Top Funds Report

Uncertainty demands patience

Geopolitical anxieties, trade tensions, and rising rates may signal a more neutral stance

The wild ride that started in February continued in March, sending investors on a roller coaster ride. While the market attempted a comeback of sorts later in February, March came in like a lion and again clawed back any gains, as the major stock indices posted losses for the month.

We can cite many reasons for the renewed volatility, including fears over the number of times the Fed will raise rates in the year, worries over Trump's trade wars, and the selloff in the so-called FANG tech giants (Facebook, Amazon, Netflix, Google-parent Alphabet), which in turn was triggered by news that Facebook users' data had been harvested without their knowledge or consent.

For the month, equity markets were largely lower, with the tech-heavy Nasdaq Composite Index leading the way down, falling close to 4% in U.S. dollar terms. China also fell on the news that President Trump intended to levy significant tariffs on many Chinese goods. The S&P 500 Composite Index was lower by 2.5%. In comparison, Canadian stocks fared better, with the S&P/TSX Composite Index slipping a very modest 0.2% on the month, as energy, materials, and real estate issues rallied, offsetting losses in industrials, financials, and tech names.

With market volatility remaining high, the U.S. dollar benefitted modestly, which helped to mute losses for investors with unhedged currency exposure.

Fixed-income investors benefitted from the flight to safety trade as bonds rallied. The FTSE/TMX Canada Universe Bond Index gained 0.75% in the month. Government bonds outperformed corporate bonds, as spreads widened and worries over Mid-east sabre rattling, trade tensions, and privacy breaches at Facebook weighed on the market. Corporate bonds were also held down by very robust new issue activity, which saw significant supply hit the market, dampening on prices across the board.

Looking ahead, there are some reasons to be cautiously optimistic on the trade front. It appears there may be an agreement in principal for NAFTA, and the White House appears to be pulling back on the China front a bit. This has buoyed sentiment, and markets have at least levelled out into a trading range, although still beset by bouts of volatility on each new Tweet from President Trump. Given the erratic nature of Mr. Trump, things could change very quickly – and are very likely to continue to do so.

In the fixed-income world, the high yield sector has been rallying, and historically, high yield has been a leading indicator, which is a potential positive.

Economic numbers remain positive, but some cracks are starting to show. This could affect the pace at which central banks raise their interest rates. The yield curve is also dangerously close to inverting, a

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		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	

signal that has historically preceded a recession and bear market.

Given the uncertainty, I am not making any meaningful changes to my investment outlook. I am still modestly overweight equities over fixed income. However, that may change based on the outlook for yields, in which case I may move to a more neutral positioning. Stay tuned.

My investment outlook is shown in the table on Page 1.

Please send your comments to: **feedback@paterson-associates.ca**.

Funds of Note

This month, I look at funds from Fidelity, Mackenzie, Ninepoint, Sentry, and Chou…

Fidelity Canadian Large Cap Fund (FID 231 – Front-End Units, FID 831 – Low-Load Units)

It's no secret that I've been frustrated by the performance of this fund over the past few quarters. The fund struggled through the latter part of 2016 and all of 2017. The main reason for this underperformance was the its defensive positioning. Manager Dan Dupont follows a very disciplined value-focused approach. Consequently, as valuations crept higher, he became more defensive, both in terms of stock selection and in increasing his cash weighting.

So why continue holding it? It is in fact the manager's defense-first approach that highlights why I like the fund. Dupont has done a great job over the long term delivering solid risk-adjusted returns, with lower-than-average volatility and excellent downside protection in falling markets.

For the past three years, it's participated in only 40% of the downside of the markets and only 22% over the past five years. The fund's volatility has been significantly below the broader market and the peer group.

The portfolio has a definite value tilt and trades at valuation levels below the broader market and other Canadian-focused equity funds. Unfortunately, the past few quarters have seen these more value-type names lag the more richly-valued growth stocks in such currently hot sectors as technology, cannabis, and crypto currency. Not surprisingly, the fund has no exposure to the FANG stocks (Facebook, Amazon, Netflix, and Google), which have driven a good chunk of the market gains.

Another contributor had been the lack of overall market volatility for a long period. Investors were more concerned about missing out rather than focusing on the quality and valuation of their investments.

However, in February it looked like market volatility returned with a vengeance, and markets have once again been rewarding quality and fundamentals. Not surprisingly, that has been a positive for this fund, which has handily outperformed both the markets and its peer group during the market selloff through February and into March.

