DESAUTELS | Capital Management
Gestion de capitaux

Newsletter Q1 2014

McGill

Global Equity Fund

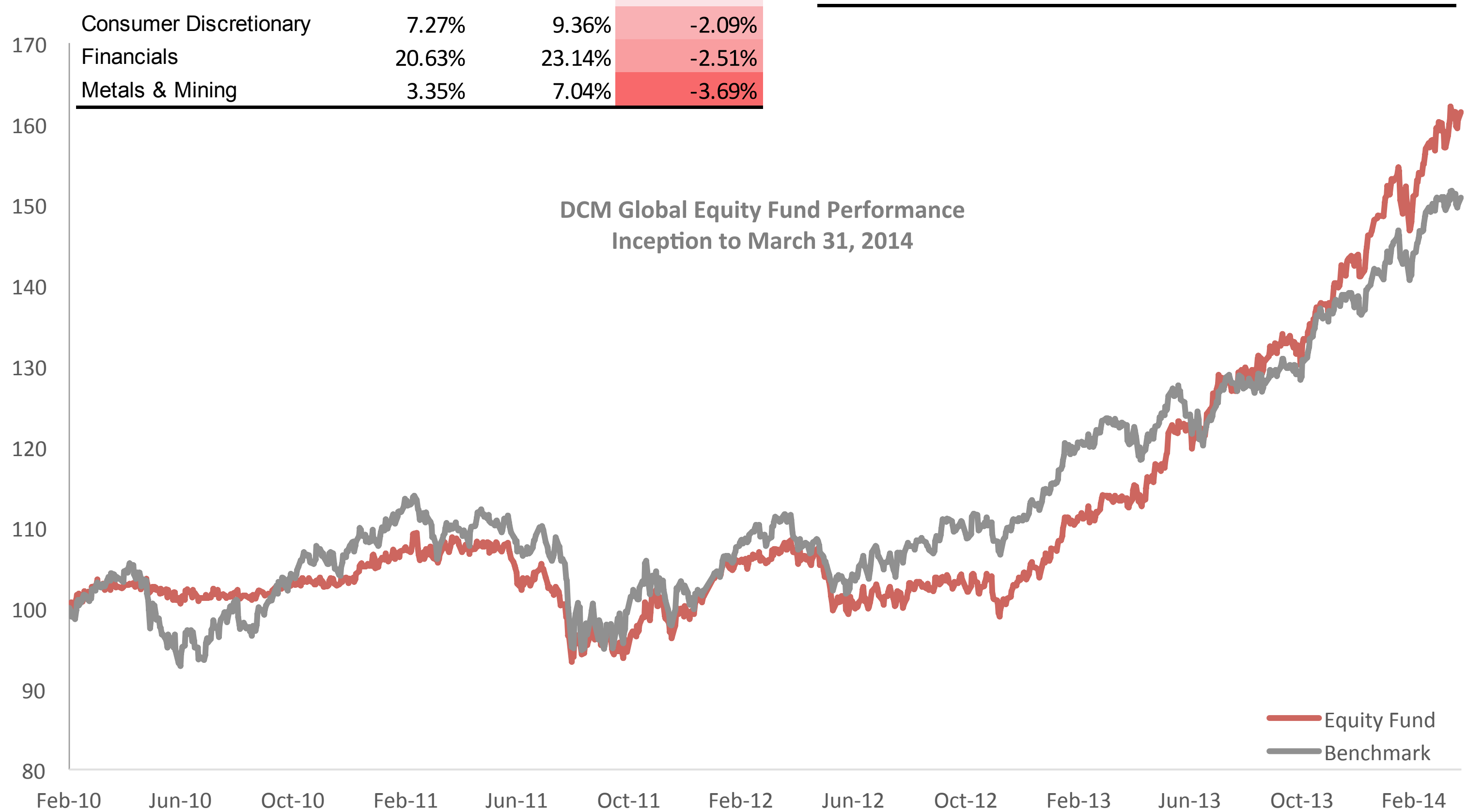
Dear Investor,

We are very pleased to report that the DCM Global Equity Fund returned 8.6% gross of fees for the 3 months ending March 31 2014, representing an outperformance of 3.1% relative to our benchmark. Performance was equally impressive when viewed on a risk-adjusted basis, with an annualized CAPM alpha of 14.3%, and a Sharpe ratio of 2.54, versus 2.12 for the benchmark. In summary, the equity fund began 2014 where 2013 left off; strong outperformance and many of our investment theses playing out as expected.

Q1 2014 Performance Metrics		
	DCM (gross fees)	Benchmark
Return	8.61%	5.50%
Annualized Std Dev	14.30%	9.95%
Annualized Sharpe Ratio	2.54	2.12
Beta	1.24	
Annualized Alpha	10.15%	

Sector Weightings (as of March 31st, 2014)			
Sector	DCM	Benchmark	+/-
Industrials	16.28%	9.50%	6.78%
Technology	14.17%	11.82%	2.35%
Currency	1.18%	0.00%	1.18%
Telecom	3.29%	3.38%	-0.09%
Energy & Utilities	19.50%	19.62%	-0.12%
Consumer Staples	6.19%	7.00%	-0.81%
Healthcare	8.14%	9.14%	-1.00%
Consumer Discretionary	7.27%	9.36%	-2.09%
Financials	20.63%	23.14%	-2.51%
Metals & Mining	3.35%	7.04%	-3.69%

Desautels Global Equity Fund (as of March 31, 2014)		
Time period	DCM (gross fees)	Benchmark
1 month	2.20%	0.55%
3 month	8.61%	5.50%
6 month	22.06%	16.63%
YTD	8.61%	5.50%
1 year	41.79%	22.67%
2 year (annualized)	22.20%	16.41%
Since Inception (annualized)	12.28%	10.46%



**Note: Performance is as of March 31, 2014, gross of fees. Benchmark is the MSCI World Index from inception to February 28, 2013 and a 60% S&P TSX, 40% S&P 500 (measured in CAD) blended benchmark thereafter. Fund inception date is January 20, 2010.*

Equity Commentary and Outlook

Global equity markets had a volatile start in 2014, with the S&P 500 volatility index (VIX) recording its highest close (at 21.44) since the fiscal cliff debacle in late 2012. Increased market correlations and higher volatility were mostly due to a mixture of poor economic data, emerging market woes, and an escalating conflict in Ukraine.

