Top Funds Report

Note to Readers

It is with mixed emotions that I announce I will be stepping aside as Editor of the *Top Funds Report*. I have enjoyed the opportunity to write for this newsletter, to speak with many clients, and provide you with my insights and opinions on the Canadian mutual fund and ETF landscape.

As you may know, I took a position at Empire Life last April as Vice President of Strategic Investment Solutions. Over this past year, I have found it increasingly difficult to continue to provide the same level of analysis and information that you have come to expect.

So, over the next couple of months, I will gradually be transitioning the publication to Mr. Paul Bamford. Readers of Gordon Pape's newsletters *The Income Investor* and *The Internet Wealth Builder* may already be familiar with Paul's work.

I have known Paul for more than 25 years. He is an exceptionally knowledgeable investment professional and independent analyst. Paul has worked for some of Canada's big banks, a large mutual fund company, and a boutique High Net Worth shop. He holds an undergraduate degree from Harvard, a Master of Finance from the University of Toronto's Rotman School of Business, and the Chartered Financial Analyst designation.

I thank you for your support over the past nine years. It has truly been an honour and a pleasure. While I am sad to be leaving, I am very comforted knowing you will be left in very good hands. – ***Dave Paterson***

March market meltdown

COVID-19 pandemic shuts down global economies, crude oil glut adds to woes…

If you thought the investment markets in February were bad, I don't even know how to describe March. The word "unprecedented" seems to have been thrown around a fair bit, and it seems to be a pretty fitting description.

Heading into the month, markets were on edge as the fear of COVID-19 began to spread across the world. What started out as a health crisis quickly turned into an economic crisis as many countries around the world shuttered large parts of their economies to help reduce the spread of the virus and prevent overwhelming their already stretched healthcare sectors.

Further adding to the uncertainty, the energy market sold off heavily after Saudi Arabia started a price war with Russia by announcing price cuts of between $6 and $8 per barrel. The Saudis made this move in retaliation for Russia's not participating in OPEC+ agreements to cut production.

The impact was both swift and severe with the price of crude oil falling by more than 50% in the month, bringing down energy stocks with it. The S&P/TSX Capped Energy Index fell by 48% in the month.

This selloff in the energy market saw the S&P/TSX Composite Index post a loss of 17.7% for the month, with widespread weakness across several sectors, including energy, real estate, consumer discretionary, and healthcare.

As the virus spread across many European nations, including the devastated Italy, the MSCI European Index sold off sharply, falling more than 14% in U.S. dollar terms. The blue-chip U.S. S&P 500 Composite Index ended a volatile month down 12.4% in U.S. dollar terms, but not before falling more than 28% in the month. As a sign of how volatile markets are, the index bounced off its low, gaining nearly 18% in just three trading days.

Bond markets, which have traditionally been thought of as a safe-haven investment, experienced significant volatility over the month. In the end, government bonds provided some safety, with the Canadian government bond index falling more than half a percentage point.

However, corporate bonds struggled in the month, with the Canadian corporate bond index down 5.4%. With fear at an all-time high, investor panic set in, and investors began to demand a much higher premium to hold corporate bonds. Spreads, the difference in yield between a corporate bond and a government bond of the same maturity blew out to levels not seen since the financial crisis in 2008-09.

Further complicating matters was evaporating liquidity in the bond markets, which added greatly to the uncertainty and volatility. This rippled through all financial markets, creating more uncertainty. It wasn't until the U.S. Federal Reserve and the Bank of Canada stepped in with massive easing measures – rate cuts and unlimited asset purchases, including corporate bonds – that some sense of normalcy returned to the bond markets.

In addition to the central bank easing, governments have stepped up and announced massive fiscal stimulus plans to help people and businesses stay afloat while the economy has ground to a virtual standstill as most normal activity is locked down. In Canada, over the past three employment reports, 22 million people have filed for unemployment benefits.

The U.S. has announced plans to put forward more than US$2 trillion to the cause, including direct payments to individuals, a massive boost to unemployment benefits, loans and loan guarantees, as well as protections against evictions.

