CUMBERLAND

Private Wealth

GLOBAL EQUITY AND CUMBERLAND INTERNATIONAL FUND STRATEGIES

Second Quarter 2018

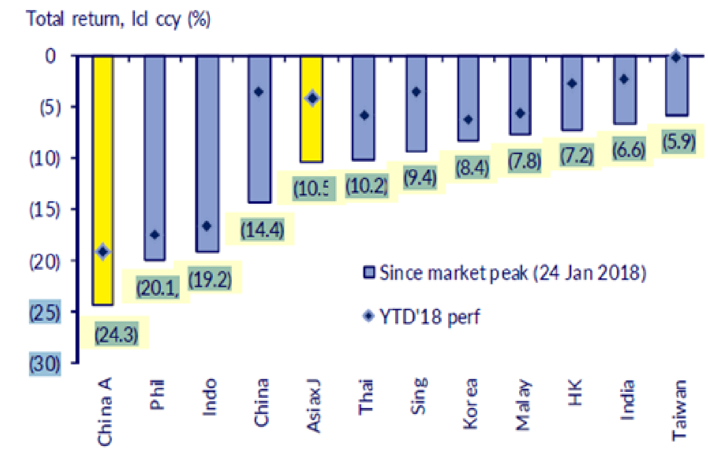
We are midway through 2018 and based on McKinsey's most recent survey of executives' sentiment on economic conditions, there is an increase in those who are more cautious on economic conditions and prospects for growth. It should not come as a surprise that changes in trade policy is the most cited risk to domestic and global growth in addition to being a risk to their own companies. The Bank of England's governor, Mark Carney, has warned global political leaders about the costs of putting up trade barriers. Based on the UK's experience with Brexit as an example, Carney pointed to their recent underperformance as a lesson in the perils of deglobalization.

Yet, when we read through the National Security Strategy of the United States, it is clear President Trump's pledge to put America first is a departure from the guiding principles that national interests were best pursued through international partnerships. The U.S. was paramount in creating the postwar international order by shaping a more structured, collaborative and rule-bound regime. It also rejected the concept of isolation and affirmed the necessity of positive participation in the world community. However, Trump's leadership style is based on his view that every winner creates a loser and a U.S. trade deficit signifies the U.S. being on the losing end. However, the RAND corporation, a non-profit, non-partisan think tank completed an intensive study as to whether the international order retains any strategic value and if such a vision can or should continue to shape U.S. strategy. Among their key findings was that the postwar order has generated tremendous value for the U.S. and many other countries, whereby the system has boosted the effectiveness of American diplomacy and military strength, and helped to advance American interests. An example cited by RAND is the global response to the 2008 financial crisis, a response that was both accelerated and facilitated by the principles, norms, institutions, and relationships fostered by the postwar economic order.

According to a recent op-ed by John Kasich, Republican Governor of Ohio, the global trading system has, on balance benefited us all. He argues that exports, growing at an accelerated pace, have totaled $6.1 trillion over the past four years and today support more than 10 million U.S. jobs. With trade making up about 55% of the world's gross domestic product, according to the World Bank and as one of the chief architects of this framework, the U.S. has shared enormously in this success. Any reasonable person would agree that the international trade system can be improved. However, a disregard for the rules-based system the U.S. helped establish and its full frontal assaults on trading friends and foes is not constructive.

As we were finalizing our review, the latest headline with respect to tariffs is not encouraging. It appears U.S. and China are ready to settle in for a long trade war as both sides slap levies on $34 billion of each other's exports. The U.S. is targeting China's "Made in China 2025" strategy that aims to guide the country's industrial modernization, including the substitution of foreign technology with innovation developed on the mainland. In the meantime, China's counter-tariffs aimed at farm products, cars, and crude oil will have the greatest impact on the U.S. states that voted Trump into office. Analysts believe the U.S. regions with more than 25% of their economy affected by the Chinese tariffs are going to feel the pain, with a possibility of a rise in unemployment. Although the U.S. is in its biggest trade battle since the Great Depression, the U.S. equity market has not fully reflected of the potential negative stance. However, this is not the case in the Chinese stock market. Shares in Shanghai are the world's worst performing among major markets this year and is reflective of the increasingly pessimistic view of China's outlook.

