Top Funds Report

Second Half Starts Strong

Markets rally back nicely in July. Many markets flirt with record highs…

After a rocky June, the second half of 2016 started strong, with global equity markets ending the month in positive territory. With the Brexit vote now in the rear-view mirror, many investors used the selloff as an opportunity to pick up some high quality companies that were sold off indiscriminately in days following the vote.

The MSCI Europe Index gained nearly all of the June drop, rising by more than 4.2% in U.S. dollar terms, which helped push the MSCI EAFE Index higher by more than 5%. Asian markets also rallied nicely, with the MSCI Pacific ex-Japan Index gaining nearly 7%.

Closer to home, North American markets were also stronger. The S&P 500 gained more than 4%, while the Russell 2000 was higher by 6.2%. In Canada, the S&P/TSX Composite gained 3.9%, which was impressive, given the nearly 14% decline in the price of oil.

Bond markets rallied, as investors reckoned the potential slowdown from Brexit, coupled with already mixed economic data was likely to keep global Central banks on hold. Long bonds outperformed shorter bonds, and government bonds outpaced their corporates, largely on a flight to safety trade. High yield, which to some extent had been tracking the energy markets, managed to eke out a nice return, despite the headwinds created by the energy selloff.

Looking ahead, I remain cautious for two reasons. First, valuations in most equity markets remain high by historical standards. While the low yields may help justify these current levels, there is some worry that the current prices do not accurately reflect the future prospects. Second, September and October are historically the most volatile months for investors, and this year could also prove to be a challenge.

Within equities, I continue to favour concentrated portfolios that focus on quality companies, trading at reasonable valuations. I believe these will hold up better than some of the more growth focused, or index type funds.

Within fixed income, I continue to like well-managed, active funds where the managers can make active calls on both duration and credit quality.

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 funds from my Recommended List of Funds…

Beutel Goodman Small Cap Fund (BTG 799 – No Load Units) – Despite outpacing its peer group with an impressive 9.6% gain, this concentrated small cap lagged its benchmark, the BMO Small Cap Equity Index, which shot higher by more than 15%. Much of this can be attributed to its underweight to energy and materials, the two best performing sectors that rallied sharply on the back of a strong commodity rally.

Even with this jump, it appears to be reasonably valued, trading at multiples below its benchmark. This is because of the disciplined, value focused, bottom up security selection process used by the management team, headed up by Stephen Arpin.

While I don't expect the recent level of absolute performance to be sustainable, the management of this fund puts it in a good position to be able to deliver above average returns over the long term, with average or better levels of volatility.

CI Signature Select Canadian Fund (CIG 677 – Front End Units, CIG 777 – DSC Units) – Managed by CI's Signature Global Advisors, this is a fund that has a very solid long term track record, and has outpaced only its peer group, but and the S&P/TSX Composite over a five and 15-year period. The risk metrics have also been decent, with volatility that is in line or modestly lower than the index. It has also delivered more upside than downside over the years.

In recent quarters, I have become concerned that the fund is not differentiating itself from its peers the way it once did. Returns have been acceptable, but have tended to be more middle of the pack. In the second quarter, it finished in positive territory, outpacing its peer group, but lagging the index. It was its underweight in gold names that was the main reason for this, with gold rallying on the flight to safety trade that resulted from the Brexit vote. Healthcare names, and its holdings in physical gold helped.

In a recent commentary, the managers noted they were cautious and defensively positioned, holding about 10% in cash. They are also overweight the more defensive sectors including consumer focused names as well has healthcare and technology. It is also about evenly split between Canadian and foreign exposure. They believe the world economy is stable, but realize that things can change quickly. In this environment, they expect to remain defensive, but will use the team's holistic, fundamentally driven, bottom up investment process to find attractive investment opportunities.

I am cautiously optimistic that we will see the risk reward metrics begin to improve. I will continue to monitor it closely.

Trimark U.S. Companies Fund (AIM 1743 – Front End Units, AIM 1741 – DSC Units) – Managed by Jim Young since October 1999, this concentrated U.S. equity fund uses Trimark's fundamentally driven, quality focused, bottom up approach to picking stocks. Mr. Young looks to find what he believes are well managed, high quality companies that have a distinct proprietary advantage, are industry leaders, and are trading at a level that is below what he believes it is worth.

Like other Trimark funds, it is fairly concentrated, holding around 40 names, and has a sector mix that is much different from its benchmark. At the end of June, he was significantly overweight in technology and healthcare, which has given the portfolio a bit of a growth tilt, and has pushed valuation levels above those of the index.