In Canada, the government has announced a plan that includes an emergency response benefit for individuals who have lost jobs because of COVID-19, a one-time GST credit, and mortgage deferrals. In addition, the federal government has set up a special emergency wage subsidy program to support businesses hit by the closure of non-essential businesses. More stimulus actions are expected to be announced in the coming days and weeks.

The toll of this pandemic is unimaginable in terms of the human cost and devastating economically. But we will get through this. The big question is when. We have recently heard calls from officials, particularly in the U.S., to get the economy started again. It will happen, but based on the comments from the medical officials, it appears to be a bit too early for that. It is also much too early to fully understand what the long-term impact of the pandemic will be.

In the short-term it will be devastating, as evidenced by the massive surge in unemployment. How could it not be devastating with much of the economy closed down?

But one compelling argument for a fairly positive outlook is that the cause of this slowdown is different from both the global financial crisis and the tech bubble. In those cases, we saw massive imbalances forming in certain areas of the economy that spilled over into the broader economy. After the financial shock, there were massive imbalances that needed to be "worked out" before the economy could return to a period of strength. In this case, the economy was by and large fine. It wasn't great, it wasn't bad, but it was fine.

There were no massive imbalances that need to be worked out.

Instead, what we have seen is a simultaneous shock to both supply and demand. It is not so much a case of demand destroyed, but rather demand delayed. When the isolation measures are relaxed, people will still need haircuts, shoes, and clothes, they'll go to restaurants and movies, they'll buy or renovate houses, buy a new car, and maybe even travel. Eventually, we will see the world return to something that resembles normal.

What we are experiencing is something that hasn't been seen in more than 100 years. It is truly a "black swan" type event. Yes, the first-quarter returns are going to be very ugly. However, when it comes to your portfolio, now is not the time to be making rash decisions. Now is not the time to panic.

This is an opportunity to take a hard look at your situation. What are your investment objectives? How much risk are you willing to accept, and what rate of return do you need to meet your objectives. Then, take a look at your asset mix to make sure it is in line with your needs. If it is not, then make the necessary adjustments.

Now is not the time to move to cash, unless you absolutely will need the cash within a period of a year or two. In that case, it makes sense to ensure you have what you need to meet your needs. However, if you have no immediate liquidity requirements, assuming your portfolio is in line with your objectives, and you have a long-term time horizon, you are likely better off remaining invested than engaging in fruitless – and money-losing – efforts at market timing.

Timing the market by picking tops and bottoms is a very difficult task. We've clearly missed the top, and it is only with the benefit of hindsight that we will be able to identify the bottom. Furthermore, the bottom usually occurs when sentiment is at its most negative, but because investing can be emotional, it becomes very difficult to invest when sentiment is at its worst.

Instead, take a deep breath. Stick to your plan. If you are working with an investment advisor, reach out to them for guidance. It's at times like these that they earn their fees. If you're a do-it-yourselfer, consult only unimpeachable information sources and market commentaries from professional money managers. The big financial institutions all publish commentaries and advisories by some of the best money managers in the world – all free for the asking. Do not consult the news media or your social media feed for financial advice.

In my portfolios, I maintain a very disciplined analytical portfolio construction process. I continue to follow that mandate, which was built to see me through the good times and the bad. I am in regular contact with the investment managers whom I follow, and each of them is also remaining disciplined and focused in their processes.

In the interim, my investment positioning remains as it has for some time with a roughly neutral asset mix between equities and fixed income, as shown in the accompanying matrix.

Within equities, I am defensive, with an emphasis on high-quality and low-volatility funds and ETFs. Within fixed income, I am underweight high yield, and I have been allocating new capital to core, high-quality investment-grade funds. Given the recent selloff in high yield, it does look more attractive from a valuation perspective, but I am hesitant to step in at the moment.

As we gain more clarity on the economic landscape, we can reassess our portfolio mixes and be better able to determine if any major changes to our outlook and positioning are required. Given the current uncertain environment, it is much too difficult to make any such decisions at the moment.

