

Top Funds Report

Markets powered up by crude oil

Fixed-income gets frisky, but I still favour equities, with a slight tilt to Canada.

October was a strong month for Canadian investors, as the S&P/TSX Composite Index rose 2.7% month over month from September supported by strength in both the energy and financial sectors.

The broader market benefitted from a surge in oil prices, which hit their highest level in more than two years. A barrel of West Texas Intermediate crude oil closed the month at \$54.38, a gain of more than 5% in the month. Energy stocks, which make up nearly 20% of the S&P/TSX index, rose by 1.8%. With interest rates moving lower recently, financials, particularly banks, have benefitted from higher margins. The financials index accordingly advanced nearly 4.6% in October.

Global equity markets also rallied in October, with the S&P 500 Composite Index rising 2.3% in U.S. dollar terms, while the MSCI EAFE Index rose 1.5%.

However, the Canadian dollar felt the effects of the Bank of Canada's decision at its October meeting to sit on the sidelines and stand pat on interest rates. In response, the Canadian dollar fell by more than 3% in the month, pushing up returns for non-hedged foreign currency exposure.

With some pressure off the fixed-income markets, bonds rallied somewhat, and the FTSE/TMX Canada Universe Bond Index gained 1.6% in the month. Long bonds benefitted most, gaining 3.3%, while bonds at the short end of the curve rallied by 0.6%.

Barring something out of left field, I would expect to see the equity markets remain relatively tame as we head into the year-end. Investor sentiment appears to have shifted towards the emerging markets (EM), and while some uncertainty around U.S. trade policy remains, the outlook appears strong. I am consequently increasing my allocation to the EM slightly, although not to the point where I would overweight EM.

Despite monthly gains in the fixed-income space, I continue to favour equities over fixed income. In the equity sleeve, I remain neutral for the most part, but I am starting to slightly favour Canadian equities over U.S. equities, as many now expect the performance gap we have experienced so far this year to begin narrowing.

I continue to favour mutual funds and ETFs that invest in well-managed, high-quality companies that are trading at attractive valuation levels. This positioning has weighed on my portfolio performance over the past year, but the market must return to focusing on fundamentals for the long term.

In the fixed-income space, I expect we'll see one more rate hikes by the U.S. Federal Reserve, while the Bank of Canada is likely to remain on the sidelines until next year. In this environment, I favour investment-grade corporate bonds, and lower duration positioning.

My investment outlook is shown below:

		Underweight	Neutral	Overweight
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 look at the preferred market, and funds from Franklin Templeton and Mackenzie...

Franklin Mutual Global Discovery Fund (TML 180 – Front end Units, TML 184 – Low Load Units)

MER: 2.60 %

Assets (\$mil): \$437.02

Fundata Rank (1Yr): 663/867

Std Dev (3Yr): 9.88 %

In early October, Franklin Templeton announced that Philippe Brugere-Trelat, long-time manager of the Franklin Mutual Global Discovery Fund, will be retiring in mid-2018. This will be a very gradual transition and given the team management approach, and the manner in which the transition is taking place, any disruption to the fund management is likely to be minimal.

In January 2018, Christian Correa will be added as a co-manager and will work alongside Mr. Brugere-Trelat and current co-manager Tim Rankin. Next May, after the transition period, Mr. Brugere-Trelat will step away from the fund, leaving the team intact. Mr. Rankin is well versed in the process used by the Franklin Mutual Group. He has more than 20 years' experience in the investment industry, of which 14 have been with Franklin Mutual.

The management process is very much a bottom-up approach that looks for undervalued stocks, with an identifiable catalyst that can unlock share price appreciation. This is a go-anywhere approach that allows the fund to invest in companies of any size anywhere in the world.

The portfolio is broken into three different components. The first is relative value, which is focused on undervalued stocks. This is typically the largest slice of the portfolio. At the end of August, roughly 92% of the equity exposure was in relative-value names. The other components of the fund include merger arbitrage and distressed companies. Combined, these sectors represented approximately 8% of the equity weight at the end of August. The amount invested in each sleeve will be dependent on the opportunity set.

Given the defensive focus of the fund, performance has lagged both the index and peer group over most time

periods. However, historically it has held up well in periods of extreme market volatility and tends to experience less fluctuation than the index or peers.