MSCI AsiaJ Markets -
Perf since market peak and 2018YTD



Source: CLSA, Factset MSCI

Meanwhile, post the North Korea – U.S. summit in Singapore, we may be witnessing history repeat itself. North Korea has promised disarmament again and again over the past thirty years, only to renege each time after pocketing generous inducements. Although Trump is proud as a peacock of having had over 2,500 reporters at the press conference and potential improvement in his ratings, the agreement is less specific than previous North Korean pledges to curb its weapons program. There was no timetable, arrangements for verification or definition of denuclearization, a term that in North Korea is typically taken to include the removal of all American forces from South Korea. In the meantime, Trump cancelled the military exercises but failed to warn South Korea and Japan. This leads us to question whether he is willing to sacrifice their security for the sake of a deal, which will consequently also threaten America's position in Asia. Trump may believe he is the master negotiator, but has made a huge unilateral concession and ultimately, a gift to China. He has given in to China's desire to have a smaller U.S. presence in Asia and now, they have it without having to give anything up in return. It is ironic that Kim Jong-Un was known for his regime's nuclear threat to the world and abhorrent treatment of his own people and now, he is negotiating an invitation to the White House while repeated violations of treaties and UN Security Council resolutions have been partly forgiven. The challenge now is for the U.S. administration to hammer out a specific timetable for the regime to dismantle its arsenal of warheads and its nuclear facilities. There is growing skepticism however in the US intelligence community about Pyongyang's intentions. In the past week, reports have indicated that North Korea continues to develop and hone its ballistic missiles and nuclear weapons capabilities.

The global order seems to be in a fragile state. Another area we are watchful of is in the Eurozone and in particular, Italy and Germany. Although Italy had an election on March 4 of this year, no political group or party won an outright majority, resulting in a hung parliament. The Italian election, similar to many elections globally in recent years, was a rejection of traditional left and right parties in both the north and south of the country. The far-right League party conquered the north, worried about the rise in immigration, while the anti-establishment Five Star Movement (M5S) took the south where concerns about the economy dominate. Having been in Sicily in May, we can attest to the less prosperous state of the region compared to their brothers in northern Italy. After a prolonged impasse, Italy at long last got a new government on May 31. There is an uneasy coalition formed from the populist left-wing Five Star Movement and the nationalist Northern League where they are promising both tax cuts and benefit increases, which could be in conflict with the EU's budget rules.

The result of the Italian election is a snapshot of a country in the grip of fears about immigration and the economy. This is the reality the EU and Germany, the most powerful country within the EU, have to deal with. Germany is becoming more diverse with their largest change coming from Merkel's "open door" policy towards refugees. However, a battle is brewing over the future direction, and Merkel's leadership is being challenged with her government's fragile coalition with Germany's version of a populist government. The outcome is particularly important given Germany is Europe's biggest economy and will likely have impact beyond Germany's borders. Their leadership is important and the challenge is huge, especially in light of the opposition within their own country and from members in the EU.

Portfolio Review

Cumberland's Global Equity Portfolio with a return of 2.3% trailed the MSCI World Index benchmark's return of

3.8% in the second quarter. The best performing sectors in the MSCI World benchmark were the Energy, Information Technology, and Consumer Staples sectors while the Financials, Telecommunications, and Industrials were the lowest contributors to the Index. Specific to Cumberland's Global Equity Portfolio, the key contributors in terms of stock selection for the quarter were our holdings in Coloplast, Essilor, and Fresenius SE while the main detractors were Starbucks, Keyence, and Samsonite.

The MSCI EAFE Index benefited from strong returns from the Energy, Healthcare, and Materials sectors. Cumberland's International Fund's second quarter return of 1.8% continued to benefit from its overweight exposure to the Healthcare sector while its benchmark, the MSCI EAFE Index had a return of 0.7%. The Fund's holdings in Safran, Hoshizaki, and Coloplast were the main contributors to its outperformance and our positions in Samsonite, Philip Morris, and British American Tobacco were the main detractors during the quarter. The Fund's underweight in Asia relative to our benchmark and not having any direct holdings in China aided to the portfolio's performance.