Emerging Markets

Emerging markets have taken center stage in 2014. The MSCI Emerging Markets Index recorded a drawdown of 8.6% by early February, before recovering and finishing the quarter down just less than 1%.

With January being the first month for the Federal Reserve's decreased level of asset purchases, emerging markets currencies experienced major selloffs. Six emerging markets currencies have declined by more than 15% relative to the US dollar since former Chairman Bernanke announced the possibility of tapering in May 2013. Several EM central banks, including Turkey, India and South Africa, have responded with increased interest rates to support their domestic currencies.

While declining EM currencies and the accompanied monetary tightening might be a potential headwind to the "Global Growth Story" in 2014, we think that the tapering-triggered currency risk is overblown. For example, aggregate EM growth last summer was barely affected by the currency turbulence. On the positive side, an increase in interest rates in the developed world might decrease the likelihood of asset bubbles developing in emerging markets, as investors flock back to the decent yielding and less risky assets of the developed world.

The biggest risk to the global growth story comes from domestic structural problems in the BRIC countries. The old growth models, driven by credit growth and fueled by infrastructure investment, will not be sustainable in the long-run. In particular, China, previously seen as the savior during the financial crisis, poses a major risk. The world's second largest economy remains suspect to a daunting asset and credit bubble.

In January, a $490m Chinese investment product, issued by one of China's biggest "trust" companies and ironically named "Credit Equals Gold Number 1", was expected to default when it was due to mature on January 31st. The investment product promised returns in excess of 10% and was backed by a mining venture. Although an unnamed "third party" stepped forward to buy an equity stake in the underlying venture and investors only suffered modest losses, the event points to an overarching problem in China's shadow banking system. Estimated to be around $6 trillion or about 70% of China's GDP, shadow banking has been growing at an alarming rate and has been mostly fueled by the increase in assets under management at China's trust firms. The main reason for concern is the potential asymmetry between these products perceived riskiness by investors and the actual risk they entail. Many of these products are marketed as safe wealth management products guaranteeing high returns, yet they invest in risky projects such as real-estate developments or even a mining venture, as noted above. Investors might not acknowledge that a high return must be accompanied with significant risks (recall Cyprus and the subprime mortgage crisis).

With that being said, Chinese officials have been aware and trying to tackle these problems through several measures. However, the concern is that reforming the economy and tackling debt fueled investment will prove to be a significant drag on economic growth in the short-term. As indicated in the National People's Congress annual meeting in early March, China has set an economic growth target of 7.5% for 2014, a seemingly aggressive goal given the necessary reform initiatives. Moreover, with only three Chinese cities meeting air quality standards, China's premier also announced that they "will declare war on pollution and fight it with the same determination we battled poverty". To reform its economy (and also its environment), China must accept a lower growth rate compared to the previous years. On the other hand, maintaining high growth levels would elevate China's assets and credit problem, making an economic reform even more painful down the road. These three goals, high economic growth, economic reform and a war on pollution, are self-limiting factors and will prove to be China's impossible trinity over the next few years.

The conflict in Ukraine has had a major impact on global markets as well, and will continue to contribute to volatility in the near term. While we acknowledge that potential economic sanctions on Russia might impose major risks on global trade, we think that the different parties involved have significant vested political and economic interest to avoid this deterrent to an already slow economic recovery.

North America

Canadian equity markets have had a good start in 2014. The S&P/TSX Composite Index returned 5.24% in Q1 led by materials and energy (both up 9.65%) and utilities (up 8.69%). Materials were mainly driven by higher precious metal prices with investors flocking to gold in fears of emerging markets contagion.

In US dollar terms, the S&P/TSX return would be around 2% when adjusted for the 3.67% decline in the loonie relative to the USD. Soft commodity prices, a dovish monetary policy, and slowing EM growth will continue to be a drag on the Canadian dollar.

Across the border, the S&P 500 was up 1.3% with a lot of volatility. We continue to be optimistic about a steady US recovery as the wealth effect contributes to increased consumer spending and stronger growth for an economy that relies heavily on consumption (70% of GDP). However, weak economic data early this year has left markets contemplating whether it is due to an exceptionally cold winter, the first impacts of tapering, or a fundamental economic slowdown. We believe that the coldest winter in 30 years has impacted US GDP growth in Q1 2014, and that much of this weather related shortfall will be made up in later quarters. Tapering may have also contributed to the weak data. The Federal Reserve, however, stands ready to exercise its discretion in the timing and pace of tapering if warranted by severe adverse economic conditions. Thus, the potential future damage from tapering is limited.

Valuations: A Swinging Pendulum

With the S&P 500 returning 30% in 2013 and more than 170% since the market bottom of February 2009, we are keeping a very close eye on market valuations. The S&P 500 currently trades at a 15.3x forward P/E multiple compared to a 10-year average of 13.9x and 15-year average of 16.2x. While current valuations might seem a bit expensive relative to the 10-year average, it is important to compare the context of current valuations to the context of historical averages.

First, historically low interest and inflation rates warrant a higher P/E multiple (lower earnings yield). In fact, at 6.5%, the S&P 500 is offering a higher forward earnings yield than Moody's Baa yield, whereas historically the opposite has been usually the case.

While one might argue that the current interest rate environment is unsustainable and rising rates might prove to be a headwind for equities, data suggests that interest rates and equities display strong positive correlations when the 10-year yield is less than 5% (current 10-year US treasury yield is at around 2.75%). The statistical relationship is rather intuitive, the Federal Reserve would only allow interest rates to rise under a healthy growing economy. Also, corporate leverage ratios are at historical lows with the S&P 500 total debt to equity ratio at 104% compared to a historical average of 171%, while cash balances are at historical highs of 30% of current assets. This lower risk also justifies a higher multiple.

