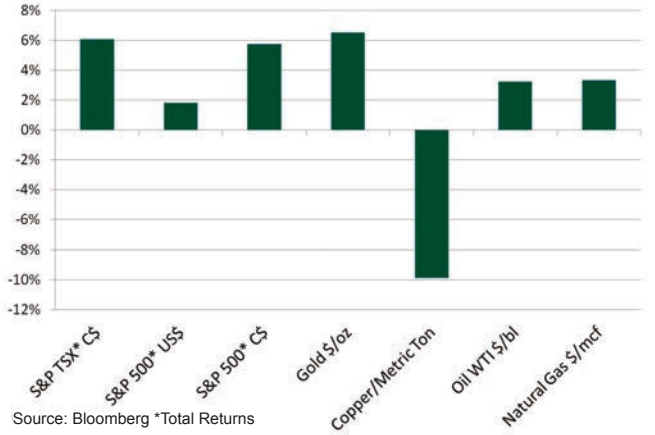
CUMBERLAND

First Quarter Review
North American Capital Appreciation Strategy
April 2014

The first quarter of 2014 saw returns shift back to Canada as the TSX outperformed the S&P 500 for the first time since the fourth quarter of 2012. The TSX returned 6.1% while the S&P500 returned 1.8% in US$. Adjusting for currency, the S&P500 returned 5.8% in C$ as the C$ declined almost 4 cents against the US closing at $0.9042. The recent decline in our dollar follows an approximate 7 cent US decline in 2013.

Quarter Percentage Change to March 31, 2014



Source: Bloomberg *Total Returns

After shifting to a more dovish or accomodating stance last October, the Bank of Canada governor Stephen Poloz has remained steadfast in keeping interest rates low indicating "the timing and direction of the next change to rate policy will depend on how new information influences the balance of risks". Our view has been that the Canadian economy is performing better than the market has generally believed and recent data seems to support that view with fourth quarter Canadian GDP running at 2.9%, versus the US at 2.6%. Even the latest GDP data for January came in better than expected after the ice storm-related drop in December, making Canada's current policy on rates seem out of sync with the US, and leaving our currency as the whipping boy. With the Quebec election looking like it is heading toward a Liberal majority, we are less concerned about another material downward leg in the C$ from here. Since we removed our currency hedge in September 2012, our Canadian clients' US$ assets have materially benefited. At such low levels however, with potential for the C$ to move higher, we put the hedge back in place during the first quarter to protect some of those gains.This is similar to what we did back in 2008 following the massive depreciation of the C$ relative to the US$ during the financial crisis. Having the hedge in place was an enormous benefit to client portfolios once the currencies eventually normalized. This time we put the hedge on at $0.90US on approximately 55% of the US dollar portion of the portfolio.

The single biggest headline issue during the first quarter was Russia's annexation of Crimea. Surprisingly though with no credible threat made by the West, there was little in the way of a retaliatory response from the US or NATO and the markets in North America have shrugged it off. It likely only becomes an issue if Russia takes a more aggressive stance with respect to the rest of the Ukraine. Meanwhile here in North America, focus remained on the US Federal Reserve as Janet Yellen made good on her promise of continuity by reducing monthly bond purchases another $10bn in March to $55bn per month. With the unemployment rate at 6.7% in the US, the 6.5% threshold set by Ben Bernanke to raise rates was dropped with a new objective of "maximum employment and 2% inflation". This was countered by Yellen's statement that the bond buying program could end by the fall accompanied by the first interest rate increase six months later, which is sooner than markets had recently been anticipating. Perhaps the outlier is inflation. Even though CPI inflation is currently running at 1.1%, there are some signs that this will pick up later this year. Services inflation, a component of CPI inflation, is currently running above 2% at 2.4% while commodity inflation, currently at 0.8% and effectively holding down CPI inflation, has recently turned up. Some of this