VanEck Vectors Vietnam ETF (NYSE: VNM) – I was recently asked by an advisor about the best way to invest in Vietnam, one of the fastest growing economies in the world. Its improving living standards and rising incomes are paving the way for it to emerge as one of the more potentially attractive investment opportunities. Vietnam has a population of 95 million, nearly half of whom are under 30. There has been significant urbanization and industrialization, with more expected to come.

However, screening mutual funds and ETFs based on country weights is a tricky proposition at the best of times. In Canada, a quick search revealed that there are no dedicated mutual funds or ETFs that focus exclusively on Vietnam. The fund with the largest exposure to Vietnam is the Franklin Templeton Frontier Markets Fund, which had approximately 14% allocated to the country as of the end of October.

In the U.S., the VanEck Vectors Vietnam ETF (NYSE: VNM) was the only dedicated Vietnam ETF currently available. It invests in companies that are incorporated in Vietnam, or generate at least 50% of their revenues in that country. At the end of October, the portfolio consisted of 37 positions, representing roughly 70% of the market capitalization of the Vietnam equity market.

VNM's sector mix looks a lot like you would expect an emerging-market country to look – heavy emphasis on consumer stocks, financial services, and real estate. Combined, these sectors make up 70% of the fund.

Year-to-date performance has been strong, with the fund advancing 14.7% to the end of September in U.S. dollar terms. Over the long-term, however, performance has been somewhat disappointing, with the fund posting an average annual compounded rate of return of just 1.3% for the past five years, while the broader MSCI Asia Pacific ex-Japan index delivered an annualized 5.4%.

For those looking for dedicated Vietnam exposure, this is really the only way to access it. But it is risky, as it is a single-market ETF focused on a very young economy. Unless you need dedicated Vietnam exposure, you're likely better off looking at a broader emerging markets fund, or if you are really looking for something more speculative, a frontier markets fund.

Mackenzie Global Leadership Impact Fund (MFC 5279 – Front end Units, MFC 5281 – Low Load Units) – On October 16, Mackenzie launched this interesting new fund. It's unique in that it looks to invest in companies that promote gender diversity and women's leadership. The fund is based on the Pax Global Women's Leadership Index, which scores companies based on their gender diversity, based on such factors as the percentage of women on the board of directors, percentage of women in key leadership roles, and whether the company is a signatory to the Women's Empowerment Principles.

In addition to the gender score, each company must meet certain environmental, social, and governance (ESG) criteria, or sustainability standards. The fund also avoids companies involved in weapons and tobacco products. These screens whittle the MSCI World Index down from more than 1,600 names to roughly 400.

The companies are then weighted based on their gender score and other risk factors. While the fund has a go-anywhere mandate, sector weights are capped at +/- 5% of the weight of the MSCI World Index. It is expected the initial geographic mix will be 60% U.S. and 40% international equities. The index will be rebalanced and re-weighted annually.

One concern with funds that use screening factors to both eliminate and weight stocks is the potential performance differential. For example, between January 2012 and September 2017, the PAX Ellevest Global Women's Index delivered an annualized 11.2%, while the broader MSCI World Index returned 11.8%. Year-to-date, though, the PAX Index is outpacing the MSCI World.

It is far too early to be evaluating the investment merit of this fund. However, the index performance and unique mandate may make this an interesting choice for those who are looking for more socially-aware investment options.

PIMCO Monthly Income Fund (PMO 005 – Front End Units)

MER: 1.39 %
Assets (\$mil): \$11,600
Fundata Rank (1Yr): 1/108
Std Dev (3Yr): 2.51 %

In a very volatile bond market, this global-focused offering continued to outperform not only the Canadian bond funds but most of the global offerings as well. This outperformance can be attributed to PIMCO's diverse global team and active management style. They use a mix of top-down economic analysis and bottom-up security selection to consistently identify mispriced opportunities while maintaining a focus on generating yield.

At the end of September, the fund had a very modest duration of 3.09 years, focused mostly on its high-quality, government-related security holdings in the U.S. and Australia.

Looking ahead, this remains one of the most consistent bond offerings around. In early October, this fund was also launched under an ETF structure, trading on the Toronto Stock Exchange with the ticker symbol PMIF. Its costs are the same as the F Class mutual fund, making it a great way for do-it-yourself investors to access this top-shelf bond offering.

