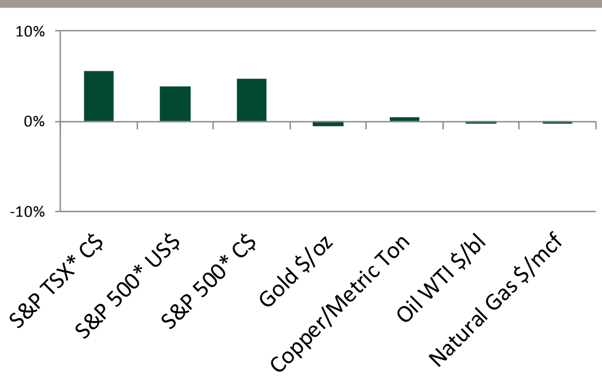
CUMBERLAND

North American Capital Appreciation Strategy
September 2016

Unlike the first quarter of 2016 where we experienced a fairly swift correction on global growth concerns, fear of rising interest rates in the US, falling commodity prices and the second quarter Brexit surprise vote, the third quarter has been relatively quiet from an economic and political standpoint. Perhaps this lull, combined with a relatively benign quarter for earnings, was the right combination that allowed markets to grind higher.

During the third quarter, the S&P500 total return was 3.9% in US dollar terms. Adjusting for currency moves, the S&P500 returned 4.7% as the Canadian dollar fell about one cent to US$0.76. Year to date, the S&P500 total return was 7.8% in US dollar terms but adjusting for currency moves, the S&P500 was up only 2.2% due to the Canadian dollar appreciation from US$0.72 at December 31st. In Canada, the TSX total return for the quarter was 5.5% and year to date was 15.8%. The strong returns in Canada reflect the rebound in energy and materials, in particular oil and gold, which have risen 30.2% and 23.9% respectively year to date.

Percentage Change for Quarter to September 30, 2016



Source: Bloomberg * Total Returns

The Federal Reserve Open Market Committee (Fed) remained on the sidelines through the third quarter announcing no interest rate increases for the time being; however, the wording of their September statement, which suggested that the economic outlook appears roughly balanced, was very similar to the wording from their December 2015 statement when the Fed actually increased interest rates by 25 basis points. Slowing consumption growth, as evidenced by weaker retail sales through the summer, and surprisingly weaker manufacturing data may have kept the Fed on the sidelines for now. The ISM manufacturing index did drop below 50 in August, a reading suggesting contraction, following five consecutive months of expansion. However, we did see a bounce back in September, after the Fed announcement, suggesting a more positive trend. Meanwhile the core PCE inflation rate, the Fed's preferred inflation measure, at 1.69% is still below its long term objective of 2%.

As we start to lap last year's lower energy prices and prices of non-energy imports due to the lower US dollar we expect inflation should begin to pick up. Strength in the US jobs data, where the unemployment rate remains at an eight year low of 4.9%, with wage growth of 2.4%, are indicative of a strong labour market and continued growth in US economic activity. Fourteen of the seventeen Fed officials do expect one rate hike this year. Being an election year, it is not expected that we will see a move by the Fed prior to the election, which only leaves the December meeting if the Fed does indeed raise interest rates this year.