Further to our discussion above of Italy and its turmoil, one of the hardest hit sectors as a result was the Italian Financials which are vulnerable to write-offs in their holdings of government debt. Fortunately we do not have any exposure to Italian Financials in either portfolios and in terms of allocation, we are underweight the financial sector. This positioning contributed to performance, especially in the International Fund. The only direct Italian holding we have in both portfolios is Luxottica and it contributed positively during the quarter. Although Luxottica is headquartered in Italy, they are globally diversified, with close to 60% of their sales derived in North America. In addition, Luxottica is trading more in line with Essilor given their pending merger.

Generally, it was a frustrating quarter in terms of developments with respect to some of our holdings, leading to three position sales. In terms of transactions for the second quarter, the Global Equity Portfolio sold its position in Philip Morris, Starbucks, and Samsonite International without introducing any new names to the portfolio. The International Fund was also required to sell its position in Philip Morris and participated in the sale of Samsonite International.

There are a few fundamental reasons for our sale of Starbucks. First, the company reduced its guidance for their third quarter on lower same store sales due in large part to slower afternoons than expected in the U.S. and flat same store sales in China. In addition to dealing with their racial relations post the Philadelphia incident, Starbucks is dealing with the decline of the Frappuccino as customers are choosing healthier options and competing restaurants. We did not see any evidence of the Company having a plan to deal with these issues. Our internal analysis reflected the Company being fully valued and called for them to execute well in China. However, with the decline of comps in China, this is less likely to take place.

We had owned Philip Morris prior to its spin-off from Altria, pre-2008 and it has been a consistent contributor over the years. Although the company increased its fiscal earnings guidance when they reported their first quarter numbers, the shares dropped significantly. The market was evidently concerned about the slowing of their iQOS product's growth in Japan and management's strong conviction to maintain their capital expenditure rather than buy back their shares to provide price support. The lower organic growth expectations particularly in the Japan, Russia, and Saudi Arabian markets continued to weigh on the shares throughout the quarter and while we believe the shares would be able to sustain the pressure in the long-term, we respected our internal non-discretionary sale rule and sold the position.

Our third sale during the quarter was Samsonite International. There was a short-seller report issued on Samsonite, resulting in a large drop in its share price. Samsonite had recently provided strong revenue growth and management reiterated its full year targets. While we did not agree on all the points raised by the short-seller, this did raise a question regarding management's credibility. Management did eventually provide a report giving rational explanations for the key issues raised by the short-seller. The Board took the right steps to defend its position, but questions still remained as to why it took an inordinate amount of time to provide an explanation.

The cash level has increased post the sale of these positions. Strategists have generally been complacent on the issue on the trade war and its implications and this is also reflected in the market's upward move during the quarter. However, we believe it is prudent to be more cautious and at this time, have not been comfortable to deploy the cash immediately.

Cumberland Global Equity Portfolio Performance as at June 30, 2018 (Gross)		
C$%	**Q2**	**YTD**
Global Equity Portfolio	2.3%	3.8%
MSCI World	3.8%	5.4%
Value Add	-1.5%	-1.6%

Cumberland International Fund Performance as at June 30, 2018 (Gross)		
C$%	**Q2**	**YTD**
International Fund	1.8%	5.8%
MSCI EAFE	0.7%	2.0%
Value Add	1.1%	3.8%

Outlook

There were times during the quarter when it felt we were going to have a replay of the last European crisis. However, the chaos was contained within Italy and did not spread to Spain. We are reminded that political issues do not always impact the markets, and fundamentals of companies do matter. Our concern with respect to the ongoing trade war, however, is the potential impact on global economic growth and hence earnings growth. If the trade war continues and is global, it is a negative development and we will have to adjust our perspective to take into account the downside risk. On a relative basis, the companies in our portfolio have healthy balance sheets and their strong market position provides confidence they will be able to withstand headwinds that come their way. We continue to be of the view that maintaining a margin of safety that serves to protect against the "unknown unknowns" associated with given investments is a prudent strategy, especially given the global political risks that exist today.

S. Yang
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