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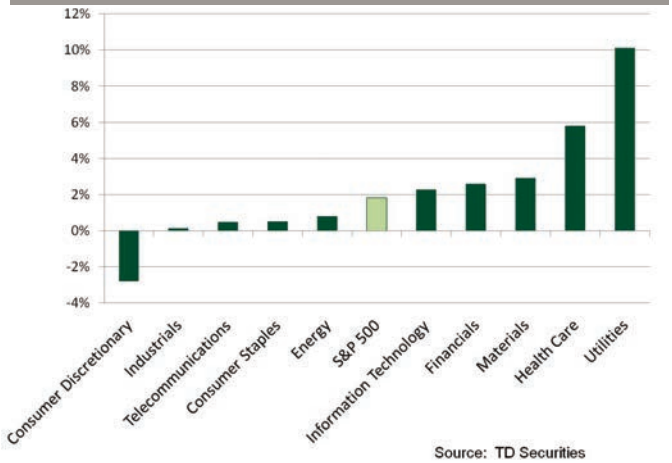
commodity inflation could be weather induced but time will tell. Our sense is, weather aside, that the US economy continues to show signs of improvement. The latest March reading on US Consumer Confidence reached the highest level since January 2008 and the latest jobless claims point to a healthier labour market. So putting this all together, short of a massive acceleration in policy move by the Fed or an imminent recession, of which neither appear to be in the cards, there is room for the economy to improve and corporate profits to move higher.

As seen in the accompanying chart for the S&P500 sector returns, the defensive Utilities and Health Care sectors performed well during the first quarter whereas the Consumer Discretionary and Industrials sectors, after a strong run in 2013, took a pause. Without question, weather played a factor on the consumer during the first quarter.

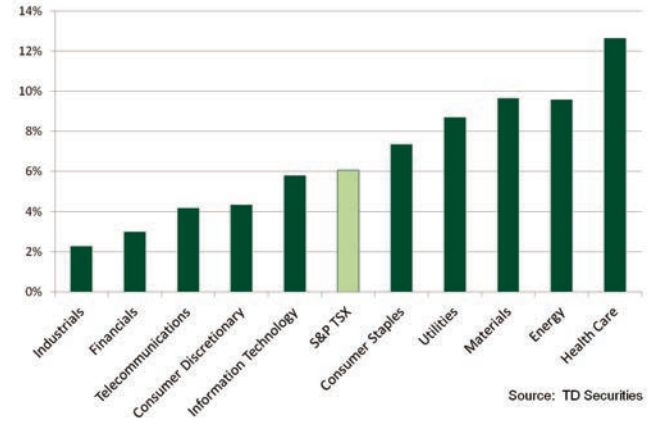
S&P 500 Sector Performance (US $)
1ST Quarter 2014



For example, seasonally adjusted auto sales in January and February fell to 15.2mm and 15.3mm units respectively after reaching a 6 year peak of 16.3mm units last November. Sales subsequently rebounded back in March to 16.3mm units. We took advantage of this weakness by initiating positions in a number of consumer-oriented names including Target, GNC Holdings and Elizabeth Arden.

In Canada the returns were driven by the larger weighted Materials and Energy sectors, with Materials up 9.7% and Energy up 9.6%. The big driver in the Materials sector was gold. After getting pummeled in 2013, gold rose from US $1,205 per ounce at December 31st to a high of US $1,386 per ounce by mid-March before reversing its gain and closing at US $1,284 per ounce for a gain of 6.5%. It's hard to know whether this move is anything more than a dead cat bounce as gold typically underperforms in a rising rate environment. Nonetheless it was a major contributor to the TSX performance during the first quarter. We currently hold a small exposure to gold through the recent addition of Alamos Gold at a 2% weight.

S&P TSX Sector Performance (C$)
1ST Quarter 2014



The Energy outperformance was fairly broad-based as a number of factors were behind it and we expect this to continue through the back half of 2014. The first factor was the improvement in oil prices. WTI oil increased from US $98.42 per barrel to US $101.58 per barrel during the first quarter of 2014. This positive move happened notwithstanding a decline

in the global oil price as Brent oil fell over US $2.00 to US $107.76. More interesting was the move in the equivalent Canadian oil price, Edmonton Par, which increased C $17.80 per barrel to C $103.02 per barrel. Constraints on both the commercial and regulatory side have contributed to oil supply pipeline bottlenecks during the past couple of years; however, these have now largely been resolved. As an example, while the average volume of Canadian crude transported by rail is currently about 200,000 barrels per day (bpd), Western Canadian oil rail loading capacity will rise to over one million bpd by the end of 2014. Removal of these capacity constraints combined with our weaker dollar during the quarter positively contributed to operating leverage for our Canadian oil producers.

