Strategy Review
April 2013

The S&P 500 started 2013 with the biggest one day gain in more than a year as investors welcomed a budget agreement that averted the "fiscal cliff". The strong performance continued right through the first quarter. Not even concerns over the Italian election results, in which Italy has not yet formed a coalition government or costs associated with quantitative easing which have raised worries that the Fed stimulus could end sooner than expected, were enough to curb market enthusiasm through the end of February. In March, the focus shifted back to the Eurozone as the European Central Bank (ECB), European Commission, International Monetary Fund (IMF) and the Cypriot Parliament worked to finalize a €10 billion Cyprus bank bailout that would see shareholders, creditors and uninsured deposit holders cover much of the cost. The main concern in the market was the possibility that this may be considered a template for future bailouts, which could derail the fragile and nascent Eurozone recovery. None of this in itself was enough to slow the market momentum as the total return for the S&P 500 in the first quarter was 10.6% in US $ or 13.0% in C$ as a result of a weaker Canadian dollar in the quarter. The first quarter was all about fund flows as liquidity poured into U.S. equities at about the fastest rate we have seen since 2007. Positive housing and jobs data in recent months have only added fuel and not even the sequestration cuts that began in March have had much impact on market momentum. The S&P 500 closed the quarter at its all time high surpassing its October 2007 peak. In contrast to the S&P500, the total return for the S&P/TSX was 3.3% or about one quarter the performance of the S&P 500. Performance in Canada continues to remain hindered by the underperformance of the heavily weighted materials index. A combination of poor operating performance in mining and disappointing commodity pricing has held back the Canadian market year to date. During the quarter, pricing pressure continued to mount on the price of gold and copper with gold closing at US$1598.75 per ounce, down 4.6% in the quarter and copper, down 4.9% at US$3.42 per pound. Below-normal temperatures across most of the United States helped oil and natural gas prices as oil closed up 4.4% at US$97.23 per barrel while natural gas increased 20.0% to close at a 52-week high US$4.02 per mcf.

During the first quarter, the strongest performing sectors in the S&P 500 were health care (+15.8%), consumer staples (+14.5%) and utilities (+13.0%) while the weakest performing sectors were information technology (+4.6%), materials (+4.8%) and energy (+10.2%). The most notable factor in the U.S. market is that even the weaker industry sectors performed pretty well with positive returns across all sectors. The information technology performance was weighed down by the underperformance of Apple, the largest weight in the sector, which fell 13% during the quarter and down 37% from its high in September 2012. In Canada, the strongest performing sectors in the first quarter were the smaller weighted health care (+22.8%), information technology (+17.5%) and industrials (+14.2%) sectors, which collectively represent less than ten percent of the TSX. Dragging down the TSX were the materials (-10.4%), and utilities (+0.5%). The other major TSX heavyweights in energy and financials performed about in line with the S&P/TSX.

Asset Allocation for Capital Appreciation Portfolios (As at March 31, 2013)	
Equity	84%
Fixed Income	8%
Cash	8%

During the first quarter, our equity exposure increased 4% with the U.S. exposure rising 6% while the Canadian exposure decreased by 2%. The net

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4% increase in equities was sourced from cash (1%) and fixed income (3%). The largest sector increases were in information technology with the addition of Apple Inc., Open Text Corporation and Macdonald Dettwiler and Associates as well as increases to the industrials and consumer discretionary sectors. This included the addition of Raytheon and CSX Corp. in the industrials sector and Coach Inc., General Motors Company and Family Dollar Stores Inc. in the consumer discretionary sector. Our energy weight also increased during the first quarter as we added to Suncor Energy. The biggest declines were in materials and financials where we lightened up in Sherritt International, as well as J.P. Morgan Chase & Co. and Berkshire Hathaway where we have realized decent gains.

In materials, our gold exposure remains low at about 3% and while we continue to see gold as a currency, inflation and volatility hedge, these factors have been relatively quiet so far in 2013. In terms of the opportunity cost of holding gold, real T-Bill yields remain low, which has historically been a positive leading indicator for out-performance in gold. From a sentiment perspective, we clearly appear to have hit rock bottom for gold. Our focus remains on the gold royalty and streaming companies within the sector that do not experience the same operating and capital cost pressures common to the traditional producers. A summary of all new positions added during the quarter including business fundamentals and valuations metrics is contained in Appendix 1 herein.

After strong performance for the S&P 500, our tactical strategy has been to remain close to fully invested, while keeping the beta of the equity portion of the portfolio near the market beta and focusing on alpha generation through stock picking. To help protect the downside, we recently purchased portfolio insurance (for eligible accounts) by purchasing puts on the S&P 500. Similar to what we did last fall, this put protection protects about 13% of a Capital Appreciation Portfolio through mid-June 2013. When combined with the cash and bond exposure, almost 30% of the portfolio would not be exposed to a market pullback through most of the second quarter yet 84% of the portfolio would participate in future market upside. During the first quarter, the overall return of the Cumberland Capital Appreciation mandate lagged the 50%TSX/50% S&P500 benchmark in Canadian dollars. This reflects a more conservative asset mix with the portfolio being less exposed than the benchmark to a sharply rising U.S. market, as well as currency, since the U.S. dollar appreciated during the quarter. Removing the foreign exchange hedge last fall worked in our favour, as it exposed our U.S. holdings to the benefit of the rising US dollar. However, our portfolios benefited to a lesser degree than the benchmark given the its greater exposure to the U.S. dollar.