Part of the reason this has happened, is the manager is willing to “pay up” for quality and growth potential, and he believes the names he holds are better positioned for the current economic environment. One of the trends he sees evolving over the next few quarters will be the accelerating rate of change that is beginning to undermine many business models. He is looking to find companies that are embracing, and in many cases driving these changes. One worry I have with this strategy is in a rapidly changing environment, there are often few winners with many losers, so there is little room for error, particularly in a portfolio as concentrated as this.

In recent quarters, there has been some erosion in the risk reward metrics of the fund. Year to date (June 30), the fund is down more than 9%, while the broader U.S. market is down only 3.1% in Canadian dollar terms. Volatility has been on the upswing, but perhaps more disturbingly, so too has the correlation of the fund compared with the S&P 500. Part of this can be explained by the heightened levels of volatility, as when markets get volatile as they have been, correlations increase. However, that is likely only part of it, and I am watching the portfolio closely for any further erosion in the risk reward metrics. Another concern I have with the fund is its cost, carrying an MER of 2.71%, which is high.

TD U.S. Mid Cap Growth Fund (TDB 312 – Front End Units, TDB 342 – DSC Units) – It’s been a tough first half for this T. Rowe Price managed offering, dropping 6%, while the Russell 2000 Index gained more than 3.5% in Canadian dollar terms. It was s similar story in the second quarter, with the fund gaining very modest 1.2%, lagging the 4.1% rise in the index.

As the name suggests, the portfolio has a growth tilt to it, and as a result, is concentrated in industrials, healthcare, technology and consumer focused names. It is well diversified, and will typically hold between 120 and 130 names, with the top ten usually making up between 15% and 20% of the portfolio. The process used by managers Brian Berghuis and John Wakeman looks for companies that have market caps of between $1 billion and $12 billion which have annual earnings growth rates of more than 12%. Companies must also be underpriced, relative to their growth prospects. Portfolio turnover is modest, averaging around 50% per year.

In a recent commentary, the managers noted that the higher growth sectors they favour have struggled as the overall pace of economic growth has moderated. They believe the market is expecting continued slow economic growth, and more modest earnings growth from many mid-cap names. They also see that many companies are being prices as though there is a recession eminent, which they believe to be unlikely. They feel that much of their portfolio has been discounted for a worst case scenario, which should help them to hold up better in periods of volatility. Further, they see this as an opportunity to find some higher quality names at more favourable prices, thus improving the portfolio.

I continue to like this fund for the long term, but have some concerns in the short term. This stems more from the valuation levels of mid cap stocks specifically, and the upside potential in the near term. However, for long term, patient investors who can withstand a higher level of risk in their portfolio, who are looking for mid-cap U.S. equity in their portfolio, this is a fund worthy of consideration.

Invesco International Growth Class (AIM 633 – Front End Units, AIM 631 – DSC Units) – This has long been one of my favourite international equity funds, with a long-term history of delivering above average returns, with below average volatility. The fund’s Austin, Texas based management team headed by Clas

Olsson, uses an investment process they refer to as "EQV", which focuses on finding high quality businesses, with sustained earnings growth, trading at attractive valuations. The process is founded on the belief that over the long term, a company's share price will be driven by its ability to deliver sustainable earnings growth.

They favour companies that are able to generate solid organic revenue growth, have pricing power in their markets, strong balance sheets and offer a more defensive growth profile. It is a very well diversified, holding around 70 names, with the top ten making up just over 20% of the fund. They take a longer term outlook when reviewing a company, which is reflected in their modest levels of portfolio turnover. The portfolio is built using a bottom up basis, and tends to be different from its benchmark. At the end of June, it was overweight consumer discretionary, technology and financial, with virtually no exposure to materials, utilities or real estate.

Performance has been strong, outpacing its peer group over the most recent five-year period, but roughly matching the MSCI EAFE Index in Canadian dollar terms. Longer term numbers are even more impressive, finishing near the top of the category for the past ten and fifteen year periods. These numbers have come with lower levels of volatility than the index or its peer group, resulting in stronger risk adjusted returns.

The fund struggled in the second quarter, lagging both the index and peer group. It was its UK holdings that created the biggest headwind in the aftermath of the Brexit vote. At the end of June, it had nearly 27% invested in the UK, by far its largest country allocation. This was somewhat offset by the strong showing from its emerging markets allocation.

Looking ahead, they see the rest of the year as mixed, and expect volatility to remain above average. In a recent commentary, they expressed some concern over the valuation levels in many developed markets, and expect earnings growth to be challenged. Despite this, they are looking to use any market volatility as an opportunity to improve the fundamentals of the portfolio.

