CUMBERLAND

Strategy Review
July 2012

After a strong start to the first quarter of 2012, in the second quarter investors were once again reminded of the macro risk factors facing the global economy and the European sovereign-debt crisis in particular. April returns were more or less flat in both Canada and the U.S. equity markets as Q1 earnings reports were generally better than consensus expectations. Actual Q1 earnings reports showed +7.3% year over year growth compared to negative expected growth for consensus earnings estimates. However, May was dominated by a series of unfavourable economic reports that supported the old adage: "sell in May and go away". Between weaker than expected data on European private sector business activity, Chinese industrial production and U.S. jobs, both the U.S and Canadian stock markets lost over 6% in May alone. This culminated with the S&P 500 testing the lows of its 200 day moving average on June 4th but quickly snapping back upward through the remainder of June.

As similar as this felt to the corrections witnessed in 2010 and 2011, there were some noticeable differences. One difference was that the VIX, an index that measures the implied volatility of the S&P 500 and is often referred to as the 'fear index', remained relatively low. Even at its recent high of ~27 reached June 4th, it remained well below 2010 and 2011 highs of ~50 and the ~90 high reached during the 2008 financial crisis. While the June 4th level was clearly higher than recent lows, it was well below previous "risk off" levels experienced in prior years.

Another difference between the recent market downturn and those experienced in 2010 and 2011 was the level of correlation among assets. In previous years, almost all risk assets, including most equities, went down. This time however, there was far less correlation between equities such that not all stocks went down. This is more typical of a correction than a contagion when investors just want out of everything. The final point has to do with valuation. The S&P 500's 2010 peak Price to Earnings ratio (P/E) was 20.1x 2010 earnings. From peak to trough, it fell 16.9% to 16.7x before climbing back to the 2011 peak of 18.4x and then falling 19.4% to 14.8x. This spring's market peak P/E ratio was 17.3x (lower than both the 2010 and 2011 peaks already) and from there has fallen 9.9% to 15.6x 2012 earnings, which is not far from the lowest point of 14.8x reached in 2011. While equities could obviously get cheaper than previous lows, this suggests the worst of the correction may already have occurred.

The month of June was greeted by the People's Bank of China cutting interest rates by 0.25% on June 7th, the first rate cut since the global financial crisis in December 2008. This was followed by the Greek pro-bailout election win on June 17th and the FOMC meeting June 20th, where the FED reconfirmed its highly accommodative stance on monetary policy agreeing to extend 'Operation Twist' until year end and indicating they were "prepared to take further action" if needed. The final straw, on June 29th, which sent the S&P 500 up 2.5% that day, was the surprise decision by EU leaders to allow the region's bailout funds European Financial Stability Facility (EFSF)/European Stability Mechanism (ESM) to directly recapitalize distressed banks. This combined with a EUR 120 billion stimulus package and plans for a single financial regulator for the region spurred the North American markets through the end of June but still left the S&P 500 ($U.S.) down 2.8% and the TSX down 5.7% in the second quarter.

Given the overall pullback in markets during the second quarter, both north and south of the border, it is not surprising that sector leadership swung from offensive to defensive. For the S&P 500, the strongest performance came from Telecommunication Services (+13.9%), Utilities

