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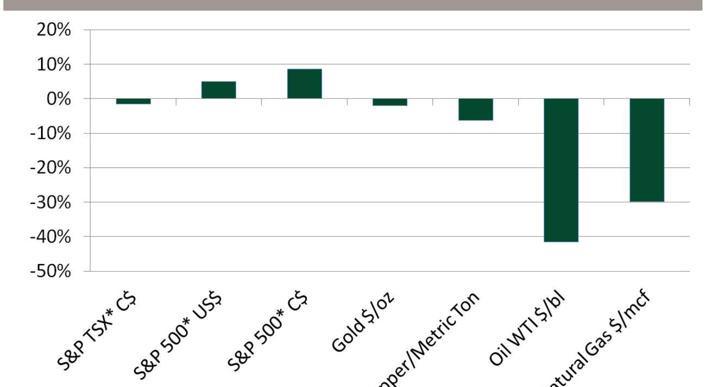
Year End Review
North American Capital Appreciation Strategy
December 2014

The fourth quarter did not start off well for the markets. By mid October, both the S&P500 and TSX were down over 7% and 11% from their respective all time highs reached in mid-September 2014. The trigger seemed to be many factors including weaker retail sales in the U.S., weak economic data from Europe and the end of quantitative easing (QE), the U.S. Federal Reserve (Fed) large-scale bond buying program that helped fuel equity markets over the past 5 years. An accelerated sell-off in oil triggering a sudden and significant widening in bond high yield spreads, which has often been an indicator of tougher markets ahead, probably created an additional layer of panic in the market. Once the market adjusted to the fact that the pain in the high yield market was mostly centered on energy companies, which make up about 17% of it, things began to normalize. Then on October 15th, comments by James Bullard, president of the St. Louis Federal Reserve Board, suggested delaying the end of the Fed's bond buying program and in fact possibly extending it with a new program, sparked a rally in the S&P500. This seemed to be a powerful enough signal to the markets that the Fed would remain accommodative in the face of further volatility notwithstanding its original goal to end QE in October. The TSX initially recovered as well but further pressure from declining crude oil prices reversed these gains. During the fourth quarter the TSX returned -1.5% in C$ while the S&P500 returned +4.9% in US$. Adjusting for currency moves, the S&P500 returned 8.6% as the C$ depreciated slightly more than 3 cents relative to the US$, closing at US $0.86 at December 31st.

Quarter Percentage Change to December 31, 2014



Source: Bloomberg *Total Returns

It seems that the worse the global economy looks, the better the U.S. economy and its capital markets seem to perform. The Eurozone is still struggling with subpar economic growth and with headline and core inflation approaching deflationary levels, currently at 0.3% and 0.7% respectively on the November reading, the European Central Bank (ECB) is likely poised to begin its own QE program early in 2015. Meanwhile, China's Purchasing Managers Index for December slipped to 50.1, the lowest reading in about 18 months. While any reading above 50 is considered positive, the pace of growth appears to be slowing. In November, the People's Bank of China cut interest rates for the first time since 2012 in response to weaker economic indicators. Add the Russia / Ukraine and Middle East conflicts and the threat of Ebola, and it is no wonder the U.S. stands out as an island of capital markets sanctuary. Some might question how long this can last before the rest of the world drags it down. Well, with the help of lower oil prices and back to back quarters of GDP growth above 4%, accelerating to 5%, on the final reading for the third quarter, it seems like this divergence may continue.

With oil closing at $53.27 on December 31st, this represents a decline of 49.4% from its close on June 30th. The latest personal consumption data suggest this could save U.S. consumers as much as US $200 billion on gasoline and heating on an annualized basis. For Canada there will obviously be regional winners and losers. However a stronger U.S. economy, cheaper energy, low interest rates and a depreciating currency should be positive for the manufacturing-intensive provinces. The Bank of Canada estimates a 40% drop in oil prices impacts the Canadian dollar by about 5%, however so far the Canadian dollar has lost 8.2% from its June 30th close of US$0.94. The latest annualized reading on Canadian GDP was 2.8%, which came in considerably better than most analysts' expectations. Combine this with better than consensus employment data and higher than expected inflation in November, the dovish stance by the Bank of Canada could reverse later in 2015.