In March, the fund was down 0.04%, while the category average slid more than 0.8%. It was a similar story in February when the fund edged down 0.7%, while the peer group lost more than 2.1%.

The manager continues to sit on a lot of cash and will step in and pick up quality companies at compelling prices as valuations become more attractive. With volatility expected to remain high, and markets likely to continue to focus on fundamentals, I expect this fund to deliver above-average risk-adjusted returns and provide better capital protection when the markets sell off. However, should we see a beta-driven rally, this fund will again lag the markets and peer group. Still, it remains one of my top picks for the long term for its disciplined, value-focused strategy.

Mackenzie Ivy Foreign Equity Fund (MFC 081 – Front-End Units, MFC 7017 – Low-Load Units)

While this fund is another of my long-time favourites, it has also been causing me a lot of frustration over the past few quarters. Coincidentally, its underperformance started around the same time as the Fidelity Canadian Large Cap discussed above.

This has been a fund with low-volatility characteristics long before it became fashionable. It is very much a defense-first type of a fund, with a concentrated, quality-focused portfolio of high-quality, multinational companies trading at what the manager believes are attractive valuation levels.

When valuations are rich, as they have been recently, the manager will hold cash. For example, at the end of February, the portfolio was allocated to more than 30% cash. This high cash balance, combined with a lack of higher beta, growth-focused names have been a major headwind for performance.

For example, in 2017, the fund gained 1.7%, while the MSCI World Index was up by more than 15% and the peer group was ahead more than 13%. But with volatility returning in February and March, things seem to have turned around, with the fund outperforming the index and peer group in both months. In February, the fund fell 0.55%, while the MSCI World Index lost 1.51%.

It's a start, but there is still a long way to go to catch up with the index and peer group after what has effectively been a couple of "lost years." I still believe that the past few quarters have been more of an anomaly than the norm for the fund, and as things return to normal, I would expect the performance to improve.

Furthermore, with volatility likely to remain above recent levels and more selling likely, this fund will once again earn its keep. I am watching the cash position and I'm hopeful the managers can find some attractive opportunities and reduce the cash drag.

All in all, this fund is a great way for more conservative investors to access global equities. However, those with a higher appetite for risk may want to consider an alternative with a bit more torque.

Ninepoint International Small Cap Fund (NPP 370 – Front-End Units, NPP 371 – Fee-Based Units)

The first thing that you might ask is, "What the heck is Ninepoint and where did they come from?" Well, Ninepoint Partners is the new name for the old Sprott mutual funds, which were bought out by the management group last summer.

Sprott had historically been very focused on resource and commodity funds. But with the arrival of John Wilson as CIO, it began shifting to a more alternative focus. Under the Ninepoint banner, this trend continues, as the group expands its product shelf into interesting and innovative parts of the investment universe. As a matter of interest, Ninepoint isn't in the startup category either. At the end of December, it had more than $3 billion in assets under management.

The International Small Cap Fund is one of their new offerings, and on the surface may not look that interesting. But it is unique in that there aren't that many small-cap funds that don't invest in the U.S. market. In fact, there are only a handful of international small-cap offerings.

This fund is managed by Robert Beauregard and his team at Global Alpha, a firm founded in partnership with Connor Clark & Lunn (CC&L) in 2008, which today manages more than $1.5 billion in international and global small-cap mandates. CC&L offers a global mandate that includes U.S. small and mid-cap stocks. The process used in the CC&L and Ninepoint funds is identical, as the manager aims to add 3% in excess return over a market cycle.

The managers use a rigorous, research-driven, bottom-up, multi-step investment process that is fundamentally-driven and looks to identify high-quality companies that can deliver earnings growth and that are trading at levels not yet recognized by the market. They also look for growth themes that can help create a tailwind for the companies. Consequently, the result is a diversified portfolio of between 50 and 70 names.

This is a new retail offering, but it has been available institutionally for many years, delivering very strong risk-adjusted returns that have met or exceeded the return target. This fund is worth a look for those seeking a small-cap fund that does not invest in the U.S.

Ninepoint Concentrated Canadian Equity Fund (NPP 151 – Front-End Units, NPP 152 – Fee-Based Units)

Formerly the Sprott Canadian Equity Fund, which was very much a small-cap, resource-focused fund, Ninepoint replaced managers James Bowen and Jonathan Wiesblatt with Connor Clark & Lunn-owned Scheer Rowlett & Associates.

