Manager Research Observer

January 2017

And the 2016 Morningstar Fund Managers of the Year Are …

These long-term winners also delivered the goods in 2016.

What a year: 2016 included a revival in Canadian stocks, political upheaval in Europe and the United States, and at long last, rising expectations for inflation and interest rates.

These factors proved tricky for equity fund managers, especially in Canada, which enjoyed the strongest gains of any major market globally. Boosted by rebounding commodity prices and surging bank stocks, domestic-equity investors faced strong competition from large- and small-cap stock indexes. Active U.S. equity managers faced a tough-to-beat benchmark in the S&P 500, while those investing abroad coped with fallout over Brexit and jitters over weakening growth in China. Bond investors finally reckoned with higher interest rates in the wake of Donald Trump's unexpected win in the U.S. presidential election.

Our nominees for the 2016 Morningstar Fund Manager of the Year awards are investors who demonstrated skill in navigating this environment. While these awards acknowledge strong performance over the calendar year, short-term returns take a backseat to long-term fundamentals. After all, there's a lot of noise in short-term numbers; a one-year hot streak is often the result of luck or extreme risk-taking.

Morningstar Fund Manager of the Year finalists must meet the following standards:

- Our nominees' funds will have been Morningstar Medalists over the entire year. That is, they will have earned a positive Morningstar Analyst Rating (Gold, Silver, or Bronze) from our manager research team, which means that we think the strategy is likely to outperform in the long term. The Analyst Rating stems from our confidence in management's abilities, the strength and risks of its strategy, and the quality of its investment decisions.

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- Finalists should have turned in strong returns relative to their category rivals and relevant benchmarks in the prior calendar year. Such success should be consistent with management's strategy.
- Finalists should also have a history of fundholder-friendly behaviour. For example, we like managers who keep a close watch on their fund's capacity and align their financial interests with those of unitholders by heavily investing their own money in the mandates they oversee.

This year, we present two awards, one for equity fund managers and the other for their fixed-income counterparts. We list our nominees and the winner below.

Nominees, Morningstar Equity Fund Manager of the Year

Finalists

Garey Aitken and Tim Caulfield, Franklin Bissett Canadian Equity (Morningstar Analyst Rating of (Silver): This duo's emphasis on higher-quality stable growers sounds unoriginal, but Aitken and Caulfield have distinguished themselves by moving into more-volatile fare when the price is right. Their decision to move into beaten-down energy stocks proved premature in 2015, but it fueled the fund's 22.5% gain in 2016 (for the F series), placing it comfortably ahead of the S&P/TSX Composite's 21% return and 85% of its Canadian-equity fund rivals.

Bill Dye, David Jiles, Richard Liley, Patrick Reddy, and Nick Szucs, Leith Wheeler Canadian Equity (Bronze): In 2015, this team's value-leaning style led it to beaten-down energy and basic-materials stocks, such as Teck Resources and Tourmaline, and financials like Brookfield Infrastructure Partners. These names contributed to a tough 2015, but sticking with them meant the fund benefited handsomely when the stocks surged in 2016. Other long-term picks, including dairy producer Saputo, also helped. All told, the team's 28% gain for the year was one the category's best showings.

Doug Stadelman and Scott Lysakowski, PH&N Vintage (Silver) and PH&N Canadian Equity (Bronze): Favouring rallying energy and materials stocks wasn't the only successful path for Canadian-equity managers in 2016. While Stadelman and Lysakowski held winning energy and basic-materials picks like Seven Generations Energy and First Quantum Minerals, the managers' strong showing was thanks more to consumer discretionary holdings such as Sleep Country Canada and Great Canadian Gaming, which were up more than 50% for the year. The F series of both funds returned 23%, placing well ahead of the competition. The funds' 10-year records remain marred by the previous management's poor performance, but returns under Stadelman and Lysakowski remain strong.

Bill Kanko, Matias Galarce, and Heather Peirce, CI Black Creek Global Leaders (Silver): Kanko and his team think like long-term business owners and look for market leaders that are gaining share. They only invest when they have developed a unique thesis that's not reflected in stock prices. Few stocks meet this standard, and those that do will often be off the beaten path—

explaining their compact portfolio and contrarian approach. Less-widely owned names like Uruguay-based McDonald's franchisee powerhouse Arcos Dorados and global plasma provider Haemonetics drove the fund's 8.7% gain for the year (for its fee-based series), more than double the MSCI ACWI Index's return over this stretch.

Winner

Stephen Arpin and William Otton, Beutel Goodman Small Cap (Silver): Arpin and Otton are the only equity manager of the year finalists to have turned in peer-beating performances in both 2015 and 2016. It's such consistency that earned the managers top honours for 2016. They built a portfolio resilient enough to weather 2015's lousy environment for Canadian small caps but with enough get-up-and-go to outpace its competitors in 2016's racier market. Their 21% return last year wasn't as strong as more-commodities-heavy rivals, but it still ranked in Canadian small/mid-cap category's top third. By preserving capital in 2015's downturn and delivering more-than-respectable gains in 2016's small-cap rally, the managers delivered nearly twice the return of its typical peer over the two-year period, contributing to their top-rate long-term record.

Nominees, Morningstar Fixed-Income Manager of the Year

Finalists

John Carswell and Vivek Verma, Lysander-Canso Corporate Value (Gold): The Canso team again demonstrated the value of independent thinking and meticulous research in 2016. Because the managers scooped up Postmedia bonds, making Canso the first to be repaid in the event of a default, they scored big when Postmedia announced its debt restructuring in July. Rebounds by other troubled issuers, such as Bombardier and Yellow Pages, also contributed to an 8.8% gain for the year—the top showing in the global fixed-income category.

Alfred Murata and Daniel Ivascyn, PIMCO Monthly Income (Silver): Murata and Ivascyn fired on all cylinders in 2016. The managers' shorter-duration portfolio paid off nicely as interest rates ticked upward at year-end. The biggest contributor, though, was their outsize stake in securitized bonds, including nonagency mortgage-backed securities, which drew upon PIMCO's expertise in the area. Their fund finished a bit behind its Lysander-Canso competitor in the global fixed-income category, returning 7.8% for the year.

Winner

Hanif Mamdani, PH&N High Yield Bond (Silver): When our analyst team met with him in late 2015, Mamdani told us that he considered Canadian high-yield energy bonds, which had taken a drubbing from sinking energy prices, to be an opportunity of a lifetime. Reflecting his contrarian ethos, he aggressively added to the fund's energy stake and briefly reopened it to new investments to fund additional purchases. Judging by his results in 2016, he made the right call: His fund rose 17% for the year, almost twice the high-yield fixed-income category average.

Exhibit 1 Finalists and Winners, 2016 Morningstar Manager of the Year

	Name	Analyst Rating	YTD Return (%)	Category Rank (%) YTD	3-Yr	5-Yr	10-Yr
	Equity						
Winners:	**Stephen Arpin and William Otton**						
	Beutel Goodman Small Cap D	Silver	20.71	34	7	41	17
	Category: Canadian Small/Mid Cap Equity		17.84	—	—	—	—
	S&P/TSX Small Cap TR		38.48	—	—	—	—
Finalists:	**Garey Aitken and Tim Caulfield**						
	Franklin Bissett Cdn Equity F	Silver	22.46	15	27	6	2
	Category: Canadian Equity		17.39	—	—	—	—
	S&P/TSX Composite TR		21.08	—	—	—	—
	Bill Dye, David Jiles, Richard Liley, Patrick Reddy and Nick Szucs						
	Leith Wheeler Canadian Equity Series B	Bronze	28.85	2	56	14	15
	Category: Canadian Equity		17.39	—	—	—	—
	S&P/TSX Composite TR		21.08	—	—	—	—
	Doug Stadelman and Scott Lysakowski						
	PH&N Vintage D	Silver	22.48	15	29	3	85
	PH&N Canadian Equity D	Bronze	22.40	16	24	28	65
	Category: Canadian Equity		17.39	—	—	—	—
	S&P/TSX Composite TR		21.08	—	—	—	—
	Bill Kanko, Matias Galarce and Heather Peirce						
	CI Black Creek Global Ldrs Corp CI F	Silver	8.52	16	13	3	—
	Category: Global Equity		3.32	—	—	—	—
	MSCI World NR CAD		3.79	—	—	—	—
	Fixed Income						
Winner:	**Hanif Mamdani**						
	PH&N High Yield Bond F	Silver	17.51	6	24	21	—
	Category: High Yield Fixed Income		9.90	—	—	—	—
	BBgBarc VLI High Yield (CAD-Hedged)		16.10	—	—	—	—
Finalists:	**John Carswell and Vivek Verma**						
	Lysander-Canso Corporate Value Bond F	Gold	8.78	1	26	9	—
	Category: Global Fixed Income		1.89	—	—	—	—
	FTSE TMX Canada All Corp Bond		3.73	—	—	—	—
	Alfred Murata and Daniel Ivascyn						
	PIMCO Monthly Income F	Silver	7.58	4	33	3	—
	Canada Fund Global Fixed Income		1.89	—	—	—	—
	BBgBarc US Agg Bond (CAD-Hedged)		2.41	—	—	—	—

Source: Morningstar, Inc. Data as of 12/31/2016.

Beutel Goodman Small Cap

This fund continues to deliver excellent results.

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Morningstar's Take 11/01/2016

Qualitative Rating: Silver

Morningstar Pillars

People	Positive
Process	Positive
Performance	Positive
Price	Positive
Parent	Positive

Beutel Goodman Small Cap's proven management, disciplined value-oriented approach, consistent track record, and below-median fees warrant a Morningstar Analyst Rating of Silver.

Under Stephen Arpin and comanager William Otton, this fund has generated strong long-term performance. Arpin has a long track record working on the fund, having been either co-portfolio manager or lead manager since its 1995 inception. The fund ranks at the top of the category over 10- and 15-year periods. Arpin and Otton have achieved this enviable track record by steering clear of speculative resources stocks that get crushed when the market takes a downturn or binary healthcare names dependent on drug approvals to survive. Instead they focus on stable, cash-flow-producing companies with defensive characteristics.

The managers follow a disciplined and repeatable value investment philosophy. They buy stocks trading at a 50% discount to intrinsic value and expect a 100% return over a three- to four-year horizon. When holdings hit price targets, they sell one fourth of the position automatically. The stock is then re-examined and if the estimated value has not increased, they will sell the stock outright. This helps mitigate downside risk as it reduces the odds of holding pricey stocks. For example, in 2008, the fund's cash level rose from 5% to 15% through the summer as holdings hit price targets and were trimmed/sold, while at the same time high stock valuations kept the managers from buying new names. Consequently, the fund went into the fall of 2008 defensively positioned and lost 29% for the year, versus a loss of 53% for the BMO Small Cap Index and 40.7% of the Canadian small/mid-cap equity category average.

In 2016 through September, the fund has returned 16.6% but trails the BMO Index by almost 16 percentage points. The benchmark's almost 50% concentration in junior oil and mining stocks, many of which have little to no earnings or cash flows, has fueled its performance. Beutel is underweight these stocks as most typically don't meet its investment criteria. While a detractor this year, longer term, this positioning has been a key source of outperformance.

Now closed to new investments from institutional clients, Beutel has accumulated a significant amount of assets in the small-cap space. That said, the managers have many years of experience running the fund at this size. Though some of the opportunity set is now off-limits due to liquidity concerns, the managers have stayed true to their style of investing, as evidenced by the fund's holdings-based style trail consistently plotting in the small- to mid-cap and value-core range.

Process Pillar: Positive
A well-defined and repeatable approach, along with stringent buy and sell criteria, merits a Positive rating for Process.