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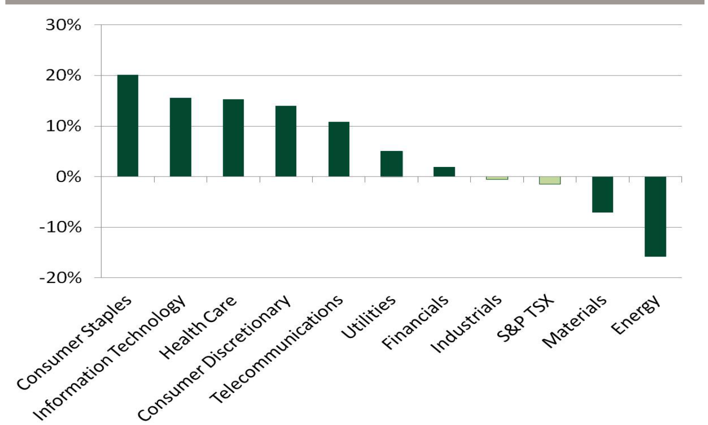
In terms of sector performance, it was a repeat of last quarter with the Consumer and Health Care segments continuing to outperform at the expense of Energy and Materials. Clearly OPEC's decision to hold market share and not to cut production at its November meeting has been a material negative for oil prices with the beneficiaries being the U.S. consumer at the expense of Russia, Iran and other OPEC countries. The question on our mind is whether this a structural change in the price dynamics for crude oil or simply a short-term meltdown in a commodity? The answer is that it is probably a bit of both. Advances in drilling technology (fracking) and its potential impact on the growth in U.S. oil production are likely here to stay. And at $100 plus oil, production growth could likely continue in the U.S. However at current oil price levels, oil production is more likely to contract in the U.S. and globally. So we think the critical things to watch are indicators that could signal a bottoming process.

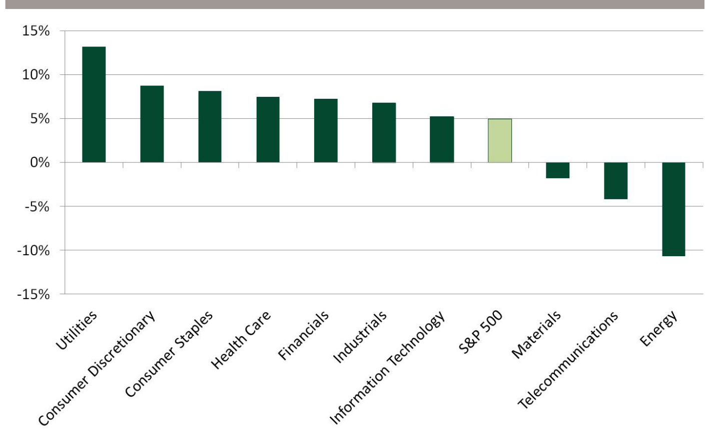
Since June, global annualized crude oil revenues have plunged US $1.1 trillion with OPEC's share down US $409 billion. The latest December data on the US crude oil rig count showed a decline to 1,499 rigs from 1,609 rigs in October, the lowest level since 2012. U.S. oil production is currently 9.1 mm bpd and the impact the decline in the oil rig count will be critical to watch through the first quarter of 2015. Another wild card is whether Russia comes back to the bargaining table with OPEC, which would change the dynamics overnight. We think it is important to understand that the circumstances behind this past OPEC meeting are not the same as in 1985 when the Saudis effectively collapsed the oil price keeping it low well into 1986. At that time, OPEC excess capacity was about 15 million barrels per day. Today it is about 1 million barrels per day. Global demand hit a record in November 2014 at 92.8 million bpd, up 0.7% year over year.

Our investment strategy at this time is to stay the course. We have taken the opportunity to add Canadian Natural Resources and Crescent Point Energy to the portfolio and increase our weight in Suncor Energy. These are all large capitalization oil producers and should be the first responders to any change in the price outlook as investors look to rebuild energy holdings. We are also looking at some of the midstream companies that process the crude, which have also pulled back significantly. At the same time, we have reduced our exposure to smaller capitalization companies with higher volatility.