The new name pretty much sums up the fund, which holds a concentrated portfolio of between 15 and 25 of the manager's best Canadian equity ideas. Their investment approach is very institutional in nature, and will use a fundamental, bottom-up, value approach.

I certainly believe this will be a much better fund with the new management team at the helm. However, until we get a few quarters of data, I can't really comment on its overall quality and am taking a wait and see approach.

Sentry Precious Metals Fund (NCE 703 – Front-End Units, NCE 203 – Low-Load Units)

This fund was one of the best performers in March, gaining 6.8% while the broader S&P/TSX Composite lost 0.2% and the S&P/TSX Gold Index gained 4.4%. Gold bullion rose by 1.2% in U.S. dollar terms. Despite this impressive showing in March, the fund is still underwater -5.5% on a year-to-date basis.

Gold has been on a slight upward trend since 2017, but given the concentrated, small- to mid-cap nature of this fund, its performance is more a consequence of company-specific results.

For example, in March most of the return was the result of a staggering 71% gain in the fund's 8% holding of Klondex Mines, which skyrocketed on news that U.S. based Hecla Mining would acquire all the outstanding shares of Klondex at a 60% premium to its 30-day weighted-average trading price. Clearly, this is not something that is likely to be repeated.

I am generally not a fan of gold and precious metals companies in a portfolio. While there is some expected benefit as a hedge against inflation and as a flight-to-safety trade, that relationship hasn't been as strong as it is often made out to be. In most cases, precious metals bring excessive volatility to a portfolio, and don't provide a significant diversification benefit.

Furthermore, following CI Financial Group's acquisition of Sentry last year, there have been some changes to various management teams, including this one. Long-time manager Kevin MacLean left the team last November, and the fund is now run by lead manager Jon Case, who has been with the fund since 2012, and associate portfolio manager Leonie Soltay, who has been with the team since 2012.

Looking at its performance over the past three years, it has been one of the more volatile funds in the category, and performance has been in the middle of the pack. All things considered, unless you want dedicated precious metals company exposure in your portfolio, I believe you are better off avoiding the category and getting any metals and materials exposure from your more broadly diversified actively managed fund holdings.

Chou Asia Fund (CHO 300 – Front-End Units, CHO 304 – Fee-Based Units)

The fund is managed by Francis Chou, a respected manager with a long tenure in the Canadian mutual fund marketplace. He is a disciplined manager who sticks to his process, rarely straying from his deep-value convictions.

His approach is very fundamental in nature and focuses on a company's financial position, free cash flow generation, quality of management, and understanding of the industry. Chou determines an estimate of a company's intrinsic value and looks to invest only in companies trading at a significant discount to that value.

He takes a very patient, long-term approach, which is reflected in his very low levels of portfolio turnover. He also has a fair bit of flexibility with the fund's mandate, and can invest in stocks, convertible bonds, and other fixed-income investments.

The portfolio is very concentrated, and at the end of December held 44% in cash with the balance spread among only six equity names. Geographically, 36% of the fund is in three Chinese holdings, 9% is in New Zealand Asset Manager Pyne Gould Corp., and 7% in Korean-based Posco. This certainly makes the portfolio much different from the benchmark.

Long-term performance has been decent, with a 5-year average annual compounded rate of return of 9.5% to March 31. Like other value funds, it has struggled in year to date performance, with nearly all its holdings suffering losses so far in 2018.

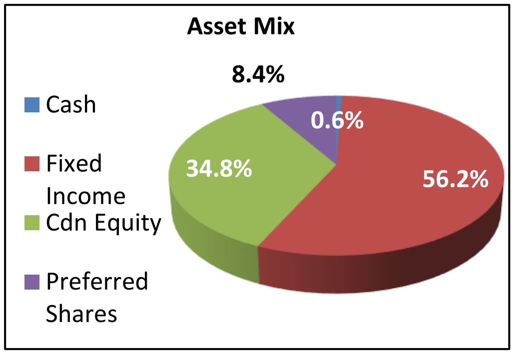
I would be very hesitant to use it as a core holding. It is far too concentrated for that role in a portfolio. The concentration also makes it potentially very volatile. And while I have a lot of respect for Mr. Chou, you are accepting a lot of key-person risk with this fund. However, if you are comfortable with the risk, it may be a nice addition to an otherwise very well diversified portfolio.