All in all, while market valuations have expanded significantly over the past few years, multiples still look rational when considered relative to their historical averages, especially when considering current corporate and macro fundamentals.

Be Wary of Stocks with a Story

While valuations are hovering around historical averages, our key concern is the rapid increase in the number of so-called "story stocks", companies whose valuations are disconnected from current fundamentals but rely on the unproven growth expected from a new innovation. The number of stocks in the Russell 1000 trading at more than 10 times their book value, a proxy for these story stocks, is around 84 which is the highest since the dotcom bubble. While time will tell if these story stocks prove to be fairy tales, DCM will always be diligent about valuations and distinguish a good stock from a good story (the average price to book at DCM is around 2, the highest being TJX at around 9.5). We are already starting to see market sentiment shifting away from these high flying stocks.

Outlook Summary

Looking ahead, we expect S&P 500 2014 full-year returns of about 6%, driven by earnings growth. Multiple expansion, although difficult to achieve at these levels, would prove to be a wild card contingent on global economic growth and the outlook for 2015. We are cautious about "story stocks" with unreasonable valuations, and we think market sentiment is starting to shift away from such companies. Globally, China and emerging markets now pose the biggest risk to the global recovery. In our view, China will have to accept lower growth rates at some point over the next few years or face a worse outcome down the road. Commodity weighted economies, like Canada, would be negatively impacted from a potential slowdown in China. We acknowledge these risks and we will position ourselves accordingly.

Holdings: Winners and Losers

Parex Resources (TSE: PXT) – *Up 44%*

Parex Resources is a 100% oil weighted E&P company exploring and developing an asset base in Colombia. Parex is our best performer in 2014, up 44% in Q1, bringing the holding period return to 101% since we initiated the position a year ago. Parex was trading close to the Net Asset Value of its core assets after being excessively penalized by the market for not delivering on its growth targets. We viewed that as an attractive entry point as the stock effectively provided, in our view, a free call option on the company's promising growth prospects.

Our investment thesis has been playing out nicely. In summer 2013, the company announced a significant increase in its reserves, thus helping somewhat restore the market's faith in Parex's growth prospects. The company's stock has continued trending upwards this year on remarkable operational results. In February 2014, Parex reported 108% YOY increase in its 2P reserves. Even more impressive was Parex's 2013 recycle ratio of 4x; profit per barrel of oil was 4 times the cost of finding and developing it. This shows that Parex is not only growing rapidly, but also achieving this growth in a capital efficient and value creating manner.

Going forward, Parex has a catalyst-rich drilling program for 2014 as it is set to participate in an ongoing 40-well drilling campaign. It is also important to note that management has become more conservative in its guidance with 2014 full year production target being in line with its current production, despite the aggressive drilling program. We continue to have strong conviction in Parex; however, we partially trimmed the position as part of our portfolio rebalancing process.

Jazz Pharmaceuticals PLC (NASDAQ:JAZZ) – *Up 30%*

Another key contributor to our outperformance in 2014 is Jazz Pharmaceuticals, a specialty pharmaceutical company focused on acquiring products in niche therapeutic areas where limited alternative treatments are available. The company's stock price appreciated by more than 30% in 2014 (until our complete exit date, on 07/02/2014) and has been one of the fund's best performers, almost tripling in value since we first initiated the position less than a year ago. Our investment thesis was centered on the company's niche products that command a premium price, the market overly discounting legal uncertainty with respect to its main product Xyrem, its lean and low R&D business model, and management's track record of creating value by executing the right acquisitions.

DCM realized its investment thesis in JAZZ as the company has made a number of very successful and accretive acquisitions, and the legal uncertainty discount regarding Xyrem was priced out of the stock as evidenced by the significant multiple expansion. In February 2014, we completely exited our position in JAZZ at an average price of 167 realizing a holding period return of 187%.

The decision to exit was based on a combination of a rich valuation and a transition in the company's business model. While we were big fans of the company's proven track record of value creation through successful acquisitions, we are now less confident about the company's recent plans to focus on organic growth going forward. This path will involve higher R&D and capital intensity, and greater potential for operational and development risks. Moreover, the stock's forward P/E multiple has expanded from around 9x, when we first initiated the position, to a current multiple of 19x forward earnings.

MEG Energy (TSE: MEG) – *Up 22%*

Our recent investment in MEG Energy, a pure play Canadian oil sands company, has done well so far in 2014. We first initiated our position in MEG in November 2013 and continued to add to our position, achieving an average entry price of $30.95 and amassing a 4.7% position by the end of 2013. Our investment thesis in MEG is twofold.

First, we are bullish on the oil sands subsector as market valuations are very depressed due to high volatility and high price differentials for WCS oil prices, a benchmark price for heavy oil in western Canada. Western Canadian Select oil prices have been trading at a significant discount to other oil benchmarks of comparable quality but different location, such as the Mexican Maya. In our view, pessimism is unwarranted and the market seems to be placing too much emphasis on backward looking information, like the recent price differential, while not fully considering the positive future fundamentals, for example better takeaway capacity and high heavy oil refinery demand, to name a few. The pessimism is already starting to get priced out of the sector with the oil sands index returning more than 13% in Q1 2014.

Second, we think MEG is attractive from a relative valuation perspective within the oil sands subsector. Despite a much more attractive growth profile (25% forecasted CAGR production through the end of the decade), MEG's 2016 EV/DACF (Debt Adjusted Cash Flow) ratio is equal to the average of its peers. In addition to its growth profile, we are big fans of MEG's management and its strategic initiatives including its cogeneration facilities, use of rail to opportunistically access higher priced markets, its plans for building a diluent recovery unit, and its high quality assets. 2014 will prove to be a key year for MEG as it is set to double its production through the ramp up of its Christina Lake Phase 2B project. We have strong conviction in MEG and that is reflected in our 5.38% allocation to the stock.

