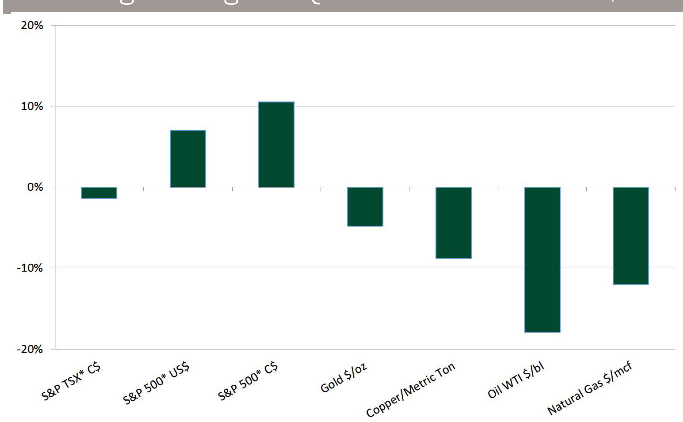
CUMBERLAND

Year End Review
North American Capital Appreciation Strategy
December 2015

The fourth quarter ended up with a pretty decent bounce in U.S. equities but not much of a recovery for the TSX. While commodities like oil (-17.9%), copper (-8.8%) and gold (-4.8%) continued to see downward pressure during the fourth quarter, the performance of the commodity-related equities was more muted. Instead, some index heavyweight stocks such as Valeant, Canadian Pacific Railway and Magna International weighed down the TSX. Much of this was earnings related, either coming up short of expectations for the current quarter or numbers coming down in future guidance. In Valeant's case, issues around disclosure, potential regulatory investigations and now the medical leave of the CEO have pressured the stock. During the fourth quarter, the TSX returned -1.4% while the return for 2015 was –8.3% weighed down by Energy, Materials and Industrials sectors. While the annual number might sound bad, it actually looks good in comparison to the equal weighted TSX index, which was down -14.1% for the year. The equal weighted index is a better reflection of what has happened with the broad range of companies in the index during the year as it weighs each company equally while the headline TSX index is a market capitalization weighted index, meaning it can easily be skewed by the performance of a few large companies.

Percentage Change for Quarter to December 31, 2015



Source: Bloomberg *Total Returns

In Canada, after suffering a mild recession in the first half of 2015, the third quarter GDP growth rate was 0.6%. However, October's GDP at 0% does not point to any real improvement and the recent trends in retail sales and employment continue to look daunting. While the latest reading of October retail sales managed to stay positive at 0.1%, after removing the effects of price changes, retail sales in volume terms declined 0.3%. Employment recovered in October mostly due to temporary work in public administration related to the Canadian elections only to see the unemployment rate move higher in November to 7.1% up from 6.6% in January of 2015. Overall, the Canadian economy continues to look weak especially compared to the U.S. Our Bank of Canada Governor, Stephen Poloz, has made it clear that monetary policy divergence from the U.S. will remain a prominent theme in 2016.

At its December meeting, OPEC failed to reach a decision on production cuts. Any new production ceiling will depend on the co-operation of non-OPEC countries and Iran, which seems unlikely right now. With oil prices where they are, the unemployment rate in Alberta increased 0.4% for the month of November, the highest level since 2010. It's hard to argue with the consensus view that oil prices will remain low for some time but here are some of the facts. The U.S. rig count has dropped from a peak of 1,930 rigs in October, 2014 to 709 rigs today and more specifically, the oil rig count has fallen from 1,609 rigs to 541. Oil production in the U.S. has declined 430,000 bpd (barrels per day) from a peak in June 2015 of 9.6 million bpd to 9.2 million bpd. Crude oil prices are positively correlated with U.S. net imports and net imports to the U.S. are now at the lowest level since 2001 with U.S. production declining and global demand growth on the rise. Also, the Commitment of Traders report, which measures changes in oil futures contracts held by large speculators has normalized. None of this suggests any imminent recovery for oil, especially without the co-operation of OPEC. However, you do need to see these things happen first before you can get a recovery.