(+6.5%) and Consumer Staples (+2.8%), all defensive sectors. The TSX pretty much mimicked the S&P 500 with Telecommunication Services (+2.8%), Utilities (+2.8%) and Industrials (+1.6%) having the strongest showing. Turning to the underperforming sectors in the second quarter, it was essentially the reversal of what worked in Q1. For the S&P 500, that meant declines in Financial Services (-6.8%), Information Technology (-6.7%) and Energy (-6.5%). In the TSX, the biggest underperformers were Information Technology (-17.8%), Materials (-10.8%) and Energy (-7.3%). The underperformance in Information Technology in Canada was essentially due to one stock, Research in Motion which fell 48.5%. With Gold down $70.95 per ounce (-4.3%) closing at U.S. $1,597.40 per ounce and copper, which is a proxy for base metals, off 9.2% in the second quarter to $3.47 per pound, the underperformance in the Materials sector was not surprising. The one area of relative strength within Materials has been the fertilizers companies which have been somewhat agnostic to the Euro crisis and slowing global economies. As for Energy, oil started the quarter at U.S. $103.02 per barrel, bottoming June 28th at $77.69 per barrel before recovering at month end to $84.96 per barrel on renewed investor optimism that meaningful steps to tackle the debt crisis were made at the EU leaders summit. We remained significantly underweight energy through the second quarter although given the significant pullback, it is back on our radar screen.

Asset Allocation for Capital Appreciation Portfolios (as at June 30, 2012)	
Equity	77%
Bonds	11%
Cash	12%

During the second quarter, our overall asset allocation, was unchanged in our core Capital Appreciation mandate. Within the equities allocation, our exposure to U.S. equities increased 3% to slightly over 30%. The biggest shift here was an increased sector allocation to U.S. Information Technology, namely IBM and Nvidia. Other new positions added during the second quarter included IMAX, Imperial Oil, Silver Wheaton and Dun and Bradstreet. Overall this quarter, our goal has been to buy companies with specific catalysts for growth, that should do well regardless of what happens in the macro environment. A summary of these companies' business fundamentals and valuation metrics is contained in Appendix 1 herein. With respect to our income-oriented investments, we continue to believe there is a substantial amount of interest rate risk in the fixed income markets (bonds), and for this reason we have kept our duration low. The allocation to bonds and cash within our Capital Appreciation portfolios provides a safe haven given the current level of equity market volatility and headline risk. During the second quarter, the overall return of the Cumberland Capital Appreciation model about matched its 50% TSX/50% S&P 500 benchmark in Canadian dollars.

Outlook

There is no doubt that certain economic data has softened in recent months and that the European debt crisis spreading across the globe poses the greatest risk to global stock markets. However, central banks appear to be prepared to act more quickly and we have been seeing them do just that. As we write this review, we have seen the ECB cut rates below 1% for the first time ever, the Bank of England embark on additional quantitative easing and China's central bank announce a second rate

cut in less than a month. This is on top of the Fed's pledge two weeks ago to extend 'Operation Twist' and take further action if needed, and the EU leaders' move last week to directly recapitalize struggling banks through the EU bailout funds. As far as the economic data goes, there have also been a number of positive data points surfacing out of the U.S.: single family homes sales have risen 35% off their February 2011 lows; retail sales are up 4.6% over the past year and have continued to improve for five consecutive months; June U.S. auto sales were up +17.5% year over year, with the Detroit 3 gaining share sequentially. As for valuation, the market remains cheap given recent earnings growth. The S&P 500 is now trading at only 13x 2013 earnings. With 54% of stocks in the S&P 500 now yielding higher than the 10 year treasuries, this is a level which surpasses the level hit at the market trough in both 2010 and 2011 and represents an all time high. Given record levels of global stimuli, an economic backdrop that does not suggest we are heading into a recession and attractive valuation metrics, we remain buyers of equities.

Peter Jackson
Chief Investment Officer
July 2012

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.

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Appendix 1: New Equity Investments-Cumberland North American Capital Appreciation Mandates
Quarter Ended June 30, 2012

Canada

IMAX Corporation
IMAX is a leading entertainment technology company with the biggest network of premium large format movie screens in the world with over 640 screens in 52 counties.

Not only does IMAX earn money when it sells a system to a theatre chain, but it also receives up to 12.5% of the studio's share of the box office revenues. In addition, about 50% of all new installations come in the form of a joint venture whereby IMAX gives the theatre the equipment for free in exchange for an additional 20% of the box office revenue. As IMAX's network matures, the majority of its earnings will eventually come from the box office, rather than from technology sales, a model which is much more recurring and less cyclical in its nature. IMAX feels it can grow its installation base from 640 screens to 1,700 in the next 5 years. With this expansion and revenue becoming more recurring, we think IMAX shares are poised to benefit from accelerating earnings and potential multiple expansion.