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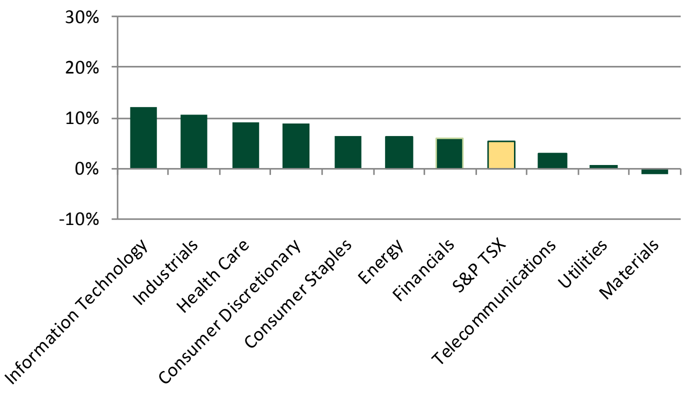
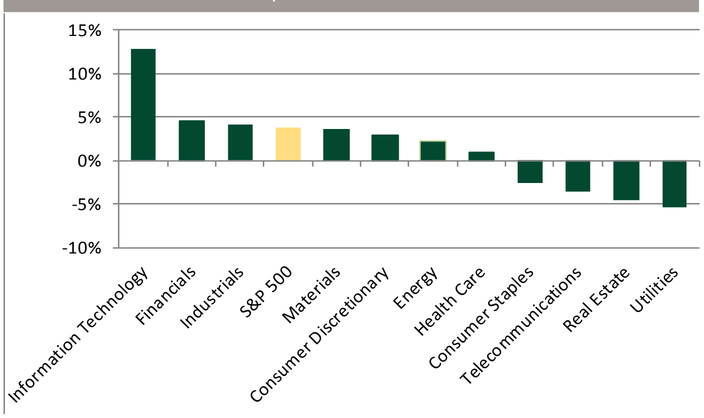
S&P TSX Sector Performance (C$)
to September 30, 2016



Source: Bloomberg * Total Returns

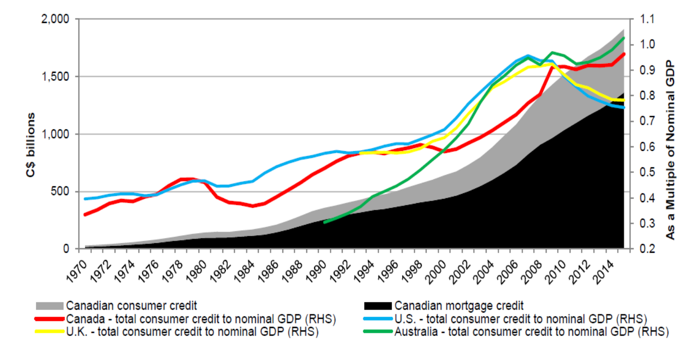
S&P500 Total Returns (US$)
to September 30, 2016



Source: Bloomberg * Total Returns

Economic growth in Canada during the second quarter decreased -0.4%, after increasing 0.6% in the first quarter of 2016. Even excluding the impact of the wildfires in Fort McMurray, real GDP grew only 0.1%. Household final consumption continues to be an area of strength but this worries us given the rise in Canadian consumer and mortgage credit. The chart below shows the sharp increase in consumer and mortgage credit in Canada over the past few years driven by exceptionally low interest rates, such that as a percentage of GDP, Canada is now approaching the same levels we saw in the US during the financial crisis. Meanwhile the unemployment rate at 7% in Canada has been stuck at this level for the past five years. While the Bank of Canada expects a pick-up in growth in the back half of 2016 as oil production recovers, it is hard to see the bank remaining anything but accommodative through the balance of 2016 and likely into 2017.

Canadian Credit Growth
Total Consumer Credit as a Multiple of Nominal GDP



Source: Veritas Investment Research

Second quarter earnings marked the fifth consecutive quarter of year over year decline for the S&P500 earnings. The results, which came in at -3.5% for the S&P500, were actually an improvement from the estimated level of -6.2% going into reporting season on June 30th. The third quarter, yet to be reported, is still pointing negative at -2.1% for the S&P500; however, since the recession in 2009 the actual numbers have consistently come in about 4% better

