CUMBERLAND

GLOBAL EQUITY AND INTERNATIONAL FUND STRATEGIES FIRST QUARTER 2017

Global Macro Review

This year's European election cycle reminds us of a tension filled three act play, with all the elements of edgy characters, criminal charges, voter insecurity, and the risk of disintegration of a political union. In this European play, the first act took place in The Netherlands. The leading character was Mark Rutte, the leader of the incumbent Liberal party (VVD) representing the old regime, who was astute enough to understand the discontent among the people. He won the Dutch election, thereby fending off the antagonist. In this case, the antagonist is Geert Wilders, a person with a checkered past including being found guilty of inciting discrimination against Dutch Moroccans back in 2014. Yet, his campaign platform continued to focus on an anti-immigration message. We consider Rutte's win a large victory against populist rhetoric of anti-immigrant and anti-Islamic politics.

We usually find increased suspense in the second act and that is definitely the case with the upcoming French election. We have a different antagonist in the name of Marine Le Pen. The objective of Le Pen and her far right party Front National is for France to leave the European Union (EU) as well as pulling out of NATO. There have been plenty of twists and turns in this act. Former frontrunner, conservative Les Republicains party leader, François Fillon is under investigation over a financial scandal which may result in his elimination in the first round. That leaves Emmanuel Macron, leader of the centrist party En Marche! who is expected to go head to head with Marine Le Pen in the second round. Meanwhile, Le Pen appeals to the disillusioned citizens but she is attempting to reach out to the general population by softening her party's toxic reputation and far-right stance. It was evident however during the first national debate in March, that fundamentally she is anti-immigration as well as anti-Muslim. We are left in suspense until April 23 when the people of France will cast their votes. However, if no candidate receives an absolute majority, there will be a second round vote on May 7 to decide the next French president based on the two leading candidates. Even if Le Pen wins, it is unlikely the French will exit the EU given the need for large parliamentary support and the requirement to alter the French constitution.

The third and final act of the European election play will take place on September 24 with the German election. In its leadership role within the European Union, as well as a counterbalance against the populist government of the US, markets view a victory by Angela Merkel as crucial. Based on what took place with the Brexit vote and the US election, it is difficult to rely on the polls, so the pundits are merely speculating at this point in time. In normal times, solid economic growth and very low employment as currently the case in Germany would almost guarantee victory. However, we do not seem to live in normal times anymore and those who feel marginalized or oppose Merkel's policy on allowing entry to Syrian refugees will continue to pose a challenge to Merkel's Christian Democrats in September's election. We expect Merkel will position herself appropriately depending on the outcome of the French election.

Meanwhile, in the Pacific Rim, tensions are running high and have reached a dangerous level given the belligerent antics of North Korea's leader, Kim Jong-Un. Although Pyongyang is barred from carrying out ballistic missile launches or nuclear tests under UN resolutions, this has not stopped North Korea from provoking its neighboring countries. In March, it fired five ballistic missiles with three of them landing close to Japan. And as we were completing this report, the eighth missile this year was launched. Pyongyang is on a quest to develop a long-range missile capable of hitting the US mainland with a nuclear warhead. Trump has taken a tough stance towards North Korea and its closest ally, China. According to the US Secretary of State Tillerson, all options are on the table and there is fear this could include the bombing of North Korea. This option has been dismissed in the past given the devastation it could bring to Korea and Japan, with a potential cost of more than one million lives. We expect Trump and his Chinese counterpart Xi Jinping will attempt to find a way to bring a certain level of order to avoid such a black swan event.

Portfolio Review

We were encouraged by the financial results and earnings guidance provided by our portfolio companies at the beginning of the quarter, especially in the case of our Information Technology businesses. Based on these, we expect earnings growth to continue when our companies report results in the coming weeks. Investor preference for the past several years has been the US over the rest of the world. While there are political risks everywhere, earnings revisions have been positive everywhere except the US. A common theme from our holdings was definitely the positive stance towards Europe, with either earnings trajectory improving in Europe or at a minimum, no longer declining.

With our Global Equity Portfolio holding between 30-35 companies while the International Fund holds between 25-30 companies, we are extremely selective when we decide to invest in any given entity. The company's performance and valuation metrics need to measure up to its global peers. Recently, Paris-based Exane BNP Paribas compared the Eurozone and Japanese equity markets as an alternative to the US market. The analysts found the Japanese markets have become overly reliant on the Bank of Japan and its influence on foreign exchange, trade and its own purchases, whereas Eurozone equities are expected to benefit from a stronger domestic macro outlook, less volatile market drivers, a higher gearing to the reflation dynamic and a milder political risk than the market fears. The two defining factors in the Japanese equity story have been the currency and foreign flows into Japanese equities, and this will continue to be the case until a strong domestic demand story takes hold.