I see this as an excellent international equity pick. My biggest issue is its cost, with an MER of 2.84%, which is well above average.

Trimark Global Endeavour Fund (AIM 1593 – Front End Units, AIM 1591 – DSC Units) – With a loss of 4% in the quarter, this concentrated, all cap global equity offering lagged both its benchmark and its competition. The biggest reason for this was a disappointing showing from a couple of its UK based names in the aftermath of the Brexit vote.

The managers believe that much of the Brexit fallout was overdone, and they were able to find opportunities in the selloff. They reduced the cash from 12% to 9%, as they added to some of their current holdings at more attractive prices.

Valuation levels remain a concern to the team but they continue to focus on finding high quality companies with strong balance sheets, and attractive valuations. This discipline, combined with a concentrated portfolio is expected to put the fund in a strong position to outperform over the long term.

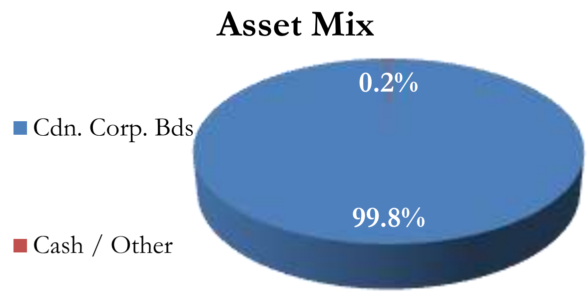
One very big caveat, is this fund is very different from its index, which means there may be periods where its performance looks nothing like its benchmark or its peer group. This can be a positive or negative, depending on which side they are on. Another concern would be the relatively high cost. With an MER of 2.56%, it is pricey, but over the long term, this cost has so far been justified.

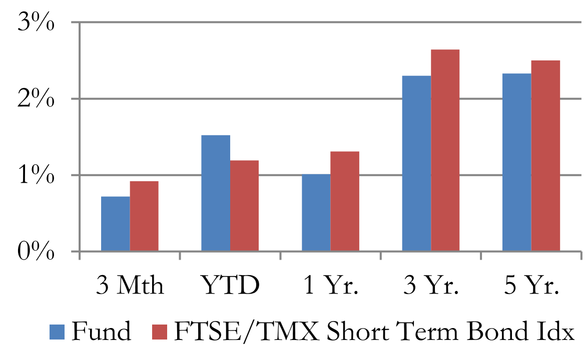
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca.

PowerShares 1–5 Yy Laddered Corp. Bond

Fund Company	Invesco Canada Ltd.
Fund Type	Cdn Short Term Fixed Income
Rating	D
Style	Laddered / Rules Based
Risk Level	Low
Load Status	Front End
RRSP/RRIF Suitability	Excellent
Manager	PowerShares Mgmt Team
MER	0.99%
Fund Code	AIM 53203 – Front End Units
Minimum Investment	$500





ANALYSIS: In June, this laddered short term corporate bond fund underwent its annual reconstitution. The five shortest duration bonds are removed from the index and replaced with ten bonds that have a term to maturity of five years are added in their place. The reason that ten bonds are replacing the five that were removed is last year, the index provider announced that over the next five years, the number of bonds in the index would be increased from 25 to 50. After the reconstitution, the fund held 35 bonds. I really see this as a positive, as the increased number of bonds increases the diversification, and reduces the security specific risk in the fund.

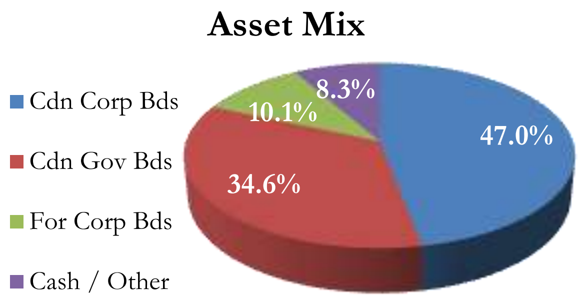
Whenever these reconstitutions take place, there are a few changes to the makeup of the portfolio. One such change is the duration will increase slightly, as longer term bonds are being added to the mix. This time around, the duration was lengthened to 3.39 years from 2.47 years. While this increases the shorter term interest rate sensitivity of the portfolio, the duration will gradually shorten as the next June 30 reconstitution date approaches.