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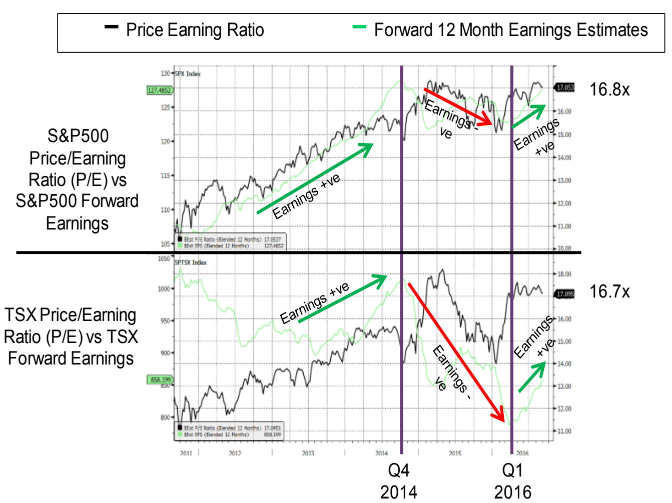
than the estimates. So it would not be a surprise to see this number end up being slightly positive, which would mark the end of the five quarter earnings recession.

Currently the S&P500 and TSX are trading at 16.8x and 16.7x forward earnings, which is not cheap by historical standards. However, this chart below, which compares the Price Earnings Ratio (the black line) for the S&P500 and the TSX to the Forward 12 month Earnings estimates (the green line) for the S&P500 and TSX suggests that markets may still move higher.

S&P Price/Earnings Ratio



Source: Bloomberg

As you can see, coming out of the financial crisis of 2008, the earnings growth for both markets was generally positive up until the fourth quarter of 2014. The Price Earnings Multiple also rose through this period commensurate with the earnings growth. Then from the fourth quarter of 2014 up until the first quarter of 2016 valuations for the S&P500 and the TSX remained range bound between about 15x to 17x for the S&P500 and 14x to 18x for the TSX. We believe this reflected the declining earnings trend (the red line) for both the S&P500 and TSX, with the TSX earnings decline exaggerated by the large drop in commodities prices given their weight in the TSX composite index. Earlier this year, we had a 10% correction in January on concerns discussed above and another 6% pullback on the Brexit news, yet the market has continued to look past these events. As indicated by the green arrows on the right in the chart, Forward Earnings Growth for both the S&P500 and the TSX turned positive around the end of the first quarter 2016 in both markets. We believe that the trend in the direction of earnings is just, or perhaps more important, than considering just the valuation of the market on its own. As long as earnings continue to rebound we believe markets can still move higher. Estimates for 2017 and 2018 earnings for the S&P500 are $132.6 and $148.1 respectively, representing growth of 13.4% over 2016 and 11.7% over 2017. Clearly we must take these estimates with a grain of salt but the negative trend on forward earnings from the end of 2014 through the first quarter of 2016 appears to have reversed. As we are close to the inflection point where year over year earnings could potentially turn positive, it's not unusual for multiples to expand ahead of that earnings inflection point.

Asset Allocation

Asset Allocation for Capital Appreciation Strategy
As at September 30, 2016

Equities	89%
Fixed Income	5%
Cash	6%

Our asset mix was largely unchanged from the previous quarter as equities remained at 89% while fixed income increased 1% and cash declined by 1%. The split between

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US and Canadian equities is about 50% US and 39% Canadian. Similar to the income fund we added a small weighting to an Enbridge US pay rate reset preferred currently yielding just under 5.5%. While the yield on this preferred is attractive for this high quality paper, the rate reset feature will protect the principal value should interest rates rise in the future south of the border. Also given our view on the Canadian economy versus the US discussed above, we are more in favour of holding more US securities and cash at this time. Currently our total US holdings represent about 52% of the portfolio and are unhedged.