The question is *how much of a rise can we get*? Currently the oil futures contract is below $50 through mid-2018 and reaches about $56 by 2024. Economics 101 seems to suggest there has been a permanent downward shift in the supply curve for a commodity that has a steep (inelastic) demand curve. What I also wonder about is

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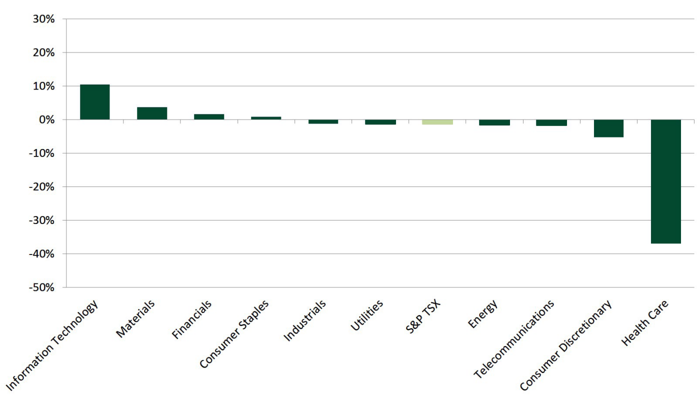
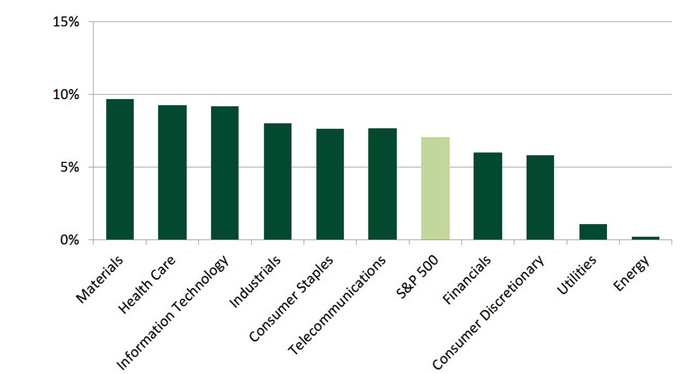
how many electric cars or autonomous vehicles will there be on the road by 2024? How much more efficient will we get at producing hydrocarbons by then? Still, the current low oil price is likely unsustainable in the near term especially given the volatile regions where much of it is produced. While we are not oil bulls, we will be opportunistic about investing in the group. Currently we remain underweight in Energy and focused on low cost producers with downstream refining and marketing exposure that remains quite profitable.

S&P TSX Sector Performance (C$)
4th Quarter 2015



Source: TD Securities

S&P 500 Total Returns (US$)
4th Quarter 2015



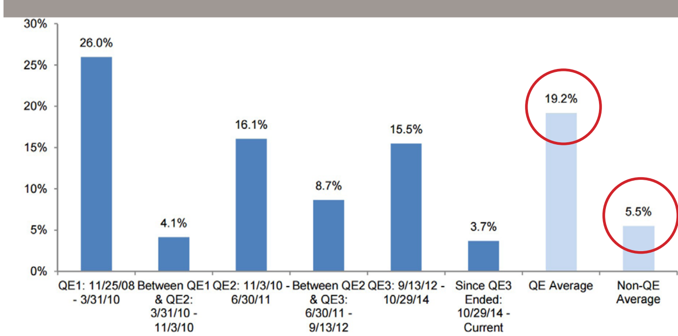
Source: TD Securities

As indicated above, the S&P500 had a nice bounce off its lows this past summer. During the fourth quarter, the S&P500 total return was 7.0% in U.S. dollars. Adjusting for currency, the S&P500 returned 10.5% in Canadian dollars as the U.S. dollar gained almost US $0.03 relative to the Canadian dollar closing at US $0.72. During the fourth quarter, with the exception of Energy and Utilities, the market recovery was fairly broad-based. For the year, the S&P500 return was essentially flat, up 1.4%. However, adjusting for currency the S&P500 returned 20.7% in Canadian dollars in 2015 as the U.S. dollar moved from US $0.86 to the US $0.72 level or about 19% in Canadian dollar terms. For the year, the same sectors that dragged down the TSX held back the S&P 500, namely Energy, Materials and Industrials. The positive performing groups were Consumer Discretionary, Health Care and Information Technology, which displayed some of the best earnings growth in 2015. For 2016 the same groups along with Financials continue to be some of the highest earnings growth sectors within the S&P500. At Cumberland we remain overweight in Consumer Discretionary, Health Care and Financials.

