

Top Funds Report

Trump Wins!?!?!?

American election surprises pundits and markets.

I'll be honest, I didn't see Trump winning. Obviously, I was wrong. But, looking at the millions of disenfranchised people living the rust belt of middle America, who have been hurt badly by globalization, and the carving out of the American manufacturing sector, and it starts to make a lot more sense. Trump isn't the old guard, and many believe a dramatic change is needed.

We now have that change, and need to figure out how to deal with it. Of the commentaries received from managers, some are fearful, some are hopeful, but the theme of most is the unknown. How best to deal with this uncertainty?

Well, first, don't do anything rash. We don't know what lies ahead. Making a move out of fear will not often play out the way you hope, and in the end, may hurt more than it helps.

In the near term, I expect we will see higher levels of volatility across all markets. Until Mr. Trump lays out his plans, we can only speculate on how we will all be effected. As more details come to light, we will be in a better position to see just how protectionist this new regime will be. Higher trade barriers will hurt not only our economy, but the global economy, which will likely have repercussions across your portfolios. Further, protectionism can also lead to higher levels of inflation because of less competition.

Finally, we will also get a glimpse of how the President's foreign policy. There have been a few ideas floated that could increase geopolitical tensions even more than they are today. That will no doubt hurt the global economy.

With this much uncertainty, I believe it is prudent to keep your portfolios defensive. Focus on strong managers, using a disciplined, repeatable investment process that looks to identify high quality investments. This will help portfolios withstand the higher volatility and external shocks better than higher beta names. This lower volatility will help investors stay invested when things get rocky. The key is for investors to have a plan, and the courage and conviction to stick with it. Managing volatility can help do just that.

For my investment outlook, I have moved emerging markets from Neutral to Underweight. This is because of the potential for more protectionist trade policies that may hurt many emerging market economies, going forward.

	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 highlight funds from Steadyhand, TD, Fidelity and more...

Steadyhand Income Fund (SIF 120 – No Load Units) – Despite lagging both the benchmark and its peers in Q3, this fixed income focused balanced fund remains one of my favourites.

Managed by Connor Clark & Lunn, it has a target asset mix of 75% bonds, and 25% in high yielding equities, such as dividend paying stocks and real estate investment trusts (REITs). At the end of September, it slightly favoured bonds, which made up 77% of the fund. Historically, the fund favoured corporate bonds, but in recent quarters, this mix has shifted. The fund now favours government bonds, with provincials making up the bulk of the exposure because of their higher yield. Corporate bonds now make up about 32% of the total fund.

The balance of the fund is invested in high yielding equity, which makes up 18%, and 5% invested in REITs.

Performance has been excellent on a year to date basis, gaining 7.6% to the end of September, handily outpacing its peers. Much of this has been driven by falling bond yields, which have pushed up prices. The equity holdings have also been key contributors. With the dividend focus, it is heavily tilted towards yield focused areas of the market such as financials, real estate, energy, and utilities. The dividend yield is well above the broader Canadian market.

Even with nearly a quarter of the fund invested in equities, volatility has remained in check, roughly matching the broader Canadian bond market.

As impressive as the recent performance has been, I don't believe it is sustainable. While interest rates in Canada aren't expected to move

sharply higher, there isn't a lot of room to move lower. Further, with the U.S. Federal Reserve expected to move rates up in December, volatility in the rates market is expected to be higher.

In this environment, the managers have become increasingly defensive, hence the shift towards more government bond exposure. This is also why the equity weighting has been reduced modestly. Their focus remains on high quality companies with growing dividend streams.

Looking ahead, this remains a solid pick, but I do expect a mix of lower returns and higher volatility. For those investors who can stomach it, this can be an excellent fixed income replacement in a volatile bond market.

TD Canadian Core Plus Bond Fund (TBD 695– Front End Units, TDB 696 – DSC Units) – This continues to be an excellent choice for investors looking for an actively managed Canadian bond fund. It is managed in a similar fashion to the highly regarded TD Canadian Bond Fund, except it can invest up to 30% in “non-core” fixed income strategies such as high yield, global bonds, and emerging market debt. At the end of August, it held just under 9% in non-investment grade bonds.

During the quarter, it modestly outpaced its rival, the **PH&N Total Return Bond Fund**. Both funds are of exceptional quality, and both have very comparable duration positioning, with TD offering a slightly higher yield to maturity. The key reason for this modest outperformance was TD had a higher weighting in corporate bonds, which made up more than 60% of the fund. In comparison, PH&N has been very active with their corporate exposure, and at the end of September held roughly 37% in corporate credit.