TSO3 (TSE: TOS) – *Down 31%*

While we celebrate our winners, we always look back at our losers and use them as learning experiences. Unfortunately, TSO3 is our worst performer in 2014 with its stock price declining 31%. Fortunately, it was the fund's smallest position (only 0.9% as of Dec. 31, 2013), and for this reason, the 31% decline detracted less than 0.28% from the fund's overall performance.

Engaged in research, development, commercialization, and licensing of a low temperature sterilizer for heat-sensitive medical devices, TSO3 has been struggling to receive FDA approval for its products. Having already received regulatory approval in Canada and Europe, our investment thesis was centered on the fact that the market was over discounting TSO3's ability to reach FDA approval with only a 40-50% probability priced in versus a historical approval rate of 75%-85% for medical devices. But the approval process has been plagued with problems. On January 15, 2014 the stock dropped 10% as TSO3 announced large layoffs in order to reduce its cash burn as it awaits FDA approval. On January 30th 2014, the FDA requested additional data points for its approval process and hence delaying the approval process by another 8 months. The stock was down 22% on the announcement.

At this point, we think that the stock offers an attractive risk-reward profile with the market pricing in very slim probabilities of regulatory approval, while TSO3's recent layoff has significantly reduced its cash burn rate. We estimate that this hibernation mode will allow the company to sustain itself for around 1 year and 8 months, which should be more than enough for the FDA process. Moreover, the company is currently evaluating its strategic alternatives and seeking advisory from an investment banking firm. Given the value proposition of TSO3's products, we think that an acquisition scenario is very possible. For all of these reasons, we will maintain our small position in TSO3 while closely monitoring any new developments.

Pulse Seismic – *Down 31%*

Another detractor from our performance has been Pulse Seismic, the owner of Canada's second largest seismic data library company. The stock has declined by more than 31% since the beginning of the year. A major reason for this performance has been the unusual trading pattern in the last 2 days of 2014, as the stock spiked significantly when Jason Donville, a Canadian hedge fund manager, made Pulse his number one pick for 2014. The stock quickly receded from these levels as retail investors' initial euphoria quickly faded.

Moreover, the company reported preliminary results that showed another weak quarter. However, we understand the volatile nature of the seismic business and we continue to believe in the long-term value of Pulse's seismic library. Pulse's lean business model allows the company to realize very high EBITDA margins while at the same time being able to hibernate through periods of lumpy or weak sales. Despite experiencing one of the weakest years during 2013, the stock still provides TTM FCF yield of more than 10%. Given this business model and the demonstrated value generation capability of the company's data library over the economic cycle, we will continue to hold the stock for the time being.

Recent Portfolio Additions

During the first quarter of 2014, we added Geospace Technologies (NASDAQ:GEOS), Colabor Group Inc (TSE:GCL), Intesa Sanpaolo (OTCMKTS: ISNPY), and Cubist Pharmaceuticals (NASDAQ: CBST) to the fund.

Geospace Technologies (NASDAQ: GEOS)

Geospace Technologies is a manufacturer and developer of innovative products for seismic data acquisition. Our investment thesis is founded on three main points.

First, Geospace is well positioned to benefit from secular growth in its wireless seismic segment. Wireless seismic acquisition systems were first invented by Geospace in 2008 and the company has been a market leader since, outselling all of its competitors combined. The technology allows seismic crews to save on time and personnel, and improve flexibility in areas of complex terrain as compared to traditional cable based systems. Given only a 10% market penetration of wireless equipment among seismic crews, Geospace is set to significantly benefit from this secular trend as the industry switches to a more effective and convenient product over the next few years.

Second, Geospace is also active in reservoir monitoring which we think is a growing space going forward. Reservoir monitoring allows Exploration and Production companies to significantly enhance the recovery rate of their reserves and increase the life of their assets.

Geospace recently announced the delay of a $30 million contract in the reservoir monitoring segment due to its customer facing financing difficulties. The market responded wiping out around $200 million in market value in the same day. We think the market response was excessive, and we found it an attractive entry point. At current prices, the market is not pricing a replacement for Statoil's $130 million contract, and only pricing low single digit revenue growth for Geospace over the next ten years. This is not consistent with Geospace's double digit growth over the past decade (even excluding the Statoil contract), nor is it consistent with the demonstrated value of the company's current products and their growth potential. We are still adding to our position in the stock at these levels.

Intesa Sanpaolo ADR (OTCMKTS: ISNPY)

In Q1 2014, we took a positive stance on Italian financials and initiated a position in the Italian bank Intesa Sanpaolo. We are increasingly optimistic on the economic recovery in Europe as tail risk is now curbed and the continent is entering positive territory for GDP growth.

Italian financials are trading at much lower multiples compared to their global peers of similar quality. Intesa is currently being classified by the market as a low tier bank as illustrated by a forward price to tangible book value multiple of 0.8x. We think this classification is unreasonable and Intesa deserves a multiple re-rate. First, Intesa has one of the highest Tier I capital ratios as compared to a basket of European banks with similar valuations. Second, the bank is one of the few in Europe, and among its comparable peers, to have fully repaid the drawn amount on the Long-Term Refinancing Operation (LTRO) loans provided by the ECB during the European financial crisis. Third, Intesa is efficiently managed with cost/income ratio of around only 50%, compared to an average of 60% for its peers.

A key catalyst going forward is the announcement of the results of the European Banking Authority's stress test of 128 euro-area banks. We believe that these results, which will be released this year, should help the market realize the higher quality and better capitalization of Intesa, and should serve as a catalyst for the multiple re-rate.

DCM Company Update

The month of April was a transition period at Desautels Capital Management. As our senior analysts depart to their respective careers, we would like to thank them for all their hard work over the past two years. Their contributions have been instrumental to DCM, the HIM program, and our learning experience as juniors. More importantly, they have set up the upcoming senior analysts for success in their new roles. The program now cumulates more than five years of knowledge, expertise, and best practices. We hope to pass this on to our newly recruited class of 13 junior analysts.

