NORTH AMERICAN CAPITAL APPRECIATION STRATEGY

First Quarter 2018 Review

The first quarter of 2018 seemed to have something for everyone involved in the capital markets. It started with a positive market reaction for the S&P500 in January from the US tax reform plan announced late in the fourth quarter of 2017, which drove some of the largest earnings increases for 2018 ever recorded in any quarter. The outlook for forward earnings growth for 2018 was 12% at December 31st and now sits at a whopping 19%. We then experienced one of the more anticipated market corrections in February, which was triggered by the sharp rise in bond yields resulting from the strong employment and wage data for January. In March we heard from the new Fed Chairman Jerome Powell who, as expected, raised interest rates a quarter of a percentage point marking the sixth rate increase since December 2015. For 2018, the Fed increased its target real GDP forecast to 2.7% from its December projection of 2.5% and lowered its unemployment rate target to 3.8% from 3.9% and from the current February run rate of 4.1%. One would think, given the direction of those changes, it would signal a faster tightening of monetary policy yet the Fed did not change its forecast for two more hikes in 2018. Perhaps this suggests a willingness to let the economy run a little hotter for a while before cranking up interest rates and that is certainly critical to our investment thinking. It is also not out of line to assume that as tax cuts work their way into the system that the US economy will likely continue to grow, and inflation may even overshoot the Fed's 2% target.

Finally, in late March, the prospect of a potential trade war with China removed all the earlier gains we had seen in the quarter for the S&P500 leaving it testing its 200 day moving average at quarter end. Our view, in a nutshell, has not changed that much since the beginning of the year. We came into 2018 thinking the market was not particularly cheap, however we felt the level of earnings growth expected from tax reform would no doubt provide some relief to that valuation. We were also concerned about rising interest rates and the impact that could have on an already reasonably high valuation multiple. As the market became overbought into January, we continued to raise cash and were ready to redeploy in the event of a pullback and we ultimately got a full-blown correction (down >10%) in early February. Currently we still have a fair amount of cash on the sidelines (15%), which we will discuss in more detail below, but we are becoming somewhat more constructive compared to where we were at year end, given the better valuations and positive direction for earnings growth. The S&P500 now trades at 16.4x forward earnings as compared to 18.2x at year end. The US, and for that matter most global economies, continue to be firing on all cylinders. Among the 47 markets in the MSCI All Country World Index, which is a pretty broad measure of global equity markets, 94% have positive forward and trailing earnings growth.

However, the latest news of a trade war with China, if it were to happen, is not good. Initial reports indicate it would impact 1300 products in ten industries in the US and since most of the goods from China are consumer products one could expect an immediate impact of rising price pressure across many household products. This is not exactly a move that is going to win a lot of votes for Trump so time will tell how serious this will get and the extent to which it will impact markets going forward. If Trump's Steel and Aluminum tariffs, which two thirds of the metals imported to the US are now exempt from, are any indication, these latest threats may just be the beginning of a long negotiation. Regardless, it is a tail risk.

The US economy also continues to outperform Canada where the Bank of Canada recently cut its 2018 GDP growth rate target to 2.2% from 3.0% in 2017 and further reduced its target to 1.6% in 2019. The negative GDP print for January last week certainly did not help either. Yet our unemployment rate at 5.8% is the lowest in 4 decades, and the latest reading on CPI inflation at 2.2% is the highest in three years. While the Bank of Canada did move interest rates up a quarter point in

January, it suggests to us that it is now stuck between a rock and a hard place on any further increases. Stronger housing data in late 2017 and softer data at the beginning of this year indicate demand was pulled forward ahead of more restrictive new mortgage guidelines. Higher interest rates would further threaten the real estate market. Also in the Bank of Canada's latest press release, they noted that household credit growth has decelerated for three consecutive months. The uncertainty about the future of NAFTA is also a factor although there seems to be some progress on this negotiation. Perhaps Trump does not want to engage in an all-out trade war on every front all at once. Once again, the US economy stands out relative to Canada but one has to wonder how much is baked into a pretty gloomy outlook up here when it looks like we are still running flat out at full employment. The TSX forward P/E has declined from 16.2x at year end to 14.7x and consensus estimates for earnings growth for the TSX are still a respectable +14.6% for 2018 although a lot of that increase is driven by the recent recovery in energy prices.

During the first quarter of 2018, the S&P500 Index was down -0.8% in US dollars. Adjusting for currency, the S&P500 returned +2.2% in Canadian dollars, as the Canadian dollar depreciated just under 2 cents, closing the quarter at US$0.775. In Canada, the TSX total return in the first quarter was -4.5%.