		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	
	Emerg Markets	X		

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

Funds of Note

This month we take a look at some of the better performing funds in March…

Mackenzie Gold Bullion Fund (MFC 2989 – Front-End Units, MFC 7190 – Low-Load Units) – Gold has typically been thought of as a great hedge against market volatility, and of the gold bullion funds, this would be one of my top picks. Managed by Mackenzie Investments, it holds at least 80% of the fund in gold bullion or gold certificates. It can invest up to 20% of its assets in silver, platinum, or palladium, and may invest up to 10% in gold equities.

In U.S. dollar terms gold was down 0.5% in March, but the increase in the value of the U.S. dollar saw the return to be approximately 4.4% in Canadian dollar terms. For the month, the fund gained 4.2%. However, it is important to note that all of this gain was the result of a strengthening U.S. dollar.

While this would be one of my top picks in the sector, I am not typically a fan of gold or gold funds and would not expect to use them in any of my portfolios.

CI Signature Global Bond Fund (CIG 624 – Front-End Units, CIG 1623 – Low-Load Units) – With a gain of 2% for the month, this was one of the top-performing funds in March. It invests in a very well diversified portfolio of government and corporate bonds from issuers around the world, focusing on high-quality with more than 75% invested in government bonds.

While the Canadian-dollar version was positive, the U.S.-dollar fund was down 2.1%, indicating to me that the very strong showing was the result of the manager's currency management rather than from the fixed-income investments. Currency can also be a detractor to fund performance, and I typically prefer a fully-hedged currency position for fixed income.

Despite the fund's strong showing in March, I believe there are better global bond offerings around. Some of my favourites in the space include **Invesco Global Bond**, **CI Investment Grade Bond**, and **PIMCO Monthly Income Fund** (which I hold in the Empire Life Multi-Strategy GIFs. Please refer to the conflict of interest disclosure on page 1 for more information).

Mackenzie Ivy Global Balanced Fund (MFC 086 – Front-End Units, MFC 7000 – Low-Load Units) – The Ivy team, headed by Paul Musson, has a very strong reputation for protecting capital in down markets, so it is not a surprise to see this global balanced offering near the top of the list of best-performing balanced funds in March. Mackenzie's Multi-Asset Strategies team uses a disciplined, systematic decision-making process to manage overall asset mix.

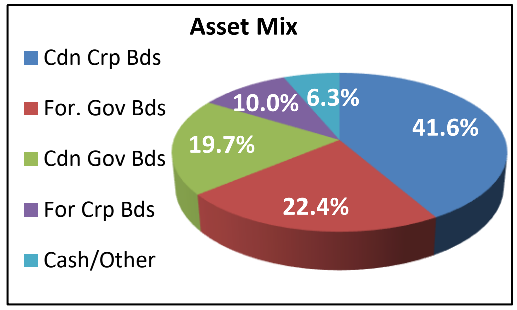
The equity sleeve is managed by the Ivy Team, using disciplined, bottom-up security selection with an emphasis on downside protection. They look for high-quality, multi-national companies that are trading at a very high margin of safety. The fixed-income sleeve is managed using a blend of top-down macro analysis and bottom-up security selection.

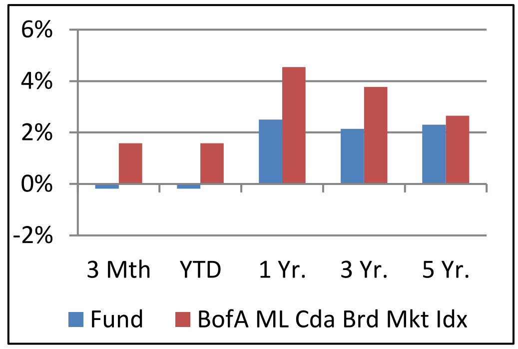
In March, the fund was down 4.2% compared with a nearly 10% drop for the category average. This sort of downside protection is the main reason you would want to hold funds managed by the Ivy team. However, Ivy funds have historically trailed in rising markets, as their defensive positioning can often be a headwind. But you certainly cannot argue with results in major market selloffs like the recent one and the global financial crisis over a decade ago.

