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The S&P 500 continued its advance through April and May hitting an all time high on May 22nd of 1,687, before pulling back almost 8% to the June low of 1,560 and eventually closing at 1,606 on June 30th. The second quarter started out on a positive note driven by better than expected first quarter earnings. In fact, 70% of companies reporting first quarter earnings in April and May beat expectations with the blended earnings growth rate for the quarter coming in at +3.3% as compared to -0.7% estimated at March 31st . All ten sectors of the S&P 500 showed earnings growth during the first quarter. The positive market momentum in April and most of May was also supported by strong economic data including better than expected auto sales, improving jobless claims and overall much stronger consumer confidence. On May 22nd, Fed Chairman Ben Bernanke indicated in his first testimony before Congress since February, that while the economy has shifted to a more sustainable growth trajectory, the employment picture still remains weak overall. This seemed to suggest status quo in terms of quantitative easing. However, the minutes from the Federal Reserve's policy meeting released that afternoon, indicated some Fed members were in favour of tapering the central bank's $85-billion-per-month bond-buying stimulus program as early as June. This mixed message resulted in the sell-off in equities and an increase in bond yields. Weaker manufacturing data out of China and concern about a possible credit crunch also weighed on markets globally. The June 19 Fed meeting caused a further downdraft for the S&P 500 as the Fed confirmed it may moderate its pace of bond purchases towards the end of the year and completely stop by mid-2014. The total return for the S&P 500 in the second quarter was +2.9% in US$ or +6.5% in C$ as a result of a weaker Canadian dollar.

The Fed statements were perhaps even more jarring to the bond market as the benchmark 10 year treasury yield increased from the mid-May rate of 1.9% to 2.5% by the end of the quarter. Investors in long dated bonds lost almost three years worth of income in a matter of about six weeks. While this did not come as a big surprise to us, there is no question that this rate of change will likely weigh on investors' perception that bonds are a safe haven. In fact, in the last two weeks, we have seen the largest weekly redemptions out of bond mutual funds since October 2008. It brings back memories of that 90's soundtrack by Harry Connick Jr., "Honestly Now, Safety is Just Danger Out of Place".

In Canada, the second quarter of 2013 was all about what you did NOT own. The resource dominated TSX Index turned in a negative return of -4.1% with gold plunging 23% or US$361 to US$1,234 per ounce. Copper fell 11%, while natural gas also lost 11%, although this decline was likely more seasonally driven than economically driven. Oil prices remained flat at US$96.56 per barrel. Oil prices have continued to hold in reasonably well which is not surprising as oil is generally the more positively correlated commodity to an improving U.S. economy. Most of Cumberland's resource exposure remains in oil related equities.

During the second quarter, the strongest performing sectors in the S&P 500 were financials (+7.3%), consumer discretionary (+6.8%) and health care (+3.8%). Leadership has clearly remained within the domestically oriented economically sensitive sectors of the S&P 500 while financials also benefited from the recent steepening of the yield curve (ie. increase in longer term interest rates). The worst performing sectors in the S&P 500 during the second quarter were utilities (-2.7%), materials

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(-1.8%) and energy (-0.4%). The exact opposite applies to utilities when interest rates start rising. Utilities initially behave more like long term bonds and their prices tend to fall when interest rates increase. In Canada, the best performing sectors were similar to the U.S., namely health care (+11.0%), which is a small weight at 2.5% of the Index, consumer staples (+8.8%) and consumer discretionary (+8.6%). Materials (-22.8%) was the worst performing sector on the TSX for obvious reasons followed by telecommunication services (-10.6%) and utilities (-4.5%). The telecommunication services group was under pressure given the growing uncertainty around wireless competition in Canada as it was disclosed that Verizon was considering entering the Canadian market place. As in the U.S, utilities in Canada came under pressure from rising interest rates that were a global phenomenon.

Asset Allocation for Capital Appreciation Portfolios As at June 30, 2013	
Equity	77%
Fixed Income	8%
Cash & Equivalents	15%

During the second quarter, our equity exposure decreased 7% while cash & equivalents increased 7%. The net increase in cash was sourced from Canadian equities. This reflected both profit taking in some stocks that reached our full valuation targets as well as a tactical move to raise cash in what we believed was an overbought market. From the November 2012 lows, the S&P 500 has risen 18.7% with over 70% of this move coming from price earnings multiple valuation expansion rather than a recovery in earnings, which has been slow to materialize. With rising bond yields, the equity risk premium has declined. Combined with heightened volatility, as measured by the VIX, and considering the market has gone straight up without a pullback for more than two times longer than any normal period, the recent sell-off in equities did not come as a surprise and actually seemed somewhat overdue.

