CUMBERLAND

Cumberland Income Fund
First Quarter 2014 Review and Outlook

The Cumberland Income Fund gained +2.1% during the first quarter of 2014 compared to the gain of +2.8% posted by the FTSE TMX Canada Universe Bond Index during the same period. On a year over year basis, the Fund has gained +4.7% while the FTSE TMX Index has gained +0.8%. There was a "flight to safety" tone in the bond market during the quarter, triggered by weaker than expected economic data and geopolitical concerns, resulting in declining interest rates (bond yields) and consequently higher bond prices. These concerns were partially offset by a signal from the U.S. Federal Reserve that the interest rate tightening cycle may start earlier than expected. At Cumberland, we continue to maintain our view that bond yields will drift higher over the medium term putting downward pressure on bond prices, brought about by a gradually improving global economy and the Federal Reserve's gradual exit from its bond buying program (Quantitative Easing or QE). Consistent with our strategy in recent quarters we have maintained our focus on preserving capital by keeping the Fund's duration low (thereby keeping the sensitivity of bond price changes due to changes in interest rates low). Moreover, the Fund continues to generate income by holding higher-yielding corporate bonds, preferred shares, and dividend-paying common equities that have attractive risk/reward characteristics, in our view.

Over the past two years, changes in monetary policy and antics out of Washington have been key drivers of interest rate volatility, but in the first quarter of 2014 we were able to add two new drivers: the weather and geopolitical tensions out of Russia and Ukraine. Abnormally harsh winter conditions in the U.S. seems to have interrupted the momentum that the economy had been gathering during 2013 and Russian President Vladimir Putin annexed the Crimea region of Ukraine causing concerns over a possible military conflict. The weaker tone was set early on in the quarter as the extreme cold and heavy snowfall in the U.S. were blamed for poor unemployment data. This set off an increased demand for bonds (and lower yields) thereby halting and reversing the previous quarter's trend of rising interest rates. The U.S. 10 year Treasury yield started the quarter at 3.0% and by the beginning of February the yield had dropped by 0.40% to 2.6%. As February progressed the market became more and more convinced that the weather was the culprit for the weak economy and began selling bonds, thereby driving interest rates back up modestly higher to 2.8%. Just two-weeks later, Russian President Vladimir Putin decreed that the region of Crimea was no longer part of Ukraine, but now belonged to Russia. The build-up of military forces and the threat of military action were reflected in the bond market by a "flight-to-safety" as investors bought back government bonds sending 10 year Treasury yields back down to 2.6%.

Not to be outdone by Putin and Old Man Winter's contribution to the volatility, the U.S. Federal Reserve did not fail to add their twist to the bond market during the quarter. On March 19th, the Fed released their scheduled monetary policy statement. The statement was largely as expected and included another $10bln reduction ("taper") in its bond buying program (QE). But the "taper" was last year's story. The bond market has now refocused itself on conventional monetary policy, that is, it is trying to discount when the Federal Reserve will actually start to raise interest rates. To that end, embedded in the FOMC statement were the committee members' own interest rate forecasts. It was revealed the median forecast was now for the policy rate to reach 1% by the end of 2015 compared to last quarter's forecast clustered in the 0.25% - 0.75% range. Moreover, during the press conference that immediately followed, Fed Chair Janet Yellen was asked what the time lag would be between QE ending and the Fed starting to raise the policy interest rate. To bond investors' surprise (horror) she answered the question with an off-the-cuff "six months". Yellen's predecessor, Ben Bernanke, never answered a question of timing so explicitly. In an instant, the bond market did the math: since QE is ontrack to end sometime in Q4 this year, the first rate hike could happen in the spring of 2015, earlier than expected. Consequently, bond investors started selling bonds as higher interest rates would translate into lower bond prices and the U.S. 10 year Treasury yield jumped 0.10% from 2.67% to 2.77%. In contrast however, during another speech a week thereafter, Yellen backpedaled somewhat on her tone and stated considerable slack remains in the labour market and the extraordinary commitment of low interest rates is still needed. This comment reversed half of the increase in the rate move we saw a week earlier during the FOMC announcement. We expect volatility in government bond yields to persist in 2014 as the U.S. Federal Reserve continues to calibrate and recalibrate monetary policy.