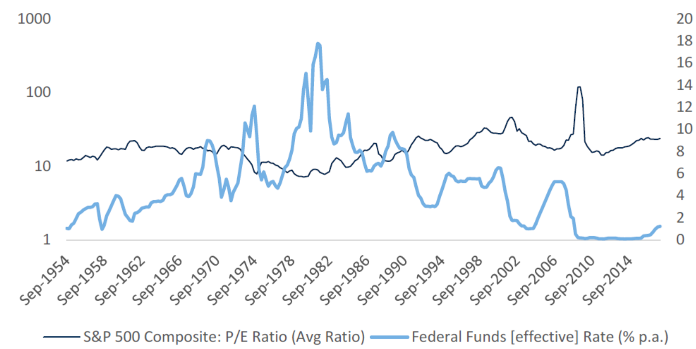
Asset Allocation for our North American Capital Appreciation Strategy
As at March 31, 2018

Equities	85%
Fixed Income	5%
Cash	10%

During the quarter our commitment to equities decreased slightly from 86% to 85%. Currently the equity portion is weighted slightly heavier in US equities at 45% over Canadian equities at 40%.

Exhibit 1 shows the relationship between the S&P500 average P/E ratio versus the Fed funds effective rate going back to 1954. Historically there has been an inverse correlation between the two. As a general observation, market P/E multiples don't expand when central banks become less accommodating and begin to tighten. The second half of 2017 was probably the exception for the S&P500 due to the impending tax cut delivered in December.

Exhibit 1
Broad Market P/E's Don't Expand When The Fed is Hiking Interest Rates



Source:RBC Capital Markets

It is important to understand this relationship between P/E multiple and interest rates as notwithstanding the strong earnings growth we are expecting in 2018 and 2019, rising interest rates can be a headwind to equity returns. In Exhibit 2, we dissect the total return contribution for the S&P500 and the TSX during the first quarter of 2018.

Exhibit 2
Contribution To Quarterly Return
First Quarter 2018

	Total Return	Earnings	Dividends	P/E
S&P 500	-0.76%	9.69%	0.46%	-9.95%
TSX	-4.52%	4.06%	0.67%	-8.82%

Source: Bloomberg

As observed in the table, while the earnings and dividend growth contributed to the performance in the quarter for both markets, the multiple contraction more than offset this contribution. This is the reason we have been patient waiting for a better valuation entry point. Both the S&P500 and TSX forward P/E multiples are lower today, which perhaps is setting up for a better entry level. Our equity risk premium model which measures the required return over and above the risk free return from government bonds is now neutral for the TSX and still suggests the S&P500 is somewhat expensive. Comparing the ten year average forward P/E multiples for both markets at 14.5x results in about the same conclusion. The bottom line is that notwithstanding the rising rate environment, you can still make a decent return but it requires understanding at what valuation level you want to be a buyer. Exhibit 3 shows the bottom up estimates for earnings growth for the S&P500 and the TSX for 2018 and 2019. The predicted level of earnings growth in both markets is materially positive suggesting equities are still the asset class of choice as long as interest rates don't rise too quickly.

Exhibit 3
Bottom Up Earnings

				% of change	
	2017	**2018**	**2019**	**2018**	**2019**
S&P 500	133.1	157.8	174.3	18.6%	10.5%
TSX	829.8	1008.0	1114.7	14.6%	10.6%

Source: Factset,Bloomberg

New positions added this quarter include ideas derived from our review of ongoing themes we anticipate will be relevant going forward into 2018 and beyond.

One of our new purchases was **Texas Instruments**.

Texas Instruments is similar in theme to TE Connectivity, which we added last quarter, as it stands to benefit from the secular shift to electric vehicles and autonomous driving. Both companies provide components that help protect the flow of data and power to enable electric mobility which we believe will have strong secular tailwinds of growth for many years.

Sealed Air Corp, a packaging company and maker of bubble wrap, provides a wide variety of innovative solutions that help make their customers more profitable and environmentally sustainable. They are aligned with the right customer trends that will further benefit from the shift away from bricks and mortar retailing to internet commerce such as Amazon.

HP Inc. was another purchase made during the quarter. Its legacy business, which is focused on the personal computer and copier market throws off a lot of excess free cash flow, however the upside catalyst for this name is in industrial 3D printing. HP Inc. is designing a product that should compete with injection molding for production manufacturing. Our research indicates that HP Inc. has the current preferred disruption technology in this space and we don't believe we are paying much for this at the current stock price.