While the economic data from the U.S. has been mixed lately, the U.S. Federal Reserve (FED) finally pulled the trigger on the first rate hike in almost ten years. Strong job growth for November and positively revised data for September and October pretty much sealed the fate of the December increase. The unemployment rate in the U.S. currently sits close to an eight year low of 5%. Meanwhile, there are some signs on the inflation front, notwithstanding the impact of the strong U.S. dollar and low oil prices, that it is also beginning to pick-up. The latest reading on Core CPI came in at 2% for November, which was up from October's 1.9% level. The FED prefers to look at another measure of inflation, the Core Personal Consumption expenditures price index which, at 1.3%, is still running below the FED target of 2%. Having said that, there is a growing consensus that inflation will pick-up in 2016 given the expected wage pressure from the tight U.S. labour market, the downward pull from lower energy prices likely fading through 2016 and slower U.S. dollar appreciation. The jury is also out on the path of rate increases for 2016 which will no doubt influence the level of the U.S. dollar. The majority of the Federal Open Market Committee (FOMC) participants are expecting at least four rate hikes in 2016 while the Fed Fund futures market puts the odds at about two-thirds that there will be two rate hikes. Either way, it suggests to us that the U.S. dollar could remain relatively strong, at least compared the Canadian dollar, assuming this path for rates continues to move higher. The other factor that may influence this is monetary policy action from the European Central Bank (ECB). We got a taste of this in early December when Mario Draghi (President of the ECB) came up short of the market's expectations for stimulus, on what some were calling a policy error. The smaller than expected size of the cut in the deposit rate and lack of further commitment to spend on Quantitative Easing (QE) in the EU caused a sell-off in European markets and a strengthening Euro. However, this was quickly reversed the next day with Draghi reconfirming he would do "whatever it takes" for the third time, including using "further accommodative tools" to meet inflation targets. So, once again we are seeing a divergence in policy in this economy that could ultimately lead to higher asset prices similar to what we have seen in the U.S. over the past few years.

Exhibit 1 shows the S&P500 performance during the three periods of QE as well as the non-QE periods. What it shows is that during periods of QE, the S&P500 generated strong returns averaging 19.2% as compared to 5.5% during periods of non-QE. As we head into a path of rate hikes in the U.S. in 2016, one could argue the U.S. looks less attractive than Europe which has an accommodative ECB that has just expanded its QE program to at least March 2017.

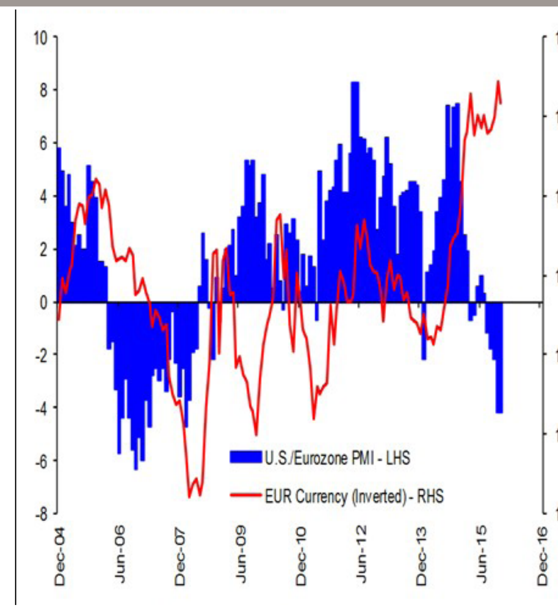
Exhibit 1:
S&P 500 Annualized Performance and Quantitative Easing Programs



Source: BMO Capital Markets

Exhibit 2 compares the U.S. ISM/Eurozone Purchasing Managers Index spread versus the Euro/US dollar. The latest data in Europe shows almost all economies in the Eurozone (with the exception of Greece) are experiencing the strongest growth in manufacturing production and new orders seen in the past year and a half. Meanwhile the U.S. has seen contraction in the latest period. The blue bars in Exhibit 2 show the ISM/PMI spread turning negative, a potential sign of a bottom for the Euro currency.