Interest rates remained fairly stable through the end of the first quarter, but there was a fair amount of intra-quarter volatility. While we expect accommodative monetary policy by central banks around the world to continue to keep interest rates at suppressed levels, we continue to believe bond investors are currently not being compensated adequately for the risk of possible rising rates. If interest rates were to revert back to the pre-2008 crisis average levels, the market price of bonds would decline, and in the case of long term bonds, decline materially. Cumberland's income strategy remains to diversify our income sources focusing on corporate bonds rather than government bonds as corporate bonds tend to earn higher income, which can help offset the negative impact on bond prices from rising interest rates. In addition, we continue to keep our duration (or weighted average term to maturity) short, and hold a core position in floating rate notes in order to further reduce the portfolio's sensitivity to rising interest rates. Within the

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Cumberland Capital Appreciation mandate our asset allocation to fixed income also remains low at 8%.

While there still remains the possibility of a risk-off event in Europe, or a period of higher financial risk, economic data in the U.S. suggest low odds of a recession. Jobless claims have improved significantly through the first three months of this year and indicate a significant improvement in U.S. hiring. The latest data on house prices for January confirmed a twelfth consecutive monthly increase, or an 8.1% increase year over year and this occurred across all twenty U.S. metro areas in the Case-Shiller 20-city composite. There is no question that homeowners are feeling better about the latest home price data and a resurgent housing market is key to the upturn in labour market conditions we are seeing today. Meanwhile household credit market debt as a percentage of total household financial assets is now at its lowest level since Q1 2002. Thanks to continued consumer deleveraging, a rebound in house prices and the Fed's policy of low interest rates, consumer financial obligations as a percentage of disposable personal income dropped to its lowest level since Q3 1981. Also after a long period of decline, the competitiveness of the U.S. manufacturing sector has improved notably in recent years. Slower unit labour cost growth in the U.S., cheap natural gas and a shift in corporate attitudes towards production overseas argues for a reversal or a slowing down of the outsourcing trend of previous years. Price earnings valuations for the S&P 500 and the TSX are currently 13.6x and 13.8x respectively, which remain below the historical averages. Equity risk premiums are also near record highs suggesting stocks are still the preferred asset class. Our main concern in the short term is that the market may be overbought after a significant advance in the first quarter of 2013. To this end, our put protection should help to dampen the negative volatility. As always, we continue to follow our investment process diligently and focus on companies with positive net free cash flow, high returns on capital employed and trading at discounts to the absolute intrinsic firm value.

Peter Jackson
Chief Investment Officer
April 2013

Appendix 1:
New Equity Investments-Cumberland North American Capital Appreciation Mandate
Quarter Ended March 31 2013

Canada

MacDonald Detwiler
MacDonald Detwiler (MDA) is a world-class Canadian manager of space technologies such as space robotics (i.e. the Canadarm for the International Space Station) and satellite building and image processing (i.e. the Radarsat satellite mission for the Canadian Space Agency). While MDA has been one of the most profitable and fastest growing public companies in Canada in the last decade, it has always been frustrated in penetrating the U.S. market which is by far the world's largest. With its recently closed acquisition of U.S.-based Space Systems Loral, the world's largest commercial satellite maker, MDA should add 40% to its earnings per share. It has also opened the door to compete on almost any commercial or military contract in the world. The stock has also moved up recently on news of winning a large contract to build the next version of the Canadian Radarsat Constellation mission.

Open Text Corporation
Open Text (OTC) is a software vendor focused on managing and analyzing an enterprise's unstructured information (i.e. text, pictures, web interactions) as opposed to the larger ERP vendors like Oracle and SAP which focus on structured information (accounting files or standard forms). Unstructured information comprises 80% of an enterprise's total information and is growing much faster than structured information. Open Text has been a very successful acquirer which has allowed it to double its revenue and more than double earnings in the last five years while exposing itself to the fastest growing areas of the business (presently Cloud Computing). Open Text hired a new CEO about a year ago from Silicon Valley with the mandate to enhance organic growth to supplement its solid acquisition-based growth. We think he has done an excellent job in right-sizing the cost structure, hiring superior managers and introducing innovative new products and that this will materially boost earnings in the quarters and years ahead.

