Global Equity and International Fund Strategies
First Quarter 2016 Review

Global Macro Review

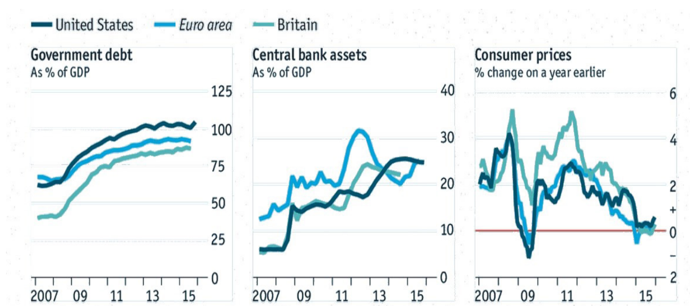
If you went away at the beginning of the year and came back at the end of the quarter, you might think that not much took place over the last three months. Well, in a way, that is true. We ended the quarter about where we started, despite the wild rollercoaster ride in the interim, with main equity indices dropping to multi-year lows and then rebounding. The tumultuous first six weeks was caused by key macro concerns centered on China, oil uncertainty, geopolitical risks and skepticism around growth in general. Widening credit spreads in January, especially in the Energy sector added to the apprehension. 50% of distressed high yield debt is in this area! However, the WTI oil price moved back up to U$38 at quarter-end from the low of U$26 in mid-February, high yield spreads narrowed, and the China devaluation concerns also seemed to diminish. Global equities, which had formally entered a bear market in mid-February, quickly reversed into one of the best low quality trade rallies in recent memory.

V-Shaped Recovery for Major Indices for First Quarter 2016

Source: Bloomberg

We observe that more than 650 central bank interest rate cuts have taken place in the past seven years without a lot to show for it given global growth is around 3.2% during this time period compared to an average of 4.2% in the decade before the crisis. Several central banks have found an option in taking yields down to negative territory. However, so far, negative interest rate policy (NIRP) have been ineffective at achieving the central banks' objectives of curbing currency strength and boosting inflation expectations. This may be the case because the market believes NIRP is an over-reliance on monetary stimulus or perhaps a case of the market becoming desensitized to new forms of monetary stimulus. Whatever the case may be, it is a concerning situation if the market loses confidence in the central bank stimulus. While this is a tail risk which we are aware of, we currently do not believe it diminishes the investment case.

Not so Pretty a Picture



Source: Economist, Haver Analytics

Japan has relied heavily on quantitative easing with seemingly diminishing returns. In fact, recent quantitative easing measures have led to an increase in the Yen relative to the US dollar, which is contrary to the government's objectives. Japan's surprise move to negative interest rates at the end of January confirmed the limits of quantitative easing. The challenge for the Bank of Japan is their need to continue with any type of policy in order to achieve their objective of 2% inflation. The timeline to hit this target has been pushed out to the second half of 2017 given the core CPI (ex-fresh food and energy) was +1.3% in January which is up only marginally from the +1.2% in December.

For the first time ever, the 10-year Japanese government bond yields went into negative territory. However, the negative interest rate policy has yet to have its intended positive impact, as witnessed in our recent meetings in Tokyo. The negative interest rate is only for excess reserves and not for reserves institutions are required to keep at the Bank of Japan. Therefore, if the theory works, this should help prop up borrowing demand related to capex, real estate, housing and meeting the government's demand goals. In late March, Japan's Finance Minister Taro Aso stated that it may take more than three months for the negative interest rate policy to take effect. This was followed by a statement by a Bank of Japan board member noting a requirement to monitor the adverse impact of negative rates on the banks.

In our view, the unintended consequences of negative interest rates will not be limited to the decline in the net interest margins of the banks. Vulnerable areas also include reduced credit creation to the real economy, impaired functioning of money markets, reduced liquidity in bond markets, and higher bank lending rates. Some of these occurred when Swiss and Danish banks posted their negative rate policy in 2015. Furthermore, it has been surmised that the movement towards a negative interest rate policy has contributed to the financial market volatility in the past few months. The rationale behind this conjecture is that while negative interest rates provide lower government bond yields, it may be causing wider credit and equity risk premiums from a more stressed banking system.

Overall, commodities, currencies and central banks are controlling the market narrative. Thus, the most challenging experience of this first quarter has been to remain true to our fundamental investing style while stock prices were responding more to the macro issues mentioned above. We are still of the view that we need to concentrate on identifying the organic growth derived from the corporate and the economy rather than relying on the support provided by central banks. The first quarter reporting season will take place in a couple of weeks. It will be interesting to see whether the companies will provide much needed momentum. We should not lose sight of the fact that 60% of the earnings for the S&P500 Index are coming from the Tech, Consumer, and Financials sectors while the Energy and Materials sectors together provide only 5% of earnings while the noise in the market seems to be focused on these latter two sectors.