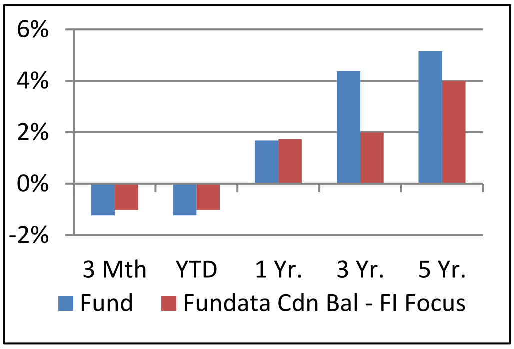
If there is a fund that you would like reviewed, please email a request to me at:

feedback@paterson-associates.ca

Leith Wheeler Income Advantage Fund

Fund Company	Leith Wheeler Inv. Counsel
Fund Type	Canadian Fixed Income Balanced
Rating	A
Style	Top-down macro Bottom-up security selection
Risk Level	Low – Medium
Load Status	Fee-Based/Do-It-Yourself
RRSP/RRIF Suitability	Good
Manager	Leith Wheeler Mgmt. Team
MER	0.79% Fee-Based, 0.85 DIY
Fund Code	LWF 030 – Fee-Based LWF 017 – Do-It-Yourself
Minimum Investment	$5K Fee-Based, $25K DIY





ANALYSIS: This is a conservatively-positioned balanced fund, with an emphasis on fixed income. At the end of February, it held 50% in investment-grade bonds, 7.5% in the diversified Leith Wheeler Multi Credit Fixed Income Fund, 8% in preferred shares, and the balance of roughly 35% in Canadian equities. There is some flexibility in the asset mix, and the managers will adjust the exposure based on the available opportunity set.

The investment process starts with a top-down analysis that sets the economic and interest rate outlook. This helps the managers establish targets for duration, sector, and credit quality factors. Security selection is bottom-up, as the managers use a fundamental credit analysis that looks for credits trading at reasonable levels, offering attractive yields for the risk.

On the equity side, the exposure comes from investing in the Leith Wheeler Canadian Dividend Fund, where the focus is on high-yielding, dividend-paying equities. The fund uses a fundamental, bottom-up, value-focused approach to find higher-yielding dividend stocks. Foreign exposure is limited to 20%, although given the focus on tax-advantaged income, most of the equity exposure is expected to be in Canada. At the end of February, less than 8% was invested abroad.

The equity sleeve looks much like what you'd expect from a Canadian dividend fund, with an overweight to the higher-yielding sectors such as financials, real estate, utilities, and industrials. Valuations look very attractive compared with the broader market.

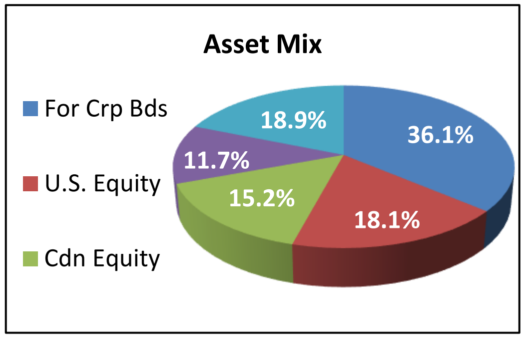
However, one drawback to the fund's overall positioning is that it carries a higher degree of interest rate sensitivity, which may hurt in a volatile and rising yield environment. This positioning also helps explain why the shorter-term performance numbers have lagged some of its peers.

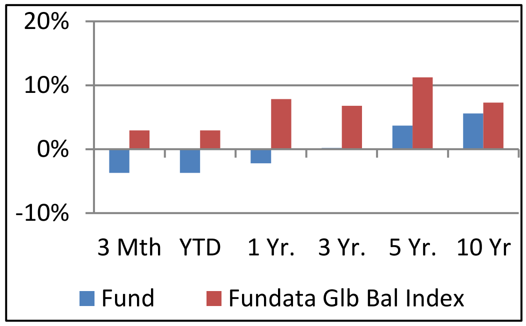
Another potential drawback is that the fund has been more volatile than many of its fixed-income balanced peers. This is because it carries a modestly higher exposure to equities.

Still, all things considered, the strong, disciplined management team, repeatable investment process, and focus on risk management make this a very strong balanced fund offering.