Sector Allocation

Other than our weighting increase in technology, our sector weightings did not change materially from last quarter. In technology we added Sabre Corporation. Originally spun out of American Airlines, Sabre provides global traveler booking solutions to the travel and tourism industry. With over 400 airlines, 125,000 hotels and 200 tour operators using its systems it is a virtual global oligopoly with the two leading players controlling 72% of the market. The other 30% of its revenues come from the sale of cloud-based software to the airline industry for services such as crew management and central reservations system software. Passenger volume growth is expected to increase at 1.5x Global GDP and this combined with the fast growing cloud segment, we expect free cash flow at Sabre to accelerate. When they announced their second quarter, in order to accommodate agency wins that will increase market share, Sabre pulled forward their capital spend from 2017 into 2016, which reduced free cash flow guidance in 2016. The stock retreated on this news and we took the opportunity to add it to your portfolio. The rest of the weighting increase in technology reflected the share price appreciation from Visa, Microsoft and Apple.

In the Financial sector, we shifted some of our Canadian bank weight in favour of Canadian lifecos with the purchase of Great-West Lifeco. In the first eight months of 2016, lifecos have underperformed Canadian banks by 22%. Lifeco valuations are currently at extreme lows largely brought on by the headwinds of lower interest rates and in the case of Great-West Lifeco, Brexit risk concerns. At this point in time, we believe much of the concerns are fully reflected in the share price. At the time of purchase the dividend yield was 4.3% and the stock was trading at under 11x next year earnings with a forecasted return on equity of 14%. We believe this represents a good entry point for Great-West Lifeco.

In the Consumer Discretionary sector, we added Lowes Companies. Lowes is a leading retailer of home improvement products with the number two market share in the US. We believe the macroeconomic indicators in the US suggest the housing market is currently at mid-cycle levels with some room to grow from here. Climate change, favourable demographics and strong consumer credit growth, combined with rising incomes in a strong labour market should continue to provide a tailwind for this industry going forward for some time.

In the energy sector, our view is unchanged and we remain overweight. While there has been talk in the past number of weeks regarding an OPEC freeze or ceiling on production, we are not sure any official decision on output means a whole lot any more. The reality is that world oil supply and demand are becoming more balanced and we think any output ceiling would be more symbolic than anything as most countries are

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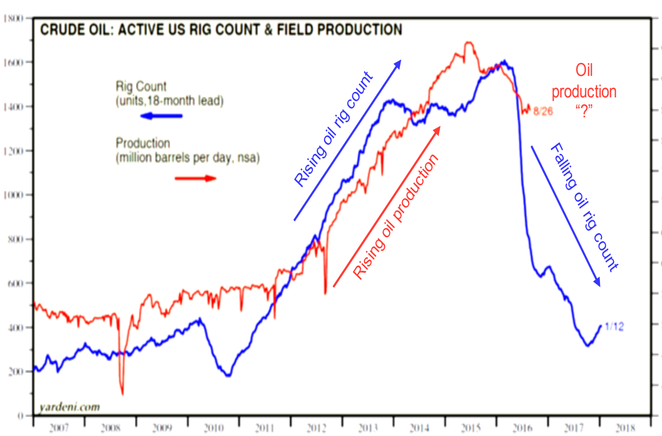
now producing at maximum capacity. We currently see global oil demand growth from 2014 through 2017 of about 4.0 mm bpd. Total non-OPEC supply during this period is expected to remain essentially flat with the call on OPEC production making up the difference, essentially using up what's left of excess capacity in OPEC. In the chart below, we compare the active US oil rig count with an 18-month lead (the blue line) to US oil field production (the red line). As indicated by the chart, much of the non-OPEC production growth related to the increase in US oil production between 2011 and 2015 due to the increase in rig count. It now appears, with the falling oil rig count, we may be near a production tipping point for US oil production. So far in the last 12 months US oil production has dropped about 1mm bpd.