We also added **Total Energy Services** on the energy side of the portfolio. Total Energy Services is a growth by acquisition story. Under the same management, the company has completed 30 acquisitions since 1997 with no asset impairments. The recent acquisition of Savanna Energy Services, combined with the fact that a majority of its revenue is now outside of Canada, provides a compelling entry point for this company which is currently offering an 11% free cash flow yield.

We also added **Rogers Communications Inc.** on the Canadian side. The opportunity to buy Rogers at a discount is rare, however its valuation has become quite attractive due to the increase in interest rates over the past 12 months and concerns over increased competition. Recent price increases for internet and the likelihood of less pro-active interest rate increases from the Bank of Canada after three rate moves in the past year, should allow the stock to perform better from current levels. Rogers also offers an attractive 3.3% dividend yield.

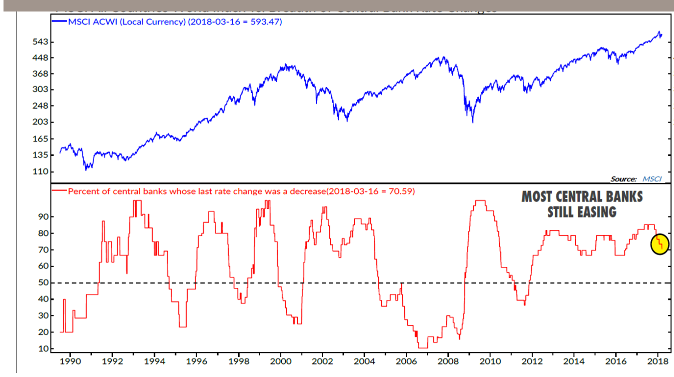
And finally, we purchased **Accenture,** which we have owned previously in the North American equity mandate and is held within other equity mandates at Cumberland. The stock sold off in the recent quarter on what appears to be a temporary margin issue. We opportunistically added to it on this weakness and it has since partially recovered.

A complete summary of new positions added during the quarter, including business fundamentals and valuation metrics, is contained in Appendix 1.

Outlook

If we were to break down how we look at the market between the macro outlook, central bank policy, valuation and the technical picture we probably come out fairly neutral overall. The Macro outlook continues to look good pretty good and as discussed earlier, 94% of global indices have positive forward and trailing earnings growth. Exhibit 4 shows the percentage of the world's central banks whose last rate change was a decrease.

Exhibit 4
MSCI All Countries World Index vs. Breadth of Central Bank Rate Changes



Source: Ned Davis Research Group

As indicated in the chart, 71%, a large majority of global central banks are still easing. A reading north of 50% has historically been associated with strong global equity performance and recently, we increased our asset allocation towards international on the North American plus international strategy from 20% to 22%. We also believe the Fed signaled a dovish rate hike in March and is likely willing to allow a temporary overshoot on inflation above 2% as an acceptable price to pay to avoid causing a recession through a premature restrictive policy stance. That brings us back to valuation. As we outlined above, valuations are definitely more attractive today than they were three months ago and combined with the positive earnings growth in 2018 and 2019, we are generally feeling more constructive than we did at the end of the year. From a technical perspective, while we retested the correction lows in February, the longer term outlook is still intact. Overall our conclusion is to stay the course and take advantage of the volatility to selectively add to our equity exposure on further weakness.

Peter Jackson
Chief Investment Officer
April 1, 2018

APPENDIX 1

NEW EQUITY INVESTMENTS:

CUMBERLAND NORTH AMERICAN CAPITAL APPRECIATION MANDATE

UNITED STATES

Texas Instruments (TXN)

Texas Instruments is a semiconductor company focusing on analog chips and microcontrollers. Both segments offer compelling growth, customer diversity and stability with excellent exposure to the growing opportunities in industrial automation and automotive automation and electrification.

HP Inc. (HPQ)

HP is a leader in personal computers. The mature PC market continues to consolidate to the largest manufacturers and HP is gaining market share amongst that group. However, we think HP will benefit from other growth opportunities in office and industrial printing, and, later, the nascent 3D print-manufacturing market. We expect HP's 3D print technology will eventually be adopted for large scale manufacturing, which is currently served by overseas injection molding.

Sealed Air Corp (SEE)

Sealed Air produces a wide variety of flexible resin packaging, protective shipping materials, and integrated packaging systems. It specializes in fresh food packaging (ex. red meat and poultry wrapping) and resin based product wrapping and protection used to ship goods to consumers. We expect Sealed Air to benefit from continuing consumer trends towards preference for fresh foods and continued penetration of online shopping and shipping direct to the consumer.

