GLOBAL EQUITY AND CUMBERLAND INTERNATIONAL FUND STRATEGIES

First Quarter 2018

Global Macro Review

As we commemorate the fiftieth anniversary of Martin Luther King's passing, we wonder about the progress we have made in America and the rest of the world in terms of equality and peace. The United Nations, an international organization founded in 1945 after the Second World War by fifty-one countries is committed to international peace and security. They also try to promote social progress, better living standards and human rights. Yet, the UN has certainly not been successful in protecting nearly 700,000 Rohingya citizens who have been displaced from Myanmar since August 2017. We are witnesses to another case of ethnic cleansing that seems to be taking place. When we presented on Myanmar post our visit to that country during their first free general election in a generation, we were genuinely hopeful that this country would emerge to become a better country for everyone under the leadership of Aung San Suu Kyi. Her silence on this subject is viewed as complicity in crimes against humanity. While discussing this with opinionated industry colleagues, we had an animated banter about this subject. They tried to convince me that Aung San Suu Kyi has no choice but to look the other way if she wanted to stay in politics and therefore, we need to accept the fact that principles are not a valid choice in the world of politics.

Perhaps we need to resign ourselves to the fact that a lack of principles is just the way things are in politics. China is now a dictatorship where they recently changed the constitution to enable the current President Xi Jinping to be its leader for the rest of his life. Thus, we are going to observe a showdown between an Asian bully in China going head to head in a potential trade war against an American president who behaves like a bully. China is the world's largest exporter, with over 13% of the total share. China has created prosperity for itself and those who have done business with it. Foreign businesses have flourished and have relied on China's growth for their own growth, although it is usually on China's terms. As China's power has grown over the years, they have punished countries using businesses as a conduit. For example, China boycotted South Korean companies such as Hyundai and Lotte for a year in response to South Korea's plans to deploy a US anti-missile system. Chinese tour groups were banned from visiting South Korea and retailer Lotte was particularly hard hit when they announced it would sell its chain of almost 100 hypermarkets in China.

We are reminded that Donald Trump is not the first American president to place unilateral tariffs on imports. What is different this time is the negative view this particular US president has of free trade compared to former leaders, and the current strength of the opponent with whom he has decided to pick a fight. China is a formidable opponent and is eager to show its muscle on the world stage.

We include a chart produced by a sell-side analyst that outlines the tariffs that have been announced. China ran a $375 billion goods trade surplus with the US in 2017. While Trump has demanded China cut the trade gap by $100 billion, Beijing has made a request for consultations at the World Trade Organization (WTO) in response to the US tariffs. Perhaps China realizes the unfair advantage they have enjoyed over the US and is willing to negotiate, but it is Trump's undiplomatic manner that has triggered the equally aggressive response from China. China's response to Trump's tariffs was to enact specific tariffs that damage the US economy in industrial and farming goods and Trump's political base. China is the biggest market for US soy and China's proposed 25% tariff on soybeans would be a large loss to American farmers. Trump's decision to instruct his administration to implement a plan to protect American farmers and agricultural interests could reflect political pressure he is facing from Republican farm states.