Europe

During our recent visit to London to attend an industrials conference, the companies reported a challenging macro environment still exists and consumer spending remains cautious. The end-markets that continue to be positive are autos, aerospace, and non-residential construction. It is comforting to have this confirmed as these end-markets are where we have exposure in our portfolios.

It should not come as a surprise that resource and marine related industries remain under significant pressure. Current orders are below replacement levels for both mining and marine companies and yet, there is a lack of visibility as to when orders will normalize.

Global industrial companies have generally cited Europe as the strongest geography, albeit still in the low single digit growth area after years of being the worst performing geography. Consumer confidence began this year near a nine-year high and independent surveys show that both investor and corporate expectations remain above their respective long-term average.

We wrote at some length of Brexit in our last quarterly and so, we shall limit our commentary on this topic. Suffice to say, the uncertainty is still elevated with the polls split almost evenly between the "Stay" and "Leave" camps. The referendum on June 23 will be the most crucial event for both Britain and Europe. We can expect much politicking from both sides. The "Leave" camp is playing on the issues surrounding the migrant crisis and fears from the recent terrorist attacks in Brussels. The possibility of Brexit has driven the British pound's volatility to its highest level in almost five years as well as taking it to a seven year low.

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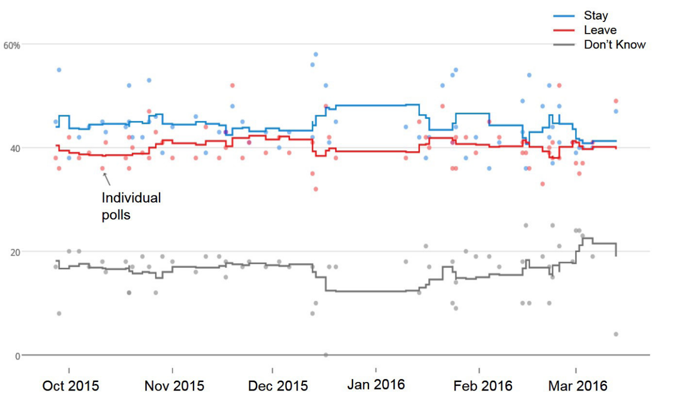
Brexit: poll of polls



Source: Financial Times

The headlines of the migrant crisis have moved off the front pages but that does not mean this crisis has gone away. The migrant crisis is feeding xenophobia and the divisive nature of the right-wing nationalism has taken hold in Europe. The debate continues on immigration and national security with no easy solution in sight.

Asia

We had a number of corporate meetings in Japan and Singapore in early March. Their sentiment was generally an echo of the global industrial companies we met in London. Of course, the impact of China and the emerging markets were felt more strongly in many of the Asian companies given the source of growth was derived from these two regions.

Japan started the quarter with their worst first week performance since 1997. This is reflecting the worst business conditions in Japan's manufacturing sector since the early days of Abenomics. The Bank of Japan's quarterly Tankan index decelerated in March (+6) compared to December (+12) which is the worst since June 2013. It was actually heartbreaking to meet with some of the Japanese companies. After close to two decades of deflation, there was a glimmer of hope when Prime Minister Abe promised great reforms with his Abenomics and his Three Arrow policies. However, the last round of consumption tax in April 2014 combined with negative interest rates is forcing residents to save even more and is resulting in retailers having an even tougher time showing growth. There is now speculation there will be a delay in hiking the consumption tax from 8% to 10% next April.

Despite these headwinds, the Japanese demonstrate their resilience with leadership in certain industries and technology. One of the secular themes where Japan has much exposure is advanced driver assistance systems (ADAS). Although it is still early days, a number of companies are developing interesting technology to make an autonomous car accessible for the general public in the near future. This is an area where we have spent some of our time researching given relevant companies in Japan.

China is the world's second largest economy. The fear of slower growth in China is provoking a lot of anxiety in the markets. The key question is what the expectations should be going forward. It is always dangerous to give one sweeping answer because it obviously depends on the industry. There are certainly some areas where the impact has been dramatically negative such as luxury goods with the central government's crackdown in bribery. We sold our position in Richemont given its direct exposure to the luxury market. Construction and manufacturing exposed companies also continue to experience weakness as many industries, particularly those related in infrastructure and commodities remain in oversupply. Our meeting with Komatsu in Tokyo confirmed that a "bubble of equipment" remains in the market, especially in the excavator sector.

Singaporean banks have taken the precaution of taking a provision for their business in China. They have conducted various stress tests to ensure they have sufficient capital to sustain a certain level of negative shock from China. It is evident that China's growth has slowed. The approach we take on the region is to have exposure in areas that we believe will experience sustainable secular growth rather than in sectors that require government funding to maintain that growth such as infrastructure spending.