Steadyhand Income Fund (SIF 120 – Front End Units)

MER: Maximum 1.04%
Assets (\$mil): \$96.6
Fundata Rank (1Yr): 433/514
Std Dev (3Yr): 3.89 %

With a quarterly loss of 1.1%, this fixed-income focused balanced fund outpaced the Canadian fixed-income market but failed to keep up with its more balanced peers. With rising bond yields putting pressure on the nearly three quarters of the fund that is invested in fixed income, the equity sleeve was a positive contributor, helping to mute the losses.

The focus of the equity holdings is on attractively-priced companies that have the potential to grow their dividends in higher-yielding sectors such as financials, pipelines, and industrials. Throughout the quarter, the manager has been actively reducing the risk exposure in the fund, but still prefers corporate and provincial

bonds over governments for their higher yield and lower interest rate sensitivity. With the benefit of some equity exposure, this remains a strong pick for those looking for a fixed-income fund in a rising yield environment.

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

feedback@paterson-associates.ca

Preferred Share Outlook

Preferred shares have had a very strong run over the past year, gaining 16.5% for the year ending September 30. In comparison, the broader Canadian equity market is up just over 9% in the same period. Despite this recent surge, the outlook for preferred shares remains strong, according to a recent research note from BlackRock.

They note three reasons they believe make preferred shares attractive at the moment.

Higher rates. With most of the preferred market now in rate reset preferreds, the market tends to be highly correlated to the yield on the Canada five-year bond. With upward pressure expected to remain on yields, this is a positive for preferreds.

Lower supply. There is expected to be less new issuance of preferred shares from banks in the near to medium term, which could see spreads tighten, pushing prices higher.

Attractive yields. The S&P/TSX Preferred Share Index recently offered a yield of 4.5%, compared with the FTSE/TMX Canada Universe Bond Index, which yielded approximately 2.5%. Factor in a more attractive tax treatment, and preferreds look fairly good.

In the preferred space, I tend to favour high-quality, actively-managed funds over the passive index. My rationale for this is that the preferred market tends to be less liquid and less efficient, resulting in inefficiencies a quality manager can exploit.

My top mutual fund pick in this space is the **Natixis Canadian Preferred Share Fund**.

MER: 0.72 %

Assets (\$mil): \$56.40

Fundata Rank (1Yr): 25/44 (Series I)

Std Dev (3Yr): 9.31 %

It is managed by the Toronto-based J. Zechner & Associates, using a mix of top-down economic analysis, and rigorous, bottom-up credit analysis.

While the fund focuses on preferred shares, it may also add other fixed-income securities, including money market securities and government, agency and/or corporate bonds to a maximum of 40% of the portfolio. The fund may also invest up to 20% in foreign securities.

As of Sept. 30, top holdings included preferred issues of Altagas, Element Fleet Management, Algonquin Power & Utility, CIBC, and Enbridge.

My top ETF pick in this space is the **Horizons Active Preferred Share ETF (TSX: HPR)**.

Management fee: 0.55%

Traded volume: 147,081

Assets (\$mil): \$1,440

Fundata Rank (1Yr): 4/17

Std Dev (3Yr): 10.84 %

Beta (3Yr): 0.89

Weighted Avg Yield to Maturity: 4.52% (Oct. 31)

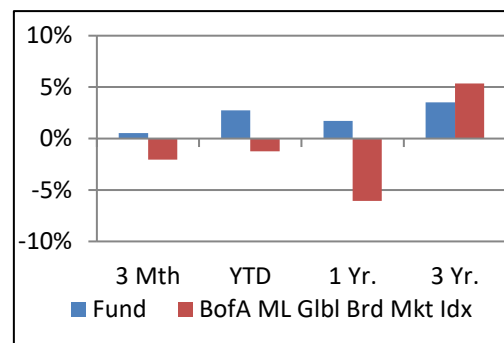
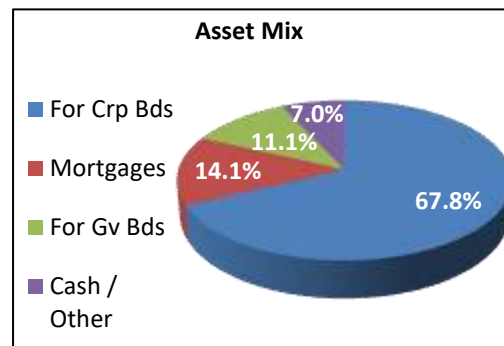
The fund is managed by Nicolas Normandeau and his team at Fiera Capital, using a fundamentally-driven, bottom-up investment process with an emphasis on credit analysis, looking for preferreds with strong yields and modest risk profiles.