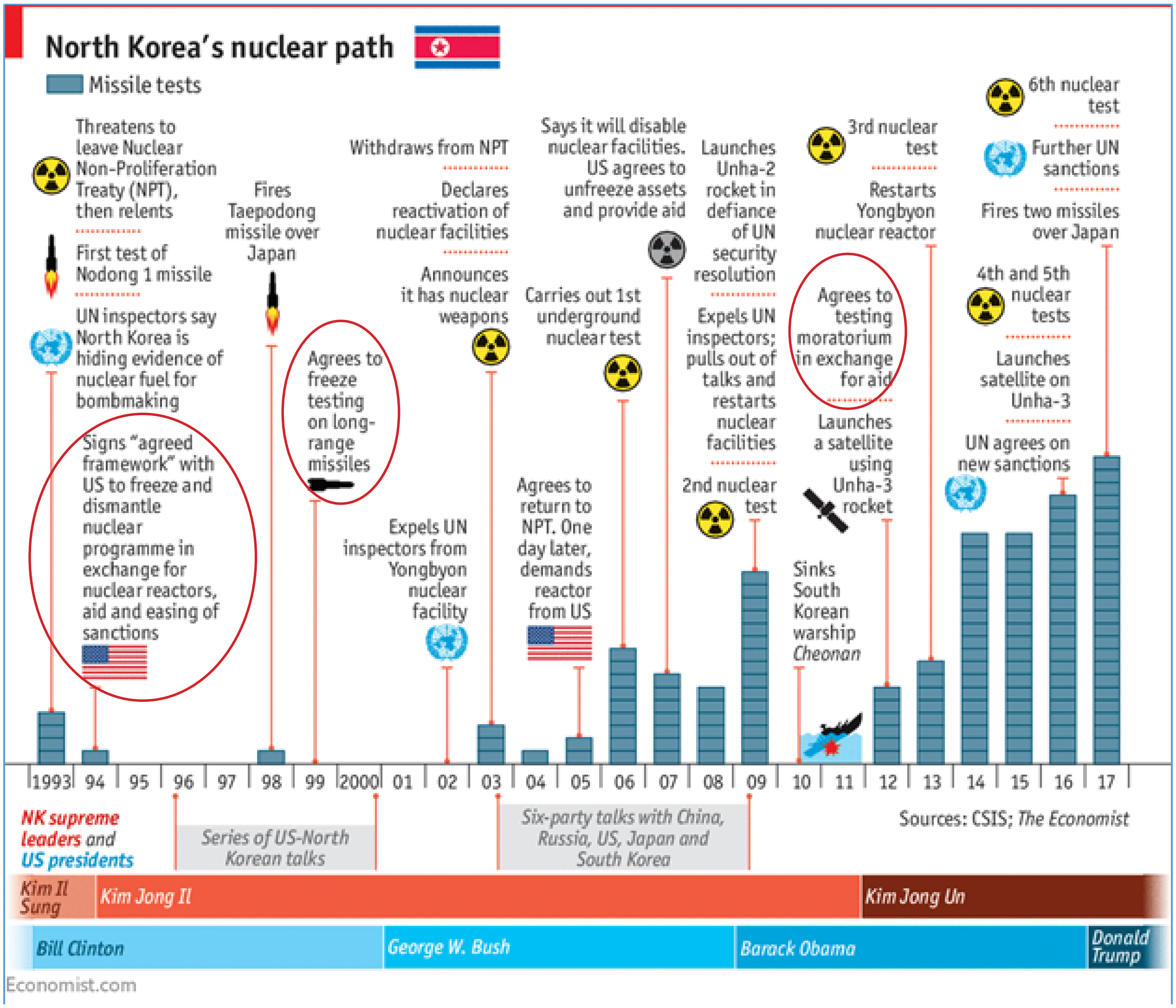
		US Tariffs on China	China's Retaliation
First Round	Date of Implementation	8-Mar-18	1-Apr-18
	Products	25% tariff on steel; 10% on aluminum	15% tariff on steel pipes, fruit and wine ($977 mn of imports involved); 25% tariff on pork and recycled aluminum ($1,992 mn of imports involved)
	Amount Subject to Tariffs	~$2bn	$3bn
Second Round	Date of Implementation	3-Apr-18	4-Apr-18
	Products	25% tariff on Aeronautics, Modern Rail, New Energy Vehicles, Telecom Communication, Machinery and High-tech Products	25% tariff on Soybeans and other agricultural products, Auto, Chemicals, Airplanes
	Amount Subject to Tariffs	$50bn	$50bn

Source: China and US governments
Credit Suisse

Economists have expressed concern that global economic activity may slow down if other governments join the mix with their own import barriers. Generally, a trade war is not in anyone's interest. Interestingly, a former official in Trump's administration believes that the side that wins in a trade war is the side that is most united, and there is no choice but to be united on the Chinese side while Trump does not have a comprehensive and thoughtful strategy.

