CUMBERLAND
Private Wealth

INCOME STRATEGY
SECOND QUARTER REVIEW

Global Volatility Continues, Domestic Data Keeping up: Still in a Cycle of Rising Interest Rates

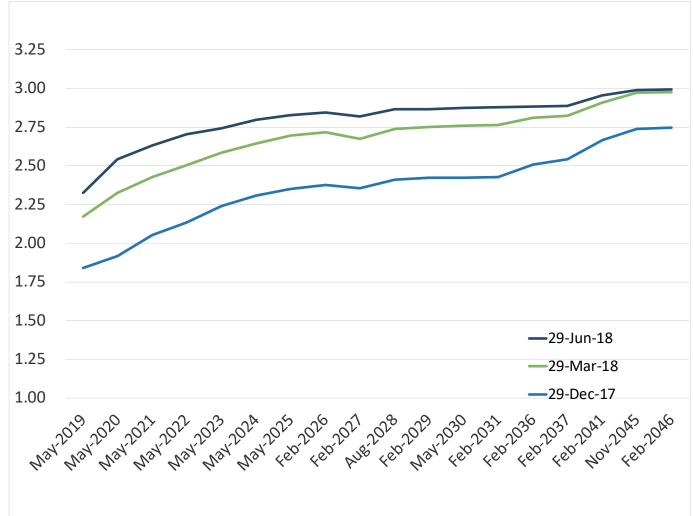
This quarter was not short of drama: global volatility continued with trade wars heating up between the U.S. and China as other countries, companies and consumers watched with concern on what/how/when this will impact them; the European Central Bank motioned that it would end 3 years of quantitative easing by December but will now keep interest rates low until mid 2019; new Italian PM promised radical change causing an increase in Italian bond yields. Closer to home, NAFTA negotiations are on going with the potential of a new agreement not signed until after the U.S.' midterm elections in early November, while the U.S. slapped tariffs on Canadian steel and aluminum products June 1st and the Mexican elections concluded with a left-wing, anti-establishment government being elected on a radical reform platform.

On the data front, the U.S. continued to post solid growth with inflation above the FOMC's target. This will keep the Fed on track with their 3 to 4 interest rate hikes this year (there has already been two rate hikes so far, one during this past quarter). Canada is another beast given the uncertainty on trade with the U.S.: our view is that we will lag the U.S. in the number of rate hikes but rates will continue to rise (as at this writing, one hike already behind us and expecting another 1 to 2 more before year-end) barring external global issues or elevated tariffs from trade wars. Canada's data continues to be mixed (i.e. April's retail sales number was a big disappointment), but the focus for our Bank of Canada (BOC) Governor is GDP, inflation and currency. GDP continues to be in line with the Bank of Canada's projections, while inflation is narrowing into their 2% target range. Additionally, the Q2 business investment outlook still remains on a relatively positive tone. So, we believe that based on the data, the BOC will continue to raise the short-term interest rate.

Review of the Quarter

As seen in the chart below, the U.S. yield curve moved 2 to 20 bps higher across the curve, with majority of the move in the 2 year to 10 year part of the curve as the Fed raised rates by 25bps in June for the second time this year. Global uncertainty buoyed the long end of the yield curve as bond investors fled to a less risky product. The spread between 2 year and 30 year bonds flattened to 45 bps at quarter end vs. 66 bps in Q1.

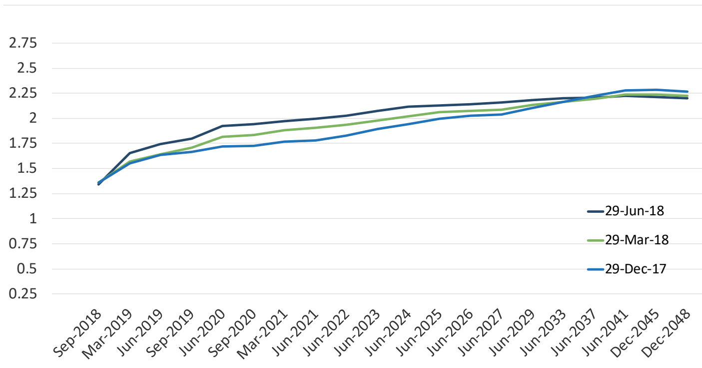
U.S. Yield Curve



Source: Bloomberg

Meanwhile, in Canada, the yield curve moved higher by 5 to 10 bps in the 2 year to 10 year part of the curve with 30 year rates moving down 2bps. Note that the 2 year vs. 30 year spread narrowed to 28bps at the end of the quarter vs. 41bps at the end of Q1.