Emerging Markets

Emerging markets recovered during the first quarter from monetary easing by major central banks as well as firming of oil prices and other commodities during the latter part of the quarter. However, sovereign debt of more than ten emerging market countries was downgraded during the

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quarter. The markets have become very cautious about emerging markets and concerned whether we are to experience another version of the 1997 Asian crisis. In our meetings with companies in Singapore, they stressed that many emerging market countries have ended their currency pegs to the dollar, built up foreign reserves and issued more debt in their own currencies, thereby diminishing the probability of another Asian crisis taking place again.

The Chinese equities markets, with their dramatic moves at the beginning of the year, triggered an extremely negative start for financial markets in the emerging markets. The measures put in place by the Chinese central government such the lock-ups on share sales by shareholders owning greater than 5% was coming to an end and an increased pace of depreciation in the Renminbi contributed to the market volatility. The Chinese February Manufacturing PMI came in at 50.2, which is the first expansionary print since July 2015, and is definitely a positive development. On a longer-term issue, a demographic crisis is looming with plunging birth rates and a population explosion of elderly people. If China does not reform, there is risk they may slide into economic stagnation, similar to that of Japan.

Portfolio Review

With the elevated concern over emerging markets, it may be worthwhile to re-iterate our strategy for this market. We are currently not invested in any companies in emerging countries directly. However, we do have exposure to many interesting emerging markets through our globally diversified companies that dominate in their business. For example, Unilever, one of the world's leading consumer products company has 60% of its revenue from emerging markets while Essilor, the world's largest lens manufacturer has 21% exposure to this area. Our companies invest in emerging markets for the long-term and take prudent measures to not be overexposed to any one country. They are also sophisticated in dealing with currency swings, which is always a risk in these countries. Our exposure in emerging countries tends to be reliant more on the growth of the consumer rather than exposure to any commodities due to our belief that the growth of the developing world is currently and will continue to be a larger part of the global economy.

Cumberland Global Equity Portfolio

Our Global Equity portfolio had a total return for the first quarter of -6.98% (C$) compared to its benchmark return of -6.49%. In U.S. dollar terms, the return was +0.14% (US$) vs. the MSCI World Index at +0.43% (US$).

The main contributor to this quarter's performance was stock selection. The key contributors were TJX, Comcast, Honeywell, and Accenture while the underperformers were Citigroup, Alexion, and Toyota. Our portfolio was underweight in the two best performing sectors for the quarter which were Utilities and Telecommunications. It is evident the market is still searching for defensive exposure and yield given the volatile equity backdrop in the first quarter. With secular growth in Healthcare given the ageing population, we continue to have a high weighting in Healthcare; unfortunately, it was the worst performing sector this quarter. There has been some pressure on the Healthcare sector in recent months given the platforms of several U.S. presidential candidates whereby they are targeting the pharmaceutical industry in general.

Generally, we were pleased with the earnings reports provided by our portfolio companies earlier in the quarter. TJX reported strong fiscal year-end numbers from stronger than expected same store sales in both their US and Canadian operations. Their solid delivery was particularly astounding given the lackluster results from many of their brick and mortar competitors. TJX's outperformance confirms their ability to execute on their differentiated business model which we believe is their competitive advantage. Comcast delivered strong subscriber growth in their cable business during the quarter as they continue to execute well and increase their market share. Honeywell delivered another solid result from their ability to execute in the challenged macro environment we discussed earlier. They continue to deliver top-line growth as well as expanding their margins along with an excellent track record in capital allocation. Accenture also impressed the markets with their strong results and raising their guidance for the current fiscal year. Similarly to TJX, this is rather impressive given the cautious commentary from Accenture's competitors. Accenture invested ahead of the curve in key growth areas such as digital and is now benefiting from their vision.

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Citigroup and Alexion were among the companies we sold during the quarter. They were also among the more volatile stocks within our portfolios and had hit our non-discretionary loss limit which caused us to sell them from the portfolio. Another U.S. name we sold in the portfolio was our long-term holding in American Express. This Company exudes service excellence as well as prestige, like the clientele they serve. Although we believe in the long-term structural growth of credit cards, American Express has been experiencing stronger competitive headwinds particularly from Visa, which is also a holding in the portfolio. We sold two European names: Richemont and Publicis. As mentioned earlier, we sold Richemont due to the headwind in growth from China, which is a quarter of the global luxury market. Publicis has been experiencing certain headwinds as they are attempting to change its organization more radically than any other agency. In addition, they are dealing with client losses while organizing succession for its long-standing CEO. Our experience has been that it may take longer than anticipated to fix these growth issues.