The fund invests primarily in Canadian preferred shares but may also include U.S. preferreds along with other income-generating securities. The fund aims to hedge its non-Canadian dollar currency exposure to the Canadian dollar.

As of Oct. 31, top holdings included preferreds from Canadian Imperial Bank of Commerce, Bank of Nova Scotia, National Bank, Enbridge, and Toronto-Dominion Bank.

Canoe Global Income Fund

Fund Company	Canoe Financial LP
Fund Type	Global Fixed Income
Rating	A
Style	Top Down Macro Bottom up security selection
Risk Level	Low
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Brian Westhoff since Aug 2013 Brad Doyle since August 2013
MER	2.07%
Fund Code	GOC 7001 – Front End Units GOC 7002 – Low Load Units
Minimum Investment	\$2,500



ANALYSIS: This “go anywhere” fixed-income fund can invest anywhere in the world, in any type of fixed-income investment, right across the credit spectrum. It can invest up to 25% in high yield issues, and must have a minimum of 30% in bonds rated A or better.

The fund is managed by Brian Westhoff, and relies on the expertise of more than 40 investment professionals. The team uses an investment process that is a mix of top-down macro analysis combined with bottom-up security selection.

Top-down analysis helps the team identify the most attractive areas of the fixed-income spectrum, while the bottom-up process considers many factors, including fundamental and technical metrics.

The managers are very active in their approach, and will adjust the portfolio based on the outlook and relative valuation. Their goal is to be very well diversified across different sources of alpha. Accordingly, as of the end of July (the most recent data available), the portfolio was

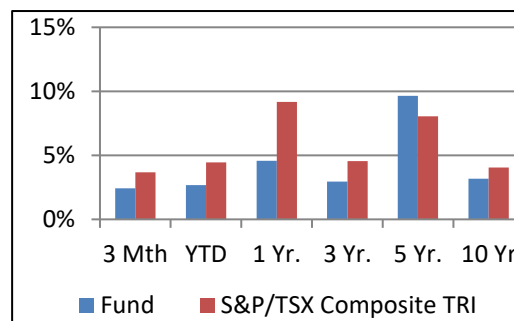
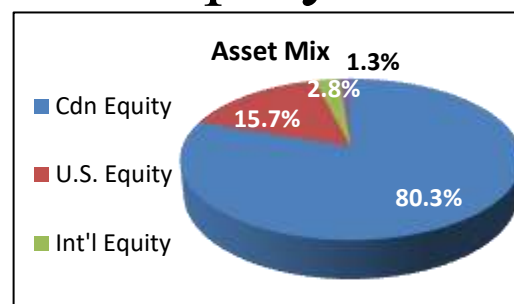
55% in corporate bonds and 18% in mortgages. Three quarters of the fund was in investment grade issues, with a quarter in high yield. Geographically, more than 80% was invested in the U.S. Almost all the foreign currency exposure is hedged.

Performance has been solid, with the fund rising 3% year-to-date (ending Oct. 31), handily outpacing its peers. For the past three years, it has returned an average annual compounded 3.4%, which puts it middle of the pack of the category. However, volatility has been well below the index and peer group, resulting in stellar risk-adjusted returns. The managers have done an excellent job protecting capital, participating in less than 10% of the downside of its benchmark

Looking ahead, I would expect the fund to continue to deliver stable, consistent returns, when compared with its peer group. This may not be the best-performing fund on an absolute basis, but when you factor in the low or modest volatility, I expect it to be near the top on a risk-adjusted basis.

RBC O'Shaughnessy Canadian Equity Fund

Fund Company	RBC Global Asset Management
Fund Type	Canadian Focused Equity
Rating	B
Style	Mid Cap Blend / Systematic
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Jim O'Shaughnessy since 1997
MER	1.51%
Fund Code	RBF 775 – Front End Units RBF 128 – Low Load Units
Minimum Investment	\$500



ANALYSIS: This fund is managed by Jim O'Shaughnessy using the proprietary methodology that he developed and laid out in his bestselling book, *What Works on Wall Street*. Essentially, he and his team screen the stock universe on several factors that historically have been found in stocks that outperform.