Another factor leading to the Energy group's outperformance was natural gas pricing, which clearly benefitted from the effects of cold weather this past winter with storage levels in the US and Canada currently 51% and 57%, respectively, below normal levels for this time of year. However, we believe there is more to the recovery in gas pricing than just cold weather. Since the peak in gas pricing at US $14 per mcf in 2008, the US gas rig count has declined from 1,600 rigs to 318 rigs. This is 71 rigs lower than last year and gas production has essentially flattened out sequentially growing only 0.4% in January. Meanwhile, the oil directed rig count has grown from 200 rigs to 1,473 rigs over the same time frame. This growth in the oil directed rig count reflects the strong economics for oil given the advancements in horizontal drilling and multi-stage fracture technology. The bottom line is that it will take a significant convergence in the economics of gas versus oil to shift capital back to gas plays. Furthermore, the likelihood of increased international demand for U.S. gas is becoming a reality as US liquefied natural gas (LNG) projects get developed. Current approvals for LNG export total 9.3bcf per day representing about 13% of domestic onshore production in the lower 48 states. Pending approvals represent another potential 36% of production with first exports scheduled to start in 2015. In all likelihood not all LNG proposals will get developed but with no current price incentive to increase gas production it will not take much to tip the scale toward higher gas prices. As a result of our view, during the quarter we added three energy names to client portfolios including Bonavista Energy Corp., Trilogy Energy Corp. and Horizon North Logistics representing about 6% of a full capital appreciation portfolio. Bonavista and Trilogy provide direct exposure to rising natural gas prices, while Horizon is more of a play on Canadian LNG development, on which we also remain positive.

Asset Allocation for Capital Appreciation Portfolios As at March 31, 2013	
Equity	82%
Bonds	11%
Cash	7%

During the first quarter, our asset mix was relatively unchanged although we reduced our exposure to US equities by 5% in favor of an increase in Canadian equities by 5%. As discussed above, the biggest sector increase was in Canadian Energy. We also increased the weight in the Industrials sector with the addition of Eastman Chemical and increased our weighting in Russel Metals. In the case of Eastman Chemical, over the past few years management has transformed the company from a seller of mostly commoditized and cyclical products to a specialty chemical company, yet Eastman continues to trade at over a 20% lower valuation relative to its specialty chemical peers. In the case of Russel Metals, after the fourth quarter report and gaining increased confidence after a meeting with management, we increased our target on the stock. A recent building confidence survey in the US confirms activity is accelerating for both commercial and institutional construction. With Russel gaining share in its Metals Service Centres business, it should generate solid growth in free cash flow and dividends in 2014. The

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stock price is currently supported by its 4.6% dividend yield.

We also added to the Telecommunications Services sector with the purchase of Verizon Communications. Verizon is the third largest telecom company in the world and a clear market leader with 40% share of the US wireless market. Verizon is set to benefit from several structural tailwinds including a shift in consumer preferences to better phones that use more data and drive overall revenue per subscriber higher. With the recent February 2014 purchase of the 45% of Verizon Wireless that had been owned by Vodafone for cash and shares, the Verizon share price has lagged its long term average valuation by 20%-25% creating a buying opportunity in the stock.

Our largest sector exposure decline notwithstanding the new investments made, was in Consumer Discretionary. A number of positions reached our target price during the quarter and with limited upside, they were sold. We also took gains in the Materials sector through the sale of Domtar during the first quarter. A summary of all new positions added during the quarter including business fundamentals and valuation metrics is contained in Appendix 1 .