S&P TSX Sector Performance (C$)
4th Quarter 2014



S&P 500 Total Returns (US$)
4th Quarter 2014



Source: TD Securities

During the broad market sell-off in October, we took the opportunity to add to some US names in the portfolio such as American International Group (AIG), CBS Corp and Walgreens, as well as add a new position in Pulte Homes. This was a continuation of our "*Buy America*" theme discussed last quarter. Our focus

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is on companies generating the bulk of their income domestically in the U.S.

Asset Allocation for Capital Appreciation Portfolios As at December 31, 2014	
Equities	84%
Fixed Income	10%
Cash	6%

During the fourth quarter, our asset mix shifted with 5% moving from cash into equities and more specifically into U.S. equities. Our Canadian equity exposure declined from 45% to 43% while our U.S. equity exposure increased from 34% to 41%. Much of this increase occurred during the October sell-off. Other positions purchased during the fourth quarter were Mitel Networks, McKesson Corporation and Goldcorp. Mitel is in the process of transitioning from a low margin hardware manufacturer to a high margin cloud-based Internet software provider of internal telephone systems for small and midsize enterprises. This, combined with its acquisition and integration strategy, should provide opportunities for significant future growth and earnings multiple revaluations. McKesson is the largest drug wholesaler by market capitalization distributing drugs to pharmacies, pharmacy benefit managers (PBM's) and institutions as well as medical surgical products to physicians and surgical centres. The company should benefit from the significant growth in generic drugs over the next few years as its size, scale and resulting purchasing power helps drive higher margins from drugs coming off patent. Growth in the specialty drug market, which is expected to be driven by new biologic and biosimilar products that were once considered too complex to be a reality, should also benefit drug wholesalers.

Finally, Goldcorp is a low cost, large cap gold producer, which will experience industry leading growth in gold production (24%) in 2015 and incremental growth in 2016. It generates free cash flow after sustaining capital at $1,200 and pays a 2.5% dividend yield. Extreme US$ dollar optimism continues to play out which is typically negative for gold, however the gold price has been holding steady for the past three months such that the risk versus reward for gold and Goldcorp from any shift in sentiment should be very favourable. A complete summary of new positions added during the quarter including company business fundamentals and valuation metrics is contained in Appendix 1.

The fixed income markets finished the year strongly as the trend of bond yields drifting lower (that has been in place all year) proved to be unrelenting. Deflationary pressures driven by a slowdown in the European, Japanese and Chinese economies, in addition to the decline in oil prices, were the key drivers of materially lower bond yields in the fourth quarter. For example, the yield on the U.S. 10-Year Treasury and the Government of Canada 10-Year bonds declined by over 0.3 percentage points (30 basis points) to 2.17% and 1.79%, respectively. The drop in North American bond yields, consistent with a flight-to-safety trade, conflicted with the evidence of a strengthening U.S. economy. And as previously mentioned, the most recent GDP release showed the U.S. growing at a very healthy rate of 5%, a far cry from the -2.1% quarterly report during last winter's polar vortex.

For all of 2014, we positioned our fixed income portfolios for a backdrop of an improving economy (thus expecting rising bond yields/declining bond prices) by keeping duration low at around 3.0 compared to 7.4 in the FTSE TMX Canada Universe Bond Index to minimize the negative impact that rising yields have on bond prices. In addition, the above-mentioned decline in 10-Year bond yields has also occurred in the face of the U.S. Fed continuing to posture that it will raise the Federal Funds Rate (and consequently short-term interest rates) sometime in the middle of 2015 mainly due to the considerable improvement in the unemployment rate. Fed Chair Janet Yellen even hinted at the possible timing of a rate hike by saying on December 15th: the process is unlikely to begin "…for at least the next couple of meetings", implying the Fed could move as early as April 29th of this year, their third scheduled meeting of 2015. Although the improvement in the U.S. economy and the Fed's commentary has played out as we had expected, unfortunately the bond market's reaction

