CUMBERLAND

Third Quarter Review
North American Capital Appreciation Strategy
September 2015

It's official, after four years we finally had a market correction. Of course, it is natural to speculate on the worst possible outcome. After all, emerging markets have sold off, commodities have collapsed, volatility has skyrocketed and there is continued uncertainty around future actions of the US Federal Reserve.

Overall however, the economic data in the US is still pretty good and fundamental valuations have improved. Moreover, the signs we consider evident of a bear market are simply not there. We went through this in some detail at our September client quarterly presentation and on a number of our conference calls. As our chief strategist Gerry Connor has said many times in the past, bear markets are usually associated with a recession or at the very least higher interest rates, neither of which appear to be on the horizon. While the Fed is likely to move to raise interest rates before year end, we do not believe there will be significant enough of a change in policy to derail this bull market.

If we recap what happened over the summer, in general the second quarter earnings results came in better than expected. Second quarter earnings estimates at June 30th were expected to be down at -4.6%. However, nine of the ten sectors were above consensus with better than expected growth rates, and overall earnings were only off by -0.7% from original estimates of down -4.6%. While still a negative number, bear in mind we have the energy sector down significantly at -55% in the quarter and without that drag, these earnings results would have been positive.

Percentage Change for Quarter to September 30, 2015

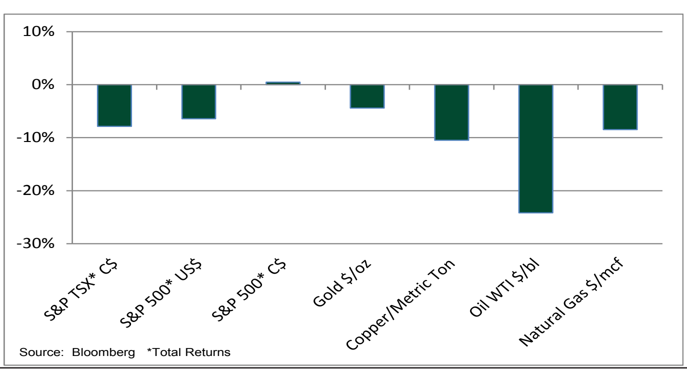
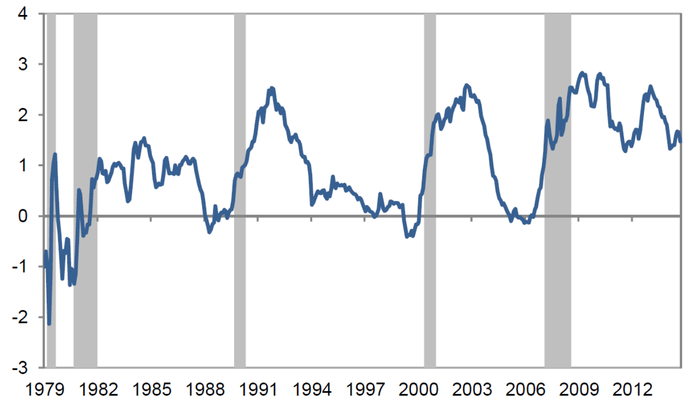


Exhibit 1:
Yield Curve Slope: 10yr vs. 2yr Constant Maturity Treasury
Positive Yield Curve Indicates No Recession
Shaded Areas Indicate Recession



Source: BMO Capital Markets

Clearly, a recognition by the market of slowing industrial profit growth in China, the 40% drop in the Shanghai Composite from mid-June through August and the collateral impact it could have on developed markets had a lot to do with the recent market correction. However, when we take into account the normal shape of the yield curve (see Exhibit 1), which usually inverts prior to a recession or in anticipation of a bear market, positive ISM (Institute of Supply Management) manufacturing data, current low levels of employment as well as the positive consumer confidence readings we are seeing in the US, these just do not support the beginning of a recession or bear market.

