CUMBERLAND

Global Equity and International Fund Strategies
First Quarter 2014 Review

After the majority of world markets performed exceptionally well in 2013, the first quarter of 2014 can be characterized as a market having little direction. There are many intertwined issues with increasing complexity and no particular issue has been taking leadership. On a macro level, we have come to accept a slower economic growth scenario globally in certain areas such as Europe and the emerging markets and central banks continuing to play a key role in financial markets. On a micro level, the companies in our portfolio had released their year-end numbers by quarter-end and provided guidance for the coming year. We found markets did not reward companies when they beat expectations to the same extent as in the past but rather companies were punished if their guidance was either cautious or not as robust as expected.

Let's review each of the most significant macroeconomic issues and how they impact the global market and our portfolio.

Emerging Market Sell-off

In recent years, investors poured their capital into emerging markets attracted to the prospects of high growth. But stock markets in many emerging markets, along with many of their currencies fell in the past several months by about 1%. This was precipitated by the start of the reduction in the U.S. programme of printing new money. The impact of the decrease in quantitative easing is an eventual increase in interest rates, which would encourage investors to withdraw money from overseas markets and bring it back to the U.S. This withdrawal of money leads to a fall in the currencies of the countries affected.

The question is whether this means further weakness or a potential collapse in emerging markets or whether this is a buying opportunity. We believe there has been an overreaction in the markets because the long-term trend for a burgeoning middle class in the emerging markets will continue. We have observed prior cases in emerging markets, only to see them come out of each crisis even stronger. Two cases in point are Korea post the Asian crisis in 1997 and China post the Lehman crisis in 2008. We have seen emerging market currencies stabilize since their share depreciation in late January and many central banks in the emerging countries raised their interest rates to defend their currencies and attract investors.

Cumberland's exposure to the emerging markets are twofold: (1) world class leaders that have a global footprint, including a strong position in the emerging markets, such as Schlumberger and Unilever and (2) companies domiciled in the emerging markets that are dominant on a global basis such as Samsung Electronics. Furthermore, we do not have any direct investments in the countries that are considered to have the most fragile economies which currently include Brazil, India, Indonesia, South Africa and Turkey.

The Debate on Chinese Growth

This is a complex subject since China impacts the global scene on many levels including political, consumer, and geopolitical issues. The new government led by Xi Jinping has reform as a key priority for the government, which involves reigning in shadow banking or off-balance sheet lending. There may be debate whether the Chinese central government has either the will or capability to execute on its structural reform, but in mid-March, the government announced some changes to its banking system that could strengthen it and help small businesses and savers. They need to curb shadow banking and reform the banking system, but at a measured pace in order to have an efficient financial system. There is no debate that the government wants and needs social stability and in order to maintain social stability, it requires growth in the economy and strong employment. So, the growth in yuan loans during the quarter may not have been a signal of growth but rather the banks moving off-balance sheet loans on to the balance sheet as part of the government's move to crack down on shadow banking. Thus, if the underlying growth in China is no longer robust at around 7.5%, then it is highly likely the government will want to keep its exports healthy by decreasing the value of the Yuan.

We do not have any direct investments in China and therefore, do not expect an excessive impact on the portfolio. However, as we stated above, China has a far reach in many areas. Our investments would be impacted firstly on the general sentiment of global markets and secondly on the growth prospects of companies doing business in China.

Central Banks and Economic Recovery

There are varying views within the Federal Reserve. Based on a presentation made by the Chicago Federal Reserve Bank President Charles Evans at a recent Asia conference we attended, he believes that interest rates in the U.S. will remain near zero until mid-2015. He believes that raising interest rates any earlier, whether to head off the risk of financial instability or unacceptably high inflation, could depress already low inflation and derail a recovery. The need to keep the policy accommodative in the U.S. has been the inflation rate of 1% which is still below the target of 2%. Yet, St. Louis Fed President James Bullard, who also presented at the same conference, expects the Fed to start increasing rates in the first quarter of next year and lift them to 4% to 4.25% by the end of 2016. However, most other policymakers see rates rising no higher than 3% by the end of 2016. It is interesting to note that Europe and the U.S. were in similar positions post the Lehman crisis and five years later, we can see the U.S. has made better progress with the aid of the Fed's extraordinary measures.