PH&N also held only a modest position in high yield, which outpaced government issues.

Both are excellent picks, particularly in an environment where the Bank of Canada is expected to keep rates on hold. If I had to choose between the two, I would likely give a slight edge to the PH&N offering. My main reason for this is the PH&N offering has a higher weight in government bonds, which would be expected to hold up better in periods of volatility. Many are expecting higher than normal volatility in both the bond and equity markets in the coming weeks. Another reason would be the modestly lower cost, with the advisor series of PH&N carrying an MER of 1.16% compared to 1.50% for TD for the advisor sold units of each fund.

Fidelity Canadian Large Cap Fund (FID 231 – Front End Units, FID 531 – DSC Units) – Since taking over the reins of this fund in 2011, manager Daniel Dupont has posted stellar numbers, gaining nearly 14% annualized to the end of September, handily outpacing the index. While a lot of this outperformance can be attributed to his U.S. holdings, which at the end of August made up 23% of the portfolio, his focus on capital preservation, quality, and valuation have also played a significant part.

Despite this, the fund has struggled recently. For the third quarter, it gained 2.9%, lagging both the index and the peer group. Year-to-date, the fund is up by 7.6%, but it has trailed the broader Canadian market by more than 800 basis points.

This recent underperformance is largely the result of its defensive positioning. It is significantly underweight materials and energy; two sectors that have accounted for most of the gains in the index this year. At the end of August, the fund had no exposure to materials, which have risen by more than 50% on a year-to-date basis. Turning to energy, the fund held about a third of

the exposure of the index, which has risen by more than 25% so far this year.

Another headwind is the high cash position. At the end of August, it held 17% in cash, up from 6% at the end of June. In a recent commentary, Mr. Dupont noted there are several risks on the horizon, including deteriorating balance sheet strength, worries the earnings cycle has peaked, and valuation levels. Combined, these risks lead him to carry more cash than he would like, but given his emphasis on capital preservation, he believes this is a prudent move in the short-term.

Cash can also be a source of “dry powder”. He has shown he is rather adept at using periods of market volatility to put his cash to work, and improve the quality of the portfolio by picking up quality companies at more attractive valuations.

As much as I am a fan of the performance numbers, I am even more impressed by the risk metrics of the fund. Volatility has remained well below the index and peer group, and the upside and downside capture ratios are excellent. Even in the past year when it has struggled by historic standards, it still managed to deliver more than half the upside of the market, and had a negative downside capture ratio, indicating the fund was likely to be higher on days when the market fell.

While some may be frustrated by the recent underperformance, I remain extremely comfortable with this fund. I believe in the manager and the investment process used. I continue to monitor it closely for any significant erosion in the risk reward outlook.

IA Clarington Canadian Small Cap Fund (CCM 520 – Front End Units, CCM 521 – DSC Units) – With a respectable 4.7% rise in the third quarter, this mid-cap focused fund lagged both the benchmark and its peers. There are a couple of reasons for this. First, the portfolio is very quality focused, holding a concentrated mix

of excellent franchises, with strong balance sheets and reasonable valuations, which have not been rewarded by the market in the recent past. Second, it is carrying a fair bit of cash, which acts as a headwind in a rising market.

It is these very factors that lead me to believe it is well positioned for the future. Valuation levels of the portfolio look attractive next to the index and peer group. It becomes even more so when the dividend yield is factored in. At the end of September, Morningstar estimates the yield of the portfolio at more than 3.4%, well above its peers. Second, the operational and management quality of the companies held is very strong, which will help the portfolio to withstand an extended economic slowdown better than companies with weaker fundamentals. Finally, the high cash balance provides the managers with the ammunition to improve the portfolio in periods of market volatility by picking up quality names at more attractive valuations. The longer-term performance numbers back this up, with better than average returns, lower than average volatility, and excellent downside protection.

This remains one of my top small cap picks.

Fidelity Small Cap America Fund (FID 261 – Front End Units, FID 561 – DSC Units) – Since Steve MacMillan took over this fund back in 2011, this has been one of the best performing U.S. small cap funds around. However, in recent months, performance has lagged. In the third quarter, it rose a modest 2.2%, while the Russell 2000 Index gained nearly 10% in Canadian dollar terms. Year-to-date, the fund is down 2.7% while the benchmark was up more than 18%.