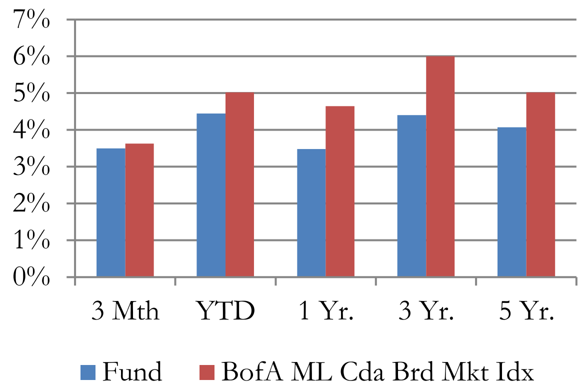
Another change that happens is the yield to maturity (YTM) will often increase. That didn't happen so much this time around in the current rate environment, with the YTM remaining essentially flat, coming in at 1.82%. Even without much of a change, it still offers a higher YTM than the PH&N Short Term Bond and Mortgage Fund, which was listed at 1.5% at the end of June.

Given the current makeup of the portfolio, I would expect it to outperform in all environments except a sharply rising yield environment. However, given the fragility of the economy, I find it tough to envision a circumstance in the near term where that is likely, making this a solid pick in the near term.

TD Canadian Core Plus Bond Fund

Fund Company	TD Asset Management
Fund Type	Canadian Fixed Income
Rating	D
Style	Credit Analysis
Risk Level	Low
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Rob Pemberton since Nov. 13 Christopher Case since Sep. 11
MER	1.50%
Fund Code	TDB 695 – Front End Units TDB 696 – DSC Units
Minimum Investment	$500





ANALYSIS: TD Asset Management has long had one of the most respected fixed income teams on the street and has consistently delivered returns that are in line with the FTSE/TMX Canadian Bond Universe, with comparable levels of volatility. This fund is very similar to the highly regarded **TD Canadian Bond Fund**, with the main difference being this offering allows the managers the ability to invest up to 30% of the fund in "non-core" investments such as high yield bond, and investment grade global bonds.

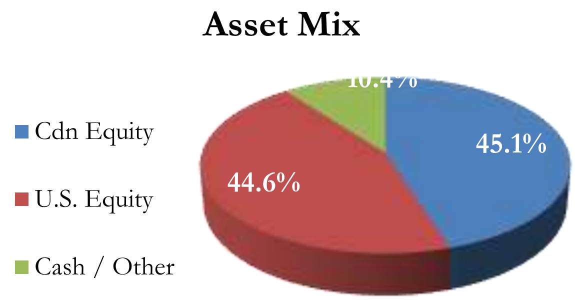
At the end of July, the fund was nearly fully invested, with 97% invested in bonds. Of this, 83% was in Canadian bonds, while 14% were invested in U.S. bonds. About two-thirds of the fund was investment grade corporate bonds, with around 10% in high yield. As a result, the fund offers a yield to maturity that is higher than the benchmark, and a duration that was modestly lower. By the end of June, the managers brought the duration to be more neutral to its benchmark. This should help it in a flat rate environment, and outperform when they start to rise.

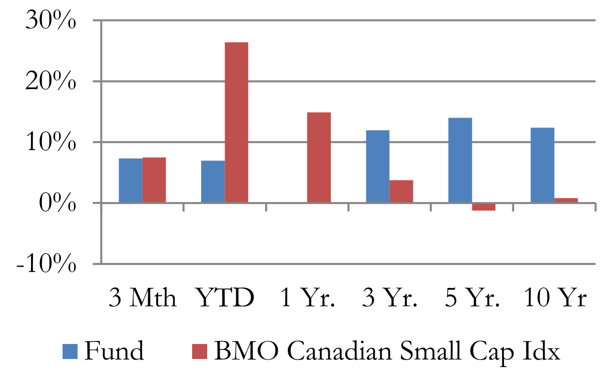
I continue to view this as one of the best Canadian bond funds around. It has a solid management team, following a disciplined, repeatable process, and is offered at a reasonable cost. It tends to deliver most of the upside of the market, while participating in less of the downside. Looking at the current environment, it is unlikely we will see any meaningful upward pressure on interest rates in Canada, making this a strong pick for now.

However, I would still likely lean towards the **PH&N Total Return Bond Fund**, with its lower MER being the differentiator. However, when it looks as though rates will move higher, this TD offering would be expected to outpace PH&N.