Japan's problems have been exacerbated by an ageing population, low inflation, wage stagnation and corporate governance issues. Certain data points suggest economic fundamentals are improving in Japan with unemployment falling to a 22-year low at 2.8%. However, part of the reason for being close to full employment is its declining population.

We have in the past expressed our skepticism regarding Japan successfully passing structural reforms and yet, this is crucial for that country to get itself out of the deflationary mode it has been in for the past twenty years. While all this may ring true in general terms, Japan has some magnificent companies in certain sectors of the market; factory automation being one of them. We have come to know a number of them and we believe we own global industry leading companies in this area such as Keyence and Nidec.

During the first quarter, we had the opportunity to visit a number of companies on our watch list in Japan. We continue to look for businesses of world class caliber to add to the portfolio. As a result of this recent trip, we have become more familiar with a couple of companies in which we would like to invest, but are awaiting a more attractive entry price.

We had the misfortune of being in London during the terrorist attack outside the Parliament Building while attending a European consumer staples industry conference. Fortunately, our meeting was in another part of the city and was not directly impacted by the event, but we could see the tension and disruption that it created.

The commentary regarding global growth in consumer staples remains weak, with emerging markets being the key driver of growth for the group. Given the overall weak demand backdrop, pricing is expected to remain tepid.

In mid-February, Kraft Heinz made a U$143 billion offer for Unilever, one of our International Fund investments. If this transaction took place, it would have been the largest takeover in the food or beverage industry. However, Unilever (dual UK and Netherlands) rejected the offer based on their view that the offer undervalues the company. Unilever historically has been a good compounding stock, and company management still needs to convince the market they will continue to derive shareholder value when they provide their strategic plan this month. If Unilever is able to improve their margins on a consistent basis and improve their capital allocation, it should be able to provide double-digit earnings growth.

Another deal announced during the quarter was the merger between Essilor (France) and Luxottica (Italy). We hold both companies in the Global Equity Portfolio and the International Fund. This combination of Essilor, the largest eyewear lens manufacturer, and Luxottica, the premier eyewear frames manufacturer, distributor, and retailer, will create the largest integrated eyewear player with a global market share of about 16%. We are quite positive on the merger and projected synergies should drive significant shareholder value creation.

The threat that e-commerce poses to retailers and malls is well known. During the first quarter, nine brick and mortar retail bankruptcies took place, which equal the number experienced in the entire year of 2016 and is on track to exceed the great recession highs. The rising number of retail bankruptcies comes as consumers are making more purchases online and shifting their spending toward travel and other experiences. Meanwhile, the supply of physical stores continues to outweigh shopper demand, putting pressure on the industry's profits. We would like to point out that our holding in TJX (US) in the Global Equity Portfolio produced excellent numbers that beat expectations and is expected to continue on this positive trajectory. Although their on-line offering is still a small part of their entire business, we believe TJX's unique business model is able to attract a loyal following and will be able to continue their strong sales growth.

The Technology sector is our largest weight in both the Global Equity Portfolio and International Fund. The sector has accounted for nearly 50% of the S&P500 Index return in the first quarter, with the top five contributors being Apple, Facebook, Amazon, Philip Morris, and Google. The Global Equity Portfolio holds three of these five names. Sharp Corp. and Mobileye, both technology stocks were the best performing stocks during the quarter for MSCI EAFE Index and MSCI World Index, respectively.

The euphoria the market experienced post the Trump presidential victory during the fourth quarter last year petered out somewhat this quarter. There is still an underlying hope the promises Trump made during the campaign will come to fruition; however, those promises were not based on logic or well-thought out plans. Trump is finding it difficult to bully his way through Washington and the market seems to have gotten ahead of itself by marking up those companies that were supposed to benefit from his policies. In short, it appears the reflation trade is starting to fade. Financials, the sector that benefited from the reflation trade, detracted from our performance last quarter due to our underweight, but that positioning was positive for the Global Equity Portfolio and neutral for the International Fund this quarter.

C$%	**Q1**	**Year to Date**
Global Equity Portfolio Performance as at March 31, 2017 (Gross)		
Global Equity Portfolio	5.5	5.5
MSCI World	5.2	5.2
Value-Add	0.3	0.3

Our Global Equity Portfolio closed the first quarter with a cash level of just over 10%. Our rationale for this has not changed from our views at year-end, which was to be prudent and wary of a market that may be ahead of itself. Other than cash being a detractor to performance, other names that detracted included Schweiter Technologies, Accenture and Toyota Motors. On the positive side, we enjoyed strong performance from British American Tobacco, Philip Morris, and AIA.