The managers consistently use a bottom-up value approach that stresses current or future positive cash flow, with the objective of identifying undervalued companies. Combinations of qualitative and quantitative screens as well as liquidity considerations whittle a 300-stock universe to a focus list of 150 and active list of 80, which undergo in-depth analysis of business fundamentals, industry, financials and management. From the active list, the managers build a portfolio of 30 to 50 names.

In order for the managers to buy or add to a stock, they require a 50% discount to intrinsic value (or a 100% return over a three- to four-year time frame). They require a ratio of 4-to-1 upside to downside risk, to compensate for risk and illiquidity in the small-cap space. When a stock's target price is reached, one fourth of the position is sold automatically. The position is then re-assessed by a different analyst; if he/she determines that the intrinsic value estimate has not increased, the position is sold outright. This ensures the portfolio maintains its value characteristics and avoids holding pricier stocks, while also limiting behavioural issues such as anchoring and confirmation bias. A downside price target is also set and if breached, a stock is similarly reassessed by a different analyst to determine if the original thesis is still valid. If it's not, the stock is sold.

Although the investment process is disciplined and consistently applied, there is an absence of portfolio-level risk management tools that some of Beutel's peers employ. Rather, the team's focus is at the stock level and understanding the risks in the individual names it holds. The team does not stress-test liquidity, either; selling large positions in the small-cap space may have an adverse impact on price and hence portfolio value. But the lack of formal risk management tools and liquidity testing has not had a noticeable impact on the fund in the past; its downside capture versus the BMO Small Cap Index equals 61% since its inception in February 1995 through September 2016.

The manager's focus on companies that generate positive cash flow lead the portfolio to more-established companies that tend to have higher market caps. Buying small companies and holding them as they appreciate also contributes to this relatively larger market cap orientation. Close to 60% of the portfolio's holdings fall in or above the mid-cap section of the Morningstar Style Box. However, the fund's weighted average market cap of $2.1 billion is still meaningfully below the category average of $2.8 billion. The fund normally exhibits many typical value characteristics such as a lower price/cash flow, price/book, and price/earnings than the category average but currently the portfolio is trading more expensive on these metrics. This is likely temporary, though, as many lower-quality small-cap stocks that the fund doesn't own have performed poorly and are cheap based on trailing numbers.

At 24.5%, well above the category average of 17.1%, the fund's largest sector weighting is in materials. About half of that amount is in gold and metal-mining stocks like Alamos Gold, Tahoe Resources, and Lundin Mining, with the other half in stable and growing cash flow stocks like packaging companies CCL Industries, Winpak, and Intertape Polymer.

On the flip side, the fund is lighter on energy companies compared with peers. This has been true since early 2014, but the gap was at its widest in February 2016 at over 5 percentage points as the team lightened up on its lower-quality energy holdings in the face of declining oil prices. Now, as conditions have improved, it has upped the stake in the sector to 13.5% as of September 2016 (compared with 15.0% for the category average). The team has taken this opportunity to upgrade the quality of its energy holdings, too. For instance, the team sold Baytex Energy in December 2015 and bought Birchcliff Energy in April 2016. Birchcliff is more profitable than Baytex and its balance sheet has less debt, too.

Performance Pillar: Positive
From its February 1995 inception through September 2016, the fund's D shares returned an annualized 13.2% versus 8.0% for the benchmark, the BMO Small Cap Equity (Weighted) Index, and 9.4% for the Canadian small/mid-cap equity category average. These superior returns result in a Positive rating for Performance.

One key to fund's success has been its performance in down markets. In 2008, when the benchmark slid by 53.3% and the category average was down 40.7%, the fund lost 29.0%. By selling names that had hit price targets and sticking with its valuation discipline, the cash balance of the fund had risen to over 15% prior to the market crash. This, combined with a focus on firms with a strong balance sheet and cash flows, provided the downside protection. Overall, the fund has had a down capture ratio of 60.9% versus the benchmark and 85.9% versus the category average since inception. Returns in 2015 were also illustrative of the fund's defensive characteristics as its negative 0.2% return compared favourably with both the benchmark and category average, which fell by 15.1% and 6.4%, respectively. Being underweight energy stocks was beneficial but stock selection was a bigger contributor. The portfolio held automotive supplier Uni-Select, real estate management firms Colliers International and First Service as well as packaging companies CCL Industries and Winpak, all of which were big winners.

The fund's 16.6% return year to date through September 2016 compared with the benchmark's 32.6% gain is also a typical experience. Junior oil and mining stocks in the benchmark have surged this year but these are generally not stocks that meet Beutel's standards. The two gold stocks that did meet the team's cash flow and valuation criteria, Alamos Gold and Asanko Gold, each gained over 130% and were large contributors to the fund's return. This helped Beutel rank in the top quartile of the category and is consistent with the fund's since-inception up capture of 86.3% versus the benchmark and 104.4% versus the category average.

People Pillar: Positive

Stephen Arpin and William Otton head up this value-oriented offering and have a long track record of successfully navigating the Canadian small-cap landscape. Their respective sector experience allows them to identify individual stock price anomalies without entirely relying on typical screening tools for idea generation, a competitive advantage that earns this fund a Positive rating for People.

Arpin, vice president and portfolio manager, has been a key contributor since the fund's 1995 inception, and has been lead manager since 2000. In addition to his small-cap responsibilities, Arpin has equity research responsibilities for the broader Canadian equity team in the technology, consumer discretionary and energy sectors.

Otton began his career as a mining specialist in 1988 and has covered a wide variety of sectors for Beutel's Canadian equity team (including small caps) since joining the firm in 1995, including metals, minerals, gold, printing, steel, and fertilizer. While his tenure as comanager of this fund goes back to January 2007, he has had an impact on the fund for much longer.

This fund is also supported by the broader Canadian equity team led by Mark Thomson, managing director at Beutel Goodman responsible for overseeing the firm's equity research process and large-cap portfolios. He took lead of the equity team in 1999 and overhauled the research process at that time.

Parent Pillar: Positive

Beutel, Goodman & Co. is a private Canadian asset manager with a mostly institutional client base. Although 49% of the firm is owned by AMG, the 66 Beutel Goodman employees that own the rest retain 100% operational autonomy.

Run by investment professionals, the firm boasts a strong investment culture. It pays far more attention to long-term performance than to marketing or product creation. This, and a consistent investment approach that the entire team buys into, has led the firm to generate strong long-term risk-adjusted returns across its various mandates.

Key personnel like Thomson, David Gregoris, and Arpin have been at the firm for 20 years or more, maintaining a high level of stability and a distinct culture. Wide age dispersion among portfolio managers and a repeatable firmwide investment process lowers key-man risk, though. For example, veteran managers Gregoris and Sue McNamara were more than capable to take the reins of Beutel's bond funds after the recent retirement of longtime fixed-income head Bruce Corneil. Overall, employee turnover is low and is attributed partly to equity ownership, which is a meaningful part of total compensation, and partly to a team-based culture where everyone is focused on a common mission or goal. And while compensation from equity ownership can tempt managers in general to focus on asset gathering as a source of profitability, Beutel's above-average level of coinvestment in its own funds mitigates this risk and aligns manager behaviour with investor interests.

In the do-it-yourself channel, where the majority of Beutel's retail assets are distributed, the fees on its Class D funds are mediocre compared with peers. However, the fees charged on Advisor-sold Class B (commission-based) and Class F (fee-based) rank more favourably.

Overall, the strength of Beutel's corporate culture and its coinvestment practices distinguish the firm and provide for an above-average investor experience, resulting in a Positive Parent rating.

Price Pillar: Positive

For do-it-yourself investors, the firm offers Class D units that carry a management expense ratio of 1.49%—4 basis points better than the channel median management expense ratio of 1.53%. For investors working with an advisor, the firm offers both Class B units (commissioned-based) and Class F units (fee-based). Class B units have a 2.29% management expense ratio (including a 1% trailer) while Class F units clock in at 1.20%. Both share classes rank favourably to the channel median management expense ratios of 2.59% and 1.33%, respectively.

Overall, the fund is attractively priced, warranting a Positive Price rating.

PH&N High Yield Bond
Risk is elevated, but the people, process, and price remain strengths.

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Morningstar's Take 01/31/2017

Qualitative Rating: Silver

Morningstar Pillars

People	Positive
Process	Positive
Performance	Positive
Price	Positive
Parent	Positive

PH&N High Yield Bond's appeal starts with lead manager Hanif Mamdani's broad-minded approach to high-yield investing. He believes in flexibility and utilizing the whole credit spectrum—from investment-grade to high yield. While the fund does not offer pure high-yield exposure, this has been a blessing. It allows management to take advantage of opportunity when it exists and get out of the way when it does not. The fund targets bonds trading well below historical valuations and takes contrarian positions when sentiment causes prices to deviate significantly from fundamentals. Management's willingness to stick with these bets allows it to profit from eventual mean reversion. Mamdani's skill in identifying and orienting the portfolio to where valuations are attractive and reducing exposure to high yield when they are not has helped the fund generate solid returns on a risk-adjusted basis.

To be sure, the fund won't thrive in all environments as Mamdani tends to act early or in a contrarian fashion. This was the case in the latter half of 2014 and throughout 2015. Mamdani moved over a third of the portfolio into Canadian energy-related names by the end of 2015, betting that the sector, ravaged by the oil price decline, was oversold. His early moves cost the fund in 2015 as it landed it in the high-yield category's bottom third with a 3% loss. The move proved prescient though, as high-yield energy bonds roared back in 2016, and the fund produced category-topping performance with a 17.5% gain, earning it the 2016 Morningstar Fixed-Income Manager of the Year award.

Mamdani also deserves credit for his enviable long-term track record, particularly for his skill in negotiating the 2008 credit crisis. By mid-2007 he saw many warning signs, such as relaxed lending standards, companies' increasingly leveraged balance sheets, and high-yield bond valuations at historically high levels. Sticking to his process by following these indicators, he positioned the fund relatively defensively, materially increasing the portfolio's allocation to investment-grade bonds. This paid off in 2008, when the fund returned 1.3% relative to a 15.5% loss for the high-yield fixed-income category average.

The fund competes extremely well on price. The 0.87% management expense ratio on the Series D share class makes it one of the cheapest active options. However, despite its low fees, the proven skill of Mamdani, and a process focused on balancing risks, the fund's large size (it is closed to new investors) prevents it from earning a Morningstar Analyst Rating of Gold. With over $4 billion under his watch, Mamdani could have a tough time repositioning the portfolio quickly or unwinding his energy trade. Further, the fund is highly reliant on

Mamdani's skill and would likely look very different without his involvement. These concerns limit the fund to a Silver rating.

Process Pillar: Positive

The process starts with the team examining credit metrics like default projections, issuance volumes, spreads, and deal structures in corporate activity to gauge the current phase of the high-yield credit cycle. Depending on where they deem the market is in the cycle, the team members determine how much risk to take. In a somewhat contrarian fashion, they'll tilt the portfolio to investment-grade bonds and cash when nearing market peaks and allocate back to high yield when dislocations in price and value caused by negative sentiment occur. They'll also examine the relative attractiveness of various industries and then scour the ones that look cheap for opportunities. The team conducts fundamental credit analysis for individual bonds, emphasizing free cash flow and interest coverage as well as testing multiple credit scenarios to understand a bond's risk/reward potential.

In building the portfolio, Mamdani balances quality and value to size positions. He assigns the largest weightings to bonds that he has deemed the highest quality and have the cheapest relative valuation. He has a bias toward more liquid bonds and bonds from larger underwriting groups.