Exhibit 2:
U.S./EurozonePMI Spread vs. EUR -USD



Source: Scotiabank GBM Portfolio Strategy

During the quarter, the biggest change to our asset mix was the shift back to cash as the S&P500 approached its pre-correction highs of last summer of 16.7x after hitting a low of 14.8x during the last week of August 2015. The S&P500 currently trades at 16.3x forward earnings. The increase in valuation combined with some year-end tax loss selling resulted in our equity weighting decreasing from 88% to 84%. While we are still constructive on the U.S. economic outlook for 2016, the reality is that earnings estimates for 2015 and 2016 have continued to decline since last summer. S&P500

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bottom-up earnings estimates for 2015 are now slightly negative at -0.5% from +0.7% last quarter. The energy sector has clearly been impacted heavily, along with the effects of the strength of the U.S. dollar on translated foreign denominated income. However, 2016 earnings estimates continue to move lower. As it stands today, the outlook for earnings growth for the S&P500 for 2016 is just under 8%. If there is a silver lining, we are overweight in, Consumer Discretionary (+14.8%), Heath Care (+10.0%) and Financials (+8.5%), which are amongst the strongest earnings growth sectors for 2016 and constitute 61% of the equity portion of the portfolio.

Asset Allocation for Capital Appreciation Portfolios As at December 31, 2015	
Equities	84%
Fixed Income	5%
Cash	11%

During the quarter, we continued to add to our Healthcare weight with Allergan and Cigna Corp. Following the sale of its generics business, Allergan will become a pure play pharmaceutical company along with an attractive recession resistant aesthetics business. Subsequent to our investment in Allergan, Pfizer announced an all-stock friendly takeover deal for the company, which has resulted in an unrealized gain in a short period of time. We also added Progressive Waste Solutions. It is the fourth largest integrated solid waste management company in North America with about 60% of its revenues coming from the United States. The Company is committed to delivering on its five year plan that should improve profit margins, free cash flow and return on invested capital. This, combined with improving industry pricing and volume growth, should provide a positive tailwind for its business. We also switched Atco (the majority owner of Canadian Utilities) for Canadian Utilities (CU). We believe the regulated utility earnings for CU should benefit from robust rate base growth over the next few years. With the unregulated operations now near breakeven, any further decline should be more than offset by utility growth. A complete summary of new positions added during the quarter including business fundamentals and valuation metrics is contained in Appendix 1.

Outlook

It is now evident that the decline in the market last summer was in fact a correction rather than a move into bear market territory as the S&P500 did rally back almost 13% from its correction lows. We highlighted our belief that this was the case as a number of indicators we watch such as the shape of the yield curve, the Institute for Supply Management (ISM) data and credit spreads were not indicating market stress. On review of those same indicators today, they suggest a less bullish stance on the economy than before. The shape of the yield curve (10-year Treasury and - 2-year Treasury), while still positive sloping, is less positive today at a 1.2% spread versus 1.4% and 1.7% in September and June, respectively. Since September corporate bond yield spreads have tracked lock step with 10-year treasuries. However, junk yield spreads have continued to widen suggesting further stress in this market. Also for the first time in 36 months, the U.S. manufacturing sector contracted in November, as measured by the ISM data coming in at 48.6. By the time this review is out, we will have another data point, which may help to confirm whether or not this manufacturing contraction is an inventory correction or not. Overall, U.S. retail sales are still pretty good so one data point certainly does not make a trend. As we mentioned above, the S&P500 has recovered from a valuation perspective. And is now trading at 16.1x 2016 earnings estimates, which is slightly above the long term average of 15.4x. This resulted through a combination of both higher 'P" (price) and lower "E" (earnings). Our equity risk premium analysis has also moved back to neutral given the lower earnings coming through, higher yields and recovery in equity markets in the U.S. from last quarter. To some degree our move to cash and purchase of what are seemingly more defensive securities is a reflection of a more cautious tone in general. In Canada, it seems much of the bad news is priced in and with the valuation for the TSX at 14.3x 2016 earnings, it is

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definitely more attractive compared to its long-term average (15.4x). However the TSX also feels like the most unloved market in the world right now reflected by its underperformance to the S&P500 five years in a row. There is no period in history that this happened for a sixth year. Even our Canadian banks, which have been expensive relative to their U.S. counterparts are beginning to look cheap again. The poor outlook for the Canadian economy continues to push against this group; however, it has consistently generated high teens return on equity and annual dividend growth. It should not be surprising at some point in the future to see us move back into Canadian financials as these are probably a lower risk way of moving some of our U.S. dollar exposed assets back to Canada without trying to call the bottom in the commodity market.