Active US Rig Count and Field Production

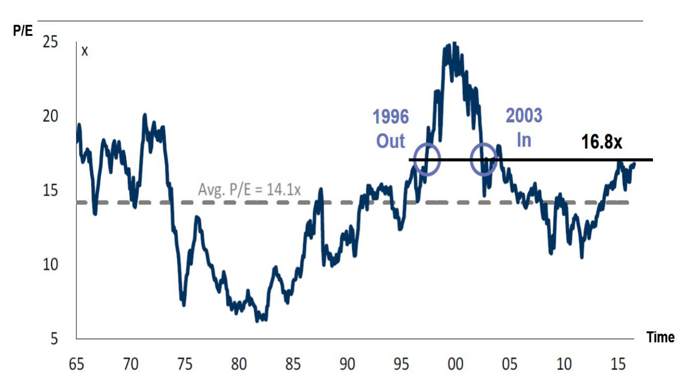


Source:Yardeni Research

Outlook

What kills bull markets is typically either a recession or a sharp rise in bond yields and we don't believe either are likely in our current market outlook. We also believe earnings trends impact the direction of markets and valuation on its own is not reason enough to get out of the market. To make a point about valuation not always being a sufficient indicator, this chart below looks at the S&P500 Forward Price/Earnings Multiple over the past 50 years. Many investors believe that Price/Earnings multiples will revert to their mean over time; however, if you strictly adhered to this, you likely would have got out of the market in 1996 at around the same multiple we are at today, meaning you left about 100% return on the table from 1996 to 2000. Alternately, if you bought in 2003 when the Price/Earnings multiple was the same as it was in 1996, and the same as it is today, the exact opposite happened and you lost a lot of money over the subsequent years. So right now given the positive direction of forward earnings growth, which as we noted has been accelerating upward since March 2016, the strength in economic activity particularly in the US and the attractiveness of stocks relative to bonds, our bias is to stay in the market and probably the US market over Canada at this time.

S&P500 FTM* Price/Earnings Ratio



* Forward twelve months
Source: S&P, Thomson Financial, FactSet and RBC Capital Markets

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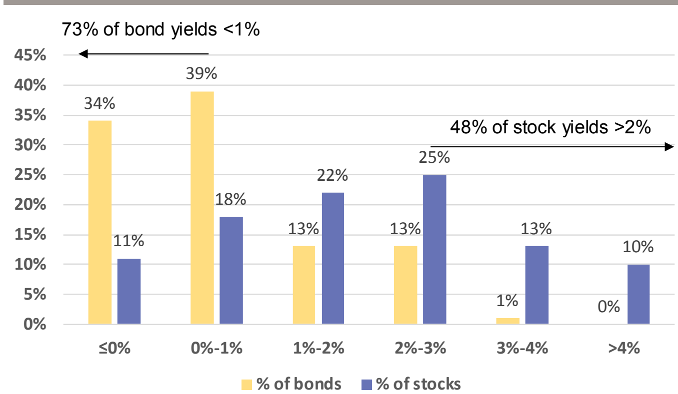
In the chart below we look at the relationship between global bond yields and global stock dividend yields. This graph compares the percentage of global bond yields (the gold bars) and stock yields (the blue bars) trading in specific yield ranges of less than zero on the left, to greater than 4% on the right. From the chart you can see that almost three quarters of global developed market bond yields are now trading at yields below 1%, while 48% of global stock yields are trading at yields greater than 2%. We believe this in itself will likely drive global valuations higher for stocks as the cost of debt remains at all-time lows. It will also likely drive yield seeking investors out of bonds and into stocks which would further help boost stock prices. It is this valuation gap, and the asset mix shift out of bonds into equities, that quite frankly could create the next top on equity markets. But we don't think we're there yet.

Bonds Yield vs Stocks Yield



Source: RBC Capital Markets

The final chart shows the overall valuation of the Cumberland portfolio compared to the benchmark S&P500/TSX. As you can see, our portfolio remains cheap relative to the market averages as measured on Forward Price Earnings valuation, price to book value and enterprise value (EV) to EBITDA, while the profitability characteristics of the portfolio as measured by 5 year average return on invested capital (ROIC) and Forward return on equity (ROE) are greater than the benchmark.

