CUMBERLAND

First Quarter Review and Outlook
Cumberland Income Fund
March 2015

Monetary policy decisions by central banks around the world during the first quarter of 2015 increased volatility in fixed income markets and fueled further demand for sovereign bonds globally. Meanwhile, corporate spreads (the yield premium investors' demand for owning corporate bonds over government bonds) were mixed during the quarter depending on the bond's maturity and credit rating, however, overall spreads remained stable. Cumberland's income strategy continues to be positioned to dampen the volatility from large swings in interest rates and the impact of changing monetary policy. Additionally, prudently managing credit risk remains central to our objective of generating a stable income stream meaningfully greater than inflation while simultaneously preserving capital.

In fixed income markets, fundamentals continue to take a back seat to central bank commentary and their unconventional monetary policy decisions. There were three main cross currents that put downward pressure on bond yields in Canada during the quarter. The first was the European Central Bank's (ECB) announcement of a Eurozone bond buying program (quantitative easing or QE). On January 22nd ECB President Mario Draghi launched a €60 billion per month purchase program of mainland Europe's sovereign bonds for a time period "until at least September 2016". Both the quantity and duration of the program surprised the market and sent European bond yields lower. The stated goal of QE was an attempt to allegedly combat deflationary pressures prevalent in Europe. However, arguably the ECB had a second goal in mind: to devalue the Euro currency in order to stimulate exports. In that respect, the ECB was also successful: The decline in bond yields caused the €/USD to decline ~10% intra-quarter from 1.16 to 1.05.

There are further implications to a depreciating Euro. We subscribe to the view that the policy tool of lowering interest rates (and launching QE) around the globe has now morphed from a tool used to stimulate domestic growth (or at least an attempt to stimulate growth) to one that is used to wage a currency war. Central bankers once refrained from making explicit comments about their currency, but nowadays it is almost commonplace to hear a European central banker say that their economy would benefit from a cheaper currency to ensure the health of the export sector. To wit, there were a total of 25 policy rate cuts around the globe this quarter alone - - the fastest pace of rate cuts since the 2008/2009 credit crisis*. Post the launch of QE we are now in an environment where the policy rates for Switzerland and Sweden are *negative,* and the ECB now *charges* commercial banks to hold their deposits. Up until recently, investors believed 0% interest rates (ZIRP or zero interest rate policy) was the lower bound, but we have now since discovered that we can go lower giving rise to negative interest rates. As this is being written, Switzerland has just issued a 10-year bond priced to yield -0.055%. That's right, *negative 0.055%*. A German 10-Year *bund* yields just 0.15%. Traditional pricing of government bonds has been flipped upside down. We remain cautious since the long term implications of negative interest rates have yet to be realized.

The second cross current is the evolution of monetary policy in the U.S. Recall, it was expected that with the U.S. unemployment rate improvements made in 2014 and early 2015 the U.S. Federal Reserve (the Fed) was well positioned to increase the fed funds rate from 0-0.25% to 0.50% as early as June 2015. However, on March 18th the Fed may have itself entered the currency war. In its statement on that date, with the U.S. dollar up 10% in the quarter alone (viewed as a headwind to the U.S. economy), the Fed declared it needed to see further improvements in the labor market before it was appropriate to raise the fed funds rate. The statement reduced expectations of a near-term rate hike and stopped the appreciation of the dollar in its tracks. Bond yields in Canada drifted lower in sympathy.

* Source: BofA MerrillLynch

Cumberland Income Fund
March 2015

The third cross current causing bond yields to decline in Canada was the surprise cut in the overnight rate from 1.0% to 0.75% by the Bank of Canada (BoC) on January 21st. Concerned about the sharp drop in the price of oil, BoC Governor Stephen Poloz cut the policy interest rate as "insurance" against the risks of lower inflation and financial stability that low oil prices may bring. The single "insurance" rate cut lead investors to extrapolate further rate cuts to come later in 2015. As a result, bond yields headed lower and bond prices higher. Although the rate cut was understandably meant to help counteract the impact of a much lower price of oil, the rate cut was a surprise to the bond market because it also added fuel to Canada's overheating housing sector and elevated consumer debt levels. As the quarter progressed without a rebound in the price of oil, further future rate cuts were priced into the bond market. That was until February 24th when Poloz gave a speech in London, Ontario stating last month's rate cut will "buy us some time" to assess its economic impact. Investors interpreted this to mean that a second rate cut was in fact not imminent. Bond yields increased modestly but by the end of the quarter with oil (WTI) still at around $50 (per barrel) the market remains convinced another rate cut is coming by year end.

Investment Grade corporations (credit rating BBB+ or higher) have taken advantage of the low rate environment. In Canada, just over $30 billion of corporate bonds were issued in the first quarter, the largest amount ever issued in a calendar quarter. Generally speaking, $30 billion of corporate issuance would typically trigger credit spreads to widen, or "cheapen" corporate bonds relative to government bonds in order for the bond market to absorb such a large supply inflow. However, this quarter other than for shorter maturity bonds whose credit spreads were unfavorably affected by Poloz's interest rate cut mentioned above, credit spreads moved narrower as investors searched for yield in longer maturity bonds. During the quarter the average yield earned in the Canadian corporate bond market (per the FTSE TMX Canada Corporate Bond Index) was just 2.2% compared to 2.7% last quarter and 2.8% a year ago.

At Cumberland, we remain cautious on the general corporate bond market as narrow spreads and low underlying government bond yields make for expensive corporate bond markets that yield barely more than inflation (assuming a 2% inflation rate). We remained on the sidelines during most of the quarter as the above mentioned $30 billion of corporate issuance came to the market. However, we did participate in a bond issued by Pembina Pipeline Corp. Pembina, a pipeline and natural gas processing company, issued a 10 year bond with a coupon of 3.54%.