We added two new positions to the Global Equity Portfolio during the quarter: Taiwan Semiconductor Manufacturing Corp. (TSMC) and Alphabet (Google) while selling Coca-Cola. While we still maintain a positive view on Visa, Comcast, Honeywell, and Fresenius SE and they remain as key holdings in the portfolio, we took advantage of elevated valuations and markets to take some gains on each of these.

TSMC is the dominant player in the outsourced semiconductor manufacturing industry with approximately 60% global market share. We believe the semiconductor industry will continue to grow ahead of global GDP. While the key drivers of semiconductor growth were derived from the expansion in PCs and smartphones, future growth will be driven by the use of semiconductors in new applications such as automobiles, high performance computing and Internet of Things. Furthermore, we expect foundry spend will grow ahead of the overall semiconductor industry as foundries continue to take share of manufacturing.

Alphabet (Google) is the global digital advertising market leader and the prime beneficiary of the secular shift in global advertising dollars away from traditional vehicles such as television, radio and print and toward digital. Alphabet is also well exposed to long-term thematic trends in artificial intelligence and machine learning, ride sharing, autonomous driving and big data.

C$%	Q1	Year to Date
International Fund Performance as at March 31, 2017 (Gross)		
International Fund	7.0	7.0
MSCI EAFE	6.1	6.1
Value-Add	0.9	0.9

During the quarter, the International Fund had strong performance from Samsonite, Unilever, and British American Tobacco. Similarly to the Global Equity Portfolio, a high level of cash along with weaker performance from Schweiter Technologies and Accenture detracted from the Fund's performance during the quarter.

We also purchased TSMC for the International Fund (please refer above for the description). We trimmed BNP Paribas by 1% to take some profits while reflecting prudence given the uncertainty created by the upcoming French election.

Outlook

For the first time in seven years, the developed and emerging markets are both showing signs of economic strength. With aggregate demand recovering in the developed markets, it will create a positive loop given the developed markets account for 60% of emerging market exports.

The US is waiting for a more stimulative tax policy, a more supportive regulatory environment, and more spending on infrastructure to drive growth. Given much of this is based on hope and the success of the Trump administration, there is some question on this strategy with the US administration's failure to repeal and replace Obamacare. We believe our companies will continue to deliver solid returns in the absence of this hope as they are not correlated to these government policy initiatives.

While US valuations may not be at extremes, they are above their five year averages and therefore, not a bargain. Last quarter, we believed the European market offered better valuations and thus, better upside potential and this should continue to be the case. The EU macro news flow has been better than market expectations along with some supportive reflationary outlook and this is reflected in the strongest fund flows into Europe hitting their highest level in over a year. The primary driver would appear to be the perceived reduction in political risk, with the antagonist not winning in the first act of the three act election drama and an improvement in earnings momentum.

When we reflect back on equity markets since the financial crisis, they were very much subjected to macro driven themes and the vagaries of central banks globally. There have been large sector rotations that took place, depending on the theme. Most recently, during the last quarter of 2016 a rotation took place into Financials and Cyclicals based on the reflationary theme. Despite this, we continue to believe that a portfolio of leading companies with strong earnings profiles is more important than trying to chase the latest theme. During the last quarterly reporting season, it was evident the market punished companies that missed much more than those that beat, which were being rewarded earlier; and therefore, it is important to protect the portfolio from potential losers.

The MSCI World Index is expecting earnings to be U$111.97 for the next twelve months for a valuation of 16.5x forward P/E, which is higher than the ten-year average of 13.7x. Similarly, the S&P500 Index forward 12-month P/E of 17.6x exceeds their ten-year average of 14.3x and is more expensive the MSCI World Index. The key valuation metrics for the Global Portfolio and the International Fund are shown below. Furthermore, both the International Fund and the Global Equity Portfolio have higher return on equity metrics than their benchmark market indices while having lower beta metrics, making these portfolios less volatile overall than the market.

	CPWM Global	MSCI World
P/E Forward 12m	18.9x	16.5x
Net Debt/12m Forward EBITDA - ex-Financials	0.78	0.43
Net Debt/12m Forward EBITDA	0.79	0.77
Return on Equity (adj.) - LFY	23.5%	21.8%
Dividend Yield	2.0%	2.3%
	CPWM International	**MSCI EAFE**
P/E Forward 12m	18.6x	14.8x
Net Debt/12m Forward EBITDA - ex-Financials	1.60	1.43
Net Debt/12m Forward EBITDA	2.45	2.62
Return on Equity (adj.) - LFY	24.0%	15.4%
Dividend Yield	2.1%	3.1%

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