Our equity exposure had the largest decreases in the materials and financials sectors. The reduction in our materials exposure is mainly attributed to the fact that we have completely exited gold. It now appears the twelve year bull run in gold has come to an end. Over the past decade, investment demand for gold has increased more than fourfold and now represents 35% of total annual gold demand. The extent that investors lose faith in gold as an attractive investment leads to material supply surpluses, which do not bode well for future gold prices from our perspective. Until the technical picture improves or gold begins to respond to negative sentiment in the market, we will remain cautious. In the financials sector, we added AIG but the overall reduction in our exposure to the group reflects some profit taking in positions that became large weights in the portfolio or have reached full value. Overall, financials continue to look attractive and represent our largest sector weight.

During the quarter, our exposure increased slightly in the energy and consumer discretionary sectors with the addition of Canyon Services Group in the energy sector and Men's Wearhouse and Live Nation Entertainment in the consumer discretionary sector. Another name added in the quarter was Black Diamond Group (Industrials). We have begun to build exposure to companies in Western Canada that will benefit from the build out of liquefied natural gas (LNG) to supply Asian markets over the next decade. We believe this opportunity will represent a major structural change to liquids rich gas production in Western Canada and given the national and international players involved, it should provide significant upside for many companies supplying this industry. A summary of all new positions added during the quarter including business fundamentals and certain valuation metrics is contained in Appendix 1 herein.

During the first half of 2013, we have continued to be active in our covered call writing strategy (for eligible accounts) as a means of adding extra income to the portfolio and reducing the net cost of any portfolio insurance we add from time to time. Our usual strategy is to write (sell) out of the money call options with an exercise price at our target price on the stock. Thus, in the event the stock price rises above the exercise price and the stock is called away (ie. sold to the call buyer at the exercise price), it is at the price we would otherwise sell the stock given the target price, plus the premium received for the sale of the call, which we would keep in any event. We generally keep the time to expiry of the calls relatively short to reduce the likelihood that a change in target price is required while the call is outstanding. During the second quarter, we wrote covered calls on Delphi Automotive and Open Text Corporation both of which were exercised in June.

For the second quarter, the overall return of the Cumberland Capital Appreciation mandate compared favourably on a risk-adjusted basis to the benchmark in Canadian dollars, with an overall return about matching the benchmark, notwithstanding a more conservative asset mix in the portfolio compared to the fully invested benchmark.

As discussed earlier, interest rates have remained quite volatile throughout the second quarter. There were three main drivers of that volatility, the first being U.S. unemployment. The U.S. jobs data showed continued improvement through the second quarter from the weak data reported in March. Given that the Fed has tied its quantitative easing bond buying program to the unemployment rate, the capital markets have become very sensitive to this data with better employment data suggesting sooner tapering of the bond buying program. The second driver, as discussed earlier, has to do with specific comments from Fed members on the potential for an earlier taper of the bond purchase program than the market was expecting. An improving economy with less bond purchasing by the Fed was a strong enough signal for many market participants to sell government bonds fueling the sharp increase in interest rates. A third factor affecting interest rate volatility, in our view, has been volatility in the Yen. Japan has been conducting its own massive quantitative easing program, which has put downward pressure on the Yen. As a result, a number of structured notes have been unwound resulting in forced selling of U.S. treasuries during the second quarter.

During the second quarter, corporate bonds have continued to outperform government bonds. Although corporate spreads (ie. the difference between corporate and government bond yields) widened slightly during the quarter, the higher coupons on corporate bonds drove the outperformance. Cumberland's income strategy is unchanged as rising interest rates remain the greatest risk to bond prices and to bond portfolios, in our view. To mitigate that risk, we continue to maintain a duration of roughly three years in our Income Fund compared to the DEX Bond Universe benchmark's duration of seven years. Furthermore, a quarter of our portfolio remains in floating rate notes and we continue to employ robust credit analysis in our corporate bond allocation to selectively buy higher yielding bonds.

The economic debate in Washington on whether the glass is half empty or half full will continue, but clearly weighing on the Fed's decision to taper will be the impact of the budget sequestration on employment and growth. With the third and final

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revision on the first quarter GDP recently reported at 1.8%, down from 2.4% in May, it likely supports no change in the Fed's bond buying policy until later in 2013. However, at that point there is reason to expect continued improvement in the economy. The latest data on house prices shows month over month and year over year gains of 2.5% and 12.1%, respectively. This should have a positive effect on state and local tax revenue, which should mean more jobs at the state and local level. The real question we believe people should be asking is whether this is a cyclical or secular bull market. Comparing the last four years of this bull market to other secular bulls suggest some similarities. However, in the short-term from an earnings perspective, we remain somewhat cautious, but this is from a 77% equity exposure. Q2 earnings estimates have come down to a point where companies should do fine but estimates in the back half of the year still look aggressive and could lead many companies to guide lower. This in turn will provide select opportunities to buy companies at lower prices and add to our equity position. What should be clear to investors now is that sentiment in the market has shifted from fear of losing money in bonds to the fear of missing out in stocks.