On the fixed income side, after the 10 year US Treasury peaked at about 3% at year end 2013, softer weather-related economic data combined with lower earnings projections capped any follow through on a further interest rate rise. Cumberland's Income strategy remains largely unchanged so far in 2014 compared to 2013. However, our expectation of a higher interest rate environment in Q1 was delayed with interest rates actually declining during the quarter. Recall, the fourth quarter of 2013 ended with economic data improving, which in turn contributed to increasing bond yields. As the first quarter unfolded, it became clear that this trend would not continue as weaker-than-expected U.S. unemployment data released in early January set the tone for a quarter of lower bond yields (higher bond prices). In addition, the demand for bonds remained strong as the extreme winter weather seemed to reinforce a slowdown in the economy throughout the quarter. This demand for example, caused the yield on the 10 year US Treasury to decline from 3.02% at the beginning of Q1 to 2.72% by the end of the quarter. We are of the view that the second quarter of 2014 will reveal that the slowdown in the economy was indeed weather-related and stronger economic data will lead to higher interest rates. In the meantime, the duration (or the weighted average term to maturity) in our Income strategy remains low at 2.9 years to help mitigate the risk of rising interest rates and a corresponding decline in bond prices.

During the first quarter we rolled forward the portfolio insurance we had purchased in the fourth quarter 2013 to protect portfolio gains through June 2014. This was accomplished by purchasing put options on the S&P500 for option eligible accounts. The puts, combined with our cash and bond exposure, protect over 30% of the portfolio from a pullback in the equity market while over 80% of the portfolio would participate in future gains.

For the first quarter, the overall return of the North American Equity strategy lagged the 50% TSX/50% S&P500 benchmark in C$. This reflects a strong upward move in the TSX, particularly in the Materials sector where we were underweight, the performance of the US market including currency, given its impact on the 50% benchmark, and our more conservative asset mix relative to the benchmark. Over the longer term, our decisions on asset mix have helped us achieve higher returns with lower volatility, which ultimately remains our priority.

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Outlook

Well let's start with the bad news; the earnings growth for the S&P500 for 2014 has slowed from 10.6% projected in December 2013 to 8.5% projected at the end of March 2014. If there is a silver lining here, it is that the decline reflects two factors. The first is that after the December projections for 2014 were made, actual 2013 earnings came in higher than expected so the percentage increase from 2013 to 2014 is automatically less. The second point is that while the first quarter bottom up consensus earnings growth rate slowed from 4.4% at December 31st to -0.4% at the end of March, the outlook for second half earnings has increased such that overall, there is not much change in the full year 2014 earnings outlook. Perhaps this explains why, even though expected earnings have collapsed for the first quarter with 84% of companies issuing negative guidance (versus the 5 year average of 65%), the S&P500 did not lose any ground year to date. When we actually roll forward the consensus estimates for the next 12 months, the Price Earnings (P/E) multiple on the S&P500 is 15.4x or exactly the same level it was at year end 2013. If you recall, this is also bang on the 25 year average forward P/E multiple for the S&P500 we discussed last quarter. So the market remains around fair value here and in our view, not much has really changed in the last three months except that it might take a little longer for the golf courses to dry out.

In Canada, with the better performance from the TSX, the forward P/E multiple has expanded from 14.7x at year end 2013 to 15.4x at the end of March. This compares to the 25 year average range of 10x-24x and the mean of 15.1x. While the current multiple is slightly above the mean, this may be somewhat skewed by the move in the Materials sector lately, in particular the gold stocks which had plenty of P but not much E.

When we compare the dividend yield of the US and Canadian markets, it is worth noting that the yield spread continues to favour the TSX over the S&P500 with the current spread at 0.89% (TSX 2.83% versus S&P500 1.94%) as compared to the historical average ten year spread of 0.53%. To get back to the average spread, the TSX would have to rise about 15% relative to the S&P500 all else being equal. This in part explains our continued shift out of US equities into Canadian equities, which now represent about 43% of a full capital appreciation portfolio as compared to 38% three months ago and 32% in June of last year.

From a funds flow perspective, we continue to see net flows in the US favouring equities over bonds so far in 2014 although flows into bonds are no longer negative as they were through the back half of 2013. In Canada, the largest fund flows continue to be into balanced funds so far in 2014, although equity flows in Canada have quadrupled during the first two months of the year from a low base and now make up 24% of total industry net sales. Canadian bond fund flows remain negative. As evidenced in the first quarter sector returns shown in the charts, performance among sectors remains fairly uncorrelated, which suggests to us that we will see a continued stock pickers market, which we are well positioned to take advantage of.