This recent underperformance is the result of the investment process used. Mr. MacMillan uses a fundamentally driven, bottom up process that places an emphasis on stocks with a history of high return on equity, and high earnings visibility. He also likes companies that have low

economic sensitivity, and are trading at reasonable valuations. Because of this focus, the portfolio tends to have less exposure to more cyclical sectors such as energy, materials, and financials. It also tends to eschew those names trading at high valuation levels. Unfortunately, it has been the materials, energy, and real estate sectors – the very sectors this fund is likely to avoid, that have been the biggest gainers. The fund had no exposure to materials and real estate, and was significantly underweight energy.

The fund is significantly overweight healthcare. Unfortunately, it also has been the worst performing sectors, losing 6.6% year-to-date. It also has significant exposure to consumer discretionary names, which have dropped 1% so far this year. Also creating a headwind in a rising market, has been the fund's 10% cash weighting.

Putting it all together, and you get the “perfect storm” for underperformance – a significant overweight in sectors that are underperforming, little or no exposure to sectors that are outperforming, and higher than normal cash.

Looking ahead, I remain cautious on small and mid-cap names in general, based mostly on valuation levels. I expect that we could see a period of underperformance from small and mid-cap stocks that will allow valuation levels to return to more normalized levels.

With this fund specifically, I expect to see further short term underperformance, however, over the long-term, with its focus on quality and valuation, I would expect it to produce solid returns, with better than average levels of volatility. I remain comfortable with this fund, and will continue to monitor it on an ongoing basis.

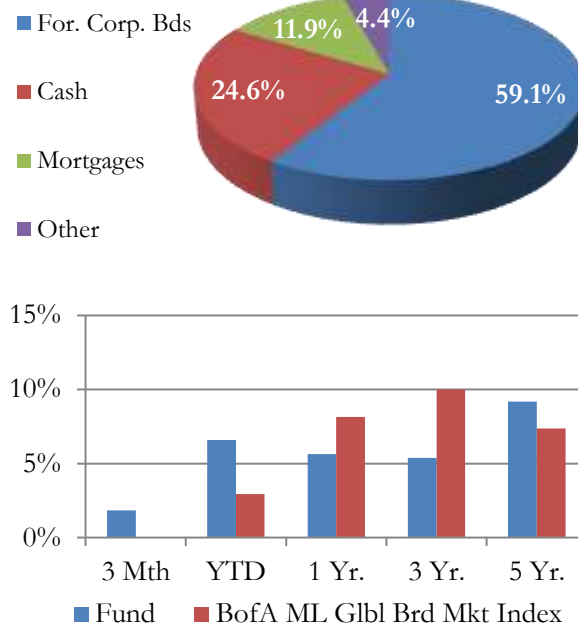
If there is a fund that you would like reviewed, please email it to me at

feedback@paterson-associates.ca.

PIMCO Monthly Income Fund

Fund Company	PIMCO Canada
Fund Type	Global Fixed Income
Rating	A
Style	Tactical
Risk Level	Low to Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Alfred Murata since Jan 2011 Daniel Ivascyn since Jan 2011
MER	1.39%
Fund Code	PMO 005 – Front End Units PMO 105 – Low Load Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: This actively managed, global bond fund has a decided focus on income generation, paying attention to protecting invested capital. The managers have a lot of tools at their disposal and can invest in a wide range of fixed income securities including mortgage backed securities, investment grade bonds, high yield debt, and emerging market bonds. At the end of September, mortgage backed investments made up 28% of the portfolio, followed by government issues, which were a quarter of the fund, and 24% weight in emerging market debt. The duration is very defensive, at 2.68 years, which is significantly shorter than the broader Canadian bond market.

The process is a mix of top down macro analysis and bottom up security selection. The macro analysis looks at the long-term outlook and the near term cyclical view. This helps set the sector mix, duration and yield curve positioning.

Securities are chosen using a fundamentally driven, bottom up process.