Europe is making progress but the main criticism is the speed at which the progress is being made. Across the 28 countries in the European Union, its GDP is expected to expand by 1.5% this year and by 2% in 2015 based on forecasts provided by the European Commission. In the 18 countries in the euro zone, the expected GDP growth is slightly less at 1.2% in 2014 and 1.8% in 2015. Certainly growth in Germany will be critical given their 30% contribution and they are expected to grow 1.8% this year. At this same Asian conference, former European Central Bank (ECB) Executive Board member Dr. Jürgen Stark stated that France and Italy had a responsibility to undergo reform as their systems badly need restructuring. If the economies in France, Italy and Spain could strengthen, this could provide a large boost to Europe's recovery. Nevertheless, the euro zone recovery this year will still not be strong enough to provide any dent on unemployment this year, which is forecast to remain approximately at 12%. This high level of unemployment will keep inflation low but it is a real balancing act for the ECB to keep the euro zone out of deflation. The fear of this happening is what probably led the ECB president, Mario Draghi to hint last week that the ECB has willingness to use quantitative easing. Before the ECB can execute on this, it would have to choose which countries' bonds they should acquire without financing governments, which is forbidden from its founding treaty. It therefore makes buying sovereign bonds politically and legally difficult. If the ECB were to purchase debt proportionate to the size of its member countries, more than half would come from Germany and France.

We have voiced our view in the past of our general pessimissim of the success of Abenomics. In a video address by Prime Minister Abe at the Asian conference encouraging investors to invest in Japan given its once in a decade opportunity and a live presentation provided by Senior Vice-Minister Yasutoshi Nishimura, there continued to be insufficient details on how Japan is going to emerge from deflation. Despite a significant move in Japan's equity market last year, we believe market prospects will be muted this year given the continued cautious corporate spending and a weakening of real personal consumption after the increase in the VAT this month.

Geopolitical Risks

Volatility in equity markets seems to have become the norm post the financial crisis. Yet with each geopolitical risk, there is an additional layer of concern. We can list a number of key conflicts that can pose a threat: Ukraine, Venezuela, Egypt, North East China Sea, and North Korea. The European market is impacted by the Ukraine crisis more directly mainly due to Germany's and central Europe's dependence on Russian natural gas.

We witnessed events unfold in the Ukraine at a dizzying pace where similar to the conflict between Russia and Georgia in 2008, the West stood by and did nothing. World politics are obviously complicated and resolutions do not come easy but the markets are more concerned with the impact these conflicts may have on global trade

and capital flows. So for each geopolitical risk, we need to assess and determine which markets will be impacted and who the winners and losers will be. The underlying issue here seems to be nationalism where there is no global rules-based order and where the 28 countries in NATO have been continually decreasing their commitment to a minimum of 2% of their GDP to spending on defence. While the U.S. spends about 4% of their GDP, most other nations do not come close to contributing their share to NATO, which may lead certain leaders and nations to be opportunistic to expand their influence.

Among all of the listed conflicts and potential conflicts, in our view the one that creates the largest fear, mainly because its unknown potential impact, is the unrest that lies beneath the surface in North Korea. On March 31, with North Korea's shells landing in South Korea's territorial waters, South Korea returned fire. North Korea is obviously challenging South Korea's resolve, but it appears South Korea will no longer stand by and is now expected to retaliate within minutes if attacked. Critical to this conflict are the reactions of both China, which supports North Korea, and the U.S., which supports on the other hand South Korea. Also significant is how Japan gets involved in this mix given the conflict Japan is currently having with China over the sovereignty over islands in the East China Sea. The international law that governs this territorial dispute favors Japan's position, but we cannot dismiss other possible outcomes based on China's ambitions and Japan's desire to reinstate their military power in the region.

The potential impact of the above situation on our portfolios is the negative sentiment that would arise towards Asia in general and Korea specifically, resulting in discounted stock prices.

Performance and Portfolio Changes

	Q1 2014 USD Price Return %	Q1 2014 Local Price Return (%)
MCSI World	0.8	0.5
S&P 500	1.3	1.3
Canada S&P/TSX	1.3	5.2
Euro Stoxx	1.6	1.7
MCSI Emerging Markets	-0.8	-0.9
Germany DAX	-0.2	0.0
UK FTSE 100	-1.6	-2.2
France CAC 40	2.1	2.2
Switzerland SMI	3.4	3.1
Japan Topix	-5.8	-7.6
Hong Kong Hang Seng	-4.7	-4.7
Korea KOSPI	-1.9	-1.3

The key benchmark, the MSCI World Index, had a total (price and dividend) return of 1.4% in US$ and 5.3% in C$. The other key benchmarks of MSCI EAFE had a total return of 0.8% in US$ and 4.7% in C$ while the S&P500 had a total return of 1.8% in US$ and 5.7% in C$. International markets underperformed the Canadian market which returned 2.1% in US$ and 6.0% in C$. The Canadian dollar depreciated by 3.9% against the U.S. dollar compared to the prior year-end, thereby increasing the returns when translated back to the Canadian dollar.