Despite the volatility in government bond yields this quarter, corporate spreads (the corporate bond yield premium over government bond yields) remained extremely stable. Corporate profits and cash flows are expected to remain robust despite the harsh weather and geopolitical concerns underpinning the healthy bid for corporate bonds. Bond investors also continue to reach for yield by buying corporate bonds in order earn a higher coupon than low yielding government bonds. The supply of new corporate bonds during the quarter remained robust but below that of the prior four quarters of 2013. New corporate bond issuance this quarter was $26 billion, below the $27 billion issued last quarter and the $32 billion issued in the first quarter a year ago. The demand for buying newly issued corporate bonds remains extremely strong keeping spreads tight and valuations expensive, in our view. We continue to be very selective in our allocation of capital towards corporate bonds. We look for bonds that offer a coupon with sufficient spread that should offset much of the price decline that could be caused by interest rates rising as the economy improves. Bonds issued by Algonquin Power Co. (an independent power producer), Goldman Sachs, and JPMorgan are three examples of bonds added to the Income Fund during the quarter that fit our criteria.

The Income Fund ended the quarter with a 12% allocation to dividend paying common stocks and income trusts. We view our holdings in this asset class as a critical tool to modestly enhance the yield and lessen volatility within the Fund. This quarter we added to our positions in Chemtrade Logistics Income Trust (CHE/U.TO), a marketer and distributor of industrial chemicals under long term contracts. Chemtrade issued units to finance the acquisition of General Chemical, a transaction that essentially doubles the operating cash flow of the firm. We also added to Northland Power Inc. (NPI.TO), an independent power producer that issued stock to pre-finance a large off-shore wind project in the Dutch North Sea. We will continue to opportunistically add to attractively valued stocks/units that, in our view, offer a sustainable or growing dividend.

The lack of follow-through in rising interest rates from the fourth quarter into the first quarter has postponed our strategy to deploy our cash holdings. Interest rate risk remains the key determinant of bond returns from our standpoint. And arguably, with bond yields lower than they were at year-end, interest rate risk is even

Asset Allocation as at March 31, 2013	
Asset Class	**% of Portfolio**
Cash and Cash Equivalents	10.9%
Government Bonds (incl. Floating Rate Notes)	23.4%
Corporate Bonds	43.5%
Preferred Shares	9.7%
Equities/Income Trusts	12.4%

Yield[1] Comparison as at March 31, 2013	
DEX Universe	2.5%
DEX Government	2.4%
DEX Corporate	2.8%
Cumberland Income Fund[2]	3.7%

1. Yield is the rate of income generated on an annualized basis. Yield does not represent the total return of the Fund or the Indices shown in the above table.
2.Gross of management fees.

greater as we enter the second quarter. In the U.S., the Federal Reserve is shifting away from unconventional monetary policy (i.e. quantitative easing) back to conventional monetary policy (i.e. adjusting the Fed Funds Rate). As a result, the bond market has now shifted its focus from discounting the demise of QE to attempting to discount when the Federal Reserve will announce its first rate increase. Under the backdrop of a likely improving North American economy, QE is on schedule to conclude by the end of 2014 and interest rate increases to start by the end of 2015. It seems to us this is an environment where interest rate movements are biased higher, not lower. Our strategy, therefore, is to keep our cash and floating rate note balances high at the expense of a higher current yield in order to preserve capital and maintain the option to capitalize on the expectant higher interest rate environment. In the near term, our focus on allocating to securities with an attractive risk/reward profile will remain the priority, contributing to the Fund's objective of generating income and reducing the probability of a drawdown.

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