I am honoured to have been elected as the new Equity Strategist and I look forward to serving DCM and our investors in the year ahead. I would like to thank our former Equity Strategist, Nicholas Di Giorgio, for all his mentorship and help during the past year. His passion and contributions to the program will always be remembered. The transition has been smooth at DCM, and I have full faith in the team for the year ahead.

To our investors, we are reminded of your generous investment in the fund and your continuous support of the program. We look forward to another exciting year.

Sincerely,

Belal Yassine
Global Equity Strategist

Global Equity Fund Holdings

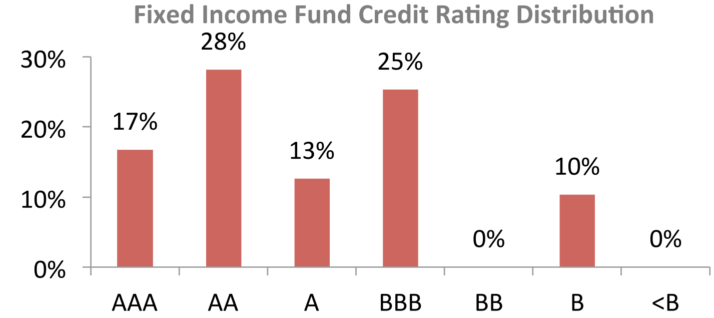
Equity Holdings (as of March 31st, 2014)

#	Security Name	Sector	Exposure	Shares	Purchase Price	Market Price	Market Value	% of Total
1	ISHARES GLOBAL HEALTHCARE ETF	Healthcare	Global	1,200	$94.46	$100.52	$120,622.22	7.2%
2	WELLS FARGO + CO	Financials	US	2,011	$32.50	$54.90	$110,404.96	6.6%
3	TERADATA CORP	Technology	US	1,650	$45.54	$54.29	$89,584.21	5.3%
4	MEG ENERGY CORP	Energy & Utilities	Canada	2,380	$30.95	$37.36	$88,916.80	5.3%
5	CONRAD INDUSTRIES INC	Industrials	US	1,928	$12.55	$43.82	$84,482.79	5.0%
6	TAKE TWO INTERACTIVE SOFTWRE	Technology	US	3,150	$16.03	$24.21	$76,246.50	4.6%
7	GENERAL MOTORS CO	Industrials	US	1,855	$32.16	$37.99	$70,473.44	4.2%
8	BAUER PERFORMANCE SPORTS LTD	Consumer Discretionary	Canada	4,850	$11.66	$14.19	$68,821.50	4.1%
9	PAREX RESOURCES INC	Energy & Utilities	US	7,200	$4.72	$9.50	$68,400.00	4.1%
10	CAPITAL ONE FINANCIAL CORP	Financials	US	800	$72.44	$85.17	$68,132.28	4.1%
11	ISHARES GLOBAL CONSUMER STAPLE	Consumer Staples	Global	630	$91.31	$95.34	$60,065.41	3.6%
12	ISHARES S+P/TSX CAPPED FINAN	Financials	Canada	2,025	$29.19	$29.65	$60,041.25	3.6%
13	INTEL CORP	Technology	US	2,100	$21.83	$28.49	$59,824.35	3.6%
14	WHITECAP RESOURCES INC	Energy & Utilities	Canada	4,795	$8.36	$12.34	$59,170.30	3.5%
15	UNION PACIFIC CORP	Industrials	US	280	$159.78	$207.13	$57,996.32	3.5%
16	LUNDIN MINING CORP	Metals & Mining	Canada	10,500	$4.85	$5.08	$53,340.00	3.2%
17	BCE INC	Telecommunications	Canada	1,100	$34.34	$47.62	$52,382.00	3.1%
18	GEOSPACE TECHNOLOGIES CORP	Energy & Utilities	US	665	$75.45	$73.04	$48,568.37	2.9%
19	ISHARES S+P/TSX 60 INDEX ETF	Benchmark	Canada	2,300	$19.58	$20.67	$47,541.00	2.8%
20	ISHARES GLOBAL FINANCIALS ETF	Financials	Global	760	$58.35	$62.42	$47,436.97	2.8%
21	TJX COMPANIES INC	Consumer Discretionary	US	700	$66.15	$66.94	$46,859.71	2.8%
22	ISHARES GLOBAL MATERIALS ETF	Industrials	Global	672	$59.09	$68.86	$46,275.91	2.8%
23	PULSE SEISMIC INC	Energy & Utilities	Canada	13,948	$2.42	$3.26	$45,470.48	2.7%
24	ISHARES US FINANCIALS ETF	Financials	US	470	$70.60	$90.24	$42,414.02	2.5%
25	COLABOR GROUP INC	Consumer Staples	Canada	9,640	$4.27	$4.00	$38,560.00	2.3%
26	ISHARES CORE S+P 500 ETF	Benchmark	US	165	$192.20	$207.69	$34,269.29	2.0%
27	TSO3 INC	Healthcare	Canada	18,500	$1.32	$0.49	$9,065.00	0.5%
Total Funds Invested							**$1,655,365**	**98.8%**
Currency Holdings		Currency					**$19,698**	**1.2%**
Total NAV							**$1,675,063**	**100%**
Top 5 holdings							*$494,010.98*	*29.49%*
Top 10 holdings							*$846,084.70*	*50.51%*

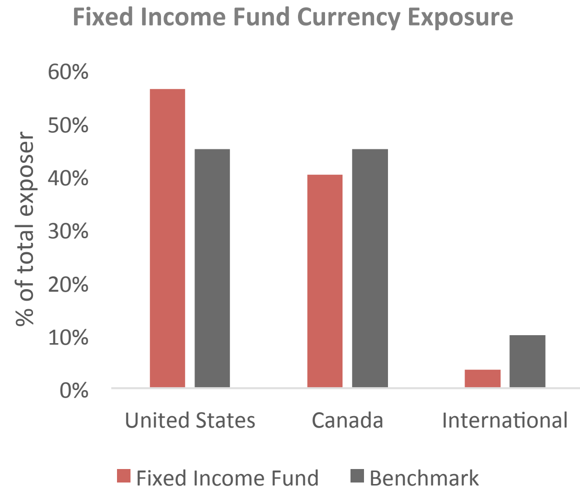
Fixed Income Fund

Dear Investor,

In 2013, the Desautels Fixed Income Fund returned 3.5%, outperforming our benchmark by 1.2%. In Q1 2014, the fund returned 3.9%, underperforming the benchmark's 4.5% gain. The 3.9% return is the second highest quarterly return for the Desautels Fixed Income Fund since inception.