Finally, international markets may be more interesting from a risk return basis over the short to medium terms, trading at 15x 2016 earnings. As such, you may also see us allocating some capital to international markets in the coming months.

Peter Jackson
Chief Investment Officer
January 3, 2016

Appendix 1
New Equity Investments:
North American Capital Appreciation Strategy
Quarter ended December 31, 2015

United States

Allergan

Originally a manufacturer of generic drugs, Allergan has transformed itself over the past decade through a series of transactions to become a diversified branded pharma company focused in seven specialty areas with limited patent risk. Following the sale of its generics business to Teva which should close by the end of the first quarter of 2016, Allergan will become a pure play pharmaceutical company with an innovative R&D driven business along with a recession resistant aesthetics business.

Subsequent to our investment in Allergan, Pfizer announced an all-stock friendly takeover deal for the company. The rationale for Pfizer was two-fold. Allergan, being an Ireland-based company, would be an ideal inversion vehicle for Pfizer to move its headquarters overseas and thereby benefit from being domiciled in a low tax regime. Pfizer was able to structure the transaction and gain the full benefits of tax inversion as dictated by the updated U.S. Treasury rules that were issued in November. A second motivation for Pfizer was to gain Allergan's young and growing list of products, which would help offset Pfizer's slowing and aging revenue base. We expect the transaction to close in the second half of 2016 following regulatory review.

Cigna Corp

Cigna Corporation, a health services organization, provides insurance and related products and services in the United States and internationally. The Company's commercial segment offers insured and self-insured customers medical, dental, behavioral health, and vision, as well as prescription drug benefit plans, health advocacy programs, and other products and services.

There was brisk consolidation activity in the health insurance sector this summer, with the announcements of three managed care transactions within weeks of each other - Aetna for Humana, Centene for HealthNet and Anthem for Cigna. Cigna received its formal takeover offer in cash and stock from Anthem in July, after rumors first surfaced in May. The transactions were in response to Obamacare where insurance companies felt they had to bulk up in order to compete effectively in the new landscape as previously uninsured Americans were now receiving health coverage for the first time.

Investors were skeptical if the three deals would receive federal approvals, which was one reason for Cigna's stock price trading at a significant discount to the offer price. Furthermore, the merger arbitrage widened in October following comments from Mrs. Hillary Clinton on the campaign trail. Our view was that the regulators would bless the acquisition of Cigna given little product and geographic overlap with Anthem. Moreover, the managed care sector was fragmented enough to support the current round of deal making. We believe investors are now beginning to factor the likelihood of approval as the deal spread has come in. In the event the regulators were to reject the transactions, we believe, the downside for Cigna's stock price is low and the company has a nice tailwind of new applicants and favorable price environment to operate effectively this year.

Canada

Canadian Utilities

Canadian Utilities generates a significant majority of its earnings from regulated utility operations in electricity and natural gas distribution where a regulated rate of return is applied to a calculated rate base. While utility earnings rose decently based upon an expanding rate base in 2015, these were overwhelmed by a significant fall-off in the much smaller unregulated power generation operations causing the stock to fall to an attractive valuation level. Going forward, utility earnings should again benefit from robust rate base growth and with the unregulated operations near breakeven any

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further decline should be more than offset by utility growth. This Company has increased its dividend every year since 1972 and provides a defensive position at an unusually attractive level.

Progressive Waste solutions

Progressive Waste Solutions is the fourth largest integrated solid waste management in North America with about 60% of its revenues coming from the United States. It provides waste collection, transfer station, landfill, and recycling services to residential, commercial and industrial clients. We believe that Progressive's current management will execute on its plan to improve profitability by operating more efficiently and by being disciplined capital allocators. Further, we think that headwinds to the waste disposal industry are subsiding and that Progressive will benefit from better pricing and volume growth over the next few years.