Top Funds Report

Markets continue to rally

Valuations in both equities and fixed income remain a concern. Focus on high quality...

First, allow me to apologize for the delay in sending out this newsletter. On January 11, I lost my father after a hard fought, six month battle with lung cancer. The pasts few weeks have been extremely difficult, both personally and professionally, as I work through this loss. However, I am now ramping back up and hope to be at full speed once again, very soon. Thank you for your patience and understanding.

In the meantime, how about that Trump? In the days since his inauguration, he has taken aim at a number of policies, including the formal withdrawal from the Trans-Pacific Partnership trade deal, and continues to talk about tearing up NAFTA. Other talk and actions have a very protectionist, “America First” tone, of which the markets, at least for now seem to approve.

The Dow Jones Industrial Average crossed the 20,000 mark for the first time in history, and other indices continue to flirt with record highs. While this is all well and good, you have to wonder how sustainable it is.

Let’s look at valuations. To say they are high would be an understatement. According to Bloomberg, the S&P 500 is trading at a price to earnings ratio (P/E) of 21.3 times. If we factor in expected earnings growth, it’s a little more reasonable at 17.6 times. Consider that the ten year average P/E is only 14.2 times. Most other equity indices exhibit a similar pattern. While some of this can be explained by expectations of earnings growth, it is unlikely there is little room for continued multiple expansion. At some point we will have to see things begin to normalize.

This doesn’t necessarily mean a correction is imminent, but the longer this bull runs, the higher the probability a correction will happen. At the very least, lofty equity returns appear unlikely at current levels, meaning more subdued returns can be expected on a go forward basis. Even still, I continue to favour equities over bonds.

For fixed income, with upward pressure on yields likely to remain, the outlook is also subdued. There is no need to panic. Rather, focus on an asset mix that will meet your long-term goals, and invested in high quality funds and ETFs that will help you reach those goals. Over the long-term, quality has been shown to hold up better.

My current 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		

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Funds of Note

This month, I highlight the best and worst performers from 2016…

Mawer Global Bond Fund (MAW 140 – No Load Units) – For the year, this fund was down 4.7%, lagging all other fixed income funds. Most of the drop came in the fourth quarter, as yields rose around the world in the aftermath of Trump's surprising election victory.

Unlike many other global bond funds, its currency positions are unhedged, which is likely to result in periods of higher volatility, relative to its hedged peers. The focus is predominantly on government bonds, and the duration is just under 6 years. The yield to maturity is listed at 1%.

I'm a fan of Mawer for most things, but I believe there are other global bond funds that will do a better job than this one over the long-term.

Dynamic Blue Chip Balanced Fund (DYN 202 – Front End Units, DYN 312 – DSC Units) – 2016 was a somewhat uncharacteristic year for this global balanced fund. It closed the year down by more than 3.2%, and was the weakest balanced fund for the year. I say uncharacteristic because the fund has been an above average performer since 2012.

It is designed to provide exposure to a mix of "best in class" large cap equity names, and high quality bonds. At the end of December, it held roughly 40% in bonds, 58% in equity, and the balance in cash. A lot of the underperformance is because of its underweight exposure to materials, and zero exposure to energy, the two best performing sectors in 2016.

One concern I have is the equity management on the fund changed in late 2015, with veteran Dana Love taking over. Given the manager change, I would likely take a wait and see approach, while the new team builds a track record on the fund.

Dynamic Diversified Real Asset Fund (DYN 037 – Front End Units, DYN 737 – DSC Units) – This balanced fund has a focus on preserving purchasing power. To do this, it invests in real assets such as real return bonds, real estate, precious metals, energy and other commodities, as well as infrastructure. Not surprisingly, it has a big overweight in materials, energy, and real estate, sectors that had a very strong showing in the year. For example, the fund's biggest holding is the **Dynamic Precious Metals Fund**, which rose by nearly 53% in the year. Another top holding, the **Dynamic Resource Fund**, gained more than 36% for the year.