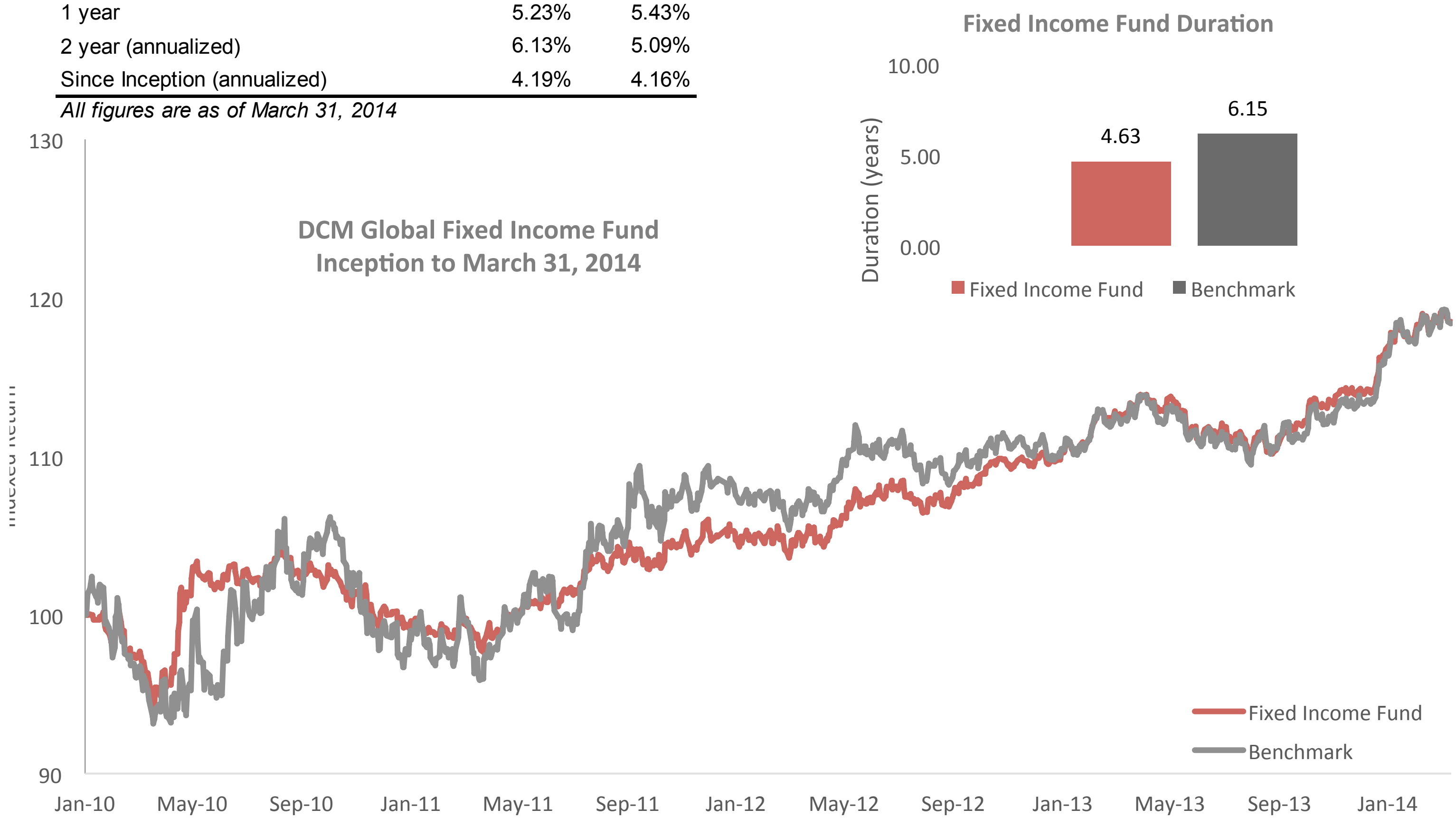


Q1 2014 Performance Metrics		
	DCM (gross fees)	Benchmark
Return	3.92%	4.47%
Annualized Std Dev	3.79%	4.41%
Annualized Sharpe Ratio	3.66	4.33
Beta	0.43	
Annualized Alpha	6.84%	



Desautels Fixed Income Fund (as of March 31, 2014)		
Time period	DCM (gross fees)	Benchmark
1 month	-0.19%	-0.47%
3 month	3.92%	4.47%
6 month	6.16%	5.54%
YTD	3.92%	4.47%
1 year	5.23%	5.43%
2 year (annualized)	6.13%	5.09%
Since Inception (annualized)	4.19%	4.16%

All figures are as of March 31, 2014



**Note: Performance is as of March 31, 2014, gross of fees. Benchmark is the Citi World Bond Index from inception to Feb. 8, 2011 and a 45% Barclays Aggregate Bond Index, 45% DEX Universe Bond Index, 10% Citi International Treasury Bond Index blended thereafter. Fund inception date is January 20, 2010.*

Fixed Income Commentary and Outlook

Q1 was a strong quarter for fixed income markets as US and Canadian government bonds rallied strongly in January as investors sought protection from equity markets and Ukraine related uncertainty. The US 10 year yield reached a low of 2.6%, some 40bp lower than December, when the Fed announced its tapering plans. In Canada, the 10 year yield fell from 2.7% to as low as 2.3% on poor economic data and an initial indication from the BoC that a rate cut may be in order. Naturally, corporate bonds lagged their government counterparts in January as spreads widened as much as 10bp in the investment grade space and 30bp in the high yield space. While equity markets recovered in February and March, government bonds did not give up their January gains; the market is now anticipating a more accommodative Fed and BoC than was expected in December.