Imperial Oil
Imperial Oil is Canada's premiere integrated oil company producing almost 300,000 barrels of oil a day and processing 430,000 barrels a day at its refinery operations. Further, it operates approximately 1,800 Esso branded retail stations. Imperial Oil has an advantage relative to other non-integrated Canadian oil producers as its refinery operations can purchase discounted Canadian oil, refine it and sell it at levels commensurate with world oil pricing providing it with a significant margin advantage. Factoring in its impressive growth profile over the next 8 years, whereby production should double from current levels, Imperial Oil should generate significant free cash flow. We believe further dividend growth and share buybacks should provide a catalyst for the shares as Imperial has a track record of buying back over 50% of its shares outstanding over the past 17 years and increasing its dividend 50% over the past 6 years.

Silver Wheaton
Silver Wheaton is a precious metals streaming company. It purchases the rights to all the silver produced from mines operated by producers which typically mine silver as a by-product only. The upfront payment helps finance the mine, and in turn, Silver Wheaton is able to acquire the silver at below market levels. Its business structure allows it to enjoy leverage to the price of the metals, as a typical mining company would, but without the risk of increasing operating and capital costs. We feel this lower risk profile is not reflected in the stock today and over time will become recognized by investors.

United States

Dun & Bradstreet
Dun & Bradstreet is a large-scale provider of commercial and credit data, via a proprietary set of databases comprised of detailed records on 200 million global businesses. Its Risk Management Solutions products allow DNB's clients, including financial institutions and manufacturing companies, to make strategic decisions about extending credit and optimizing collections. The company is nearing completion of a multi-year project to replatform its databases to a more flexible and scalable web-based system, which should provide operating leverage as loan growth picks up. The stock's dividend yield is 2.1%, and dividends have grown at an impressive compounded rate of 9% over the past 5 years.

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Appendix 1: New Equity Investments-Cumberland North American Capital Appreciation Mandates Quarter Ended June 30, 2012

IBM

IBM is one of the world's largest IT companies and a significant player in virtually every major segment of the industry including software, services, servers, storage and semiconductors. IBM stands out as one of most defensive and consistent tech stocks due to its high value systems mix, recurring/annuity businesses and, consistent focus on productivity increases. IBM has clear competitive advantages in providing leading technology services and complete IT solutions that are virtually indispensible to its customers. In addition, IBM is a beneficiary of the growth in emerging markets where sales are growing at more than double its competitors. Fiscal 2011 marked IBM's 9th consecutive year of double digit EPS growth, up more than 60% since the broad IT market's last peak in 2007 and better than most of its more cyclical peers. At today's price, IBM trades at just 14.2x 2012 EPS and is supported by strong dividend growth averaging greater than 17% over the past five years. It also has a robust share buyback program that was just increased by $7 billion in the second quarter of 2012.

Nvidia

Founded in 1993, NVIDIA Corporation is primarily engaged in creating graphics chips used in PCs and mobile processors used in cell phones, tablets and infotainment systems (gaming consoles). Nvidia is the industry leader in graphics processing and has a dominant market share in this space. Their graphics products are sold across multiple industries/sectors and touch our lives in many more ways than we realize. Growth in sales of mobile devices is expected to drive Nvidia's mobile division, which in turn is expected to drive overall sales for the company. In fiscal 2012, Nvidia grew its top line 13% on the strength of its mobile processors. This year Nvidia has secured 30 new design wins in mobile devices, compared to 15 wins last year. With over $3 billion in cash, no debt, on an $8 billion market capitalization, we feel there is also ample room for significant share buybacks.