Peter Jackson
Chief Investment Officer
April 2014

Cumberland Private Wealth Management Inc. is a leading independent investment firm that provides discretionary investment management and wealth management services for high net worth individuals, their families and foundations, with $1 million or more in investable assets. All of Cumberland's investment mandates are centered on building and preserving our clients' financial wealth. Founded in 1997, the firm is privately-owned by its employees and headquartered in Toronto, Canada.

Appendix 1
New equity investments:
Cumberland North American Capital Appreciation Mandate
Quarter ending March 31, 2014

Canada

Trilogy Energy Corp.

Trilogy is an oil and gas exploration and development company with a focus on liquids-rich natural gas in deeper parts of the western Canadian sedimentary basin in western Alberta. With the majority of the company's market valuation supported by an already established and successful resource play (the Montney), the company is left with material upside potential from two primary sources. The first is the company's excellent land position in an exploration play that is easily among the industries most exciting in the last decade (the Duvernay) where significant news is expected in 2014. The second is their leverage to the rise of natural gas prices which have been depressed in recent years but which we expect will rise meaningfully in upcoming years.

Bonavista Energy Corporation

Bonavista is also an oil and gas exploration and development company with a focus on the same liquids-rich part of the western Canadian sedimentary basin as Trilogy. This excellent operator has laid out a 5 year plan where they will grow volumes by 5% a year while paying a 5% a year dividend thus providing a 10% a year return. The plays underlying this growth have already been identified and the lands have been purchased. Upside from here is also provided by strong leverage to an expected rise in natural gas prices and participation in the highly prospective Wilrich exploration play.

Horizon North Logistics Inc.

Horizon North Logistics provides remote accommodations (camps) to the resource industry in Western Canada. It is a very similar operator to our previous successful investment in Black Diamond. While Black Diamond stock has risen significantly in the last six months, Horizon North's stock has slipped during the same period due to what we feel are temporary operational issues allowing us to get a decent position in the stock at an attractive price. The company benefits from the same oligopoly industry structure, which affords strong pricing and rapid spending paybacks. The industry has powerful tailwinds from two multi-year, multi-billion capital spending cycles in western Canada, the oil sands around Fort McMurray and the build out of infrastructure to support LNG export from the west coast of Canada to Asia.

Alamos Gold Inc.

Alamos Gold Inc. is engaged in the exploration, acquisition and development of precious metals primarily in Mexico and Turkey. Beginning in 2003, the company built its foundation by developing its flagship asset, the low cost Mulatos mine in Sonora, northern Mexico.

Alamos Gold has a long history of purchasing development projects at fire-sale prices during low points in the gold cycle, which has enabled them to develop an industry-leading growth profile while maintaining a strong balance sheet. In 2009, Alamos Gold bought its two development projects in Turkey: Kirazli and Aği Daği, for only $80 million, while the projects will more than double the company's current production of 190,000 ounces per year, when permitted. In 2013, the company bought the Esperanza development project in Mexico for $47 million or a total of just $33 per ounce.

In January, the company released its one-year guidance that included a 16% decrease in production and a 23% increase in cash production costs. The market hastily slashed 28% off the entire value of the company, leaving valuation at a historical low during a time when its production profile has never been so robust. Alamos Gold has

no debt, $410 million in cash and at current costs can fully fund its Turkish development. The company also pays a $0.10 semi-annual dividend, which currently yields 1.9%.

United States

Eastman Chemical Company

Eastman Chemical is a global specialty chemicals company that manufactures and sells chemicals, plastics and fibers. It is a producer of copolyester materials for packaging, cellulose acetate fibers, and raw materials for paints, coatings, inks, graphic arts, adhesives, textiles, and other products with a broad array of consumer and industrial end-markets. Over the past few years, management has transformed the company from a seller of mostly commoditized and cyclical products to a specialty chemical company. The acquisition of Solution in July 2012 added products in areas such as performance films and advanced interlayers, expanded the manufacturing footprint particularly in Asia, and provided access to new customers. Despite upgrading the free-cash-generation abilities of its asset portfolio, Eastman continues to trade at a lower valuation than its specialty chemical peers. Excess cash will be used for accretive acquisitions, buybacks, and dividend increases.