Mamdani also reserves a slice of the portfolio for opportunistic positions. Here, he looks for issuers where negative investor sentiment has unduly punished its bonds and is banking on an eventual reversion to historical averages.

The fund is not a pure play on the high-yield space. Mamdani routinely mixes in investment-grade bonds to reduce portfolio risk and prefers bonds that lie around the cutoff between investment-grade and high yield. As a result, the portfolio will typically have more allocated to higher-rated bonds than the average peer.

The portfolio is concentrated by issuer and by industry, but the process gains its edge from the multitude of ways that management balances risk. Assessing the macroenvironment, setting position sizes based on value and quality, and favouring liquid bonds all help to offset the risks, resulting in a Positive rating for Process

Although the team believes corporate fundamentals remain strong, sentiment readings like aggressive lending practices, robust mergers and acquisitions activity, and increasing leverage indicate the high yield credit cycle is getting long in the tooth. That being said, a sharp sell-off in the high-yield markets (particularly in the energy sector starting toward the end of 2014) created a value opportunity and prompted the team to load up in the energy sector, raising the fund's risk exposure to volatile commodity prices.

As of November 2016, the fund's exposure was mostly in Canadian bonds. Its domestic component had fallen below 50% for much of the five years prior to 2015, but Hanif Mamdani's buying of bonds from Canadian energy producers such as Baytex Energy and Paramount Resources and energy-services companies such as Precision Drilling and Western Energy Services pushed the Canadian content back up. With his buying and the rebound in prices, the energy stake makes up close to half of the portfolio. Balancing some of the risk with issuer and industry concentration is an allocation to investment-grade bonds and cash. As of November 2016, the portfolio held 9.1% in cash and over 14% in investment-grade Canadian bank debt. Lastly, a preference for bonds with a shorter term to maturity, especially among those with a lower credit rating, also lessens risk somewhat.

Performance Pillar: Positive

The fund's 10-year returns ended December 2016 ranked in the top decile of the high-yield fixed-income category. Since its inception in July 2000 through December 2016, the fund returned an annualized 7.8% relative to 5.0% for the category average. The fund generated these returns with one of the lowest standard deviations in the category, leading to a Sharpe ratio, a measure of risk-adjusted returns, that was more than twice that of the category average. This earns the fund a Positive Performance rating.

The fund's lower volatility is a result of Mamdani's bias toward higher-quality bonds within the high-yield sector and timely shifts to investment-grade bonds. Mamdani's discipline in interpreting various credit metrics and indicators to make tactical shifts in the fund's credit quality helped it generate positive returns in years like 2007 and 2008, which were turbulent for high yield. The fund returned 1.3% in 2008, while the category average lost 15.5%.

However, the fund won't outperform in all environments. The fund's defensive positioning caused it to perform similar to category average from 2012 to 2014, and an early move into the depressed energy sector in 2015 caused the fund to decline 3.0% versus a gain of 0.7% for the category average. The fund hedges its U.S. dollar exposure, meaning it also didn't receive any boost from the strengthening greenback in 2015 compared with some peers that either don't hedge or hedge more tactically. The fund returned 17.5% in 2016, though, placing at the top of the high-yield category and more than making up for 2015's lackluster showing.

People Pillar: Positive

Lead manager Mamdani joined PH&N in 1998 after working in New York with two global investment banks for 10 years. He has a master's degree from Harvard in applied science and an engineering degree from Caltech. He has built an enviable track record as lead manager on this fund since its inception in July 2000. He is also lead manager on PH&N Absolute Return, a multistrategy hedge fund, and oversees RBC's alternative investments business unit as well. Mamdani's pedigree and focus on long-term value while being mindful of the credit cycle, investor behaviour, and the associated risks set him apart, and our Positive People rating is contingent on his continued involvement in the management of the fund.

Mamdani is supported by Emil Khimji and Justin Jacobsen, who conduct high-yield credit analysis. Although the team size of three including Mamdani, who is both manager and mentor, is about average compared with peers, it can leverage the expertise of PH&N's broader credit research team for investment-grade issuers, if needed. Mamdani provides final approval for every holding, and is responsible for portfolio construction. He notes that he is able to make decisions quickly given the small size of the team.

Rather than outsource it to a dedicated group within the firm, the team does its own trading, which is a little more common in the bond universe. Mamdani views the structure as vital in high yield for the analysts to fully understand the liquidity constraints of each issue and get market intelligence from the dealer desks.

Parent Pillar: Positive
RBC Global Asset Management has leveraged its wide-ranging lineup of funds and coast-to-coast branch network to become the largest asset manager in Canada. It has established a strong track record of acquiring and retaining talented investment professionals and firms and has proved willing to adopt their strengths into areas of existing weakness. These qualities, combined with industry-leading levels of coinvestment to align the interests of their managers with investors' and fees that consistently rank among the cheapest in the retail industry, allow the firm to deliver an overall positive experience for its fundholders.

Although there isn't a unifying theme across its lineup, it also hasn't launched gimmicky products. The 2008 acquisition of PH&N helped beef up its bond capabilities, and in 2011 it brought in Bill Tilford to oversee the quantitative efforts under which it has launched low-volatility and dividend-oriented funds and exchange-traded funds.

That being said, the firm has a mixed track record when it comes to capacity management. While funds under the PH&N banner have capped their high-yield offerings when deemed worthy, in general RBC has failed to prove that it will cap products that become bloated with assets. Until this aspect of its culture improves markedly, its goal of joining other top-tier global firms might go unrealized.

Price Pillar: Positive
RBC Global Asset Management, which owns PH&N and distributes its funds, competes extremely well on price across all distribution channels. Its Series D units are available through discount brokers and directly through PH&N. The management expense ratio on this series is 0.87%, which is among the cheapest direct-to-investor options.

The firm also offers commission-based share classes (Advisor/Series C) that carry a management expense ratio of 1.44% compared with the category median fee of 2.05% and a fee-based share class (Series F) that carries a management expense ratio of 0.89% compared with the category median of 1.15%.

The fund ranks in the cheapest quintile for each distribution channel, which earns it a Positive rating for Price.

And the Morningstar Steward of the Year Is ...
Lower fees and transparency set these finalists apart.

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"To stand still is to fall behind," as the great American author Mark Twain (reputedly) said. Put another way, those who don't up their game will find themselves surpassed by rivals. That's especially true for money managers, which face ever-tougher competition in recognizing and retaining talent, identifying and sustaining their investment edge, demonstrating alignment with investors, and providing a good value proposition. What constitutes best practice in each of these becomes standard practice over time.

Morningstar recognizes industry-leading practices with its Steward of the Year Award. To be eligible, a fund company must have a history of fundholder-friendly behaviour: We only consider those with a Positive Parent Pillar rating. (The Parent rating is a component of the qualitative Morningstar Analyst Rating. In Canada, Morningstar rates approximately two dozen parent organizations.) We then winnowed the field by focusing on firms that distinguished themselves on the stewardship front in 2016. Investors shouldn't take the lack of a nomination as a sign that a fund company has slipped. It's just that our two finalists highlight practices that their competitors would do well to emulate.

Winner: RBC Global Asset Management

As the country's largest asset manager, RBC Global Asset Management probably could rest on its laurels. By and large, it has not. Long the industry cost leader, RBC sliced expenses broadly across 85 funds in 2016. Amid intensifying fee competition, the cuts, which on average shaved off 0.2 percentage points from fund management expense ratios, maintained RBC's cost advantage. This award recognizes RBC for passing along the benefits of growing economies of scale to fundholders more than similarly sized rivals. Because of the strong relationship between costs and investment performance, lower fees improve investors' odds of success. By lowering the bar on fees, RBC's heft raises the bar for its competitors to do the same.

Our nomination also acknowledges the well-managed reopening of PH&N High Yield orchestrated by its Phillips, Hager & North subsidiary. In early 2016, the fund briefly took in new money to allow manager Hanif Mamdani to add to his stake in depressed energy and basic-materials issuers and closed shortly after reaching its asset target—a decision that benefited fundholders handsomely. RBC has not always managed capacity so well—domestic-equity funds like RBC Canadian Dividend are saddled with bloated asset bases—but we credit it for doing so in this case.

Finalist: Steadyhand Investment Funds

Steadyhand remains the poster child for good stewardship. The firm continues to stand out for its transparency, consistent approach to investment management, and investor-first orientation. Our nomination is a nod to its efforts in minimizing the behaviour gap—the oft-large difference between what a fund and its fundholders earn. Investor returns often fall short because of counterproductive behaviour. The political turmoil of 2016 offered such opportunities, but Steadyhand's calm, accessible commentary helped investors maintain their sanity, improving the odds that fundholders would stick with their investments over the long haul. Similarly, when it changed subadvisors at its small-cap fund, Steadyhand clearly outlined its rationale for the change and described the differences in the new subadvisor's approach in direct communication with clients and on its website—a nice change of pace from the formulaic press releases that typically announce manager changes. Such candor shouldn't be uncommon: When fundholders put their capital at risk, they deserve to know who's watching over it and why.

Steadyhand also deserves kudos for disclosing the extent of its employees' investments in the firm's funds. It's not that co-investment is unusual elsewhere, but the firm provides evidence of its financial alignment with fundholders. With 83% of their financial assets invested in the firm's funds on average, Steadyhand employees enjoy the same experience as its clients.

Active Share Doesn't Live Up to the Hype

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Summary
Academic research tying high active share—a measure describing how different a fund's stock picks are from a benchmark—with future outperformance quickly popularized its appeal. In reality, active share hasn't been the Holy Grail its boosters often claim.

Using data from January 2001 through December 2015, we examined historical active share levels among actively managed funds in the Canadian equity category relative to the bellwether S&P/TSX Composite Index. On average, active share changed little over the period aside from a one-time drop early on. Canadian equity managers exhibited lower active share than their counterparts in other categories, but the benchmark's sector and stock concentration help explain why.

We tested active share's predictive power in two 10-year periods, 2001-10 and 2006-15. We then divided each in two five-year periods. The first half provided an in-sample observation period in which we calculate active share and other measures of activeness, and the second half an out-of-sample evaluation period where we measured the results. Using gross-of-fee returns, we found higher active share was associated with relative underperformance in the 2001-10 period and relative outperformance in the 2006-15 period. These differences virtually disappeared after adjusting for the market, size, value, and momentum factors.

Higher active share may not ensure better results, but it is likely to lead to more-extreme ones. We found a positive relationship between active share and a wider range of performance outcomes, though surprisingly there was no relationship between active share and volatility or maximum drawdowns. We detected a strong relationship between active share and tracking error, but it was not perfect. Thus, using them in tandem provides a fuller picture of a fund's active bets versus its benchmark. Last, even if higher active share were to lead to better outcomes, investors may not be able to reap the benefit. We found that funds with higher active share had higher fees, which means investors may not reap the reward that higher active share could bring.

Introduction

In medieval mythology, or at least in Monty Python movies inspired by it, King Arthur's knights endure numerous trials, including giants and beasts, in pursuit of the Holy Grail, a magical cup promising happiness, health, and abundance. In medieval lore, Sir Galahad finds the cup and ascends to heaven, though the 1975 movie ends when police cut the search short. As a myth, the latter tells a truer tale: The quest for a simple, single solution to life's problems is futile.

Fund investors search in vain for a Grail of their own, one that reliably identifies skilled active managers. Returns-based measures of all sorts have been poor indicators of future success because strong performance rarely sustains itself. Fundamentals-based metrics like turnover, manager tenure, portfolio concentration, and fund size have mostly fallen short as well.