We added two iconic American names, Coca-Cola and Apple to the portfolio during the quarter.

As you are aware, Coca-Cola is the global number one beverage company with strong brands, premium pricing and significant scale advantages. Although they are largely reliant on carbonated soft drinks, the Company continues to expand into other faster growth product verticals including energy drinks, juice, water and tea. Coca-Cola is undergoing a significant amount of operational and strategic change and the market has not priced this potential.

Apple, also very well known, designs, manufactures and markets mobile communication devices, personal computers, tablets and portable digital music players. The Company is viewed as an innovation leader and over the past 15 years it has revolutionized the music industry with the iPod, the mobile industry with the iPhone and the PC industry with the iPad. As Apple adds more services and products, the ecosystem should become stickier and drive incremental profit dollars. At its current valuation of less than 12x P/E and 1.9% dividend yield, we believe investors are getting a free option on Apple's ability to innovate.

Cumberland International Fund

During the quarter, the Cumberland International Fund had a return of -6.53% (C$) vs. its MSCI EAFE benchmark's return of -9.0% (C$), outperforming the benchmark by 2.5%. In U.S. dollars, the Fund returned –0.4% (US$) during the quarter vs. the MSCI EAFE benchmark's return of –2.25% (US$).

With the sale of two European names (Richemont and Publicis discussed under the Global Equity Portfolio), the cash level increased to slightly over 20% during most of the quarter. The higher level of cash helped during the first two months while the market was declining but it detracted from performance during the rebound that took place in March.

There was a strong rebound in the oil price in March and as such, the Energy sector was the best performing sector in the quarter. Our underweighting to this particular sector dampened our outperformance. However, our underweight exposure to the Financial sector helped our performance as this sector underperformed. Overall, the key contributor to this quarter's performance was the stock selection. In terms of individual names, the largest contributors were Accenture, Samsonite, and Tyco while the detractors were Publicis, Allergan, and Toyota.

Similar to the Global Equity Portfolio, we were generally pleased with the earnings reports of our International holdings. Samsonite and Tyco stood out during the quarter as a result of corporate actions. In addition to reporting strong fiscal 2015 results with margin improvement amidst a more challenging macro environment, Samsonite announced the acquisition of Tumi, a leading high-end luxury luggage brand. The market took this news favorably with the expectation Samsonite will be able to integrate Tumi's operations and thereby improve on margins and top-line growth. When Tyco announced their agreement to merge with Johnson Controls, the shares of Tyco moved up 11.6% on the day. Despite this positive move on the shares, we do not believe the market is valuing the potential synergies to its full potential. Post the merger, Tyco shareholders will own about 44% of the combined entity and will become one of the largest players in building products and services.

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Index Performance

The total returns of the global markets for the first quarter in US$ and local terms are:

Indices	Q1 2016 USD Return%	Q1 2016 Local Return%
MSCI World	-0.4	-0.4
S&P 500	1.4	1.4
Canada S&P/TSX	11.4	4.5
Euro Stoxx	-3.3	-7.7
MSCI Emerging Markets	5.7	5.7
Germany DAX	-3.2	-7.2
UK FTSE 100	-2.2	0.1
France CAC 40	-0.6	-5.1
Switzerland SMI	-7.3	-10.2
Japan Topix	-5.8	-12.1
Hong Kong hang Seng	-4.8	-4.7
Korea KOSPI	5.0	1.8

Outlook

It has been a difficult first quarter given the elevated level of volatility and we expect this to be the playbook for the rest of 2016. The diverging policies of the central banks has also added to the uncertainty. However, we are optimistic that quality companies will continue to shine in the slow growth environment we have become accustomed to. As we wrote earlier, the ability of central banks to generate inflation is questionable. On a macro level, however, the lower costs for energy and other inputs should make its way to the US consumer which is 70% of the economy and thereby reflect its positive impact on the overall economy. As a result, investors need to focus on company fundamentals and their ability to have pricing power and increase market share. We are still of the view that a strategy of having a portfolio of companies with these characteristics is the best strategy given a cyclical rally is currently not supported by earnings growth.

The MSCI World benchmark is expecting earnings to be U$113 in 2017 for an earnings growth of 13%. The 2017 Price to Earnings (P/E) valuation of 14.7x is slightly higher than the ten-year average of 12.7x. While we do not believe the market is extremely inexpensive, there are certain areas where we should be able to make additions to the portfolio. We expect our portfolio companies to grow their earnings at a rate exceeding the market average for the coming year and overall, we still believe earnings growth from quality companies are the key to good investment performance. Furthermore, both the International Fund and our Global Equity Portfolios have higher return on equity metrics than its market index while having a lower beta metric, making the portfolios less volatile than the market.

S. Yang
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April 5, 2016