While the latest payroll data for September came in weaker than expected, the unemployment rate is still a staggering 5.1% such that the number of people receiving unemployment benefits is the lowest that has been seen in 15 years. The ISM manufacturing data (see Exhibit 2) also remains positive and has been in expansionary territory for most of the past six years. Recessions do not typically coincide with periods like this. Finally, when we look at the latest housing and auto sales data, we note that single-family home prices grew steadily for the 12 months ending July by +4.7% and

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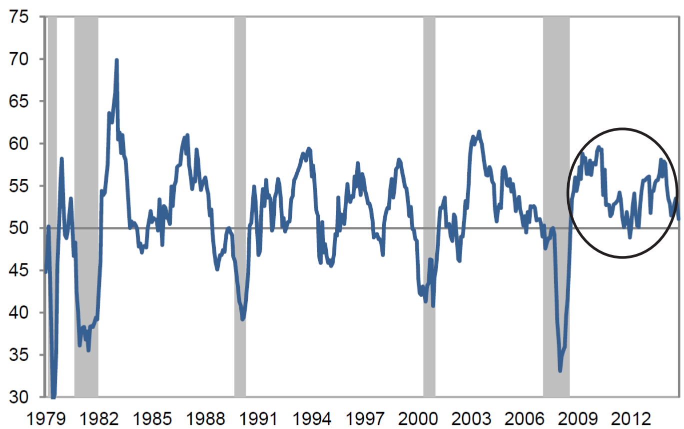
September US auto sales hit a record at 18 million units, which is the highest seen in ten years. Even Volkswagen had a surprise increase in sales for the month of the September.

Exhibit 2:
ISM Manufacturing Index
ISM Remains in Expansionary Territory
Shaded Areas Indicate Recession



Source: BMO Capital Markets

So what about market valuation? Well, we do not want to sound like a broken record but we have been saying for some time that the market was not cheap although we still believed we were in a bull market. In mid-August, the forward P/E for the S&P500 was 16.7x and traded as high as 17.2x earlier in 2015. This compares to the 25 year average of 15.4x. At the low in August, the S&P500 touched 14.8x and as we write this review, it is currently back to a more reasonable level of 15.4x 12-month forward earnings and 14.9x 2016 earnings.

Asset Allocation for Capital Appreciation Portfolios As at September 30, 2015	
Equities	88%
Fixed Income	8%
Cash	4%

The biggest change in our capital appreciation portfolios during the quarter was the increased exposure to equities, which rose from 81% to 88%. We took advantage of this market correction to materially add to the equity weight in portfolios, particularly in the US where we see greater opportunities for growth. This increase was sourced from Cash while the exposure to fixed income remained unchanged.

While our exposure to the US has risen for many of the reasons cited above, in Canada we continue to believe economic growth will remain anemic at best. Real GDP growth in July rose 0.3% month over month, after rising 0.4% in June followed by five consecutive months of monthly declines from January to May. Canada's unemployment rate has risen from 6.6% in January to 7%, the exact opposite of the visibly downward trend in the US, which is not that surprising given that oil prices are back to the 2008 financial crisis lows and the resulting pressure on the employment situation in the west. However, the latest unemployment data for Ontario and Quebec in August was also negative as more people are now looking for work in these provinces as well.

While the latest polls put the Conservatives and the Liberals about neck and neck, depending on the outcome of the election on October 19th, there may or may not continue to be pressure on the Canadian dollar. Given that the dollar has already depreciated from US $0.86 to US $0.76 this year, rather than attempting to speculate on the election outcome or the next interest rate move by Bank of Canada governor Stephen Poloz, for our Canadian resident clients we have hedged a portion of our US dollar exposure to help mitigate the impact of the Canadian dollar appreciating from here.

