrealized growth potential, excellent management, and high return on invested capital.

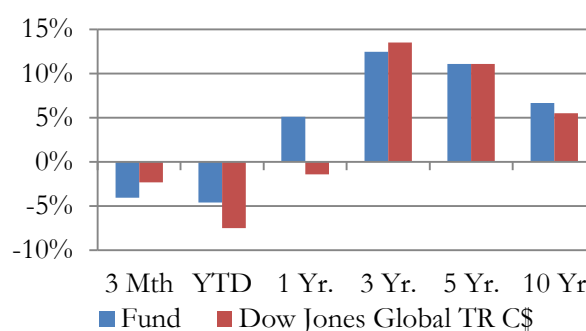
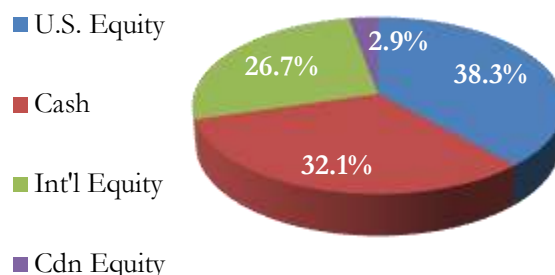
They meet formally monthly to discuss the relative attractiveness of the various investment opportunities available. With this information, they decide which of the managers can most effectively allocate capital in the coming month. Sector mix and geographic exposure is solely the by-product of the stock selection process. Cash is high, currently nearly 50% of the fund, as they seek out quality investment candidates that meet their strict criteria. This could be a drag in a rising market, but will also keep volatility in check. This is one thing I am monitoring closely.

Performance, particularly since 2012 has been very strong, but more impressive, the volatility and downside protection numbers have been stellar. Given the all-cap nature of the fund, I would be reluctant to use it as a core holding, but rather as a compliment to an otherwise well diversified portfolio.

Mackenzie Ivy Foreign Equity

Fund Company	Mackenzie Investments
Fund Type	Global Equity
Rating	B
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Paul Musson since January 2001 Matt Moody since January 2009
MER	2.53%
Fund Code	MFC 081 – Front End Units MFC 611 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: With market volatility high in the first quarter, this concentrated, quality focused global equity fund did what it does best – protect capital better than its benchmark and peer group.

For the three months ending March 31, the fund was down by 1.4%, handily beating the -6.5% showing of the MSCI World Index. Historically, the fund has experienced about half to two-thirds of the drawdowns of the market, as the managers place an extraordinary emphasis on preservation of capital.

This outperformance came from a couple areas. First, the fund is carrying a high level of cash, which at the end of March sat at more than a third of the fund. Also helping were the fund's U.S. and UK stocks, which were net contributors to the performance.

In a recent commentary, managers commented that they continue to find the market valuations

extremely rich, and as a result, they are having trouble finding new opportunities. Further, they have needed to trim exposure to a number of existing holdings to reduce risk in the portfolio as many have reached full valuation. The result is a very high cash balance, which at the end of March was nearly a third of the fund. This will help buffer against any downside in the markets, and provide ample dry powder should opportunities arise. It will also be a headwind in a rising market.

Still, this remains one of my favourites, particularly for periods of higher than normal market volatility, which I believe we will continue to experience in the near to medium term. I see this as an excellent core global equity holding for risk averse investors looking for global equity exposure. I expect it to provide average returns and excellent downside protection over the long-term.