Corporate bonds also rallied strongly in February and March, with high grade and high yield spreads tightening 20bp and 60bp, respectively. Going into 2014, we were slightly short duration in the US, and this caused us to underperform our benchmark in January. Much of that underperformance was recovered in February and March due to our large allocation to credit.

As a reminder, our fund's overall exposure to government securities and government agencies is approximately 33% with the remaining 67% held in corporate securities. In Q2, we maintain the same investment themes explained in our annual report; the US Fed continues to engage in tapering, which together with robust economic data, will contribute to a rising interest rate environment. As a result, we remain short duration by 1.5 years relative to our benchmark, with the difference largely coming from lower duration positions in the US. While credit spreads are certainly not as attractive as they were in 2013, we still believe the carry opportunity in the corporate sector, particularly in high yield, more than justifies the added risk (see Credit section for further details). As mentioned in previous reports, high yield bonds have historically outperformed in rising rate cycles. As such, we continue to seek out those bonds that offer, in our view, the highest return to risk ratio within the corporate sector. Later we discuss our rationale for our recent acquisition of a Newalta 2021 bond.

Canada Overview

The tone from Governor Stephen Poloz has largely remained constant, save for hints at a possible interest rate cut, which we interpret as the BoC's Draghi-inspired way of letting investors know that the BoC will do whatever it takes to support Canadian growth and maintain inflation targets. We expect the BoC to leave the overnight rate at 1% until the end of 2014, in line with consensus estimates. Despite having seen better than expected GDP growth in Q4 2013 (2.9% annualized vs economists' expectations of 2.5%), we remain cautious of Canada's prospects from now until 2015. Even under a Poloz approach designed to stimulate exports, which are required to make up the gap in Canada's GDP growth, we do not believe 2014 will be the break-out year that sees exports rising enough to compensate for weak consumption. Indeed, as noted by the BoC, Canada is struggling to improve productivity and maintain competitiveness among some export markets within the US.

Another problem facing the BoC is chronic low inflation, which the BoC is having a difficult time explaining. Though inflation has very recently risen back to the low end of the target range, we maintain the view that inflation is likely to remain low, and it is unlikely that levels warranting a rate hike will be reached before Q1 2015.

Finally it is important to discuss the losses in the Canadian dollar this past quarter. As we expected, the Canadian dollar continued to depreciate relative to the USD, beginning the quarter at 94 cents and declining to approximately 90 cents by March 31. These losses occurred following announcements of improving US economic data, in line with our expectations that Canada's economic performance would lag its neighbour's.

U.S. Overview

Many investors were largely focused on one word in the latter half of 2013: tapering. With improving housing prices, GDP growth and employment numbers, and the Fed's remarks on tapering, many analysts expected 10 year yields to rise to a level of between 3.30% and 3.50% by Q3 2014. Nevertheless, the Fed's December move to reduce bond purchases by $10bn a month surprised us, alongside others, by the announcement's timing. Our expectation for tapering to occur by Q1 2014 led us to maintain our shorter duration position in anticipation of rising yields. We maintain this view following Chairwoman Yellen's March FOMC announcement that the bond buy-back program will decrease by a further $10 billion to $55bn per month.

Looking forward, we maintain our relative optimism for the US economy in light of the strength seen in GDP growth, housing, and employment. With respect to the former, US GDP for Q4 2013 may be revised upward to 3% from 2.4% following better than reported consumer spending. Home prices continue their rising streak with December 2013 posting the second largest YoY increase of 13.2% since early 2006 amid improvements in other indicators such as foreclosures and home sales. In addition, home sales of 3.4% in March significantly outpaced consensus expectations of 1%, representing the largest month-over-month gain since May 2011. Finally, despite the recent severe cold weather, the US economy managed to add 175,000 jobs, surpassing estimates of 150,000 and the disappointing January figure of 129,000, which had been expected to reach 180,000. We continue to monitor unemployment, recognizing that the unemployment rate, like many macroeconomic indicators, provides an unclear view of the underlying situation. We look to improvements in the labour force participation rates, decreases in the number of workers unemployed longer than twenty-seven weeks, and take note of the geographic and economic sectors responsible for these gains. Only by seeing increases in participation do we expect GDP growth to rise in a sustainable matter.

Abroad

Entering 2014, investors faced emerging market bond selloffs and erosions in equity values last seen in June 2013 when then Fed

Chairman Bernanke first began serious talks of tapering. The $3 trillion dollars in losses have since been recovered as emerging market countries have made efforts to stem capital outflows and defend their currencies. The JP Morgan Emerging Market Bond ETF recorded a 2.7% gain for the quarter. While tapering has led us to avoid emerging market exposure, we are open to the possibility of investing in EM bonds in the medium term. Indeed, there could be an attractive entry point where higher GDP growth will see these countries' credit ratings revised upwards as they continue to decrease their debt burdens. Moving forward, the outlook for 2014 has improved with global GDP growth forecasted at 3.7% by the IMF and 3.2% by the World Bank. We welcome indications of improving global performance, particularly as it relates to our macro views on the US and we note the growth of some emerging market countries having higher correlation with US, rather than Chinese, economic performance. Despite a recent IMF report slightly upgrading China's 2014 GDP growth, we do not believe the Chinese leadership will alter its recent comments of maintaining lower growth in the "medium term". In our view, the nation's increased indebtedness requires acceptance of lower growth. We do submit, however, that the ability to implement domestic policy overnight and the discrepancy in debt levels across China's regions may offer some room for the possibility of increased growth. We are cautious of the country's increasing debt required for GDP to continue growing.

Duration

As discussed above, our strategy has changed little since the publication of our annual report. We aim to match our Canadian duration in 2014 given the lack of consistent data warranting expectation of an interest rate hike. In contrast, we maintain our relative bullishness on the US economy by remaining shorter duration there with the view that yields will rise beyond the run-up we experienced in December 2013. Overall, our portfolio enters Q2 2014 with a duration of 4.6 years, approximately 1.5 years below that of our benchmark.