These factors include valuation, market cap, momentum, and return on invested capital, which includes dividends, share buybacks, and debt repayments. Stocks are scored on these factors, and then ranked from most attractive to least attractive. The portfolio is then built from the 150 top-rated names. The focus tends to be more on mid-cap names.

The fund targets a 20% weighting in U.S. stocks, and any currency exposure is typically fully hedged back to Canadian dollars. At the end of September, just under 20% was invested in the U.S. This is not a sector-neutral fund, as it will be overweight and underweight sectors based on their relative attractiveness. At the end of September, the fund was underweight energy and telcos, while maintaining an overweight to consumer names.

Valuation numbers are very attractive, with the fund trading well below the index and peer group, and

showing decent growth prospects. Performance over the past five years has been roughly in line with the category average, with an average annual compounded rate of return of 9.7%, compared with 8.1% from the S&P/TSX Composite.

Volatility has been roughly in line with the index and peer group, but the managers have done a decent job protecting capital in down markets of late. For the past five years, the fund has captured 90% of the upside, yet participated in only 60% of the downside.

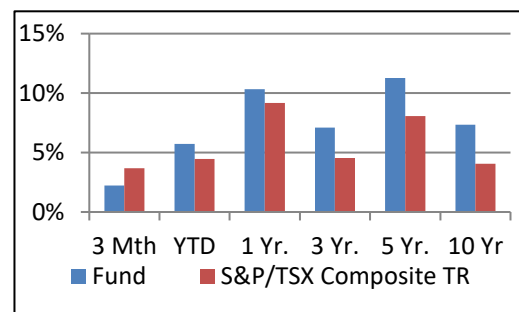
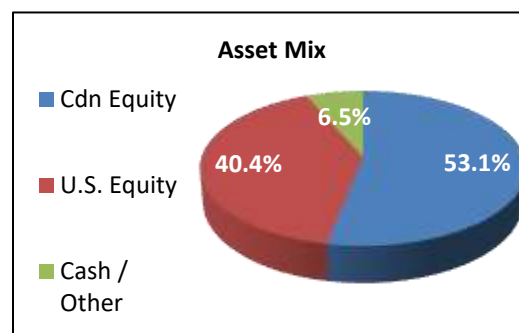
There are three reasons to like this fund:

- 1. Cost** – It has an MER of 1.51%, which is well below the category average;
- 2. Process** – The disciplined, repeatable, and transparent stock selection process has worked over the long-term;
- 3. Portfolio positioning** – It has a decided value tilt, and as market fundamentals begin to play a key role in driving share prices, this fund is likely to benefit.

While not my top pick, it is a Canadian-focused equity fund that is worth a look, particularly for do-it-yourself investors looking for Canadian equity exposure.

RBC North American Value Fund

Fund Company	RBC Global Asset Management
Fund Type	Canadian Focused Equity
Rating	A
Style	Large Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Excellent
Manager	Stuart Kedwell since May 2005 Doug Raymond since May 2005
MER	1.97%
Fund Code	RBF 766 – Front End Units RBF 130 – Low Load Units
Minimum Investment	\$500



ANALYSIS: Managed by the team of Stu Kedwell and Doug Raymond of RBC Global Asset Management, this fund invests in a mix of Canadian and U.S. companies that are attractively valued, fundamentally sound, and that offer above-average returns on capital.

The managers' use a multi-stage portfolio construction process that incorporates both quantitative screening and fundamental, bottom-up analysis.

The first stage in their process is a series of quantitative screens that weed out the undesirable companies in their selection universe. The team then conducts a fundamental analysis on each of the companies along with a series of scenario analyses, looking at a wide range of possible outcomes for each stock. Stocks are also evaluated using a two-factor matrix model that evaluates earnings projections relative to valuation.

Top holdings recently included Bank of Nova Scotia, Royal Bank of Canada, Toronto-Dominion Bank, Brookfield Asset Management, and Enbridge Inc. Cash was at 6% of portfolio weight.