If there is a fund that you would like reviewed, please email a request to me at: feedback@paterson-associates.ca

CI Investment Grade Bond Fund

Fund Company	CI Investments Inc.
Fund Type	Global Corporate Fixed Income
Rating	B
Style	Top-down macro Bottom-up security selection
Risk Level	Low to Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Paul Sandhu since Dec 2014
MER	1.60%
Fund Code	CIG2185 – Front-End Units CIG1185 – Low-Load Units
Minimum Investment	$500





ANALYSIS: March was a tough month for most investment assets, including fixed income. Still, this offering from CI, managed by Paul Sandhu of Marret Asset Management, held up relatively well, falling 3.3%, outpacing the peer group.

Managed using a blend of top-down macro analysis and fundamental, bottom-up security selection, the fund invests in Canadian, U.S., and European corporate bonds. Starting with core portfolio of underlying bonds, the managers use an overlay strategy designed to tactically hedge interest rates, credit, and currency exposures. The strategies are actively managed to take advantage of market opportunities.

The portfolio is well diversified, with more than 200 individual positions. Geographically, 69% of assets are in Canada and 31% in the U.S. Heading into March, the fund held 41% in Canadian corporate bonds, 19% in foreign government bonds, 18% in Canadian government bonds, 10% in foreign corporate bonds, and around 11% in cash. Credit quality remains high, with a weighted-average credit rating of A.

Performance in absolute terms has been decent, but unspectacular. The 3-year average annual compounded rate of return to March 31 was 2.1%, which is roughly middle of the pack for the category.

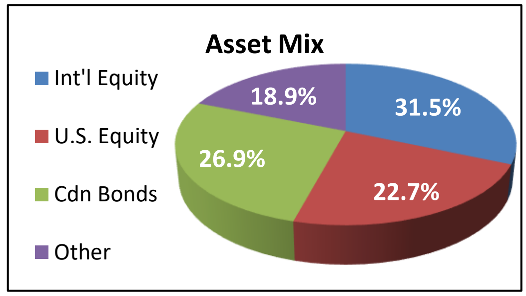
However, where this fund really shines is on the risk side. For the same three-year period, the standard deviation was slightly more than half the average of the global bond funds, resulting in above-average risk-adjusted returns. It has also protected capital in down markets, participating in less than half of the market's downside.

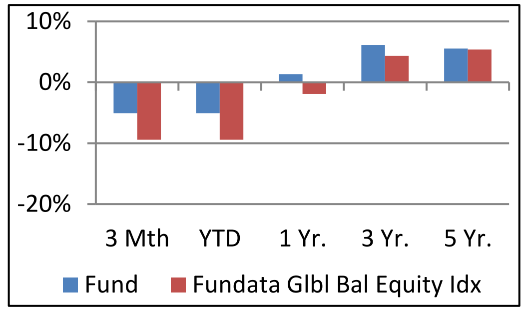
Bear in mind that there may be times when the managers don't get their high-conviction calls exactly right, which could result in periods of lagging performance.

Costs are reasonable, with an MER of 1.60%, compared with 1.68% for the average of the global bond funds I follow. With its fundamental security selection, active duration strategy, and focus on risk management, this fund is worth considering for a portion of the fixed-income sleeve of your portfolio. If you prefer an ETF structure, a substantially similar mandate is available in the **CI First Asset Investment Grade Bond ETF (TSX: FIG)**.

Mawer Global Balanced Fund

Fund Company	Mawer Investment Mgmt
Fund Type	Global Equity Balanced
Rating	B
Style	Large-Cap Growth
Risk Level	Medium
Load Status	No Load
RRSP/RRIF Suitability	Excellent
Managers	Greg Peterson since June 2013
MER	1.09%
Fund Code	MAW130 – No-Load Units
Minimum Investment	$5,000





ANALYSIS: I'm a big fan of Mawer Investments, and their disciplined, risk-sensitive, investor-first approach shines through in this global balanced offering.