CI Signature High Income Fund

Fund Company	CI Investments
Fund Type	Global Neutral Balanced
Rating	D
Style	Tactical
Risk Level	Low – Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Managers	Geof Marshall since Dec. 2010 Eric Bushell since March 2016
MER	1.59%
Fund Code	CIG 686 – Front-End Units CIG 1786 – Low-Load Units
Minimum Investment	$500





ANALYSIS: Over the long-term, this fund has been a stellar performer, offering an attractive mix of solid total returns, a stable stream of income, and below-average volatility. In the shorter term, however, it has struggled, trailing the index and peer group in 2017, and year-to-date in 2018. A key reason for this underperformance has been the portfolio's construction.

The fund's main objective is to generate income without taking on excessive risk. As such, it has avoided growth-focused sectors such as technology and high-flying consumer names. But because these have been key market drivers for the past 12 to 18 months, this fund's performance has lagged.

Contributing to that lag was the fund's high exposure to the energy sector, which has suffered from rising rates and general lack of interest in energy in general. And with the fund's higher level of interest rate sensitivity in the equity sleeve, rising rates have created an additional headwind to performance.

So where do we go from here? Despite the recent underperformance, this remains an excellent fund. Managed by Eric Bushell and the Signature Global Asset Management team, the fund has a tactical mandate and can invest anywhere in the world. The approach is somewhat style-agnostic, involving an analysis of a company's entire capital structure, as well as the many qualitative aspects of the company, such as management, disclosure, and governance. This gives the fund its opportunistic slant, allowing it to buy the most attractive part of a company.

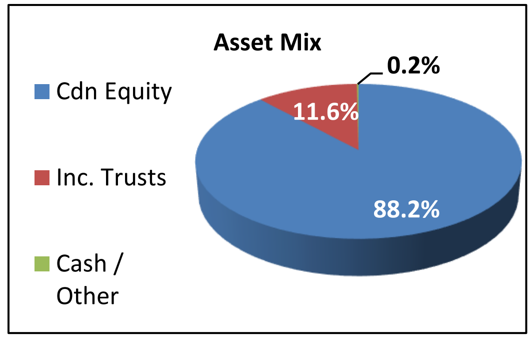
At the end of February, the portfolio was allocated 40% to bonds, 9% preferred shares, 47% equities, and the balance in cash.

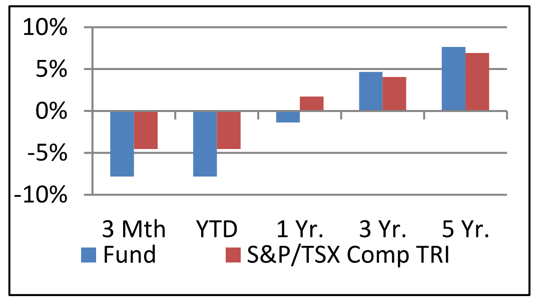
The fund pays a monthly distribution of $0.07, for an annualized distribution yield of 6.6%. My concern is that we may see a cut to the distribution if performance doesn't pick up; otherwise, there will be a continued erosion of net asset value, as the fund pays out more than it earns.

Still, I expect the fund to continue delivering modest returns, with low volatility, resulting in very decent risk-adjusted returns for investors. In addition, I expect the fund to hold up better than many of its "growthier" peers in periods of heightened volatility.

PowerShares Cdn Dividend Index Fund/ETF

Fund Company	Invesco Canada
Fund Type	Cdn Dividend & Income Equity
Rating	B
Style	Large Cap Value
Risk Level	Medium
Load Status	Front-End/Fee-Based
RRSP/RRIF Suitability	Excellent
Manager	PowerShares Canada
MER	ETF 0.55% / Front End 0.62%
Fund Code	ETF – TSX: PDC Front-End Units – AIM 44207
Minimum Investment	$500





ANALYSIS: Research has long proven that dividends account for the lion's share of long-term stock market returns, contributing nearly 70% of the total return for the S&P/TSX Composite Index over the past 10 years. That's a very compelling reason to consider stocks, mutual funds, and ETFs that carry a high dividend yield.

The PowerShares Canadian Dividend Fund and its mirror ETF are among my favourites in the Canadian Dividend & Income space, and I currently use it in my ETF portfolios.

It invests in highly liquid Canadian stocks that have paid a stable or rising dividend over the past five years. The managers screen for dividends and then hold the 45 largest stocks ranked by market capitalization.

The portfolio is in effect an adjusted market cap index that is reconstituted annually to counter the danger of excessive single-company weighting. And it is also rebalanced on a quarterly basis.

During its recent annual reconstitution, the fund increased its weighting to the energy sector to 28% from 17%, adding high-yielding names like TransCanada and Enbridge. It also raised its allocations to financials, to 36% from 30%, adding such notable names as Bank of Nova Scotia, National Bank, and Great West Life.