As we were finishing our final draft of this quarterly review, President Trump escalated the trade war with an order to put together a plan for an additional US$100 billion in tariffs on imports from China. We should not be surprised by this tactic since Trump has said that when he is attacked which he surely views in the Chinese response, he will attack back harder rather than negotiate. This response will definitely not be the last round in the tariff war and therefore, we assume an elevated level of uncertainty as a given. One hundred billion dollars represents 20% of US imports from China last year. We should remember, however that none of the tariffs proposed by either side have been imposed yet and there is still room for both China and the US to back down.

Ironically, we may witness peace talks between the two Koreas that have been separated since 1945. Post their show of unity at the recent winter Olympics that was hosted by South Korea, supreme leader of North Korea, Kim Jong-Un has invited US President Trump for a summit this May. As reflected in the chart below, we have been down this road before with North Korea promising to freeze their nuclear program a few times over the past twenty-five years. So we temper our enthusiasm as peace may not be an immediate outcome. With North Korea's backing coming from China, the upcoming summit may be at risk given the strong tension between China and the US.



China may be seeking to strengthen its ties with its Asian neighbors as a means of easing the pressure from the Trump administration. The leaders of China, Japan and Korea are scheduled to hold a three-nation summit in Tokyo on May 9. There have been a number of cancellations of this summit in recent years due to the tensions among these three nations. This year also marks the 40th anniversary of the signing of the Treaty of Peace and Friendship between Japan and China, offering an opportunity for the respective countries to ease their tensions and bolster ties prior to Trump's meeting with North Korea.

Despite all the rhetoric in global politics and the gloomy headlines, leading global companies are still forging ahead with innovation to keep themselves relevant and to maintain their competitive advantages. However, most strategists view a trade war and countries going into a protectionist mode as being negative for global growth and as a result, there is risk to the bull case for equity markets. Global companies have been able to improve their margins through innovation and with free trade, they have also decreased input costs, allowing them to successfully sell their products and/or services around the world. If this door closes or decreases, margin growth will surely wane and revenue growth will become muted. This is a development that we shall monitor closely.

Portfolio Review

If you have ever ridden a rollercoaster, then you know how the markets behaved this past quarter. When the bell rings to signal the end of the day, you are just glad to get off the ride, knowing that the bumpy ride may repeat itself the next day. Many of these moves are based on overnight tweets of Trump or any one of the games that are being played on the political stage. It is also interesting to note that the Russian and Brazilian equities indices were among the two best performing markets in the first quarter. Given our quality screens and approach to investing, it should not come as a surprise that we do not have any exposure to either of these indices. The FTSE 100, the UK's benchmark index, on the other hand has been the worst performing major index, down more than 8%. Fortunately, our exposure thereto has also been minimal.

We came across an interesting article examining the recent weakness of the DAX index, the benchmark for the German market. Its composition, dominated by carmakers and the chemicals industry has become a proxy for world trade and the market is betting against them. While these cyclical sectors helped the DAX perform well in 2017, the broader macro situation is less favorable and the DAX is now lagging every major European index with the exception of the UK's FTSE 100. This situation also highlights the downside of buying an index where you are subject to the larger swings of the market rather than the fundamental issues of the underlying stocks. At this time, our exposure to Germany is limited to Fresenius SE and SAP. We discussed our view on Fresenius SE at length last quarter, and its situation appears to have stabilized and we remain of the view that the Company will return to having strong earnings growth. SAP continues to make progress in their S/4 HANA software sales. Interestingly, our exposure in Germany are in two sectors that have little representation in the Dax Index.

Cumberland's Global Equity Portfolio with a return of 1.5% generally kept up with the MSCI World Index benchmark's return of 1.6% in the first quarter. The best performing sectors in the MSCI World benchmark were Information Technology, Consumer Discretionary, and Cash, with Consumer Staples, Energy and Telecommunications Services sectors being the lowest contributors to the Index. Specific to Cumberland's Global Equity Portfolio, the key contributors for the quarter in terms of stock selection were our holdings in S&P Global, JPMorgan, and Nidec while the main detractors were Comcast, SAP and Schweiter Technologies.