In a 2007 paper, researchers Martijn Cremers and Antti Petajisto hailed active share, a clever new measure quantifying how different a fund is from a benchmark, as the exception. The paper, "How Active is Your Fund Manager? A New Measure That Predicts Performance," tied high active share to future outperformance.[1] The professors presented evidence demonstrating active U.S. equity funds with the highest active share—that is, those most unlike their benchmark—outperformed those with the lowest active share over the 1983-2000 study period. Petajisto's 2013 follow-up paper updated the study with data through 2009 and found similar results.[2] In a 2015 paper, Cremers detected another positive link between high active share and better performance, this time among highly active funds with low portfolio turnover.[3] This is as close to a Holy Grail as it gets.

Not only did the measure make active share appear effective as a forecasting tool, it had the added appeal of being easy to understand conceptually: Funds with 100% active share look nothing like the index, those with 0% look exactly like it, and those in between look something like it. A fund with 60% active share exhibits 40% overlap with the benchmark, while 40% active share signifies the opposite. Next to tracking error, the standard deviation of excess returns relative to a benchmark, the math of active share is less difficult to grasp. Lastly, there is an intuitive explanation for why funds with high active share should outperform: Funds that look too much like the benchmark are unlikely to beat it.

Although a distinctive portfolio may be a necessary condition for outperformance, it alone is not sufficient. If it were, then unskilled investors could improve their odds by making bigger bets against their benchmark. Giving these investors a longer leash would likely result in worse outcomes. Even in the hands of skilled managers, a highly active portfolio is no assurance of success. William Sharpe's arithmetic of active management reminds us that every winning bet must be matched with a losing one and must underperform in aggregate after fees. This is true no matter the active share. While some highly active managers will outperform after fees, they can't do so as a whole.

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1 Cremers, Martijn and Antti Petajisto, Jan. 15, 2007. "How Active Is Your Fund Manager? A New Measure That Predicts Performance."
2 Petajisto, Attni, July/August 2013. "Active Share and Mutual Fund Performance." Financial Analysts Journal, pp 73-93
3 Cremers, Martijn and Ankur Pareek, Dec. 1, 2015. "Patient Capital Outperformance: The Investment Skill of High Active Managers Who Trade Infrequently."

Our Methodology

Using data from January 2001-December 2015, we examined the relationship between active share and performance through actively managed Canadian Equity funds. We tested active share's predictive power in two 10-year periods, 2001-10 and 2006-15. We then divided each in two five-year periods. The first half provided an in-sample observation period in which we calculate active share and other measures of activeness, and the second half an out-of-sample evaluation period where we measured the results. two 10-year periods, 2001-10 and 2006-15. We then divided each in two five-year periods. The first half provided an in-sample observation period in which we calculate active share and other measures of activeness relative to the S&P/TSX Composite Index, and the second half an out-of-sample evaluation period where we measured the results using gross-of-fee returns. As Exhibit 1 details, we use the first half—the observation period—to collect our five performance- and portfolio-based measures of activeness for each fund in our data set. We use the second half—the evaluation period—to examine the relationship between these measures and subsequent performance.

Exhibit 1 Study Periods, Data Points Used

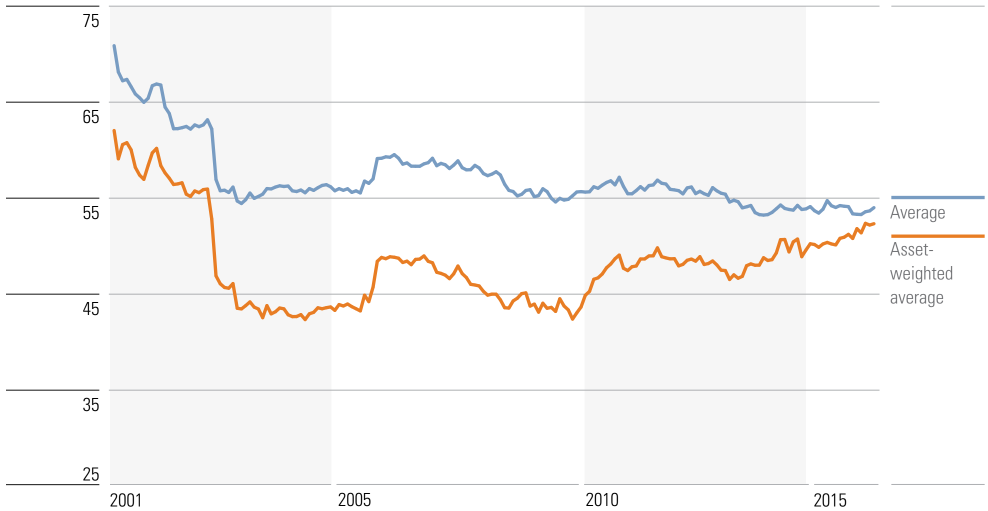
Observation Period	Evaluation Period	
2001-06	**2006-11**	**2011-16**
	Observation Period	Evaluation Period
Observation Period	Evaluation Period	
Active share Stock concentration Sector bets Excess return Tracking error Alpha	Excess return Tracking error Alpha Active share	

Source: Morningstar, Inc. Data as of 12/31/2015.

Have Canadian Equity Fund Managers Become Less Active?

Average active share was considerably lower at the end of the study period than at the beginning, falling from a high of 73% in January 2001 to 54% by December 2015, as Exhibit 2 demonstrates. Had our study period begun in 2003, changes in active share would appear more modest. Nearly the entire fall took place in the first two years of the study as one-time tech darling Nortel Networks went from 21% to 3% of the index. As the stock fell to earth, so did active share.

Exhibit 2 Average Active Share, 2001-2015



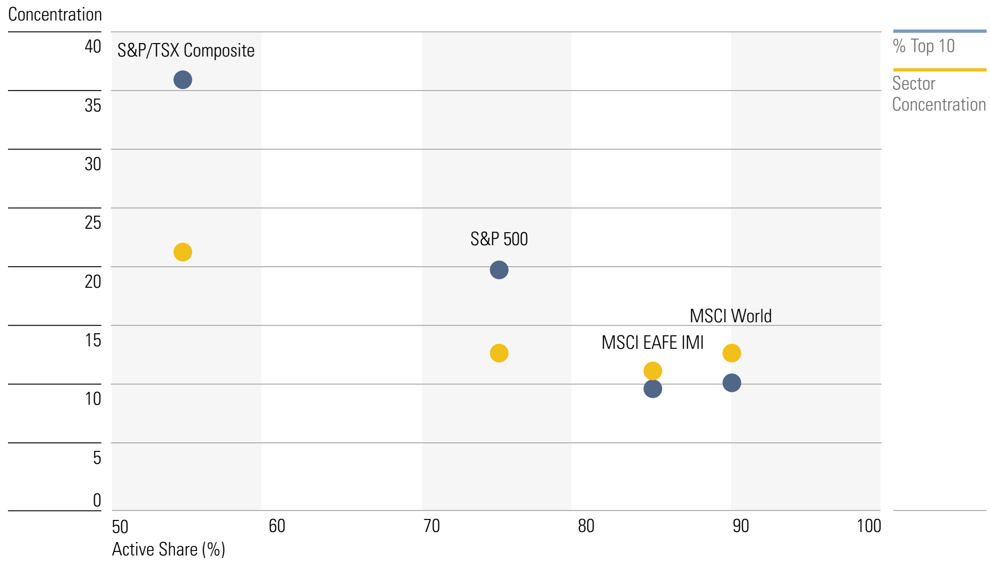
Source: Morningstar, Inc. Data as of 12/31/2015.

The funds that Canadian investors held were less active on average over the 15-year period: While active share averaged 57% on an equal-weighted basis over the period, it averaged 41% on an asset-weighted basis. The difference has shrunk in recent years, though, with the asset-weighted active share at 47% in December 2015.

Canadian equity funds appeared less active than foreign equity funds over our study period. That is at least partly thanks to quirks in the Canadian benchmark. Funds with less-concentrated benchmarks tend to have higher active share as Exhibit 3 illustrates. The Canadian market was significantly more concentrated by stock and sector relative to broad foreign-market benchmarks, helping explain why Canadian equity funds had lower active shares on average. (We measured stock concentration using the percentage of assets in top-10 holdings and sector concentration using the Herfindahl-Hirschman Index,[4] which is commonly used to measure market concentration.) The data suggest investors should evaluate active share within the context of funds of similar type.

4 Hirschman, Albert, September 1964. "The Paternity of an Index." The American Economic Review, p. 561.

Exhibit 3 Active Share and Concentration, Major Market Benchmarks (January 2011–December 2015)



Source: Morningstar, Inc. Data as of 12/31/2015.

Active Share: A Fair-Weather Friend

Active share proved a weak and inconsistent predictor of future returns in our study, whether judged by excess returns (versus the S&P/TSX Composite) or four-factor alpha. Active share explained around 10% of the variability in excess returns and alpha (as measured by R-squared) in both periods, meaning other factors drove performance to a much greater degree.

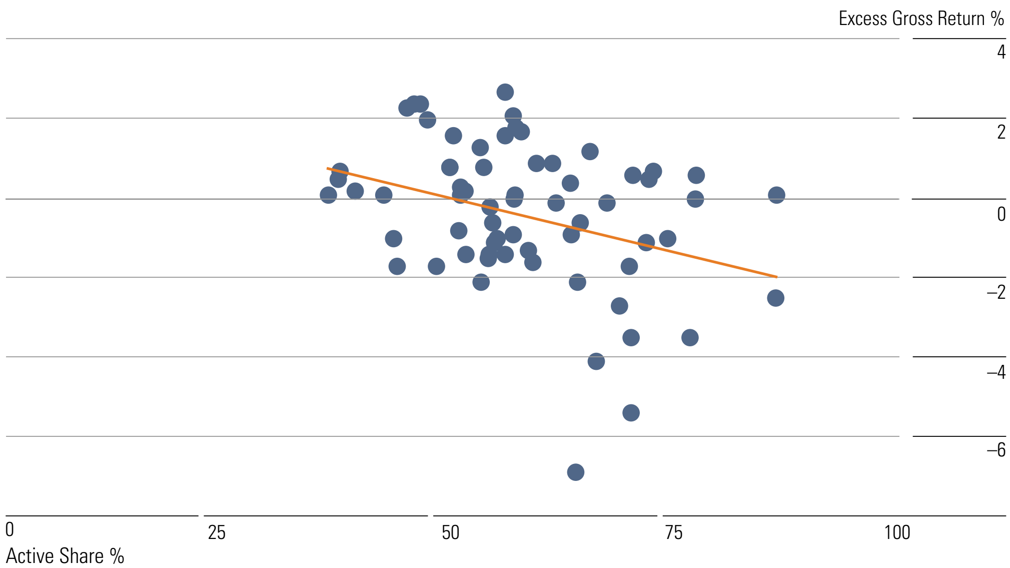
To the extent it mattered, active share was associated with diametrically opposed outcomes. Performance was about as negatively correlated with higher active share in the first evaluation period (2001-05) as it was positively correlated in the second evaluation period (2011-15). These relationships, which we plot in Exhibits 4a and 4b, weren't especially strong—correlations were around negative 30% in the first period and about 30% in the second—but they were statistically significant.[5]

Higher active share did not foretell better returns but it helped explain performance extremes. One might have expected wider outcomes in a period punctuated by the 2007-08 financial crisis and its immediate aftermath. This period was also marked by the worst recession since the Great Depression and unprecedented intervention by central banks. With broad, macroeconomic themes driving returns, stocks fell and rose together. With relatively high correlation and low dispersion across market sectors, the payoff from stock-picking was relatively low. The TSX Composite proved tough to beat: As Exhibit 5 illustrates, funds in four of five active share quintiles lagged the index on average, with the least active outperforming modestly. (After adjusting for exposure to the market, value, size, and momentum factors, all active share quintiles added virtually no value, as measured by alpha, on average.)