While this fund may seem similar to the highly-regarded **Mawer Balanced Fund**, there are some key differences. First, this fund's well-diversified global focus has only about 6% Canadian equity exposure, but 27% in U.S. equity and 25% in international (Europe and the U.K.). The 30% fixed-income allocation is about the same, but the global fund has about a third of its bond exposure in global bonds.

In addition, unlike the Mawer Balanced Fund's fund-of-funds approach, the equity portfolio of the global fund is purpose-built, using the firm's fundamentally-focused, bottom-up stock selection process. The fixed-income sleeve is still invested in the underlying Mawer bond funds.

To build the equity sleeve, the managers use a highly disciplined investment process, looking for wealth-creating companies that are trading at discounts to the managers' estimate of intrinsic value, and that generate high returns on equity. The process is one of the best in the business and includes a rigorous scenario analysis to get a stronger understanding of a company's true worth under a range of situations.

The equity sleeve holds around 70 names, with the top 10 making up about a third of the equity holdings and roughly 20% of the portfolio. Sector and country weights are largely the result of the stock selection process.

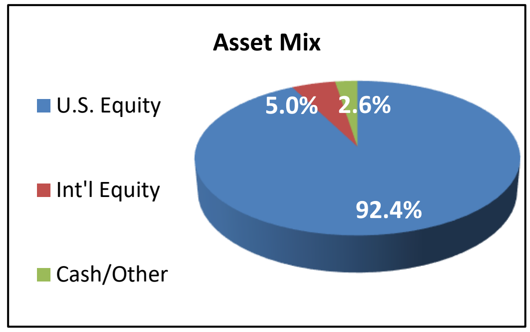
Performance, particularly over the long-term, has been excellent. To March 31, its 5-year average annual compounded rate of return was 5.5%, handily outpacing both the benchmark and the peer group. During the March market meltdown, the fund's quality focus held up, providing capital protection as the fund posted a modest 4.2% loss, for first-quartile performance ranking.

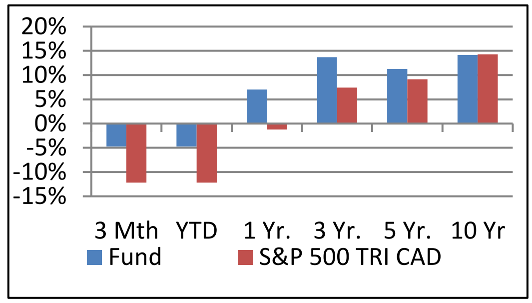
Capital protection has been exemplary. Morningstar shows the fund's downside capture ratio at 64%, indicating less than two-thirds participation of the drop in markets.

Mawer is available in fee-based accounts and directly from Mawer. If purchasing the fund through a dealer, the minimum purchase is $5,000. The manager's focus on quality combined with a disciplined, repeatable investment process make this an excellent core holding for most investors.

Mackenzie U.S. All Cap Growth Fund

Fund Company	Mackenzie Investments
Fund Type	U.S. Equity
Rating	C
Style	Bottom-up Growth
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Richard Bodzy since Sept 2014
MER	2.54%
Fund Code	MFC1537 – Front-End Units MFC7101 – Low-Load Units
Minimum Investment	$500





ANALYSIS: As growth stocks led the performance sweeps over the past few years, Mackenzie's offering has been one of the stronger U.S. equity funds, at least on an absolute basis. With an average annual compounded rate of return of 11.2% to March 31, 2020, the fund, managed by a team led by Richard Bodzy of Putnam Investments, has outpaced both the index and the peer group.

The investment process is a blend of top-down thematic analysis combined with bottom-up, fundamental security selection. Looking for companies that have a high level of growth and an above-average duration of growth, the manager scouts for growing revenues, earnings or cash flows faster than the market, high free cash flow conversion, operating momentum, and a business/ industry where there is a high potential market.

The team then considers themes, such as the advent of 5G telecom and the "Internet of Things," Amazon's influence, digital marketing, personalized medicine, and the humanization of pets.

The next step is to find well-managed companies, whose managements have ownership interest, with strong organic growth in revenue, profit, and free cash flow, with balance sheet flexibility and a history of responsible capital allocation. While not strictly value managers, the Putnam team seeks a price for the growth potential and the industry.