The MSCI EAFE Index benefited from strong returns from the Industrials, Information Technlogy, and Consumer Discretionary sectors. Cumberland's International Fund's first quarter return of 3.9% continued to benefit from its exposure to the Information Technology sector while its benchmark, the MSCI EAFE Index had a return of 1.3%. The Fund's holdings in Dassault Systèmes, Nidec and TSMC were the main contributors to its outperformance via security selection and our positions in British American Tobacco, Schweiter Technologies and Cheung Kong Infrastructure were the main detractors during the quarter.

In terms of transactions for the first quarter, the Global Equity Portfolio sold its position in Wells Fargo, Apple and Enbridge while introducing a position in Raytheon. The International Fund did not have any changes within its portfolio.

There a few fundamental reasons for our sale of Enbridge. First, they missed their earnings guidance for the last three quarters and had a substantial, dilutive equity issue. Despite this issue, their leverage remains high as a result of the Spectra acquisition in the U.S. and the bulk of its capital spending has been delayed. Finally, we also witnessed a downgrade of the Company by Moody's.

Our position in Apple was initially purchased in 2016 and we have been pleased with the performance of our investment. At the time of our purchase, the market was discounting negative growth and was too pessimistic on its growth profile. However, at the time of disposition, we were of the view the market had become overly optimistic on the smartphone growth at a time of increasing competition in the high-end smartphone segment.

Our third sale during the quarter was Wells Fargo, which had entered into a Consent Order with the Federal Reserve that required the Bank to satisfy the Fed of its Board governance, compliance and operations and risk management practices. This order is serious and punitive. Although we believe Wells Fargo was making progress in their governance and risk management, we think their growth will come at the expense of other balance sheet items. Hence, we decided to sell our position.

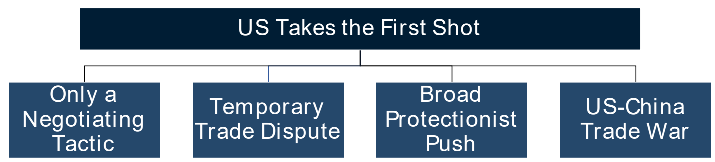
We introduced Raytheon as our preferred name in the Defense industry where we see continued opportunity for value creation. Raytheon benefits from missile defense and high exposure to non-US defense budgets with high growth. Missiles and missile defence systems including Patriot drive the narrative against an increasingly volatile geopolitical environment. The US Department of Defense (DoD) remains in prime territory to see budgetary increases under the current Administration while international orders continue to build as the threat from Russia, China and North Korea do not seem to subside. Raytheon is less sensitive to changes in the US government's budget given their higher proportion of revenue derived from international markets compared to its peers. However, shareholder returns via consistent free cash flow should support the stock in most environments, including a potential recession.

Following our research trip to Japan in late February, we decreased our exposure to certain holdings in the Technology sector. Although it is still our view that technology is crucial for certain secular trends such as automation, artificial intelligence, and Internet of Things, we wanted to take advantage of the strong momentum in the sector to take some gains during the quarter.

Cumberland Global Equity Portfolio Performancec as at March 31, 2018 (Gross)		
C$%	**Q1**	**YTD**
Global Equity Portfolio	1.5%	1.5%
MSCI World	1.6%	1.6%
Value Add	-0.1%	-0.1%
Cumberland International Fund Performance as at March 31, 2018 (Gross)		
C$%	**Q1**	**YTD**
International Fund	3.9%	3.9%
MSCI EAFE	1.3%	1.3%
Value Add	2.6%	2.6%

Outlook

The chart below, courtesy of our fixed income manager looks at the different scenarios that can take place post the first shot taken by the US in the tariff discussion. Our house view is that the U.S. is using this as a negotiating tactic but we cannot be complacent as it may not remain as a static situation. We shall continue to be vigilant, assessing the moving parts and how they will impact our portfolios.



The volatility experienced during the first quarter reflects the fear that the synchronized global expansion is coming to an end. Our conservative stance, both in our stock selection as well as our cash position, helped us preserve capital during the quarter. We continue to be of the view that maintaining a margin of safety that serves to protect against the "unknown unknowns" of an investment is a prudent strategy, given the global political risks that exist today.

S. Yang
Lead Manager, Global Equities
April 5, 2018

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