While this was a great showing, I don't see it as being able to consistently deliver this type of outperformance on a go forward basis. Given the underlying holdings, I would expect it to be more volatile than its peers, and dependent on direction of commodity prices. I like the idea of this fund, but I prefer a more traditional balanced fund.

Chou RRSP Fund (CHO 102 – Front End Units) – Francis Chou is known for running concentrated, value focused, contrarian portfolios. Sometimes that works, and sometimes it doesn't. 2016 was a year that it didn't, posting a 3.6% loss, making it one of the worst performers in the Canadian equity space.

A big reason for this underperformance is his contrarian approach. He often buys stocks that have fallen out of favour with the market. His portfolio is littered with troubled names like Valeant Pharmaceuticals, Blackberry, and Torstar. While he may be right about these names in the long term, he is often early, sometimes resulting in further downside, and quite often, higher volatility.

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I respect Mr. Chou, and like his philosophy and process. However, I also believe there are other small/mid cap funds that can offer a more favourable risk reward profile than this one.

Leith Wheeler Canadian Dividend Fund (LWF 019 – No Load Units) – This Canadian dividend fund is managed using a bottom up, fundamentally driven, value focused approach to stock selection. It is a high conviction portfolio of companies with stable earnings, long term business models, and quality management teams that have a long-term history of not only paying, but also growing their dividends.

The sector mix of the fund looks a lot like you would expect a dividend fund to look, with overweights in the higher yielding sectors such as financials, real estate, utilities, and industrials, and less exposure to more cyclical names such as materials, energy, and healthcare.

While this was the best performing fund that focused on Canadian equities in 2016, its performance is no fluke. Looking at the longer term numbers, it has handily outperformed both the broader Canadian market and its peer group since its launch in 2010.

Given the deep management team, disciplined, repeatable process, and lower than average management fee, this is a fund that I believe can continue to deliver above average returns, and lower levels of volatility into the future.

Dynamic Power American Growth Fund (DYN 004 – Front End Units, DYN 704 – DSC Units) – Like all Power branded funds, this is a "high octane", concentrated, high turnover growth fund. Managed by veteran Noah Blackstein, it holds 22 names, has nearly half invested in technology, 30% in healthcare, and 20% in consumer discretionary. When it wins, it wins big, but when it loses, it loses big, which was the case in 2016, when it posted a drop of more than 14%, worst in the U.S. equity group.

It was largely the tech and healthcare names that dragged performance in the year. Given the manager's style, I don't see this as a core holding, but instead could see it as a return enhancer for those investors with a big appetite for risk. If you don't like to ride the risk rollercoaster, this is a fund you should avoid.

RBC U.S. Small Cap Core Equity Class (RBF 793 – Front End Units, RBF 893 – DSC Units, RBF 493 – No Load Units) – The strategy of this fund is to find neglected U.S. small cap companies that have solid long-term fundamentals, a near term catalyst to improve profitability, and an attractive valuation. They look for market leaders with sustainable competitive advantages, strong balance sheets, and attractive cash flows. The sector mix is the byproduct of the bottom up security selection process. The portfolio is extremely diversified, holding just shy of 2000 positions. Still, the top ten make up just under 30% of the fund.

It is positioned for growth, and is overweight industrials, consumer, and tech, sectors expected to benefit from an economic recovery. Like the index and peer group, the fund stumbled in January and February, and then rallied nicely throughout the year, finishing with a 21% rise for the year, outpacing the benchmark and peers.

I don't see this outperformance as being sustainable going forward. The valuation level of the fund gives me some concern, as it, like U.S. small caps in general are trading well above historic levels. I would expect to see returns moderate in time, as valuations catch up.

Dynamic Power Global Growth Class (DYN 014 – Front End Units, DYN 714 – DSC Units) – Despite being the worst performing global equity fund in 2016, I like this fund. Don't get

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me wrong, it's not for everyone, or even most people for that matter. It is the global equivalent of the **Dynamic Power American Growth Fund** discussed earlier. It is run by the same manager, using the same process, and is a similar, high conviction, high turnover growth portfolio, that is overweight tech and consumer cyclicals.