United States

Apple Inc.
Apple (AAPL) designs, manufactures and markets mobile communication devices, personal computers, tablets and portable digital music players. With more than $150Billion in annual sales Apple is among the top companies in the S&P500 by market capitalization. The company is viewed as an innovation leader in the technology sector and over the past 15 years it has revolutionized the music industry with the iPod, the mobile industry with the iPhone and the PC industry with the iPad. Over the past few months Apple has seen its valuation multiple contract significantly as the market anticipates higher competitive threats and margin pressures. Given the stickiness of Apples mobile operating system, we expect growth in current products to stabilize as Apple counters competitive threats with new products. Further, incremental growth should be driven by entry into new markets through innovation in the field of payment technology, television and wearable computing. Apple's $137B of cash & equivalents on the balance sheet represents 33% of its market capitalization. This has also been a source of significant investor activism and any move by the company to return cash to shareholders would be seen as an incremental positive. At its current valuation of less than 10x P/E and 2.4% dividend yield, we believe investors are getting a free option on Apple's ability to innovate.

Raytheon
Raytheon (RTN) is one of the largest defense electronics companies in the world and is a pre-eminent manufacturer of missiles, radar, and electro-optics. Products include electronics for F-18 aircraft, the Aegis integrated defense system used on Navy ships, and Patriot missiles. Raytheon has the largest exposure to international markets of any of the U.S. defense primes, with 26% of 2012 sales going to foreign countries. Defense stocks are presently out of favour due to U.S. political

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uncertainty and sequestration-related budget cuts. However, spending on defense electronics historically outpaces growth in the overall defense budget. As Raytheon provides platform-agnostic components such as radar and electronics, it is less exposed to specific "big-ticket" jet or ship programs most at risk for cuts. Among defense primes we prefer Raytheon because it has the most diverse and broad program base, with 8,000 programs and 15,000 contracts; its contracts are long duration, typically 3-5 years in length, with predictable margins. RTN expects to generate $2.0-$2.2 billion of free cash flow in 2013, which will go towards share buybacks and ongoing dividend increases.

CSX Corp.
CSX Corp. (CSX) is America's third-largest freight railroad by revenue, and serves the eastern U.S. with 21,000 route-miles of track in 23 states, shipping 4 million annual carloads. The network includes 36 yards and access to 70 ports. Low natural gas prices led to sharply reduced coal volumes for the eastern rails in 2012 which impacted the price of CSX. CSX management believes coal tonnage volumes to utilities are "near the bottom", though stockpiles remain elevated. Switching pressure should stabilize, as most utilities that can switch from coal to natural gas have already done so. While weathering the coal downturn, CSX management has done a good job improving the efficiency and productivity of the business over the longer term, demonstrated by return on invested capital (ROIC) rising from 9.2% in 2005 to 13.2% in 2011. As a result, CSX's operating ratio improved from 82% in 2005 to 71% in 2011. CSX has averaged $140-$145 million of productivity savings per year, and achieved $200 million in 2012. After a 17% dividend increase in 2012, the stock yields 2.3%.

Coach
Coach (COH) is one of the world's most recognized retail brands, with 545 stores in the U.S. and 402 in Asia, including 117 in China. Founded in 1941 and public since 2000, Coach has two store formats: full price stores, typically in urban centres, and factory stores, in suburban locales. Factory stores offer both "made for factory" product and some discounted full-price-store product. The global accessories market has historically grown at a CAGR of 10% and Coach has typically outgrown this pace, with revenue quadrupling in the past decade. However, the stock declined sharply in January after reporting an unusual 2% North American same store sales decline due to weak mall traffic and promotional activity by competitors. Now trading at a much cheaper valuation than peers, Coach will invest in numerous areas to leverage its brand and resume growth, including men's leather goods, a global relaunch of footwear, introducing Coach-branded apparel items in Holiday 2013, and better penetration of Asian markets, including opening 30 net new stores per year in China.

Family Dollar Stores Inc.
Family Dollar Stores (FDO) operates a chain of approximately 7,400 general merchandise retail discount stores in 45 states. After falling 27% since last summer, on slower quarterly reported sales growth, we initiated a position in FDO with the view that the shares were being unjustly punished by investors who felt the company had reached a permanently slower growth trajectory. We disagree and instead believe the recent slowdown was more a result of the company's deliberate attempt to move its merchandise towards more stable and predictable consumer items. With this change now behind it, new management and a renewed strategy to target discretionary items towards holidays, we think FDO is on pace to continue its high single digit comparable sales growth.

CUMBERLAND

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GM

GM (GM) trades at a cheap multiple relative to the progress the company has made since emerging from bankruptcy in 2009. Its closest peer, Ford, already has 80% of its products on "global platforms", allowing the use of common components to achieve scale, while GM has only 50% of its products on global platforms; GM is aiming to raise that over time to Ford's level. After 3 years of below-average product cadence, GM is substantially ramping up new product launches and over the next 18 months, nearly the entire lineup will be replaced with redesigned models. The product refresh will bring 23 new products to market between now and 2016, with management highlighting the new Cadillac (CTS, XTS and ATS) and full-size pickups (Chevrolet Silverado K2XX, GMC Sierra). Planned fixed cost reductions of $500million from 2013-2015 will enhance operating leverage from the launches. North American 2013 Auto sales are estimated at 15.0-15.5 million units and with a refreshed product slate GM should be able to recapture market share in 2013. The company has no mandatory pension contributions for 5 years and as a result of net operating losses it was permitted to retain its arrangement with the U.S. Government; it will not be a cash taxpayer until 2017.