Portfolio Valuation

	North American Capital Appreciation	50/50 S&P500/ TSX Benchmark
Price/ Earnings	14.9x	16.9x
Price/ Bookvalue	2.0x	2.3x
EV/EBITDA	10.3x	11.4x
ROIC 5yr average	10.3%	9.7%
ROE Latest FY	20.5%	19.5%

ROE: Return on Equity
ROIC: Return On Investment Capital
Source: Bloomberg

Our final comment is on the US election. It appears to be a close race with many twists and turns but it feels like a close race to the bottom. We will decline from offering views on the candidates here; however, for a historical perspective dating back to 1936, we looked at what a Democrat versus a Republican win means to the market one year from the time of the November election. What we found is that on average the market is up about 9% one year after a Democrat is elected and essentially flat if a Republican wins. In both cases the market generally rallies 2%-3% over the first few months following the election.

Peter Jackson
Chief Investment Officer
October 3, 2016

Appendix 1
New Equity Investments:
North American Capital Appreciation Strategy
Quarter ended September 30, 2016

United States

Lowe's Companies (LOW)

Lowe's is a leading retailer of home improvement products, with 1857 stores across the United States, Canada, and Mexico at the end of F2015, and most recently completed the acquisition of the Rona home improvement chain in Canada. As the second largest home improvement retailer in North America, Lowe's possesses meaningful scale advantages against a fragmented group of smaller independent operators. Going forward, we believe Lowe's will be a beneficiary of both cyclical and secular tailwinds. Cyclically, our view is that the US residential housing market continues to have recovery potential, which will in turn drive demand for home improvement projects. Secularly, we believe Lowe's can leverage its massive infrastructure and scale advantages to capture an increasing share of professional contractor spend going forward.

Sabre Corporation (SABR)

Sabre Corp. provides technology solutions to the travel and hospitality industry. The company's travel network segment operates a b2b travel marketplace that offers inventory mangement, price and availability for a range of travel suppliers including airlines, hotels, car rentals and cruise lines. This business, also known as global distribution system (GDS), comprises 70% of revenues and is growing steadily as global travel demand grows. The GDS market as a whole is an oligopoly with 2 main players and high barriers to entry. The Airline & Hospitality Solutions segment (30% of revenue) is a cloud based software business that provides solutions for airline and hotel operators. These solutions include flight crew and hotel property management systems, central reservation systems, CRM and loyalty program modules. Prevalent in-house IT systems at many airline and hospitality providers are outdated and inefficient. Sabre Corp's solutions enable providers to reduce cost and complexity and upgrading of legacy systems should lead to significant demand growth for the foreseeable future. This segment has doubled in the last 5 years and is expected to grow at a mid-teens CAGR through 2020. The combination of a stable oligopolistic GDS business along with a fast growing software solutions business makes Sabre a good investment opportunity.

Canada

Great-West Lifeco (GWO)

Great-West Lifeco is Canada's second largest life insurer with $1.2 trillion consolidated assets under administration and operations in Canada, US, Ireland and the UK. The insurer is a member of the Power Group of Companies, controlled by the Desmarais family, who own 70% of Great-West.

Great-West has consistently generated market-leading returns on shareholders' equity, primarily on the strength of its Canadian and European segments. Recently, earnings growth has been challenged by low interest rates, Brexit-related currency weakness and asset outflows from its fledgling US asset management subsidiary, Putnam. However, these challenges are also likely to present new opportunities. First, rising interest rates are generally beneficial for life insurance earnings. Great-West also has the strongest balance sheet its

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industry group and can capitalize on opportunities to acquire beleaguered UK-based insurers or further consolidate US group retirement plan administrators. Finally, we believe Great-West may concede that Putnam is too tough to fix on its own and may sell all or part of the unprofitable US asset manager. As the above potentially contributes to earnings growth, we believe Great-West share price and dividend payout will rise.