5 T-statistic was -2.8 for excess returns in the first period, 2.7 for excess returns in the second period.

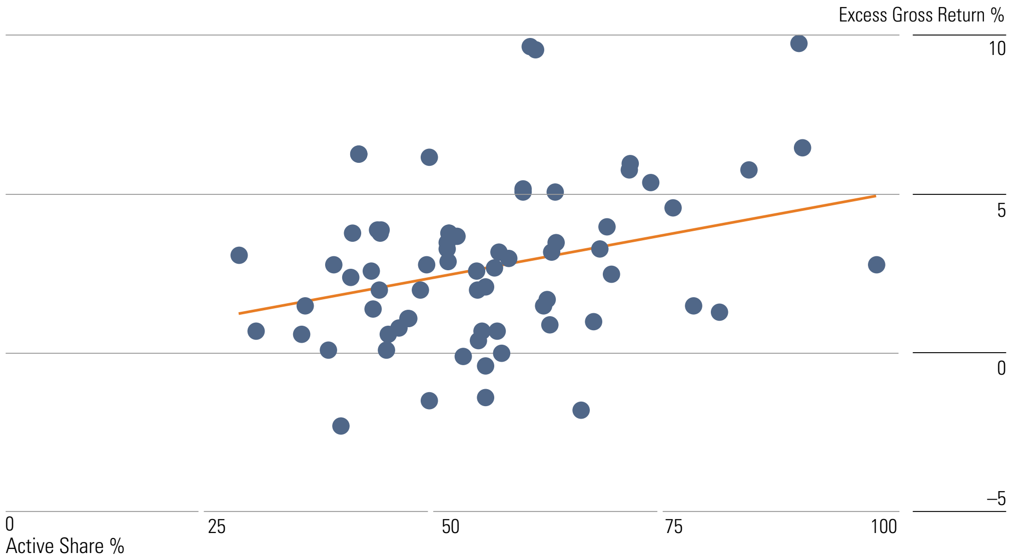
Active managers found the 2011-15 evaluation period to be more fertile ground. As correlations weakened and dispersion grew over this stretch, more differentiated portfolios generated a wider range of results. Put another way, the potential payoff from high active share was stronger in the second period than in the first. Funds delivered positive excess returns on average across all active-share quintiles, with the most active delivering the widest margin of outperformance. Investors benefit from higher active share in periods of high dispersion and vice versa.

Exhibit 4a Period One: Active Share (Observation Period) and Excess Return (Evaluation Period)



Source: Morningstar, Inc. Data as of 12/31/2015.

Exhibit 4b Period Two: Active Share (Observation Period) and Excess Return (Evaluation Period)



Source: Morningstar, Inc. Data as of 12/31/2015.

Exhibit 5 Excess Return and Alpha by Active-Share Quintile, 2001-2010

	Observation Period			**Evaluation Period**		**# Funds**	
Active-Share Quintile	Active Share (%)	Excess Return	Alpha	Excess Return	Alpha	Obsevation Period	Eval Period
1	43.88	1.69	0.00	0.62	0.00	14	14
2	53.01	1.58	0.11	–0.48	–0.01	13	13
3	57.27	1.54	0.00	0.36	0.00	13	13
4	65.31	2.52	0.00	–1.39	–0.02	13	12
5	75.06	2.70	0.00	–1.22	–0.02	14	12

Source: Morningstar, Inc. Data as of 12/31/2015.

Active Share Doesn't Mean Active Risk

Describing activeness only in terms of how different a fund's holdings are from its benchmark's leaves out the possibility of other distinguishing characteristics, such as the style and factor bets discussed above, in addition to differences in sector or country exposure. A positive active share also tells us that a fund is different from its benchmark, but it does not say how.

We should be able to observe the cumulative effects of stock, style, sector, or other factor bets in performance. Tracking error, a measure of the volatility of a fund's excess returns, describes how much past performance deviates from benchmark results. The less a fund looks like its benchmark, the more its returns should deviate: A near-benchmark clone should behave a lot like the index, while a concentrated portfolio with heavy sector concentrations likely will not.

Because tracking error and active share both describe how different a fund is from its benchmark, we would expect the relationship between the two measures to be strong. And it was: Tracking error and active share were 66% correlated in the first evaluation period and 67% in the second. This relationship was not perfect, though, suggesting each measure brings different qualities to an investor's tool kit. If the measures were driven by the same things, they would have moved in lock step. Together, active share and tracking error give a fuller picture of how funds differentiate themselves from their benchmarks.

Higher Active Share, Higher Volatility, Bigger Losses?

While higher active share went hand in hand with higher tracking error and wider swings in relative performance, it didn't necessarily contribute to higher volatility or vulnerability to losses. In fact, there appeared to be no relationship at all between active share and standard deviation or maximum drawdown in either evaluation period, as Exhibit 6 illustrates. In both periods, the most- and least-active quintile of funds exhibited similar levels of volatility and suffered nearly identical maximum drawdowns.

This finding is somewhat counterintuitive. We might expect the odds of a blow-up to increase along with active share. Low active share limits risk relative to the benchmark but not to the risks of the benchmark itself. Because the S&P/TSX Composite is highly concentrated by sector, funds with low active share will be, too. The benchmark's heavy exposure to the cyclical financials, energy, and basic-materials sectors makes less-active portfolio susceptible to high volatility and large losses.

The most-active funds were significantly underexposed to the TSX Composite's dominant sectors. Our sector bet measure, the ICI score, was 7 times higher in the highest active-share quintile than that of funds in the lowest quintile. Treading lightly in major market sectors requires heavier weightings in minor ones, such as telecom and staples, which tend to be more defensive in character. Rather than magnifying volatility, sector bets may moderate it. This effect is difficult to see in the data—more-active funds weren't less volatile—but overweighting defensive stocks may have helped tame other potential sources of volatility like heavier exposure to value stocks.

Exhibit 6 Standard Deviation and Maximum Drawdowns, 2006-10, 2011-2015

	Evaluation Period 1		**Evaluation Period 2**	
Active-Share Quintile	Standard Deviation	Max Drawdown	Standard Deviation	Max Drawdown
1	16.9	–44.0	9.3	–19.4
2	15.5	–41.8	9.6	–18.0
3	16.3	–43.2	10.3	–21.6
4	16.4	–45.1	9.8	–18.3
5	16.2	–43.9	9.4	–20.0

Source: Morningstar, Inc. Data as of 12/31/2015.

Don't Forget About Fees

We used gross-of-fee returns in our study because we wanted to examine active share as a purely as a gauge of manager skill. What matters to investors, though, is whether managers deliver good enough returns to overcome their costs.

As Exhibit 7 demonstrates, Canadian equity funds become more expensive the more active they become. (The table breaks down management expense ratios by distribution channel using the most recent management expense ratio data. Active-share quintile data uses a five-year average. We excluded do-it-yourself funds because the sample was too small to be meaningful.) Higher active share may increase the potential for stronger excess returns, but the investor won't benefit if higher costs eat the surplus. Because fund costs and future performance are negatively correlated, funds with high active share may be more likely to underperform after fees.

Some managers have used high active share as a justification for high fees. These managers, the argument goes, are truly active and worth the added expense. There may be instances where this is the case, but it also may be these managers take more risks relative to their benchmark because they must overcome their fee hurdles.

Exhibit 7 Management Expense Ratio by Active-Share Quintile

Active-Share Quintile	Commission-Based Management Expense Ratio (%)	Fee-Based Management Expense Ratio (%)
1	2.2	1.0
2	2.4	1.2
3	2.4	1.3
4	2.4	1.3
5	2.6	1.6

Source: Morningstar, Inc. Data as of 12/31/2015.

Active Share Isn't a Holy Grail. So What?

Active share may not be the "new measure that predicts performance" as Cremers and Petajisto claimed in the title of their 2007 paper, but just because it is less useful than promised does not make it useless. It has given fund investors a simple way to understand the extent of a fund's active stock bets. Active share gives us no easy answers, but it can help us ask good questions about strategy, portfolio construction, and a fund's value proposition next to cheaper passive alternatives.

Flawed as active share may be as a gauge of future performance, other measures investors commonly use to identify skilled managers, such as the Sharpe or information ratios, turnover, or manager tenure, also suffer from having little predictive value on their own. Measures like these are more meaningful together than apart. Similarly, using active share in concert with performance-based measures like tracking error and portfolio-based analysis of stock and sector concentration gives a better picture of how different a portfolio is from its benchmark. Incorporating these considerations with other research concerns, such as the depth of management's resources and the strength of its research and risk management practices, historical performance, and costs, paints a more vivid picture of investment skill.

Lastly, investors should resist the temptation to make holding less-active and more-active funds together an either/or proposition. If low (or in the case of index funds no) active share is beneficial in some markets and high active share in others, investors could reap diversification benefits from holding them in concert. They may be better together.

Note: This article is an annotated version of a January 2016 Morningstar paper on active share. Morningstar Direct users can view the full paper, which offers a detailed explanation of our methodology and a more in-depth look at our findings, here.

Why Hasn't Indexing Taken Root in Canada?

Big banks, incentives, and backward self-regulation are to blame.

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If *The Wall Street Journal* is to be believed, stock-picking is a dying business.

At first blush, rumors of active management's death appear greatly exaggerated. After all, active managers still oversee 66% of U.S. long-term industry assets. A decade ago, though, active management's market share weighed in at 84%. Ominously, investors continue to vote against active management with their feet, even amid healthy market performance: While USD 1.3 trillion gushed into passive investments for the three years ended September 2016, USD 84 billion flowed out of active strategies. Active management ain't dead yet, but passive alternatives are clearly ascendant.

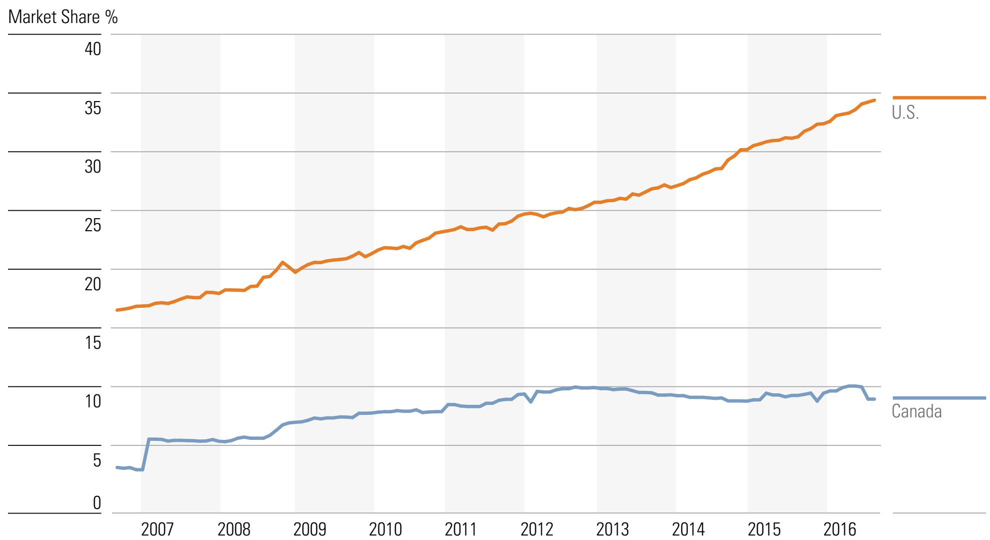
If the spectre of death looms over U.S. active managers, their Canadian counterparts have only begun feeling the mild aches and pains of a still-spry middle age. Passive investments have enjoyed healthy growth—driven almost entirely by exchange-traded funds—but actively managed funds continue to rake in greater sums, as Exhibit 1 illustrates. ETFs have nibbled active managers' market share over the past decade, but they still hold less than 10% of Canadian industry assets. While the share of active investments has fallen precipitously in the U.S. in recent years, Exhibit 2 shows just how slowly it has done so in Canada. The last time U.S. active managers were this dominant was in 1998.