The key difference is this fund invests outside of the U.S., and at the end of October had 80% invested abroad. It has volatility levels that are well above the index and peer group.

Again, this is not suitable for everyone, and should only be considered for those with an extremely high appetite for risk. And even if you are a high risk investor, this is not a core holding, but rather a piece of your larger portfolio.

Vertex Value Fund (VRT 600 – Front End Units, VRT 602 – Low Load Units) – With small caps leading the charge higher across the globe, it's not surprising to see a fund with significant small cap exposure as the best performing global fund for the year. It posted a one year gain of more than 40%, handily outpacing its peers and benchmark. The managers take an opportunistic approach and invests in Canadian and U.S. companies they believe are trading at levels that are attractive compared to the market, their peers and growth rates. Longer term numbers are also strong, with a five-year gain of 23.5%, again, outpacing the index and its peer group. The drawback I see with this fund is it is more volatile than the benchmark and peer group. Looking ahead, this is a fund that has the potential to deliver above average gains over the long term. However, there will also be periods where returns may lag, sometimes significantly. If you're comfortable with that, this may be worth looking at. A word of caution, I don't believe this would be a good core holding, but rather a portion of a well-diversified portfolio.

CI Global Health Sciences Corporate Class (CIG 201 – Front End Units, CIG 701 – DSC Units) – 2016 was a rough year for healthcare, with every fund in the category losing ground. With Trump in the White House poised to repeal and replace Obamacare, more volatility and uncertainty is expected in 2017. A bright spot is valuations and earnings look attractive compared to other sectors, which may make it an attractive pick for the long term. This fund has been an okay long-term performer, but currently has the lowest average market capitalization. Valuation levels look rich compared to the broader market, but look sound compared to the sector. Given the uncertainty, I'm not sure I'd be comfortable taking a dedicated healthcare position at the moment, and if I were going to, I believe there are stronger alternatives than this at the moment.

Mackenzie Precious Metals Fund (MFC 1042 – Front End Units, MFC 1192 – DSC Units) – Precious metals had a roller coast ride in 2016, but the materials sector ended up being the best performer, gaining 41%. This fund blew that out of the water, posting a 67% gain. What makes this impressive is that came after dropping nearly 30% in the second half of the year.

Looking ahead, I have mixed views on the precious metals space. On one side, if we see increasing geopolitical uncertainty, or Trump's policies look to be inflationary, that will be positive. However, if we see strong U.S. economic growth that drives the dollar higher, or a U.S. Federal Reserve that is not afraid to keep inflation in check, which could be a headwind. Regardless, given the volatility in the sector, I am often reluctant to take a dedicate position, instead allowing my more broadly positioned managers make that call on my behalf.

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

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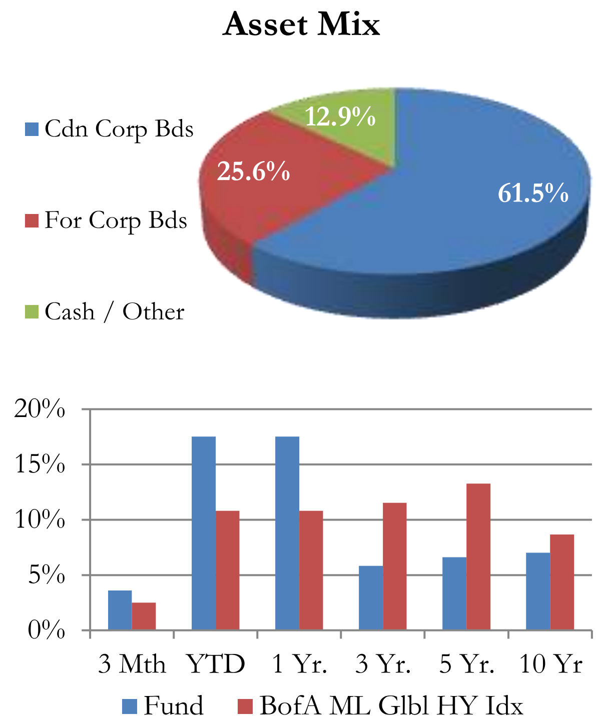
PH&N High Yield Bond