Canada Yield Curve

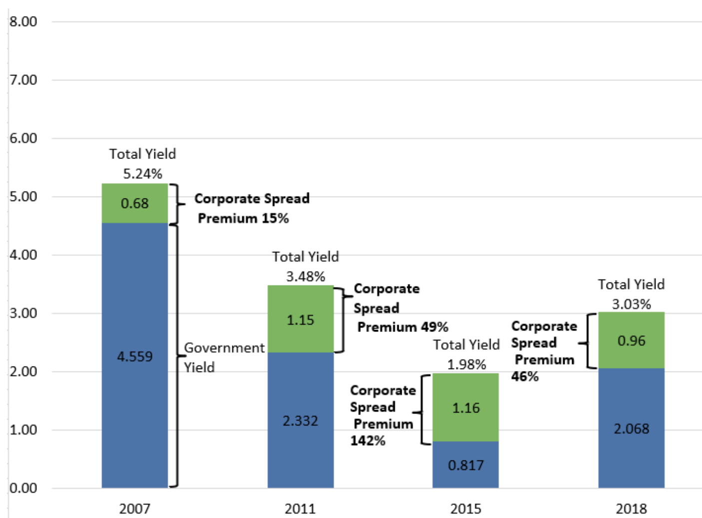


Source: Bloomberg

Canadian credit continues to reflect a very flat curve, as credit spreads take a similar shape to the Canadian yield curve. Spreads moved out 8-14 bps across the curve and across the investment grade ratings range, as heavy issuance weighed on spreads (note spread widening means bond prices are lower).

In Q2 corporate debt issuance was $37 billion vs. last year's Q2 total of $32 billion. Investor demand continues to be robust to match the supply as portfolios continue to overweight corporate bonds, in anticipation of more interest rate increases by the BOC (note that the additional spread on top of Government of Canada bonds helps to offset the depreciation in the price of the bond when interest rates rise). The chart below highlights 5-year credit spread premiums. Despite the fact that all-in yields are still low vs. 2007 and 2011, note that the corporate spread premium is still consistent with 2011 levels. Typically, the movement in credit spreads are negatively correlated with the move in interest rates (i.e. if the economy is doing better, interest rates move higher, but credit spreads compress as the risk of default is reduced because companies should also be faring better). We believe there is still value in corporate bonds at this time, and are continuing to favour and invest in this category over government bonds.

5 Year Corporate Yields



Source: BMO Capital Markets, Bloomberg

Results for the different bond asset classes are set out below. While we are transitioning the Cumberland Income Fund (the "Fund") to reflect our investment views, our existing overweight in corporate bonds and underweight in Federal bonds helped the portfolio vs. its benchmark but our underweight in Provincial bonds was a drag on performance. (*note: the Provincial bond index has a duration of +10 years and long term rates rallied slightly vs. the rest of the curve*).

Asset Class Returns	Q2/18	Q1/18	2017
Bond Universe Index	0.51%	0.10%	2.52%
Federal Bond Index	0.34%	0.33%	0.13%
Provincial Bond Index	0.76%	-0.27%	4.33%
Corporate Bond Index	0.42%	0.28%	3.38%
High Yield Index	1.33%	1.47%	9.94%
S&P/TSX Preferred Index	0.61%	-0.15%	13.62%

Transitioning of the Management of the Fund and our Fixed Income Strategy Going Forward

Since Cumberland Investment Counsel Inc. assumed the lead Manager role on the Fund after our recent merger closed in May, we have been starting to transition the Fund to find ways to improve its results. Anticipating further uncertainty in the pace of interest rate hikes (but knowing that we are on a path for continued rate hike cycle), we started to and will be continuing to transition out of government bonds, higher duration bonds and overvalued corporate bonds. We are replacing these positions with undervalued corporate bond opportunities. We are being selective on issuers, maturity time frame, and valuations even within each individual issuer's credit curve.

The Asset Allocation table at the end of this commentary will give you an idea of what has happened since our last quarterly report. Duration has been shortened from 7.1 years at the end of Q1 to 4.6 years at the end of Q2. There is no specific target portfolio duration at this point, but we will certainly continue to be selective and look for where there is value in corporate bonds and also along the yield curve and within each issuers' credit curve. We are staying within the overall parameters of the existing portfolio mandate but will continue to tweak the mix of assets within the mandate parameters to reflect our current view on the fixed income market today.

We do not expect an overly active summer in new bond issues but do expect volatility in the market to continue and particularly into Q2 earnings where any downward revisions to forecast earnings due to tariffs/global uncertainty/lack of global growth could create opportunities for the Fund.

In the meantime, enjoy your summer and I look forward to meeting you at the next client quarterly in September!

Diane Pang
Portfolio Manager, Fixed Income
Cumberland Investment Counsel Inc.
July 5, 2018

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Asset Allocation		
Asset Class	**Q2/18**	**Q1/18**
Cash and Cash Equivalents	1%	1%
Government Bonds	4%	17%
Provincial Bonds	5%	18%
Investment Grade Bonds	82%	58%
High Yield	4%	2%
Preferred Shares	4%	4%

Yield[1] Comparison as at June 30, 2018	
Cumberland Income Fund	3.54%
FTSE TMX Canada Universe	2.67%

Performance[2] June 30, 2018	Q2/18	YTD	2017	2016
Cumberland Income Fund	0.25%	0.11%	3.07%	4.26%
FTSE TMX Canada Universe	0.51%	0.61%	2.52%	1.66%
Value Add	-0.26%	-0.50%	0.55%	2.60%

1. Yield is the yield to maturity for bonds and current dividend yield for equities and preferred shares. Yield does not represent the total return of the Fund or the indices shown in the above table.
2. Gross of Fees. Past performance does not guarantee future results.

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.