Same Afflictions, Different Outcomes

Many conditions that *The Wall Street Journal* article attributes to indexing's U.S. success—such as discontent with long-term performance and high fees—also ring true in Canada, if not more so. Actively managed Canadian funds have hardly been more successful than their U.S. counterparts in outpacing broad market benchmarks. As of September 2016, fewer than 20% of Canadian-equity funds survived and outperformed the S&P/TSX Capped Composite Index over the prior 10-year period, for example. One big reason why: Canadian fund expenses rank among the planet's highest, giving active managers a high hurdle to surmount. Canadians have more reason for dissatisfaction than their southern neighbours; American fund investors enjoy low fees by global standards.

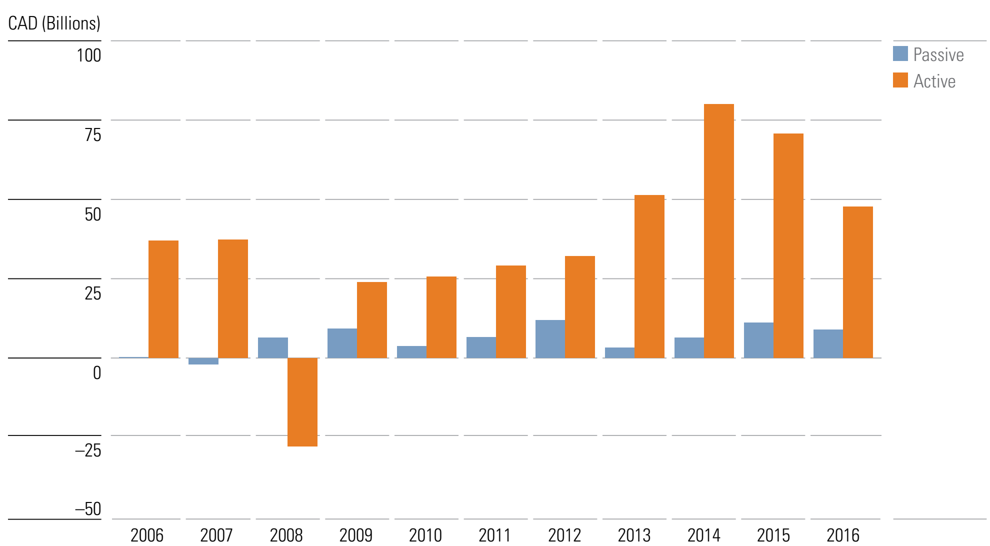
When the mid-2000s energy boom led to soaring stock prices, high fund costs were easier for Canadians to stomach. Likewise, U.S. investors worried little about fees in the 1980s and 1990s as stock markets consistently delivered double-digit returns. After middling market performance in the 2000s, not to mention the trauma of 2008 financial crisis, the move to passive investments accelerated.

Exhibit 1 Passive Market Share, Canada vs. United States



Source: Morningstar, Inc. Data as of 9/30/2016.

Exhibit 2 Estimated Net Flows for Canadian Active/Passive Mutual Funds and ETFs



Source: Morningstar, Inc. Data as of 9/30/2016.

Canadian fund industry observers commonly attribute the failure of indexing to take root to its advice-driven market. This account may explain why the indexing wave got a head start in the United States—it was do-it-yourselfers who drove its ascent in the 1990s—but it doesn't explain why indexed assets accelerated as advisors and other intermediaries have gained increasing control of investment decision-making in recent years.

Despite the clear virtues of passive management—not to mention a robust ETF industry eager to provide alternatives to high-cost active funds—traditional active managers in Canada have been able to resist the tide thanks to market and regulatory factors that have historically favoured their interests. The tide could be turning, however.

Those With Market Power Have Made the Rules

With market power concentrated in a relative handful of market players, Canadian asset managers tend to compete more on the breadth of their investment offerings and distribution muscle. This competitive dynamic stacks the deck against ETF providers and other would-be market entrants that are dependent on third parties for distribution.

That's not a problem for Canada's six largest banks, which have successfully used their built-in distribution network of bank branches to sell in-house funds. The banks control an increasingly large slice of long-term mutual fund assets. According to Morningstar data, the banks' combined share rose from 39% at the end of 2011 to 48% by September 2016. Investors Group, which uses a similar distribution model as the banks, controls another 7% of long-term fund assets. (The firm sells funds with its house label through its giant national network of advisors.)

These funds are almost always actively managed strategies. TD distributes moderately priced index options to its online brokerage customers but none through bank branches. Other bank-run asset managers include index fund options in their lineups, but they are limited in scope and high in price, at least by the passive-management standards. Even BMO, the country's second-largest ETF provider, wraps its moderately priced ETFs in high-priced mutual funds before selling them at bank branches.

The bank-run index funds are no bargain from the investor perspective, but they still translate into lower management-fee revenue for the advisor. No wonder they've ended up in few investors' hands: Excluding TD's Emerald funds, which are geared to institutional investors, indexed assets account for just 2% of the bank-run fund total. And among the 150-plus Investors Group offerings, not one is an index fund.

To be sure, independent fund providers like Fidelity and CI Investments have been successful without controlling the pipes by which their products flow. This isn't to say they don't have distribution advantages of their own. The deep relationships they've built with advisors took years to develop and would be difficult for scrappy upstarts to replicate, insulating them from the competitive pressures posed by ETFs or other low-cost providers. Some have also built advisor networks of their own, as CI has with its subsidiary Assante Wealth Management, which it acquired in 2003.

It's the Incentives, Stupid

The same fund companies that have little incentive to offer index funds have given advisors little reason to use them. Paying advisors far larger commissions to sell clients active funds tilts the field against index funds. The commissions, which are built into the management expense ratio and are commonly known as trailer fees, generally add another percentage point to the management fees paid to active stock funds but add half that amount (or less) to the price tag of index funds. (Commission-based series from ETF providers like iShares, PowerShares, and Purpose Investments, which have 1% trailer fees, are an exception.) The commission-based business model is on the decline, but historically fund companies paid advisors to sell more-costly funds, and they've gotten their wish.

Hey, MFDA: Why Can't Advisors Embrace a New Way?

There's another reason why many advisors don't put their clients in cheap ETFs: They can't. The Mutual Fund Dealers Association (MFDA)—the self-regulatory organization overseeing 95 dealers that represent more than 80,000 advisors and nearly $500 billion in investor assets—doesn't expressly forbid its members to trade ETFs, but few can do so. The MFDA (understandably) requires that advisors meet minimum educational standards before selling ETFs, but it has yet to issue long-promised proficiency requirements. (A comment period on these standards ended in September.) Even when this hurdle is out of the way, most dealers won't have the operational capabilities to trade ETFs. (Quite amazingly, more than 25 years after the world's first listed ETF launched in Toronto, a better part of the country's advisors still can't touch them.)

Change in the Air

To borrow a phrase from Ernest Hemingway, change comes gradually, then suddenly. The threat that Canadian active managers have faced from passive rivals has been modest thus far, but the warning signs of a coming storm are there. The U.S. shift to passive investments has primarily been market-driven. Such factors are at play in Canada, too. As advisors increasingly move to fee-based business models, commission-driven decision-making should fade away. Canadian regulators have given the invisible hand a helping hand, though. In July, they required advisors to begin disclosing to clients their fees in dollar terms and returns in dollar-weighted terms. These rules, known as CRM-2, don't require fund companies to disclose investment management costs in dollars, which make up the lion's share of the management expense ratio.

The regulation (rightly) pressures advisors to prove their worth to clients, but it doesn't ask the same of investment managers, at least not directly. I'd expect some advisors to demonstrate their value by shifting to low-cost investments, the benefit of which should shine through in higher returns. Asset managers tell us the regulation has accelerated the trend from commission-based to fee-based advice, the latter being more amenable to passive management for reasons discussed above. As a roundabout nudge toward passive management, CRM-2 looks more like a force for gradual change.

If CRM-2 is a nudge toward passive management, Canadian regulators are considering new rules that could give it a push. Outlawing embedded trailing commissions—an outcome the Canadian Securities Administration (CSA) appears to be inching toward—would tear down one of the largest structural impediments to the spread of ETFs and other low-cost investments. Banning trailing commissions in the United Kingdom in 2012 turned the trickle into passive funds to a flood. As Morningstar equity analyst Michael Wong noted in the October 2015 *Morningstar Financial Services Observer*, passively managed U.K. assets increased approximately 140% from 2011 to June 2015, and market share significantly increased from about 7.4% to over 12.0%.

Along with doing away with embedded trailers, the U.K. also introduced a best-interest standard—another step under review by the CSA. Such a standard, which requires advisors to act in their clients' best interests, would likely tilt the field in favour passive management. Under the lesser "suitability" standard that currently governs advisors, it's acceptable to sell a high-priced fund with middling performance as long it's aligned with the client's financial situation and risk tolerance. Advisors need not avoid conflicts of interest, such as commissions that give them incentive to choose some funds over others, as long as they're disclosed. The best-interest standard obliges advisors to avoid conflicts of interest and choose investments with reasonable fees. This higher standard doesn't limit advisors to passive investments, nor should it. But with lower costs and above-average historical performance, they're easier for advisors to defend.

Critics of regulatory change argue (with some justification) that ditching embedded trailers could make it uneconomical for advisors to service clients with smaller accounts. Automated, or robo, advice could fill the void and would give passive funds a boost. There's no rule against robo-advised portfolios holding actively managed funds, but the reality is they don't. Canadian robo-advisors like BMO, Wealthsimple, Nest Wealth, and Questrade build portfolios using ETFs. Some, such as Nest's, rely on market-cap-weighted strategies entirely, while others mix them with strategic-beta, or "smart-beta," ETFs. Just as technology has upended industries ranging from retailing to energy, the emergence of automated advice poses a challenge to traditional active management.

The End Will Come, Either With a Whimper or a Bang

The bell tolls not necessarily for active management in general but for expensive closet index funds—that is, high-cost active funds with indexlike portfolios. These funds face long odds against cheap index funds. There always will be investors who are enticed by the prospect of market-beating returns. Strategic-beta or rules-based ETFs, which systematically replicate the modest factor tilts of closet index funds, provide a way for investors to scratch this itch less expensively. For managers to earn high fees, they will have to do something that can't be easily replicated by machine.

Vanguard Canadian Aggregate Bond ETF

The lowest-cost option for broad Canadian market exposure.

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Morningstar's Take 1-11-2016

Qualitative Rating Gold

Morningstar Pillars

People	Positive
Process	Positive
Performance	Positive
Price	Positive
Parent	Positive

Suitability

Rock-bottom expenses and a conservative profile earn Vanguard Canadian Aggregate Bond ETF VAB a Morningstar Analyst Rating of Gold. VAB's benchmark, the Bloomberg Barclays Global Aggregate Canadian Float Adjusted Bond Index, provides exposure to Canadian investment-grade bonds, but it is an imperfect reflection of actively managed rivals' hunting ground, which typically includes more credit risk. While the median Canadian fixed-income fund roughly splits its portfolio between corporate and government bonds, the latter account for approximately 80% of the benchmark, even higher than the 70% stake in the more widely used investment-grade proxy FTSE TMX Canada Universe Bond Index. VAB's benchmark differs from the FTSE benchmark by adjusting for available float and excluding corporate issues valued at less than $300 million ($100 million is the FTSE index minimum). Omitting smaller corporate issues helps explain why government bonds play a disproportionately larger role.