Fund Company	RBC Global Asset Management
Fund Type	High Yield Fixed Income
Rating	B
Style	Opportunistic Credit
Risk Level	Low – Medium
Load Status	No Load / Optional
RRSP/RRIF Suitability	Excellent
Manager	Hanif Mamdani since July 2000
MER	1.44% (advisor units)
Fund Code	RBF 1280 – No Load Units RBF 6280 – Front End Units RBF 4280 – Low Load Units
Minimum Investment	$500



ANALYSIS: This has been one of my top picks in the high yield space for years. Unfortunately for those wanting to buy in, it has largely been closed to new investors, and it is not expected to reopen anytime soon.

Managed by Hanif Mamdani, it takes a very flexible approach to fixed income investing that allows it to invest across the entire credit spectrum. Their credit analysis takes a value slant, and looks to find bonds that are trading at deep discounts to their historic levels and peers. It is this disciplined process and flexibility in the process that allowed the fund to deliver a stellar 17.5% (DIY units) in 2016.

Back in 2015, Mr. Mamdani saw many high-quality energy issues trading at significant discounts, thanks to the selloff in oil. He and his team stepped in and did the credit work, identifying several extremely attractive opportunities with very limited downside risk. He was so confident in these opportunities, that he invested around a third of the fund into energy related names.

It took a little time for this trade to pay off, but it started to turn around in a big way in the second quarter of the year. For the year, the fund outpaced its peer average by more than 700 basis points.

Looking ahead, this type of outperformance is not expected to be repeated. It happened because of a very specific, rare event. What this does highlight is how the team's investment process can be opportunistic and add value for investors.

I continue to like the fund, but would expect to see a more modest return going forward. If you hold it, it's probably not a bad idea to take some profits and rebalance your portfolio back to your strategic asset mix.

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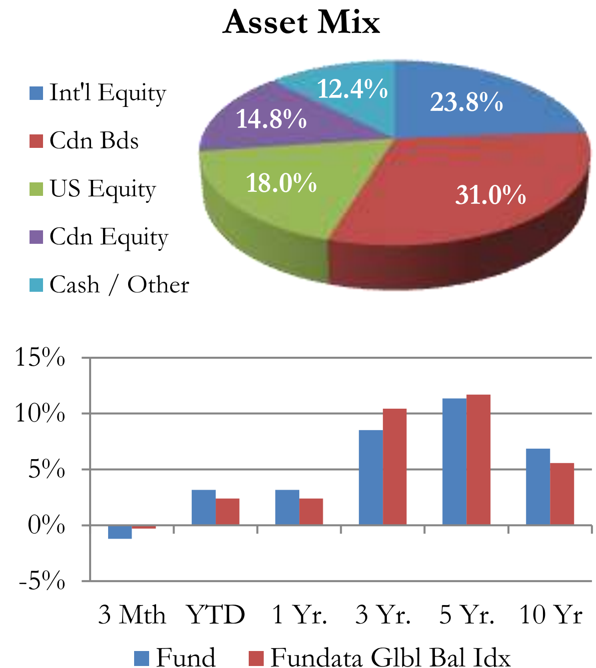
Mawer Balanced Fund

Fund Company	Mawer Investment Management
Fund Type	Global Neutral Balanced
Rating	C
Style	Strategic
Risk Level	Low – Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
Manager	Greg Peterson since June 2006
MER	0.94%
Fund Code	MAW 104 – No Load Units
Minimum Investment	$5,000



ANALYSIS: Despite a modest underperformance in 2016, this remains one of the best balanced funds around. It is managed much like a fund of funds, investing in other mutual funds managed by Mawer. The asset mix is managed by Greg Peterson, and any changes to this mix are done in a very measured and gradual manner.

The portfolio is diversified quite nicely, with exposure to most key asset classes, including domestic and foreign large cap and small cap stocks, as well as domestic and foreign fixed income. At the end of November, a third was invested in bonds, 16% Canadian equity, 22% in U.S. equity, and 21% international equity.