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has generally been to ignore the U.S. data and focus on the deflationary pressures mentioned above. These pressures have also spilled over into the corporate bond market. Investment Grade corporate spreads (the extra yield demanded by investors for taking company risk versus government risk) widened during the quarter by around 0.13 percentage points (13 basis points) signaling greater perceived risk. The High Yield bond market was also focused on the risks. As discussed, oil and gas high yield issuers were particularly hit hard as the price of oil collapsed forcing investors to scramble and reevaluate the strength and liquidity of company balance sheets. At Cumberland, we are very aware of the global deflationary risks at hand, but we continue to have a cautious view of the risk/reward in the bond market. We expect the benefits from lower oil/gasoline prices and close to 3 million new jobs created in the U.S. in 2014 to result in a pick-up in consumer spending (representing 70% of the economy), which in turn, increases the probability of interest rates rising in our view.

OUTLOOK

What seemed to be clear from the December Fed meeting is that barring a collapse in the economic data, an interest rate hike is a foregone conclusion and focus should begin to shift to the pace and magnitude of the liftoff versus its timing. What happens to the yield curve during this normalization process and what does that mean for the stock market? We need to rely on the assumption that the Fed raises rates because the economy is doing better and therefore implicitly there is less at risk. Volatility as measured by the VIX, or what's commonly referred to as the fear index, has been steadily falling for five years. Yet, in the fourth quarter we had a couple of large spikes in that volatility. We would expect rising interest rates to contribute more to that and contribute somewhat to greater correlations between stocks going forward. Currently the S&P500 is trading at 16.3x forward earnings. While this is up from last quarter (15.2 x) and above the longer term average of 15.4x, it is still not high and is supported by approximately 8% earnings growth in 2015. Given the combination of improving economic conditions and positive earnings growth in the U.S., 2015 should represent another year of decent market appreciation overall. Higher valuations will likely cap the upside to something less than we have seen in the previous five years, however. Ten year yields fell considerably during the fourth quarter and through 2014, which is also supportive of stock valuations; however it remains to be seen how sustainable this is in a rising interest rate environment. We will continue to position the portfolio in sectors that should benefit from rising interest rates. In the third quarter earnings season, 230 of the S&P500 companies discussed the impact of currency during their earnings conference calls with many commenting on the negative impact of the stronger U.S. dollar. We have and will continue to favour having more of your assets in U.S. companies with domestically-oriented earnings that will also benefit from further economic recovery.

Finally, it is interesting to note the Fed's December comment regarding energy and its impact on inflation – "is viewed as transitory". So it seems that at least the Fed agrees with our view. During 2015 we will continue to selectively add to your energy weighting, as we believe the downturn in oil prices is not sustainable.

Peter Jackson
Chief Investment Officer
January 4, 2015

Appendix 1
New Equity Investments:
Cumberland North American Capital Appreciation Mandate
Quarter ending December 31, 2014

Canada

Canadian Natural Resources Ltd.

Canadian Natural Resources is one of Canada's largest oil & gas producers with daily production of 800,000 barrels of oil equivalent. Despite the steep drop in oil prices in 2014, the Company's diverse reserve base and strong balance sheet will allow it to continue to invest in 2015 with the goal of boosting production to over 1 million barrels per day by 2018. Much of the capital expenditure is directed towards expansions of existing oil sands plays in Alberta. Once these substantial upfront investments are made, the Company will benefit from much lower operating costs (i.e. <$30 per barrel at its Horizon mine) and tremendous free cash flow generation from these 20+ year reserve life assets. We believe this free cash flow will offer management the flexibility to increase dividends and make opportunistic acquisitions in coming years.

Crescent Point Energy Corp.

Crescent Point is a large cap Canadian energy company that produces nearly 150,000 barrels per day of medium to light grade oil, largely from the Bakken oil play in Saskatchewan. Shares of energy producers with high dividends, including Crescent Point, have fallen substantially in late 2014 as oil prices collapsed and investors feared dividends would be slashed. Crescent Point shares have lost more than a third of their value since the Company raised $750million at $43.40 per share in September 2014. Low oil prices will certainly hurt Crescent Point's cash flows in 2015 and its dividend may be at risk if oil prices stay below $60 through 2015 – a scenario we are not anticipating. However, the Company's high quality reserve base, industry-leading low cost structure, low indebtedness and experienced management team will allow Crescent Point to survive this cycle and we believe shares are attractively valued at today's price.