Taking less credit risk generally translates into lower returns, and that's likely to be the case here. Over the past decade, approximately 75% of actively managed funds beat the similar FTSE benchmark before fees, though approximately 90% of funds couldn't earn high enough excess returns to outpace FTSE index tracker iShares Canadian Universe Bond Index ETF XBB. VAB's heavier government weighting may result in slightly lower gross returns, but its 21-basis-point fee advantage compensates for some of that lower return expectation, and most actively managed rivals will be hard-pressed to keep up. At 0.88%, the median actively managed, non-commission-based fund in the category is nearly 7 times VAB's 0.13% levy.

Skimpy government-bond yields virtually assure low absolute returns here. Higher interest rates could hit this fund relatively hard as bond prices and interest rates move in opposite directions. VAB's portfolio also exhibits a fair amount of interest-rate sensitivity, with a 7.9-year duration. Even so, VAB should still play an effective role as a portfolio diversifier. Relatively low expenses should allow it to capture a bigger slice of the market's skimpy yield than more expensive rivals, giving it an enduring edge.

Fundamental View

With approximately 80% invested in AAA and AA rated federal and provincial government bonds and a corporate stake dominated by high-quality names, VAB takes on little credit risk. In contrast, its median peer holds roughly 50% in government bonds and nearly 15% in BBB rated bonds (the fund has less than 10% in BBB rated fare). More credit risk means more sensitivity to equity market fluctuations, so VAB's high-quality portfolio should continue to insulate investors from such volatility.

Such safety comes at a cost, however. Thanks to demand from jittery investors, yields for investment-grade Canadian bonds stand near all-time lows. VAB's 1.7% yield to maturity has fallen by nearly half since the peak of the 2008 financial crisis. In real terms, its yield looks especially modest. The 1.5% expected inflation rate implied by long-term real return government bonds leaves investors with a paltry 0.2% real yield.

Today's low yields are far from their January 1981 peak, when long-term Canadian government bonds yielded 18%. Because bond prices and yields move in opposite directions, the epic decline in interest rates powered outsize gains. From its 1980 launch through September 2016, the well-known Canadian bond market proxy FTSE TMX Universe Index returned 9.1%, or 6.7% in real (after-inflation) terms.

These returns far exceed historical norms. According to Credit Suisse, the Canadian bond market has averaged 2.3% annualized real returns from 1900-2015 and 4.2% from 1966-2015. Because asset-class returns tend to revert to historical averages, investors should expect subpar long-term results in absolute terms.

Moreover, bonds look modestly to extremely overvalued relative to stocks. Since 1980, the FTSE benchmark has a skimpy 0.2% return advantage over the TSX Composite. That's not far from the 0.4% premium stocks earned over bonds from 1965-2015 but way out of line with the 3.3% premium stocks enjoyed from 1900-2015.

An uptick in interest rates could also bite. VAB's 7.9-year effective duration implies that a 1% rise in interest rates would result in a 7.9% loss in net asset value. Such losses aren't assured—duration unrealistically assumes yield curves shift in a parallel fashion—though history still suggests a steep, unexpected hike would take a toll. In the first half of 1994, for example, the FTSE TMX Universe Index fell 9.2% as the Bank of Canada bank rate soared to 6.9% from 3.8% and longer-term bonds were hit hard.

Higher rates may be a distant threat, though. As the U.S. Federal Reserve raised rates in 2015, the Bank of Canada went in the other direction. Citing the impact of plunging oil prices, Bank of Canada governor Stephen Poloz cut the bank rate by 0.25% in January 2015 and another 0.25% in July. With inflation well below his 2% target and oil prices still depressed, Poloz appears in no rush to reverse course and indicates he would loosen monetary conditions further if the economy weakens. With a longer-duration portfolio, a downward move in rates would give it a boost, while its high-grade holdings would likely be less effected by economic weakness. As these conditions prevailed in 2015, VAB beat nearly 90% of rivals, albeit with a modest 3.2% gain.

Portfolio Construction

The fund tracks the Bloomberg Barclays Global Aggregate Canadian Float Adjusted Bond Index. Because it adjusts for float, the benchmark omits bonds held by the Canadian government. For liquidity purposes, the index excludes corporate issues valued at less than $300 million. As of August 2016, VAB held 741 of 786, or 94%, of the index's holdings. Because the fund may have small amounts of cash at any given time, management may minimize its effects on the portfolio by investing in bond futures. It can use securities lending to reduce tracking error, though it did not do so in the most recent reporting period. VAB rebalances its holdings monthly. Government bonds constitute 80% of the benchmark. Corporate bonds soak up the remainder of the portfolio. The largest nongovernment sector exposure, at 11%, is financials. More-stringent banking regulations require many financial institutions to issue bonds that convert to equity if they're nonviable, but the index methodology excludes these issuers. The index also excludes small bond issues, all but leaving out the energy sector. As of August 2016, the fund's duration clocked in at 7.9 years and sported a 1.7% yield to maturity.

Fees

VAB is a category leader on price, with a 0.12% management expense ratio. It enjoys a considerable advantage over near-rival XBB, whose management expense ratio is 0.33%, and an enormous one over its category peers: The management expense ratio for funds sold in noncommission channels averages 0.87%. Given the relatively low expected long-term returns of investment-grade bonds, higher-priced funds will find it difficult to overcome their cost hurdles over the long haul.

Alternatives

Bronze-rated exchange-traded funds iShares Canadian Universe Bond Index XBB and BMO Aggregate Bond Index ZAG track the most widely used proxy for Canadian investment-grade bonds, the FTSE TMX Canada Universe Bond Index. Government bonds make up 70% of the funds, split evenly between federal and provincial issuers. (VAB has 80% in government bonds.) With slightly higher corporates exposure than VAB, these offerings take marginally more credit risk, though both are less credit-heavy than most active funds in the category. They come with higher price tags, however: XBB and ZAG levy 0.33% and 0.23% management expense ratios, respectively. Long-term investors will likely find ZAG the more cost-effective option. XBB's higher liquidity had led to smaller bid-ask spreads historically, which may make it a better choice for heavy traders or those investing very large sums.

IShares Core High Quality Canadian Bond Index XQB matches VAB on price, with a 0.13% management expense ratio. Its benchmark, FTSE TMX Liquid Universe Capped Bond Index, shares the same liquidity requirements, though not float-adjusted methodology, of VAB's Bloomberg Barclays benchmark. The FTSE benchmark is less comprehensive, though, because it is limited to bonds rated A or above. (VAB, XBB, and ZAG have modest BBB stakes.) XQB could hold appeal for investors who want to limit credit risk while reducing government-bond exposure, as its weighting is 10% smaller than TMX universe's. XQB is a bit less interest-rate-sensitive, with a 6.5-year effective duration. The trade-off is a heavy concentration in financials: The sector makes up 30% of the fund, vying with federal government bonds as its largest sector exposure.

The Best Things We Read and Heard in 2016

Our analysts list their favorite books, articles, and podcasts.

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It has been a long, if fascinating, year in the markets, politics, and culture. Fortunately, there's been no shortage of books, magazine articles, and podcasts to help us make sense of the world we inhabit. Here are some of our 2016 favourites.

Books

Superforecasting: Successful forecasting requires not just smarts but also curiosity and a mind where, "Beliefs are hypotheses to be tested, not treasures to be guarded," according to authors Phil Tetlock and Dan Gardner. The best investors and analysts embody this mindset. The authors also tackle seemingly unanswerable questions, such as "How many piano tuners are there in Chicago?" by breaking them into smaller, more answerable ones. Taking a step back from the question at hand—"How many piano tuners do other similarly sized cities have?"—helps.

The Most Important Thing: This collection of essays by Oaktree Capital's Howard Marks is a must-read on many investors' reading lists for good reason. Marks writes in a clear, engaging style, and although he is a high-yield specialist, his wisdom applies to investors of all stripes. Value investors will recognize his core investment principles, such as the importance of margin of safety and thinking differently than the crowd. Marks' description of investing as management of risks, which requires recognizing all the things that can go wrong even when they don't, is what stands out most.

Hillbilly Elegy: J.D. Vance's big-hearted but unsparing account of his dysfunctional upbringing in the hills of Appalachia and a down-on-its-heels factory town in Ohio brought to life a world characterized by intense loyalty, pride, and distrust of outsiders. With this demographic credited for helping lift Donald Trump to the U.S. presidency, the book is especially well timed. You can't help but love Vance's colourful and fiercely protective grandmother, who Vance credits for shielding him from his environment's worst excesses. Vance is a Yale Law graduate, but inside him still beats the big heart of a hillbilly.

Between the World and Me: Written as a letter to his teenage son, Ta-Nehisi Coates guides us through his inner-city childhood, his time at historically black Howard University, and his adulthood in Paris and New York City. Coates' beautifully written and painful to read book was a real eye-opener. To be African-American, he explains, is to not feel ownership over your own body—a tradition that began with slavery and continues with police abuses today. This isn't a hopeful book, but given the reality he depicts, I can see why.

Blogs/Web Articles

Alpha or Assets: Investment managers want to outperform and pull in hefty amounts of investor cash, but as researcher Patrick O'Shaughnessy, CFA, explains at his blog, Investors Field Guide, these goals are at odds. In a back-test of stocks in the S&P 500, O'Shaughnessy finds that concentrated, equal-weighted portfolios holding cheap stocks outperform broad market-cap-weighted alternatives. The hitch: These strategies rack up heavy trading costs if assets balloon beyond modest levels, underscoring the importance of investing with managers who prioritize performance over asset growth. O'Shaughnessy also deserves a shout-out for his podcast, Invest Like the Best, which launched in 2016.

Indexing Makes Markets and Economies More Efficient: Critics of passive management are right when they point out that markets wouldn't work if everyone indexed. It logically follows that fewer active managers means markets are less efficient. In this lengthy but digestible post on his blog, Philosophical Economics, Jesse Livermore explains why that's not so, noting it's become harder to outperform as investors have flocked to index funds over the past decade. That may be because indexing has crowded out less-talented managers, leaving the strongest to compete against each other. Livermore convincingly demonstrates why active management is a zero-sum game even when active and passive managers trade with one another.

Machine Bias: ProPublica's analysis of software used in courtrooms to identify repeat offenders identified a disturbing pattern of racial discrimination. The authors discovered that black defendants in the United States were far more likely than whites to be identified as future criminals even after accounting for factors like criminal history, age, sex, and income. Quantitatively driven processes, whether applied to criminal justice or investment strategy, may help correct some behavioural biases, but they still can suffer from the flaws of their human creators.

Theranos Whistleblower Shook the Company—and His Family: Theranos, a one-time Silicon Valley darling, lured luminaries like former U.S. Secretaries of State Henry Kissinger and George Shultz to its board of directors with a charismatic CEO and a promise to revolutionize blood testing. *The Wall Street Journal*'s John Carreyrou brought to light its fraudulent business practices with the help of Shultz's grandson, who as an employee saw the firm bury evidence that its tests were wildly inaccurate. Shultz resisted pressures to keep mum from his grandfather and threats from Theranos' high-calibre legal team to hold the powerful accountable.