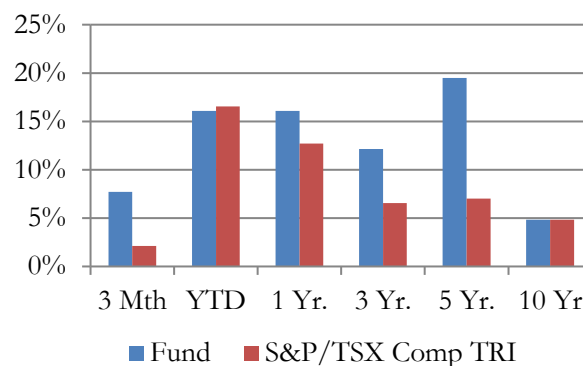
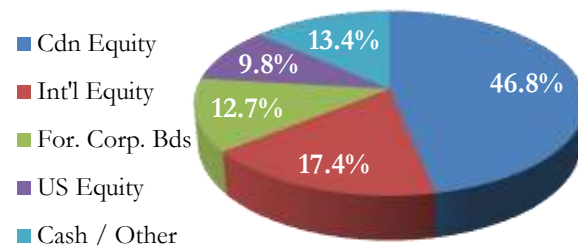
The managers look at the portfolio in two distinct parts; high quality core, and non-core. Within the high-quality core portion, they focus on investment grade issues in developed countries and agency mortgage backed securities. This portion is designed to provide down-side protections and modest returns in periods when economic growth is weak. The non-core portion holds lesser quality issues such as high yield bonds, emerging market debt, and non-agency mortgage backed securities and is for growth.

Year to date, it's up nearly 6.5%, making up for a somewhat disappointing 2015. This fund has the potential to deliver excellent risk adjusted returns when compared to its peers. While not a core holding, it can be a great addition to an otherwise diversified fixed income sleeve.

Brandes Canadian Equity Fund

Fund Company	Bridgehouse Asset Managers
Fund Type	Canadian Focused Equity
Rating	A
Style	All Cap Value
Risk Level	Medium High
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Brandes Management Team
MER	2.72%
Fund Code	BIP 121 – Front End Units BIP 221 – DSC Units
Minimum Investment	\$500

Asset Mix



ANALYSIS: It's been a tough few years for the value style of investing, yet, this fund has been an exception, posting excellent return numbers over the long-term. For the three years ending October 31, it has gained an annualized 12.1%, nearly double the 6.6% rise in the S&P/TSX Composite.

It is a concentrated, all cap, Canadian focused equity fund. It is managed using a disciplined, team based approach that looks to find Canadian companies that are trading below what Brandes believes it is worth. It is concentrated, holding around 25 equity names. It can invest up to 49% outside Canada, and gets that exposure by investing in the **Brandes Global Equity Fund**.

The investment process is very much a fundamentally driven, bottom up one that starts with the Brandes team looking for well managed companies trading at deep discounts. Once they find an idea, a detailed analysis is undertaken, where they look to gain a full understanding of the

business. After an idea is thoroughly researched, it is presented to the Investment Committee who decides if it can be added to the portfolio. The weight of a stock is the function it's margin of safety and risks. The result is a portfolio that is much different from the index. It is also a portfolio that tends to have more attractive valuation metrics than either its index or peer group.

While performance has been above average, so too has volatility, running higher than either the index or the category. Even with the higher volatility, risk adjusted returns have been well above average.

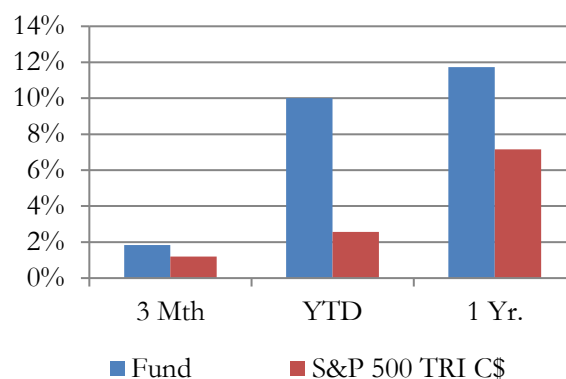
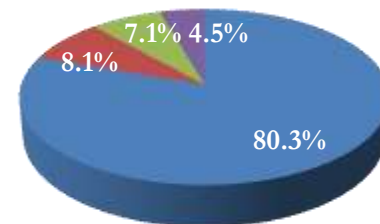
I like this fund, because of its team based approach, disciplined process, and attractive valuation metrics. Volatility levels would prevent me from recommending it as a core holding, but instead, as a portion of a well-diversified portfolio. The biggest drawback is its high cost, with an MER of 2.72%. But for those with an above average appetite for risk, this is a fund to consider.

Capital Group U.S. Equity Fund

Fund Company	Capital International Asset Mgt
Fund Type	U.S. Equity
Rating	D
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Christopher Buchbinder Barry Crosthwaite since Jan 14 Mark Hickey since January 14
MER	2.05% Front End, 2.20% LL
Fund Code	CIF 847 – Front End Units CIF 867 – Low Load Units
Minimum Investment	\$500

Asset Mix

- U.S. Equity
- Int'l Equity
- Cdn Equity
- Cash / Other



ANALYSIS: While the fund is only publishing a track record of just under three years in Canada, it is now modelled after the firm's oldest portfolio, the **Investment Company of America**, a fund that was launched in 1933, and boasts a strong track record of performance. Like all Capital Group funds, it is managed using a multi-manager approach, with it divided into different sleeves that are managed independently by managers of different backgrounds and styles. There is also a portion of the fund that is made up of the top picks from the firm's analyst teams. The result is a portfolio that tends to be rather style agnostic.