Sentry Small Mid Cap Income Fund

Fund Company	Sentry Investments
Fund Type	Cdn Fcsd Small Mid Cap Equity
Rating	A
Style	Mid Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Aubrey Hearn since March 2006 Michael Simpson since Mar. 08
MER	2.75%
Fund Code	NCE 721 – Front End Units NCE 321 – DSC Units
Minimum Investment	$500





ANALYSIS: Over the years, this has been one of the best small/mid cap funds around, delivering strong performance with lower than average volatility, resulting in superior risk adjusted returns. Manager Aubrey Hearn uses a bottom up security selection process that looks for reasonably valued small and mid-cap companies that have a history of delivering high return on capital, low leverage, rising free cash flow, strong management teams, sustainable competitive advantages, and the ability to consistently grow their dividends.

The portfolio tends to be fairly well diversified, typically holding in the neighborhood of 60 names, and the top ten will usually be around 30% of the fund. Because the manager is building the portfolio on a stock by stock basis and the sector mix is the result of the stock selection process, it often looks dramatically different than its benchmark and its peer group.

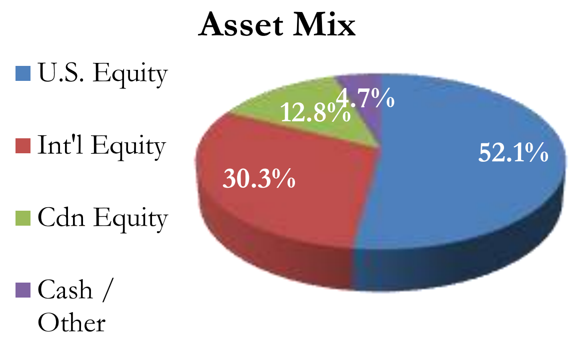
This is important to note because this is precisely why it has underperformed of late. With significant underweights in the two hottest, and largest sectors of the benchmark, energy and materials, it has been unable to keep pace. Another drag has been its U.S exposure, which has lagged their Canadian brethren.

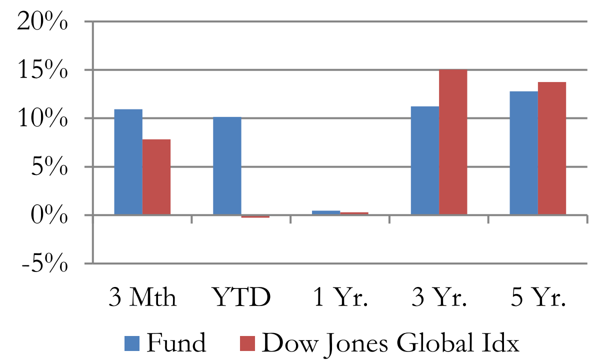
Despite this recent blip, I continue to believe in this fund, and see it as one of the stronger small/mid-cap offerings available. It has a solid management team using a disciplined, sound and repeatable investment process. They focus on the long term, and will use short term price dislocations to improve the portfolio.

I expect we'll see more volatility in the near term. But longer term, I expect it to deliver what it has over the longer term, above average returns with below average levels of volatility. I continue to follow it closely.

Manulife Global Infrastructure Fund

Fund Company	Manulife Investments
Fund Type	Global Infrastructure Equity
Rating	B
Style	Large Cap Growth
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Craig Noble since May 2008
MER	2.75%
Fund Code	MMF 4569 – Front End Units MMF 4469 – DSC Units
Minimum Investment	$500





ANALYSIS: After struggling in the second half of 2015 and the first quarter of the year on the energy selloff, infrastructure bounced back nicely, with this fund gaining 8.8%, handily outpacing the MSCI World Index and its peer group. Much of this rebound can be attributed to the bounce back in energy infrastructure names, as nearly a quarter of the fund is in energy. Even with this rally, the managers are still finding attractive valuations in the space. They are looking to focus more on gatherers and processors in the North American Shale basis, as they expect these companies to be the beneficiaries of the first uptick in spending by oil and gas companies.

They did note that valuations in utilities are higher, but they are focusing on finding companies that have a specific catalyst that can help push stock prices higher. Given the uncertainty in Europe, they are reducing some of their exposures in the region.

The outlook for infrastructure looks positive. With interest rates likely to be lower for longer, investor demand for the higher yields that are typically offered from infrastructure stocks is expected to remain very strong.

Further, with many countries looking to boost their struggling economies, a number of governments have announced significant investment in infrastructure projects, which will provide an underpinning of support for many names in the sector.

I believe that infrastructure is a very solid long term investment, and can be a part of a well-diversified portfolio. I like this offering specifically for the management team involved. Brookfield has a long track record in infrastructure, and believe they can deliver strong risk adjusted returns over the long term. However, I continue to watch the fund closely for any meaningful erosion in the risk reward metrics.