The fund has negligible exposure to materials, which makes sense, given its focus on yield. It is also underweight consumer names, healthcare, industrials, and technology.

After the reconstitution, the underlying dividend yield is 5.0%, down slightly from 5.3%. However, this comes with a slight improvement in its valuation metrics. Average market cap has also increased, nearly doubling to more than $34 billion from $19 billion.

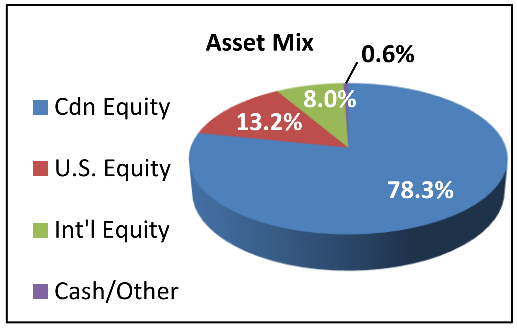
The portfolio's overall earnings outlook is also one of the most attractive of the dividend peer group, providing runway for share price growth in addition to attractive yield.

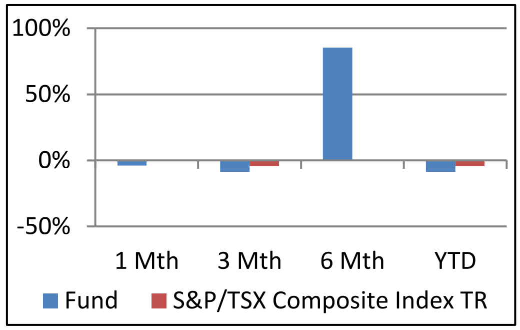
A potential drawback is the concentration of the portfolio, with nearly 63% invested in energy and financials, roughly matching the concentration found in the broader S&P/TSX Composite Index at a 65% weighting in these same two sectors. The danger here is that if the weighting persists for a longer period, the fund starts to look like a closet indexer. However, I think this is simply a short-term anomaly.

Costs are reasonable, but not cheap, with an MER of 0.55%. On balance, this fund remains a solid way to play the Canadian market, while offering an attractive yield.

Horizons Marijuana Life Sciences ETF

Fund Company	Horizons ETF Management
Fund Type	Sector Equity
Rating	N/A
Style	Small Cap Growth
Risk Level	High
Load Status	N/A
RRSP/RRIF Suitability	Poor
Manager	Horizons ETF Management
MER	0.94%
Fund Code	TSX: HMMJ
Minimum Investment	N/A





ANALYSIS: In the past few months, interest in the marijuana sector has grown considerably, and not a week goes by where I don't get a question or two on my thoughts about it. With legalization likely to become a reality later this year, many are speculating that we are in a once-in-a-lifetime transition, not unlike the end of prohibition. While there may be some truth to that, it's tough to justify the current valuations of many of these companies, even after recent selloffs.

To invest in the space, investors really have only two options: invest directly in the underlying companies or invest in a fund. In the ETF space, there are three options, of which the Horizons marijuana offering is the most established, having debuted a year ago.

The ETF invests in companies involved in the legal aspects of the marijuana industry, including those involved in medical research, growers, and other ancillary businesses.

Some of the top holdings include medical marijuana companies Aurora Cannabis, Canopy Growth, and Aphiria. Ancillary business holdings include fertilizer company Scotts Miracle Gro.

Recent performance has been stellar, to say the least, as the fund gained more than 85% in the past six months and is up 40% since its launch in April 2017. However, it's been a bumpy ride, particularly of late, with the fund dropping more than 35% from its peak in early January.

There is no doubt the market for marijuana will grow substantially, with conservative estimates for the size of the total market at just shy of $6 billion in annual sales. However, it's too early to rely on these estimates. The market is crowded, consolidation is underway, and valuation levels reflect extreme optimism.

For example, the price-to-forward earnings ratio of Canopy Growth, the largest holding in the ETF, is -434 times (meaning the company is trading on huge expectations of future earnings while currently posting a loss). And it's not unique. Clearly these valuation levels are unsustainable.

I don't currently view this sector as an "investment," but rather as a trade or speculation. However, most investors will want to steer clear until the dust settles and more reasonable fundamentals are demonstrated.

For those looking for a one-ticket diversified portfolio in this sector, the Horizons ETF is a good option. But again, with the current risk profile of the sector, it is clearly not something I'd recommend for everyone.