Citigroup Inc.

Citigroup is a global diversified financial services holding company. It has 1,043 branches in the US and operates in 160 countries. Citi is the most global of the U.S. large banks and derives 56% of its revenue from outside the U.S. and 40% from emerging markets (EM). International loans are 56% of the loan book; of these, half are consumer and half corporate. Citigroup's US branch banking business, with 5.3% market share, has the best 5-year CAGR of deposits per branch among its peers at 8.7%, and the best asset-gathering per new branch as of 10 years after branch opening date. Net interest margin troughed in Q3 2013 and should start to turn back upwards. Citigroup's balance sheet is in good shape with a Basel III Tier 1 Common ratio of 10.5%.

In FY2013 Citigroup's ROE was 7.1%, up from 4.1% in 2012, and ROA was 74 bps, up from 40 bps in 2012. For 2015, management is targeting ROE of 10%+ and ROA of 90-110 bps. We expect Citigroup to continue to materially reduce expenses to drive towards 2015 targets even in a subdued loan growth environment.

Target Corp.

Target is the 3rd largest retailer in the US with over $70B in sales and a growing footprint in Canada. Over the holiday season, the company suffered from a slew of negative headlines related to a credit card fraud and a poor Christmas selling season, which lead the stock to dramatically underperform the market. Our experience covering similar events in the past has been that they have proven to be shorter in duration and far less impactful than initially assumed. Couple this with near all-time low valuation levels and a best-in-class retailer committed to correcting course we applied the Buffett adage of "Buy when others are fearful". More tangibly, the 3% dividend yield in addition to a $2 Bn share repurchase program provides a compelling annual return of almost 10% to shareholders while cost savings efforts and a maturation of the Canadian store base should provide further uplift as the credit card issues fade into the past

GNC Holdings Inc.

GNC Holdings is one of the many retailers that have been impacted by the terrible weather this winter, which in turn has provided us with a compelling entry point into the stock. As the leading global retailer of nutritional supplements, GNC is uniquely positioned to profit from the structural Health & Wellness trend both domestically and across the globe. As we become more physically active and awareness surrounding the benefit of supplements rises the overall category should continue to grow +5%-7% per year. In addition, GNC has done a tremendous job of building a loyal customer base and a line of proprietary products that drive both sales and margins. Internationally, GNC has ample room to expand as key markets such as the EU, China and Brazil which remain largely untouched. All

told, the company is a remarkable growth story and the recent setback in the shares has provided us with an opportunity to participate at a discounted price.

Verizon Communications Inc.

Verizon Communications is the leading provider of wireless services in the US with over $125Bn of revenue. Recently, the company bought back the minority ownership of the wireless business from Vodafone for $130Bn in cash and stock, which has resulted in short-term underperformance as the market digests this sizable transaction. Longer-term, the deal is of strategic importance as it allows Verizon to begin bundling its internet and wireless services to better meet the needs of clients and create barriers to entry. The company is also poised to capitalize on one of the largest structural trends in consumer behavior today, which is the shift to mobile technology. As we trade-up to new iPhones and other advanced devices our consumption of wireless video and data rises dramatically thereby increasing the utilization and value of Verizon's best-in-class network. We expect this growth to become apparent to the market over the near-term and in combination with the 4.6% dividend yield should result in Verizon shares providing a significant return.

Elizabeth Arden Inc.

Elizabeth Arden is a top 20 beauty company with significant exposure to some of the fastest growing personal care categories globally. As the US mass consumer slowly continues to recover from the great recession and the company continues to aggressively drive penetration of international sales from 36% to 60% over the medium term, Arden should see a substantial recovery in sales and margins from current levels. Recent investments in support of a brand refresh as well as the introduction of several new innovations have been received positively by the industry and should lead to an uplift in same store sales and counter traffic. Also, the recent hires of senior L'Oreal and Procter & Gamble executives materially improves the depth and quality of leadership, which will likely result in improved execution and cost efficiencies over time, driving further improvement in shareholder returns.