In the MSCI World benchmark, utilities and healthcare were the top performing sectors in the quarter. Although the Cumberland Global and International strategies were overweight in Healthcare, benefits from sector allocation were offset by some negative performances amongst our holdings in the sector. The key detractor in this sector was Elekta. Based on our review of the Company, we believe it was a timing issue of booking certain contracts rather than a secular issue and therefore, we have decided to keep Elekta in the portfolio. Consumer Discretionary and Telecommunications were the worst performing sectors in the quarter. While we benefited from our reduced exposure to the Telecommunications sector, our overweight in Consumer Discretionary detracted from performance in the first quarter. Another detractor to performance was BG Group where its investment thesis was no longer intact due to a change in its operating record and in this case, we sold the Company during the quarter.

During the first quarter, Cumberland's Global and International portfolios saw the following changes to their holdings:

Global Strategy	International Fund
Purchases	
Bonavista Energy Citigroup Dollar Tree	AIA Group Samsonite International
Sales	
BG Group Hutchinson Telecom. Hong Kong Vodafone Borg Warner CIBC Rona	BG Group Hutchinson Telecom. Hong Kong Vodafone

New Investments

Dollar Tree, based in the U.S. is a leading North American discount retailer with the vast majority of its stores selling under the Dollar Tree banner, which sells all of its goods at the $1 price point in the U.S. and the $1.25 price point in Canada. We believe the Company's business model offers a highly differentiated value proposition to consumers and we see a long runway for robust revenue growth driven by square footage growth in addition to market share gains in the U.S. retailing market. Combined with consistent execution on cost control and share buybacks, we believe Dollar Tree can offer consistent double digit earnings per share growth going forward. Given the Company's strong balance sheet, we also believe there is the potential for the Company to increase capital returns to shareholders.

Citigroup is a global diversified financial services holding company with operations in 160 countries. Citigroup is the most global of the large banks in the U.S. and derives 56% of its revenue from outside the U.S., with 40% from emerging markets. We believe the Company's geographic exposures will allow the Company to drive loan growth going forward. In addition, we believe management has laid out a credible pathway to meaningful improvement in a two to three year time frame from improving operating efficiencies. Over time, we also believe Citigroup will be able to drive improved capital returns to shareholders.

Bonavista Energy, is a Canadian oil and gas exploration and production company focused on two major areas in the deeper, multi-zone and liquids-rich natural gas prone areas of west central Alberta. We believe Bonavista will be a beneficiary of our positive long-term outlook for natural gas. In addition, while the Company's production has historically been skewed towards natural gas, management have done a commendable job in developing the Company's presence in liquids-rich natural gas plays and we believe the market is not adequately valuing Bonavista's large acreage position in the liquids-rich deeper part of western Alberta.

AIA, based in Hong Kong, is a leading life insurance company with operations across 15 countries in the Asia-Pacific region. We believe the adoption of insurance products in Asia will benefit from the rise of the middle class and AIA is well positioned to take advantage of this trend given its brand recognition as well as its significant scale and distribution advantages over its competitors.

Samsonite International, based in Hong Kong, is a leading global manufacturer of travel accessories. We see Samsonite as a beneficiary of the secular rise in global air travel and view the Company as a winner in its industry given its ability to marry its dominant global

market share with a localized product offering, multiple brand strategy, and strong pricing power. In addition, we believe management's strategy of leveraging and extending its capabilities into adjacent categories as favorable and should be a profitable source of growth going forward. With a clean balance sheet, we believe the deployment of capital towards acquisitions and/or capital returns to shareholders represent additional sources of potential upside for investors.

Dispositions

The sale of Canadian Imperial Bank of Commerce was used as a source of funds for our Citigroup purchase, which in our view offered superior upside potential. Our sale of Rona was precipitated by its disappointing earnings report and reduced expectations around the Company's turnaround plan. Similarly, our sale of BG Group was also driven by our diminished view on management's ability to execute on its previously communicated growth strategy and it was replaced with our purchase of Bonavista. We sold our remaining stake in Hutchison Telecom Hong Kong as we believe the regulatory environment in Hong Kong has worsened, which will have adverse consequences on incumbents' profitability going forward. We had taken significant gains in Hutchison Telecom Hong Kong in two prior tranches. Both Borg Warner and Vodafone also appreciated significantly since our purchase and we decided to reduce our exposures as the shares approached our estimate of fair value.

Outlook

The number of transactions during this quarter has been unusually high with dispositions outnumbering our new investments. Based on the current valuations in the market which are generally not compelling, we believe that good stock selection will be even more crucial in the coming year. For example, based on Bloomberg, the S&P500 is trading at 15.4x the next 12 month's expected earnings while it traded at an average of 13.6x over the past five years and 14.3x for the past decade based on the same metric of expected earnings. We shall continue to concentrate on companies that have a global reach with a competitive advantage and attractive growth prospects which aligns us with our goals of growing our clients' capital while protecting it.

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