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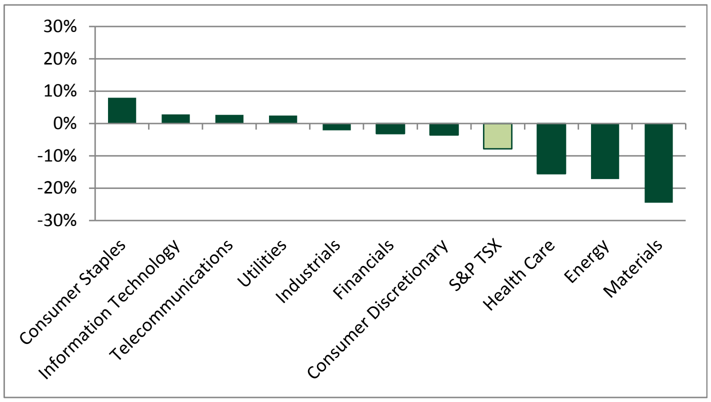
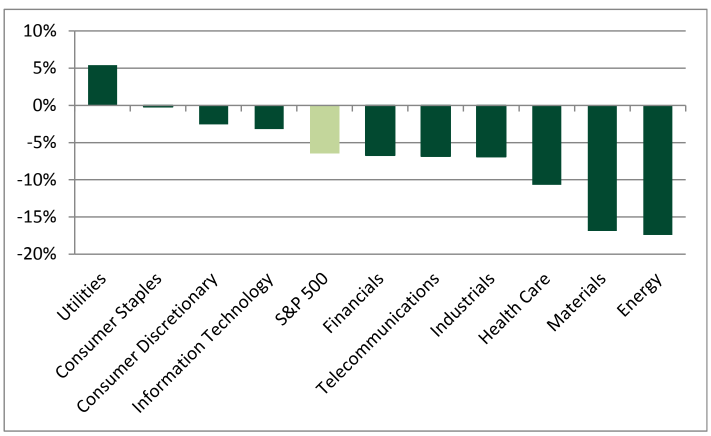
S&P TSX Sector Performance (C$)
3rd Quarter 2015



Source: TD Securities

S&P 500 Total Returns (US$)
3rd Quarter 2015



Source: TD Securities

The sectors that saw the largest increases in your portfolio were Industrials, Information Technology and Consumer Discretionary. In Industrials, we added Russel Metals and Chemtrade Logistics and increased our exposure to Union Pacific Corp. (UNP). As reflected in Russel Metals and Chemtrade, we are finding pockets of value in Canadian companies that source a significant portion on their revenues in US dollars and that stand to benefit from a pickup in the economic activity we are seeing south of the border. We have also focused on companies offering attractive dividend yields whose stock prices are out of line relative to their historical averages. Both Russel and Chemtrade fit this description with 30% and 65%, respectively, of their revenues from the US while being backed by sustainable dividend yields of 7.0% and 6.7%, respectively. In the case of Union Pacific, while US rail stocks have come under pressure due to lower coal and oil volumes, rail car loadings have picked up in the back half of 2015 and when combined with cost reduction measures, we expect UNP's earnings results to improve throughout the balance of 2015 and in 2016. In Consumer Discretionary and Information Technology, companies in both these sectors are expected to generate above average earnings growth through 2015 and into 2016. In the Consumer sector, we added Carnival Corp. and Newell Rubbermaid. In Information Technology, we added eBay Inc. and SanDisk Corp. and increased the portfolio's weight in Mitel Networks. And finally, we added Altus Group, on the Canadian side. Altus is a leading provider of independent advisory services and data solutions to the global commercial real estate industry. Altus' business mix is shifting towards high margin, recurring revenues streams that are capital light and relatively predictable. With year to date recurring revenue growth of 50%, we believe we are in the early-innings of a compelling software analytics play that is quickly developing into the leader in its technology space. A complete summary of our new investments during the quarter is contained in Appendix 1.

During the third quarter, the TSX returned -7.9% while the S&P500 returned -6.4% in US dollars. Adjusting for currency, the S&P500 returned 0.5% in Canadian dollars as the US dollar gained about US $0.05 relative to the Canadian dollar with the Canadian dollar closing at US $0.75. It is not surprising that during the quarter, the best performing sectors were the defensive Utilities and Consumer Staples groups while the worst performing sectors were Energy and Materials. During the third quarter, oil fell by 24% while natural gas and copper fell by 8.5% and 10.5%, respectively. Recognition by the market of slower growth in China continued to aggravate the downward trend in commodities prices. We continue to be underweight Oil and Gas and we currently have zero exposure to Base Metals or Gold.