Each of the underlying funds are managed using Mawer's disciplined, research driven, bottom up process that looks to find well managed, wealth creating companies that are trading at less than they are worth. This approach is very team focused, with portfolio managers and analysts constantly challenging ideas. Another interesting aspect is the stress testing of valuations the team conducts helping to provide an extra layer of insight to the companies they own.

The equity portfolio holds what can best be described as quality companies, and the sector mix is somewhat similar to the benchmark, except for a modest overweight in financials and industrials, and an underweight in healthcare, utilities, and energy. It is the quality bias which created a headwind to the performance during the year, as it was the commodity focused sectors, materials and energy that led the way higher.

Fixed income is a bit of a weakness with this fund, as its positioning looks very much like the indices, resulting in a high levels of interest sensitivity, which hurt in a rising yield environment.

Still, this remains one of the best choices for investors looking for a one ticket solution. It offers a very disciplined management process, and a rock bottom MER of 0.96%. Even adding in 1% for dealer compensation this fund is still cheap.

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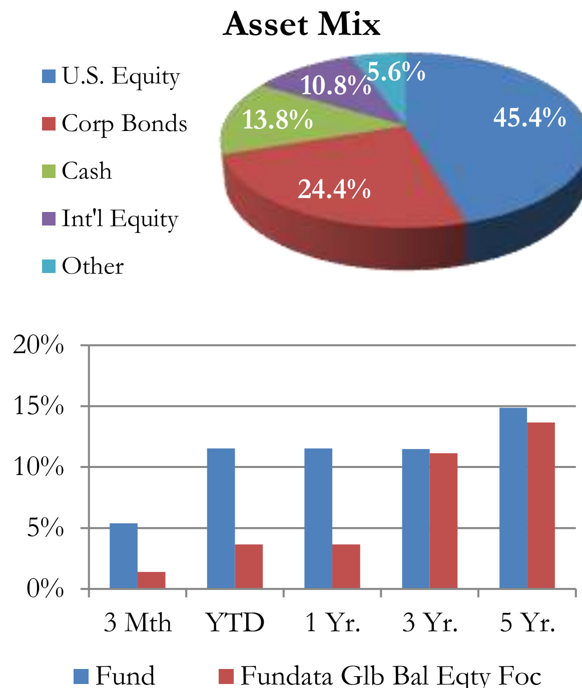
EdgePoint Global Growth & Income

Fund Company	EdgePoint Wealth Management
Fund Type	Global Equity Balanced
Rating	B
Style	Bottom Up / Mid Cap Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	EdgePoint Management Team
MER	2.03% (Front End)
Fund Code	EDG 180 – Front End Units EDG 380 – Low Load Units
Minimum Investment	$15,000



ANALYSIS: As a firm, EdgePoint keeps things simple. They offer four funds, and each is managed using the same disciplined, patient, and long term approach. Regardless of the security type, the management team looks to build a concentrated portfolio of high quality businesses they can buy at prices that are well below what they believe they are worth.

The managers have a fair bit of flexibility around the asset mix, and fixed income can range between 25% and 60%, depending on where they see the most attractive opportunities. At the end of December, they held roughly 60% equity, 30% in corporate bonds, and the balance in cash.

On the fixed income side, they can invest in both investment grade and high yield issues, and at the end of September, the average credit quality was listed as BBB on Morningstar.

On the equity side, they use a fundamentally driven, bottom up investment process that looks for high quality, undervalued businesses." Not surprisingly, this bottom up approach results in a portfolio that is significantly different than its benchmark or peer group. From a sector perspective, they are meaningfully overweight industrials, and underweight the more defensive sectors such as utilities, healthcare, and consumer defensives.

Performance has been excellent, with a five year annualized gain of nearly 15%, handily outpacing the benchmark and peer group. A drawback to this approach is it tends to be more volatile. There is also a likelihood it will experience periods of performance that is dramatically different than what others are doing, both good, and bad. But, if this is something you can be comfortable with, this is a balanced fund worth considering. It checks all the boxes – a deep management team using a disciplined, repeatable process, and carrying a reasonable cost to investors.

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