Overseeing the portfolio is the firm's Portfolio Coordinating Group, who monitor it in real time. They are also responsible for setting the manager mix, based on their outlook for the environment.

The sector mix is different than its index. It holds 70 names, with the top ten making up just over a

third of the fund. Valuation metrics, while not cheap, do look more attractive than the S&P 500.

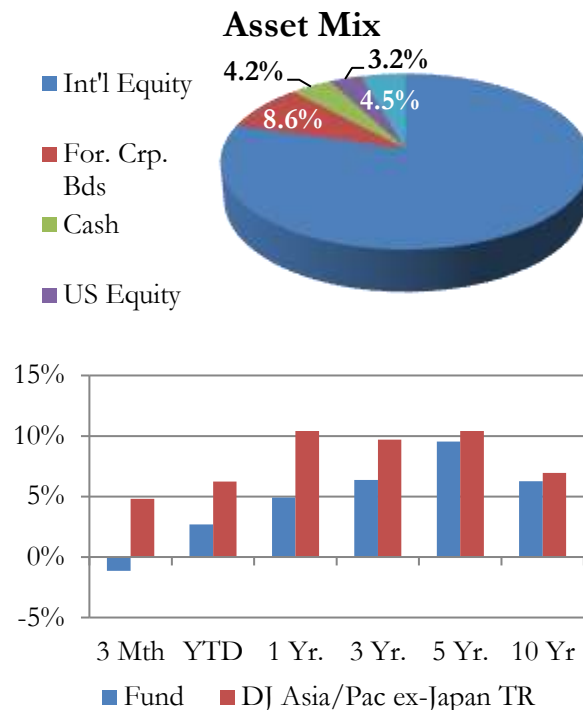
The managers take a longer-term outlook to investing, which is reflected by their very modest 23% average annual portfolio turnover. Capital Group is well known for its high level of manager co-investment in the funds. At the end of September, 97% of the firm's managers had more than \$1 million invested in their mandates, aligning their interests with their investors.

Costs are very reasonable, with an MER of 2.05%, which is well below the category average.

Given the emphasis on risk management, I wouldn't expect this to shoot the lights out, but I would expect it to deliver index like or better returns with volatility levels that are slightly better than the broader market. All these factors align to make this a very compelling reason to consider this fund for your U.S. equity exposure.

BMO Asian Growth & Income Fund

Fund Company	BMO Investments
Fund Type	Asia Pacific – ex Japan
Rating	B
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Robert Horrocks since Aug 09 Kenneth Lowe since Dec 11
MER	2.62%
Fund Code	GGF 620 – Front End Units GGF 120 – DSC Units
Minimum Investment	\$500



ANALYSIS: Asian markets had a very strong quarter, with the MSCI Pacific Index gaining nearly 9.5% in Canadian dollar terms. In a recent commentary, the managers of the fund noted that this rebound was likely the result of a few factors including a reduced likelihood of major capital outflows in the wake of slower than anticipated rate hikes in the U.S., and the success of China's accommodative monetary policies, that appear to have stabilized the country. This backdrop helped to fuel strong capital inflows into emerging markets, with all Asian markets benefitting, and large cap companies being the largest benefactor.

Despite this positive market backdrop, the fund lagged the index, rising 4.2%. Much of this underperformance was the result of the fund's lack of exposure to the high-flying tech names, which rallied nicely in the quarter. It's exposure to convertible bonds, preferred shares, and cash also acted as a headwind in a rising market. Combined,

these investments account for nearly 20% of the portfolio.

The managers remain cautious. They note that much of the market rally is because of an influx in capital, rather than an improvement in market fundamentals. They expect 2016 to be another year with no growth in corporate earnings. Further, market valuations remain on the high side. There are several risks that could impact Asia including a more protectionist trade environment following the U.S. election, further threats to the stability of the E.U., and troubles in the European and Chinese banking sector.

Given the riskier outlook, I believe this remains one of the best ways to access Asia, with its mix of equities and convertible bonds. A drawback to this is the probability of underperforming in a rising market. However, I believe this is more than offset by the lower volatility and stronger downside protection offered.