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Outlook

Recently, we examined two studies of US historical market corrections, one of which encompasses a period from the 1950's to today and the other goes back to 1928. In the case of the former study, the average duration of the 27 corrections analyzed was 124 days and the average market decline was 12.8%. If August 25, 2015 was in fact a recent market bottom then this compares to the current period of 96 days of which the peak to trough S&P500 decline was 12.4%, about in line with the historical average. In the case of the data going back to 1928, there were 52 periods of greater than a 10% market decline, of which 63% did not develop into a bear market (defined as greater than a 20% decline), and 37% that did. The average decline in the non-bear market cases was - 13.9% and the number of days from market trough back to the previous peak was 101 days. If August 25th holds as the 2015 correction trough and using history as a guideline to extrapolate forward, we could see the market (S&P500) move back up to the 2,130 peak, or 9.2% from its current level, by some time around mid-December.

While it is interesting to look at the past, we base our forecast for the market on more than just history. So let's examine the outlook for earnings and valuations. Last quarter, we highlighted the earnings growth for the S&P500 at +1.6% (rounded to +2%) for 2015, which has now declined to +0.7%. The third quarter earnings season is now upon us and it will be an important determinant of the direction of stock prices; however we continue to be positioned in the strongest sectors for earnings growth in 2015, namely Financials (15.6%), Health Care (11.7%), Consumer Discretionary (10.6%) and Information Technology (4.6%) which collectively make up 75% of the equity portion of the portfolio.

Since last quarter, 2016 earnings growth has slowed from +12% to +10%. However, it is important to note that last quarter, Energy was ranked as the largest earnings growth contributor of the ten S&P500 industry sectors with estimated growth of +33.8% followed by Materials at +18.8%. Today, Energy is forecast at +9.7% and Materials at +15.8% for 2016. So the point worth noting is that while estimates for the S&P500 have come down about 2% for next year, this has been mostly due to sectors that continue to underperform. In general, this is not surprising given commodity prices are still under pressure with the consensus shifting to that of "lower for longer". The sectors we are positioned in still look very attractive from an earnings growth perspective and with the overall market now trading at 14.9x 2016 earnings, it is no longer expensive. Finally, the low level of bond yields continue to act as a valuation catalyst. Our equity risk premium model suggests a normalized level for the S&P500 at 15% higher. So in conclusion, we have been waiting for this market correction for some time, we have opportunistically added to our portfolios' equity exposure through the downturn and we remain active. While it is early days, so far our strategy is playing out.

Peter Jackson
Chief Investment Officer
October 4, 2015

Appendix 1
New Equity Investments:
North American Capital Appreciation Strategy
Quarter ended September 30, 2015

United States

Carnival

Carnival (CCL) is the world's largest cruiseline with over 100 ships, 9 brands and $15 billion in revenue focused mostly in the developed markets of North America and Europe. CCL is currently benefiting from an array of both structural and cyclical tailwinds as ageing demographics and emerging market demand are combining with a recovery of the US and European consumers to drive an acceleration in revenue trends. In addition, the cruise industry has shifted from a focus on growth and occupancy at all costs towards a more rational pricing and return focus, which should lead to improved profitability over time. Carnival in particular has suffered from execution mis-steps and brand issues, which are steadily showing signs of improvement as new management has increased marketing and driven significant operational improvements. Finally, we see the opening of the Cuban travel market as a likely near-term catalyst that should further increase cruise demand and positively benefit Carnival.

Newell Rubbermaid

Newell (NWL) is a global consumer products company with a diverse portfolio of brands including Rubbermaid, Irwin Tools and Paper Mate. Historically, NWL had been an under managed company with little integration between brands, poor allocation of capital and excessive layers of bureaucracy. With the hiring of the current CEO in 2011, Newell has been on a steady path of restructurings, divestments and stepped up marketing efforts in order to rationalize costs, speed decision making and improve brand equity. Now in the middle innings of this turnaround, the company is beginning to see a virtuous cycle take hold whereby cost savings are driving brand investments which in turn are driving peer leading sales and earnings growth. These efforts coupled with a highly fragmented competitive set and significant white space both globally and by product category should lead to multiple years of above average growth and significant cash returns to shareholders making the current valuation discount to the sector unwarranted in our view.