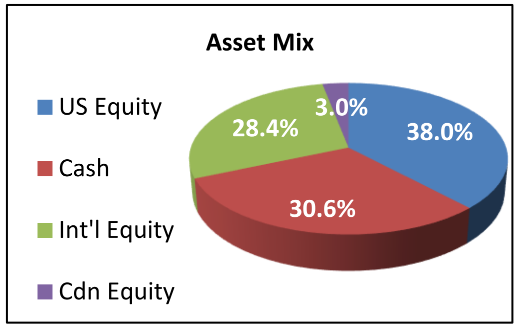
Though the fund has an all-cap mandate, it tends for focus on the large-cap space, and the end portfolio has between 60 and 80 individual stocks. Given its thematic approach, it's not surprising to see the fund is overweight in technology, communication services, and consumer cyclical names.

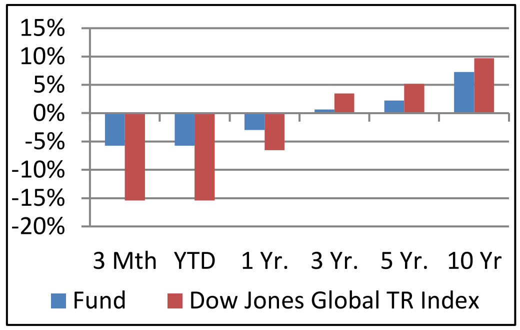
Valuation levels are very high compared with the index and peer group, but this is somewhat offset by the higher-than-average forward-looking growth rates. Despite the very marked growth tilt, volatility has been only slightly above the index and peer group. Capital protection has been decent, with the fund showing a down capture ratio of 81% over the past three years and 100% over the past five years, according to Morningstar Research. Even in March, one of the most volatile months on record, the fund held up surprisingly well, falling 5.7%, outpacing both the index and the peer group.

While I don't expect that the level of performance is sustainable going forward, this growth-focused fund is definitely worth a closer look.

Mackenzie Ivy Foreign Equity Fund

Fund Company	Mackenzie Investments
Fund Type	Global Equity
Rating	D
Style	Bottom-up Blend
Risk Level	Medium
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Paul Musson since Jan 2001 Matt Moody since Jan 2009
MER	2.50%
Fund Code	MFC081 – Front-End Units MFC7017 – Low-Load Units
Minimum Investment	$500





ANALYSIS: The Ivy investment process used in this fund is synonymous with capital preservation. While I haven't been sold on the fund's high cash allocation, the strategy has paid dividends recently. The fund was down only 1.8% in March, very impressive when compared with the 7.9% drop in the MSCI World Index.

Manager Paul Musson and his team use a bottom-up, fundamentally-driven approach that seeks high-quality companies with distinct competitive advantages. The concentrated portfolio consists of 20-30 profitable large-cap companies with strong balance sheets and excellent management teams that are trading at valuations well below the managers' estimates of true worth.

Portfolio turnover tends to be relatively low, and high cash levels are not uncommon – at Jan. 31 the fund held more than 30% in cash. The sector and geographic mix are the result of the managers' investment process. At the end of January, the fund was overweight consumer defensive and healthcare, with underweighting in financials, energy, and technology. While valuations are a tad high, the portfolio scores rather well on several metrics, including financial health and profitability.

The fund's defensive positioning has helped keep volatility in check, with a standard deviation well below the index and peer group over the past three- and five-year periods.

In down markets, the fund has done an excellent job of protecting capital, participating in only 60% of the downside in the past three years and 65% over the past five. However, the cost has been dampened upside participation, with only about 50% over the past three years and just shy of 60% over the past five.

While the fund suffered only a modest loss of 3% over the past year, its 3-year average annual compounded rate of return to March 31 was 0.6%, and 2.2% for five years, trailing both the index and peer group.

While the strong downside protection offered by the fund and its management team is impressive, I'm not convinced it's worth the price in dampened long-term performance. Consequently, I'd likely look at other high-quality global equity funds with a more balanced tradeoff between upside and downside participation.