Accenture (ACN)

Accenture is a leading global information technology services company. We believe Accenture represents a superior investment opportunity for our funds as the company possesses leadership positions across its services portfolio, global reach, and is well positioned to take advantage of fast growing areas within the IT services industry including cloud deployment, big data, and digital transformation. The company sports a clean balance sheet with over $3.5b in net cash and a management team which has a strong operating track record and discipline in capital deployment. We took advantage of a post earnings pullback in the shares to initiate a position in the company

CANADA

Rogers (RCI.B)

With the highest mix (70%) of growing wireless as a percentage of total earnings in the Canadian telecom universe, an attractive dividend yield of 3.3% and a 57% payout ratio on 2018 free cash flow, Rogers represents our preference for both a defensive and growth investment. A temporary stumble late last year caused by a computer glitch, which has since been fixed, finally brought the stock down (18% from its November high) to our target acquisition price.

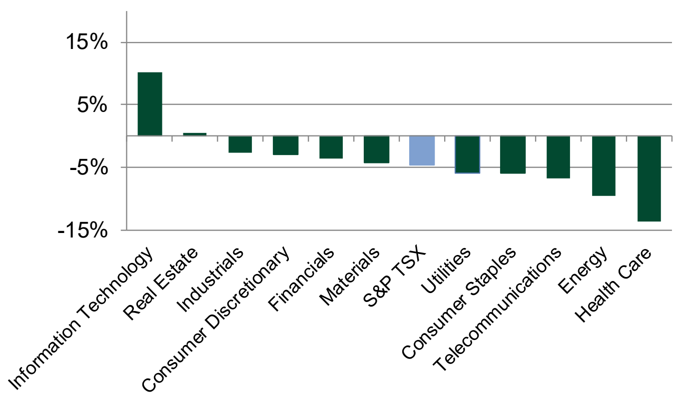
Total Energy Services (TOT)

Total Energy Services Inc. is a well-run, diversified energy services company that provides drilling, equipment rentals, well servicing, gas compression and processing packages. Total completed its $355 million acquisition of Savanna Energy Services in 2017, which more than doubled its business and expanded its revenue base in the US and Australia. The deal was well timed as Total acquired Savanna's assets at a fraction of cost, and we are now seeing a strong revenue recovery as asset utilization increases in the oil patch. We believe Total will see a material increase in profit starting in 2018 as the company benefits from continued strength in oilfield spending, cost savings from the acquisition and relocation of unproductive assets from Canada to the US and Australia.

APPENDIX 2

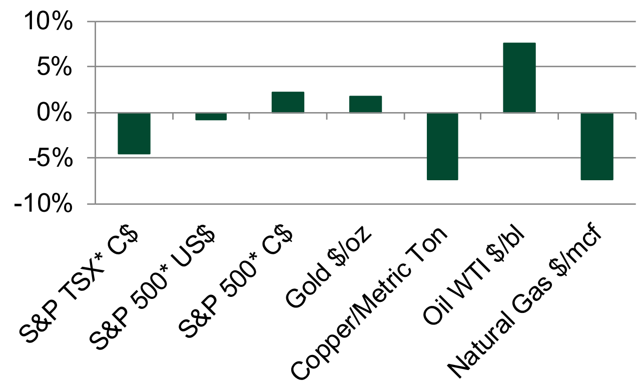
PERFORMANCE CHARTS

S&P TSX (C$ Total Returns)
Quarter Ending March 31, 2018



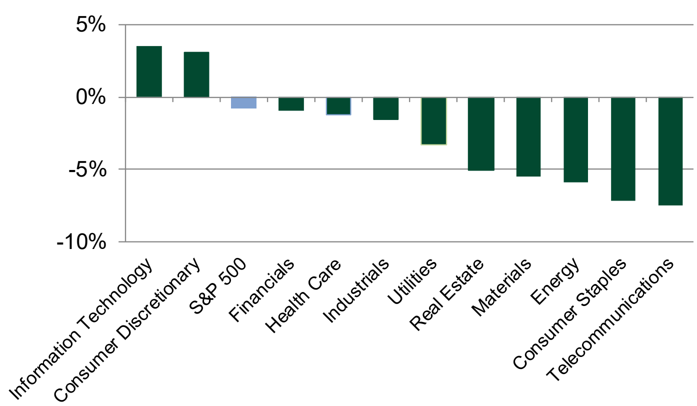
Source: TD Securities

Quarter % Change
Quarter Ending March 31, 2018



Source:Bloomberg *Total Returns

S&P 500 (US$ Total Returns)
Quarter Ending March 31, 2018



Source: TD Securities