Peter Jackson
Chief Investment Officer
July 2013

Appendix 1
New Equity Investments - North American Capital Appreciation Mandates
For the Quarter Ended June 30, 2013

Canada

Canyon Services Group

Canyon provides hydraulic fracturing and other well stimulation services for oil and gas producers in Western Canada. Canyon has effectively grown from a startup in 2009 with 38,000 hydraulic horse power (HHP) pumping capacity to 225,000 HHP today. The top 3 players represent over 50% of the fracturing capacity in Canada with Canyon sitting in third place. We believe, the build out of LNG in Western Canada to supply Asian markets over the next decade will be a major structural change to liquids rich gas production and companies like Canyon stand to significantly benefit from this. Canyon has pulled back from a high of $15.50 in March of 2012 to about $11.00 on weaker gas prices which have firmed up lately. It has no debt and generates significant free cash flow to support its 5.5% dividend yield while we wait for the secular theme to play out.

Black Diamond Group

Black Diamond Group provides remote worker accommodation (camps) primarily to resource companies in Canada and Australia. The economics of the business are excellent with capital payback in 3 to 4 years and the useful life of the structures from 20 to 25 years. The Company has strong relationships with its large resource customers like Canadian Natural Resources and Cenovus and with the native bands that reside in their areas of operation creating significant barriers to entry into the business. There are two main growth drivers for the business over the next five years. One is the large number of planned steaming (as opposed to mining) oil sands projects in the Fort McMurray area and the other is the build out of liquefied natural gas infrastructure required to get the LNG to port in British Columbia for export to Asia. These two drivers alone could drive an increase in the total Canadian camp business by 60% of current capacity and keep demand exceeding supply during the period.

United States

Live Nation

Live Nation resulted from the 2010 merger of Live Nation, a producer of live music concerts and Ticketmaster, the global leader in ticket sales, marketing, and distribution. In 2012, Live Nation promoted 22,000 events for more than 2,300 artists and sold 148 million tickets globally. The Company's business model is to break even in the concerts business and earn its profit in the ancillary businesses of ticketing, sponsorship/advertising, and merchandise. This model creates barriers to entry that has cemented Ticketmaster as the industry leader. Ticketmaster shares its fees with the venues, locking in their loyalty. Live Nation has stated their intent to increase adjusted operating income 35% by 2015, by expanding the platform to sell more tickets, driving conversion of ticket sales through social and mobile channels, and growing sponsorship and advertising. A major IT upgrade currently being completed is aimed at cutting operating costs, while a secondary-ticketing add-on to Ticketmaster's platform, should allow it to capture business now being lost to StubHub and scalpers. We believe Ticketmaster's strategy has positioned itself to expand its dominance in the live-entertainment ecosystem.

Appendix 1
New Equity Investments - North American Capital Appreciation Mandates
For the Quarter Ended June 30, 2013

Men's Wearhouse

Men's Wearhouse (MW) is the largest specialty retailer of men's suits and provider of tuxedo rental product in North America. It operates 638 Men's Wearhouse stores in the U.S. and 120 Moores stores in Canada. Since acquiring the two dominant U.S. tuxedo rental chains in 2007, Men's Wearhouse has consolidated the business by closing underproductive tuxedo rental stores as leases expire; the incredibly profitable tuxedo business from the closed stores is then captured by the nearest Men's Wearhouse store. Headwinds from the macroeconomic environment in 2012 hit volumes, forcing a more aggressive promotional strategy. CEO Douglas Ewert told us he believes operating margins should improve from the present 8% level, and moreover, gradually return to pre-recession levels of 10-12%. Management's key margin-boosting strategy is to raise sales contribution from "exclusive designer brands" (i.e. direct-sourced, in-house brands) from 45% to 65%. Further, management sees room for "at least" another 100 full-line Men's Wearhouse stores in the U.S. taking the footprint to ~750 stores. While a messy exit by the founder put short-term pressure on MW's price, the core value proposition the brand offers to consumers is intact and the stock is inexpensive on price/earnings multiples considering its prospects. MW has no net debt, raised its dividend by 50% this year, and has a $200 million outstanding share repurchase authorization. We expect employment performance in the U.S. economy to support volume, while new stores will add productive square footage as the "exclusive" brand strategy rebuilds margins.

AIG

AIG is an American insurance company which operates predominately within the property and casualty space. Since the financial crisis of 2008/2009, in which AIG had to be recapitalized by the U.S. government, it has greatly de-risked and simplified its business. With the U.S. government no longer an overhang and with its capital issues now mostly behind it, we believe the next step for AIG is to improve its operating margin through better underwriting practices, mix shift and expense reductions. If AIG can achieve a combined ratio in the low 90's, then its return on equity ratio could rise to 10% or higher from 5% today. In addition, AIG is currently overcapitalized and we expect it could soon initiate a dividend, begin buying back stock or both. At just 0.6x price to book value, we think the risk/reward on AIG is very favorable.