Goldcorp

Goldcorp is engaged in the exploration, acquisition and development of gold. The company was built on the success of its three low-cost mines in northern Ontario and has since ventured south through the Americas in order to help grow its twelve-mine production base. By 2016, the company is poised to grow its production by over 20% to 3.7 million ounces as it completes the current ramp-up of its two newest mines: Cerro Negro in Argentina and Eleonore in Quebec (it is believed that both will contribute over 0.5 million ounces annually, for 20 years thereafter).

Importantly, while the company has continued to grow production at a robust rate, it has never jeopardized its trademark low-cost structure, which has forever been anchored in the lowest quartile of its peer group and currently stands, on an "all-in" basis, at just under $1,000/oz. Furthermore, Goldcorp has also continued to operate in low-risk political jurisdictions and is the only senior gold producer to have consistently kept its net debt/capitalization ratio below 20%. Taken as a whole, Goldcorp boasts a strong, organic production growth profile and is one of the highest-quality gold companies in the world which should continue to provide significant shareholder returns. The company pays a monthly dividend of $0.05 which equates to an industry-leading 2.5% dividend yield.

Mitel

Mitel is a provider of voice telephony management equipment and software (known as private branch exchanges or PBXs) with a storied history going back to its founding in the 1970s by two of Canada's most successful technology entrepreneurs. Its present CEO comes with extensive acquisition experience from one of America's premiere acquisition companies (Danaher) and intends to consolidate the PBX business. They have already done one major and highly accretive acquisition (Aastra Technologies) with plans for more. The stock trades at quite a low earnings multiple which reflects the slow growth prospects for the overall PBX industry but has yet to reflect their ability to grow earnings through acquisitions similar to such Canadian technology acquisition successes as Constellation Software and Enghouse Systems which trade at materially higher multiples.

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New Equity Investments:
Cumberland North American Capital Appreciation Mandate

United States

McKesson

McKesson (MCK) is the largest U.S. drug wholesale company by market capitalization and sales. The company operates two businesses – distribution and healthcare IT (HCIT). The distribution business supplies pharmaceutical drugs to drug store retailers, PBMs and institutional customers. The segment also supplies medical surgical products across ambulatory, physician offices, surgery centres and long-term care settings. The HCIT business provides billing, claims payment, practice management, inventory management and EMR software.

Over the next few years, drug wholesalers will continue to benefit from the dual themes of increased generic drug and specialty drug distribution. Generic drug price inflation and a steady stream of new generic products create a durable tailwind for the drug wholesalers. There are roughly $50 billion of branded pharma products that are expected to lose patent protection in the next three years. The specialty drug market is also expected to see strong growth with a number of new biologic products and biosimilars advancing through late stage clinical trials.

MCK has a stellar balance sheet, a strong track record of generating free cash flow and has been involved in shareholder friendly activities through share buybacks and dividend increases. The company recently entered into strategic relationships with Rite Aid and Omnicare as well as acquiring Celesio to increase its heft in being able to generate greater discounts when procuring generic drugs. As a result, the company serves an important function in the pharmaceutical supply chain in being able to help drive down the cost of delivering drugs to the end user.

Pulte Group

PulteGroup (PHM) is one of the largest homebuilders in the U.S., on track to delivering more than 15,000 homes in 2014. The company has one of the broadest footprints nationally and is positioned in 55 markets across 28 states. After the disastrous experience of the housing bust in 2008 PulteGroup's management has been vocal about judiciously investing in new projects and is focused on targeted improvement in ROIC. The company has also improved its margin profile through development and implementation of more efficient operating practices. This has helped PulteGroup achieve pre-crisis operating margins in 2014. Additionally, while house prices have bottomed in the United States, new home inventories are below normalized levels and home affordability is high by historic standards. An improving employment picture in the U.S. and the fact that the 30 year mortgage rates are at historic lows should spur new home sales growth. Assuming new home sales approach normalized levels and margins improve modestly over the next 5 years PulteGroup's stock presents significant upside to investors in our opinion.