For the quarter, the fund gained 2.2%, outpacing most of its peers, but trailed the S&P/TSX Composite's 3.7% return. Much of this underperformance can be attributed to the fund's U.S. holdings, which at Sept. 30 sat at just shy of 40% weighting in the portfolio.

At present, portfolio valuations look a bit rich for a value fund. However, when you factor in the expected growth rates of the underlying holdings, it is much more reasonably valued. From a sector standpoint, the fund is overweight technology and healthcare, and is modestly underweight energy and financials.

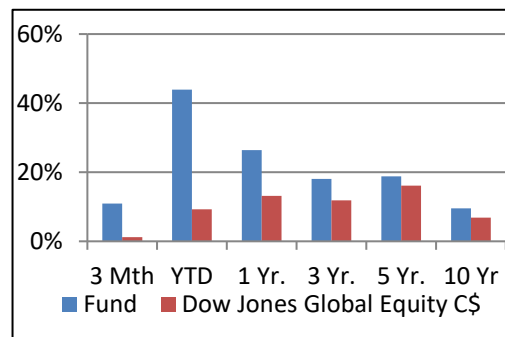
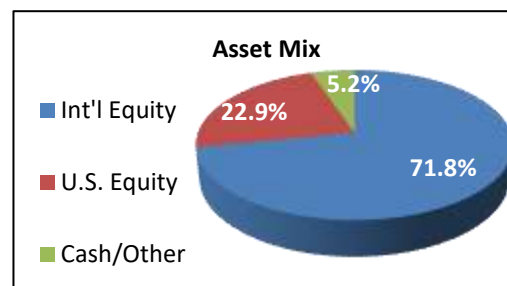
The managers concede that in absolute terms, stock valuations are high, but note that when compared with fixed income, they are reasonable.

At this stage in the cycle, it will take strong earnings growth to propel the market higher, which explains the fund's tilt towards higher growth sectors in the market.

This remains a strong pick for those looking for a mix of Canadian and U.S. equities for the long-term.

Dynamic Power Global Growth Class

Fund Company	Dynamic Funds
Fund Type	Global Equity
Rating	C
Style	Large Cap Growth
Risk Level	High
Load Status	Optional
RRSP/RRIF Suitability	Fair
Manager	Noah Blackstein since January 01
MER	2.49%
Fund Code	DYN 014 – Front End Units DYN 614 – Low Load Units
Minimum Investment	\$500



ANALYSIS: This global offering should come with a warning label telling those who suffer from heart conditions that they may want to avoid it. However, for those looking for a way to add a little excitement to their investment portfolio, the Dynamic Power Global Growth Class may be just the ticket.

Managed by Noah Blackstein Vice-President and Portfolio Manager at 1832 Asset Management LP, the fund holds a very active, concentrated portfolio of between 20 and 30 companies from around the world that he believes to have the best growth prospects, strong earnings momentum, and a history of upside earnings surprises.

Over his 20-year tenure with Dynamic, Mr. Blackstein has built a reputation as one of the premier U.S. and global growth fund managers. Over the long-term, he has indeed been very successful with his strategy for this fund.

As of Oct. 31, the fund had posted an average annual compounded rate of return of 15.3% for the past 15 years, nearly doubling the 7.8% rise in the MSCI World Index. Recent numbers have also been strong, with the fund gaining more than 50% year-to-date to the end of October.

However, running such a concentrated, growth-focused portfolio means a significant level of volatility over the year. When it wins, it wins big, but when it loses, it tends to lose big. In the past five years, portfolio volatility has been nearly double the broader market. Further, if we look at 2008, the fund lost more than 47%, while the index was down 25% in Canadian dollar terms.

The fund's portfolio is concentrated not only in number of holdings, but also in sectors. At the end of September, it held 22 names, and nearly two-thirds were invested in tech, with the balance in consumer names.

Top holdings at the end of August included Weibo Corp., TAL Education Group, Alibaba Group, Sunny Optical Technology, and Tencent Holdings.

The portfolio turnover is high as Mr. Blackstein boldly goes where the growth is. In the past five years, turnover has averaged nearly 200%.

Over the long-term however, this fund has the potential to outpace its peers. But be warned: The ride will be very bumpy. If you have the stomach to stick with this high-conviction offering, you have the potential for outsized returns over time. This is more a fund you'll want to trade rather than buy and hold, taking profits after a big run to protect your capital.