eBay

eBay is one of the leading global e-commerce players with over $83 billion worth of merchandise sold on its various websites each year. Over its 20 years the business model has evolved from its early days of auctioning used items consumer-to-consumer towards becoming a global platform (60% ex-US) for small businesses selling to consumers at a fixed price (now 80% of volume). Although revenue has more than doubled since 2010, more recently the company has faced several significant challenges including a security breach, changes at Google that led to lower web traffic as well as the spin-off of the PayPal division. With these issues now behind the company, management will be able to direct its full attention and resources back towards improving the core business, which should help to re-accelerate growth. From a financial perspective Ebay exits the PayPal business with a substantial net cash position of around $2 billion in addition to annual cash generation of a further $2.5 billion, which are likely to be returned to shareholders through repurchases and would represent a material additional yield to investors (+10%). With the stock trading at similar levels to slower growth and much lower return brick and mortar retailers, we see significant upside to the stock as management executes its turnaround and returns significant cash to investors.

SanDisk

SanDisk Corporation provides NAND flash storage solutions. The Company designs, develops and manufactures data storage solutions in a variety of form factors using flash memory, controller, firmware and software technologies. The Company's solutions include a range of solid state drives, embedded products, removable cards, wireless media drives, digital media players, and wafers components. SanDisk is one of the main beneficiaries of growth and proliferation of digital data. The preferred storage medium of this digital data is moving from Hard Disk Drives (HDD) to NAND flash solutions as it has better performance characteristics, low power usage and relative price/performance parity. SanDisk is an 'Intellectual Property' leader in this space and has a track record of bringing innovative

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products to market. Over the last year the company's stock has suffered due to share losses in key verticals and execution issues at their production facilities. Management has since corrected these problems. With $4 billion of gross cash on balance sheet and secular NAND storage tailwinds we view SanDisk as an attractive investment opportunity.

Canada

Altus Group

Altus Group is comprised of two major divisions, with a large commercial appraisal consulting firm providing the bulk of present cashflow and a hidden gem in two separate software operations aimed at commercial real estate valuation and reporting. Using software industry standard valuation metrics, the software operations can already easily account for the majority of Altus's entire valuation and they also have the potential to form a new industry standard software suite for commercial real estate managers which could dramatically increase growth prospects.

Russel Metals

Russel metals is engaged in 3 businesses: metals distribution, metal services and energy products. The energy products business has come under pressure in the past year as demand and price for its energy products used in drilling and production of oil has fallen and hence the decline in the stock price. However, most of Russel's business model is really about managing its inventories at its steel service centres. Once those inventories are back in line, Russel is able to manage its margins very effectively. We expect this to sort itself out and in the back half of 2015. Steel pricing is also showing signs of bottoming and new import tariffs, designed to reduce cheap steel imports into the US, will come into effect in November 2015 and should also tighten the market. While clearly a cyclical business, Russel's average return on capital over a business cycle has been very attractive at about 16%. Even with the depressed results today Russel is still more than adequately covering its dividend after meeting all its capital funding obligations with an average dividend payout ratio in the first half of 2015 of 67%. Russel also has an outstanding $175 million convertible debenture that will likely be called early after September 30th. This could also create a short squeeze in the stock as we believe some of the 12% short position, of the shares outstanding, are short against this convertible debenture. Our intrinsic value based on our discounted cash flow model is $27 which represents 29% upside plus the 7.1% dividend.

Chemtrade Logistics

Chemtrade is one of the world's largest suppliers of sulphuric acid and other industrial by-products as well as water treatment chemicals. The biggest segment in terms of end use remains US industrial/ manufacturing. Chemtrade's business model is surprisingly more stable as it is supported by fee-based contracts and risk sharing/risk mitigation agreements and diversification. Recent selling pressure in some of Chemtrade's competitors has spilled over to Chemtrade presenting a buying opportunity in the name. At its current level Chemtrade is trading at an attractive free cash flow yield of over 12%. Its six month annualized dividend payout ratio to June 30 was 52% of free cash flow after all maintenance capital expenditures. Chemtrade has a long track record of making very accretive acquisitions and while we are not depending on this, there are potential opportunities we believe they are looking at right now that could be highly accretive. In the meantime we are collecting a 6.4% dividend yield on a business that has strong tailwinds from both the strength in US industrial production and US dollar revenues. Our intrinsic value target is $23 or 25% above its current stock price plus the dividend yield of 6.2%.