The High Yield bond market (credit ratings BB+ and lower) rebounded from a difficult fourth quarter in 2014. The FTSE TMX High Yield Index, heavily weighted to the energy sector, returned 1.25% as the price of oil (WTI) stabilized during the first quarter. Much like equity markets, the high yield market has bifurcated into two segments: bonds issued by companies related to the energy sector, and those that are not. The high yield bonds of energy (and other commodity) related companies are trading, on average, at a discount to par (less than 100¢ on the dollar) whereas industrial, telecommunications, and media bonds still have strong demand and trade at a premium to par (greater than 100¢ on the dollar), on average. Within our income strategy, we currently favor committing new capital to high yield bonds issued by non-energy related companies given the high level of uncertainty in the future price of oil and the sensitivity that changes in oil prices can have on the cash flows of a highly levered energy company. As an example, towards the end of the quarter we deployed capital into a new 5 year, 5% coupon convertible bond issued by DH Corp. Over the past three years, DH Corp (formerly Davis + Henderson) has been transforming itself from a check printer suffering from declining volumes to a higher margin, higher growth financial technology company offering software solutions to U.S. financial companies. We continue to be on the lookout for similar opportunities.

Our allocation to preferred shares was adversely affected by the BoC's surprise policy rate cut in January. The S&P/TSX Preferred Share Index declined

4.9% during the quarter and was primarily attributed to the "rate-reset" sub-category of preferred shares. The structure of rate-reset preferred shares is such that the dividend is re-set every 5 years based on a predetermined spread over the Government of Canada 5 Year bond yield at the time of issuance. The surprise rate cut caused the Canada 5 Year bond yield to decline and therefore the expected "new" dividend on a re-set preferred share as well. The decline in preferred share prices was also exacerbated by the low level of liquidity available in this asset class. The Income Fund's weighting in preferred shares remains low at 9% so the impact has been relatively contained. We are beginning to see some attractive pricing/yields in this market.

Activity in the dividend-paying common share allocation was modest. The Income strategy sold its holdings of Bank of Montreal (BMO.TO) and CIBC (CM.TO) on the premise that lower energy prices would be a headwind to the Canadian economy generally and mortgage issuance may deteriorate. Furthermore, the decline in interest rates brought on by the Bank of Canada could reduce the banks' net interest income and expected return on equity possibly putting downward pressure on valuation. In addition, we continue to add to our position in Northland Power (NPI.TO). Northland Power raised equity during the quarter to fund their previously announced acquisition of German off-shore wind assets. The shares were offered at an attractive dividend yield of 6.75%.

Outlook

As we progress through 2015, our income mandate remains focused on two over-arching themes: 1) the change in the way central banks conduct themselves and 2) inflation expectations. With respect to central bank conduct, it is our view that forward guidance is gone. After the 2008 credit crisis, the U.S. Federal Reserve (Fed) and other central banks around the world issued carefully crafted statements and other communiques that arguably gave the capital markets plenty of warning to what the next change in monetary policy would be (forward guidance). However, during this quarter it became clear that central banks are now changing tact. For example, on January 15th the Swiss National Bank suddenly removed the Swiss franc (CHF) peg to the Euro (€) which had been in place since 2011. The franc appreciated 20% overnight causing turmoil in the currency market. In Canada, the Bank of Canada shocked markets with the 0.25% policy rate cut (discussed above). The open-ended parameters of the ECB's QE program announcement was also not telegraphed in advance. And finally, the Fed's ambiguous March statement specified the Fed had not "decided on the timing" of an increase in the target fed funds rate. Without "guidance" from the Fed and other central banks we expect increased volatility in the bond market from either unexpected results from economic indicators or surprise announcements from the central banks themselves.

The second theme is inflation. Simply put, we consider there to be upside-risk to core inflation expectations. In our view, evidence of inflationary pressures continue to surface as both wage growth and outstanding commercial loans expand. Anecdotally, McDonald's, Wal-Mart, Target, TJ Maxx all raised their minimum wage this quarter, meanwhile the unemployment rate continues to show signs of improvement. We view these factors as increasing the risk of higher-than-expected inflation later in the year which would likely lead to higher bond yields and declining bond prices. Both these themes (central bank induced volatility and higher inflation/interest rates) lead us to continue to position the Cumberland Income strategy for a higher interest rate environment. As a result, we continue maintain a duration near 3 in our bond holdings compared to the 7.6 of the FTSE TMX Canada Universe Bond Index (note: lower duration bonds mature sooner and their prices typically have less sensitivity to changes in interest rates). Furthermore, we remain focused on prudently managing risk in the higher yielding segments of the income strategy which include high yield bonds, preferred and dividend-paying common shares by focusing on the credit profiles and cash flows of the issuers. We also continue to maintain a high level of liquidity in the Fund. Cash and highly liquid government

Cumberland Income Fund
March 2015

issued floating rate notes (FRN's) continue to make up a quarter of the portfolio and are ready to be deployed in either a higher interest rate environment or securities offering attractive risk/reward characteristics in the current ultra-low yield environment.

R. Schulte-Hostedde
Portfolio Manager, Fixed Income
April 15, 2015

Asset Allocation as at March 31, 2015

Asset Class	% of Portfolio
Cash and Cash Equivalents	6.9%
Government Bonds (incl. Floating Rate Notes)	16.8%
Corporate Bonds	52.9%
Preferred Shares	8.8%
Equities/Income Trusts	11.9%

Yield[1] Comparison as at March 31, 2015

FTSE TMX Canada Universe	1.7%
FTSE TMX Canada Government	1.6%
FTSE TMX Canada Corporate	2.2%
Cumberland Income Fund[2]	3.6%

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 fees.