Credit

Our view remains that credit is resilient. We continue to see strong solvency (Net Debt/EBITDA) and performance ratios (Gross and EBITDA margins) of 1.84x, 32.2%, 19.4% within the S&P 500 and 1.66x, 28.6%, and 23.9% within the TSX. Respective 2007 figures for both indices stood at 4.51x, 31.39%, and 23.04% within the S&P 500 and 1.79x, 30.8%, and 26.1% within the TSX. Within credit, we continue to favor high yield given the repatriation of funds from emerging markets caused by tapering, improving strong corporate solvency and cash balances, high-yield's historical outperformance compared to other fixed income assets in rising rate environments, and our view that there remains more room for Canadian high-yield spreads to tighten from the current 553bp to the pre-crisis level of 346bp. Investment grade Canadian bond spreads, in contrast, have already reached their pre-crisis level of 185bp.

Investment Opportunities

It has been the fund's overall view that one of our primary strengths is selecting corporate bonds that will outperform. This approach has led to several investments in the US banking sector over the past few years. While the holdings performed very well, they also represented a significant concentration (19.8%) in the financial sector. As such, we have sought to diversify our exposure by selling our Goldman Sachs bonds on April 1, whose investment thesis we felt had materialized.

Following the sale of the Goldman Sachs bonds, we initiated a close to 4% position in Newalta (2021, 7.75% coupon, 5.36% YTM, 337 G-spread, B1 Moody's rating), Canada's largest provider of industrial waste management and environmental services focusing on the recovery and recycling of saleable products from processing waste material. Despite the firm's plans for continued expansion in order to continue growing its customer base and 80% of its CAPEX devoted to growth initiatives, we took comfort in the firm's diversified customer base, the increasing percentage of CAPEX financed by cash flow from operations, and optionality in its financing sources which would not require Newalta to issue additional debt.

At the time of purchase, Newalta Net Debt/Adjusted EBITDA, CFO/Interest Expense, and Net Debt/Total assets of 2.9x, 10.1x and 26.7% compared very favourably to its peer group's median figures of 3.3x, 5.6x, and 42.3%, even though these peers were rated investment grade. We further forecasted Net Debt/EBITDA declining to 2.1x by 2017 driven by EBITDA margins improving slightly from 19% to 23% by 2017 and continued strong coverage and low solvency ratios. Additionally, we would not be surprised to see Newalta receive a ratings upgrade in the medium-term.

Under the conservative assumptions in our forecasts, Newalta will not breach its respective Debt/EBITDA and Interest Coverage covenants of 4.0x and 2.25x. While the bond does have a call provision, if such a call were to occur, it would result in an attractive return based on the call schedule.

Fund News

I would like to inform you that the fixed income fund is currently in the process of recruiting very talented junior analysts for the coming year. They will be joining our current team consisting of Pengchao Liu, Alexander Ohrn, Faicy Aboobacker Hussain, Debra Kelsall, and myself. We would also like to thank those leaving the fund: Alexis Lemieux-Cardinal and outgoing Fixed Income Strategist Michaela Hirsh both played an instrumental role in our development throughout the year and during this transition period. We wish them all the best in their future endeavours.

As we continue to fulfill our duties in the fixed income fund, we remain mindful of the generous and trusting support of our loyal investors. Without your commitment, this company, program, and unique learning experience would not be possible. Thank you and we look forward to a great year ahead.

Sincerely,

Daniel Sorek
Fixed Income Strategist

Fixed Income Fund Holdings

Fixed Income Holdings (as of March 31st, 2014)

#	Security Name	Units	Purchase Value	Purchase Price	Market Price	Market Value	% Market Value	Duration
1	ISHARES MBS ETF	550	58,706.54	$106.74	$117.14	$64,427.54	14.60%	5.37
2	SPDR BARCLAYS HIGH YIELD BOND	1,000	39,400.43	$39.40	$45.60	$45,595.91	10.33%	3.72
3	ISHARES 3 7 YEAR TREASURY BOND	300	37,618.06	$125.39	$133.23	$39,970.10	9.06%	4.55
4	ISHARES CANADIAN HYBRID CORP	1,900	39,604.99	$20.84	$20.93	$39,767.00	9.01%	5.76
5	PROVINCE OF ALBERTA	40,000	39,816.00	$99.54	$97.31	$38,922.95	8.82%	7.69
6	BANK OF AMERICA CORP	34,000	32,537.82	$95.70	$107.21	$36,453.00	8.26%	2.82
7	MORGAN STANLEY	30,000	29,280.00	$97.60	$107.66	$32,297.55	7.32%	2.63
8	BMO SHORT PROVINCIAL BOND IN	1,465	22,062.90	$15.06	$14.35	$21,022.75	4.76%	2.99
9	BMO LONG FEDERAL BOND INDEX	1,100	19,417.30	$17.65	$16.37	$18,007.00	4.08%	13.82
10	AIMIA INC	16,000	17,782.40	$111.14	$111.61	$17,858.21	4.05%	2.49
11	CI INVESTMENTS INC	17,000	17,464.10	$102.73	$103.88	$17,659.36	4.00%	1.55
13	GOLDMAN SACHS GROUP INC	15,000	13,852.50	$92.35	$104.73	$15,709.03	3.56%	2.77
14	WISDOMTREE BRAZILIAN REAL STRA	700	14,095.90	$20.14	$20.47	$14,332.19	3.25%	0.00
15	CANADA HOUSING TRUST	13,000	14,485.90	$111.43	$108.83	$14,148.10	3.21%	6.25
Total Funds Invested						**$416,170.69**	**94.30%**	**4.63**
Currency Holdings						**$25,134.97**	**5.70%**	
Total NAV						**$441,305.66**	**100.00%**	
Top 5 holdings						*$228,683.50*	*51.82%*	
Top 10 holdings						*$354,322.01*	*80.29%*	

All values in CAD

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