Podcasts

EconTalk—Ending Medical Reversal: Medical practices considered good for you today might be considered useless or worse tomorrow. One example: Post-menopausal women were routinely treated with estrogen until later research demonstrated that this dramatically increased their risk of heart attack and stroke. In this EconTalk podcast, guest Adam Cifu, a professor at the University of Chicago School of Medicine, explained why such reversals happen. Often, it's the case when the prevailing practice makes theoretical sense. (It was true in the case of treating menopause with estrogen.) If medicine still gets things wrong even with the benefit of double-blind research—the gold-standard methodology—then findings based on the messy world of markets deserve extra skepticism.

Morningstar Analyst Ratings Roundup

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New Ratings

TD U.S. Mid-Cap Growth | Gold

Morningstar first rated this offering in November, but it has covered the strategy managed by the respected U.S.-based subadvisor T. Rowe Price since the 1990s. Manager Brian Berghuis has led U.S.-domiciled T. Rowe Price Mid-Cap Growth since its 1992 inception and this fund since 1994. Berghuis harnesses T. Rowe Price's large, capable analyst team to identify a mix of steady growers and up-and-comers. Using a valuation-conscious approach keeps volatility relatively low by growth fund standards. Long-term performance has been stellar relative to the Canadian small/mid-cap category, though less impressive versus the cost-free S&P MidCap 400 Index thanks to above-average fees in its commission-based series. The F series, though, offers a better deal. The fund's experienced, capable manager and long record of success outweigh our concerns over price. An added bonus is its diversification potential: Canadian investors often rely on large-cap-focused strategies for U.S. equity exposure.

Beutel Goodman Canadian Dividend | Gold

Although this offering is new to coverage, managers Mark Thomson and Stephen Arpin are no strangers to us. Thomson and Arpin, along with teammates William Otton, James Black, and Pat Palozzi, won the Morningstar Equity Fund Manager of the Year award in 2013. Thomson and Arpin lead Gold-rated Beutel Goodman Canadian Equity employing a similar strategy. This fund distinguishes itself from its purely domestic sibling by investing up to 30% of the portfolio in U.S. and international stocks and by having a dividend requirement of at least 1.5% at purchase. Given the hefty sums that Beutel manages in Canadian equities, the managers' broader hunting ground gives them flexibility to invest where capacity constraints aren't a concern. This fund's Gold rating reflects our confidence that management can continue to harness its experience and discipline to produce peer-topping results.

PH&N Vintage | Silver

This offering shares the same management team and a similar process as Bronze-rated PH&N Canadian Equity, but its more distinctive portfolio earns it a Silver rating. Doug Stadelman and Scott Lysakowski, finalists for the 2016 Morningstar Equity Fund Manager of the Year award, stand out for meticulous bottom-up research and disciplined execution. Where they excel most is in artful portfolio construction. The managers rely on their "playbook"—their guide to investing in stocks or sectors based on the economic environment—and valuation relative to a company's growth rate for position sizing. Lead manager Stadelman has only been on board since 2009. Poor performance in prior years still casts a pall on the fund's long-term record.

Manulife Global Real Estate Unconstrained | Neutral

Subadvisor Standard Life has a long tradition of investing directly in real estate on behalf of institutional clients, but its foray into real estate stocks is more recent. The firm's heritage benefits managers Svitlana Gubriy and Bill Pekowitz, who can draw upon top-down insights developed by Standard Life's direct real estate team. Unfortunately, the managers haven't been able to translate this potential advantage into winning stock picks. The fund's record is brief but poor: Since its November 2013 launch through December 2016, it lagged its benchmark FTSE EPRA/NAREIT Developed Index by 4.9 percentage points.

Sun Life MFS International Growth | Bronze

Managed by subavisor (and Sun Life subsidiary) MFS, this offering benefits from a veteran crew of managers and strong analyst research. The fund's valuation-conscious approach to growth investing is time-tested and has led to fine long-term results at its U.S.-domiciled counterpart MFS International Growth, which is also rated Bronze. This offering, launched in 2010, has lagged its sibling because it's more expensive. Even so, it remains a solid choice relative to its category peers.

Sun Life MFS U.S. Value | Silver

The U.S. equity category has few actively managed funds with benchmark-beating results. This offering, also led by subadvisor MFS, stands better odds. Like its internationally focused sibling, it profits from seasoned managers. Management prioritizes investment quality and moderate valuations over distressed businesses selling at fire-sale prices. This approach has helped U.S.-domiciled MFS Value, which this fund replicates, deliver fine long-term returns with less volatility than its value counterparts. Higher costs mean this fund won't deliver similarly strong returns in absolute terms, but its strengths should keep it ahead of its weak peer group.

CIBC Global Bond | Bronze and Renaissance Global Bond | Bronze

These funds, subadvised by Brandywine Global Investment Management, provide benchmark-agnostic exposure to global bonds. Managers Stephen Smith and David Hoffman mostly favour government bonds with high real yields and strong or improving fundamentals. This puts their portfolios at odds with market benchmarks that give the most-indebted countries the highest ratings. The managers will move into corporate and securitized bonds when opportunity strikes and will make meaningful adjustments to duration based on their interest-rate outlook. This approach can contribute to relatively high volatility, but it has generated strong risk-adjusted returns. High costs are a negative, though, limiting our ratings to Bronze.

Reassigned From Under Review

Beutel Goodman International Equity | Neutral

Beutel Goodman doesn't always spin investment gold. This fund shares its siblings' disciplined, value-oriented approach, but execution has been poor, leading to lousy long-term returns. Beutel has tried to right the ship by changing the crew. In mid-2013, for example, it enlisted longtime analyst Colin Ramkissoon as comanager. In November 2016, the firm moved Ramkissoon off as a co-lead manager and brought Stanley Wu on board as his successor. Wu came from Jarislowsky Fraser with 15 years of experience and joined existing comanager KC Parker. (Ramkissoon continues to focus on Beutel's global strategies.) We placed this fund under review in response to the change in management before affirming the Neutral rating that we had before Wu's appointment. Wu's experience and the added analytical strength he brings bode well for the fund, but it's not yet clear if he can turn it around.

Capital Group Global Equity | Gold

Galen Hoskin, one of this fund's three portfolio managers, started an extended personal leave in December 2016. Leo Hee, who has been with the firm for 11 of his 22 years of investment experience, is Hoskin's successor. Capital Group employs a unique multimanager approach, splitting the portfolio into independently managed sleeves. After meeting with the firm, we concluded Hee's focus on higher-quality firms complements existing manager Dina Perry's contrarian approach and Carl Kawaja's growth orientation. Hee isn't as experienced as Perry and Kawaja, but he's no newbie.

Capital Group's long-standing success in cultivating capable managers and packaging them together in a single fund also inspires confidence. Strong management, a solid process, an investor-focused investment culture, and low fees earn this fund a Gold rating.

Exhibit 1 Morningstar Analyst Rating Update—Q4 2016

	Morningstar Analyst Rating
New Ratings	
TD U.S. Mid-Cap Growth	Gold
Beutel Goodman Canadian Dividend	Gold
PH&N Vintage	Silver
Manulife Glboal Real Estate Unconstrained	Neutral
Sun Life MFS International Growth	Bronze
Sun Life MFS U.S. Value	Silver
CIBC Global Bond	Bronze
Renaissance Global Bond	Bronze
Reassigned From Under Review	
Beutel Goodman International Equity	Neutral
Capital Group Global Equity	Gold

Source: Morningstar, Inc. Data as of 12/31/2016.

Market Data

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Exhibit 1 Trailing Total Returns

Index	3-Month	YTD	1-Year	3-Year	5-Year	10-Year	15-Year
Canadian Equity Market							
S&P/TSX 60 TR CAD	5.59	21.36	21.36	7.92	8.99	4.86	7.53
S&P/TSX Capped Composite TR CAD	4.54	21.08	21.08	7.06	8.25	4.72	7.44
BMO Small Cap Blended (Weighted) CAD	3.03	35.39	35.39	5.27	5.19	3.86	8.26
S&P/TSX Completion TR	1.48	20.50	20.50	4.67	6.15	4.46	7.60
S&P/TSX Small Cap TR	3.12	38.48	38.48	5.44	4.28	2.20	5.13
U.S. Equity Market							
S&P 500 TR CAD	5.94	8.09	8.09	17.66	21.15	8.47	—
Russell 2000 TR CAD	11.05	17.11	17.11	15.36	20.94	8.60	—
Global Equity Market							
MSCI ACWI NR CAD	3.25	4.13	4.13	11.46	15.55	5.04	4.70
MSCI World NR CAD	3.93	3.79	3.79	12.18	16.66	5.31	4.61
MSCI EAFE NR CAD	1.31	-2.49	-2.49	6.34	12.57	2.19	4.07
MSCI EM NR CAD	-2.21	7.34	7.34	5.31	7.01	3.29	8.23
Canadian Fixed Income Market							
FTSE TMX Canada Universe Bond	-3.44	1.66	1.66	4.61	3.22	4.79	5.39
FTSE TMX Canada All Government Bond	-4.04	0.89	0.89	4.62	2.87	4.57	5.20
FTSE TMX Canada All Corp Bond	-1.82	3.73	3.73	4.65	4.19	5.40	5.91
FTSE TMX Canada ST Bond	-0.50	1.01	1.01	2.22	2.08	3.56	3.90
FTSE TMX Canada MT Bond	-3.12	1.61	1.61	5.17	3.88	5.57	6.02
FTSE TMX Canada LT Bond	-7.54	2.47	2.47	7.71	4.29	6.27	7.37
FTSE TMX Canada Real Return Bond	-4.58	2.86	2.86	6.17	1.36	5.09	7.16
S&P/TSX Preferred Share TR	1.52	16.14	16.14	4.17	7.06	6.70	7.56
S&P/TSX Preferred Share TR	5.30	6.98	6.98	-0.94	-0.03	1.16	—

Source: Morningstar, Inc. Data as of 12/31/2016.

Exhibit 2 Historical Asset-Class Returns

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Best	MSCI EM GR CAD 18.5	FTSE TMX Canada Universe Bond 6.4	S&P/TSX Small Cap TR 62.4	S&P/TSX Small Cap TR 35.1	FTSE TMX Canada Universe Bond 9.7	S&P 500 TR USD 16.0	Russell 2000 TR CAD 48.1	S&P 500 TR CAD 23.9	S&P 500 TR CAD 21.6	S&P/TSX Small Cap TR 38.5
	S&P/TSX Composite TR 9.8	Russell 2000 TR CAD –17.2	MSCI EM GR CAD 52.0	S&P/TSX Completion TR 30.3	S&P 500 TR CAD 4.6	MSCI EM GR CAD 16.0	S&P 500 TR CAD 41.3	MSCI World GR CAD 15.0	MSCI World GR CAD 19.5	S&P/TSX Composite TR 21.1
	S&P/TSX Completion TR 5.8	S&P 500 TR CAD –21.2	S&P/TSX Completion TR 47.7	Russell 2000 TR CAD 20.2	S&P 500 TR USD 2.1	MSCI EAFE GR CAD 15.3	MSCI World GR CAD 35.9	Russell 2000 TR CAD 14.3	MSCI EAFE GR CAD 19.5	S&P/TSX Completion TR 20.5
	S&P 500 TR USD 5.5	MSCI World GR CAD –25.4	S&P/TSX Composite TR 35.1	S&P/TSX Composite TR 17.6	Russell 2000 TR CAD –1.8	MSCI World GR CAD 14.0	S&P 500 TR USD 32.4	S&P 500 TR USD 13.7	MSCI ACWI NR CAD 17.1	Russell 2000 TR CAD 17.1
	FTSE TMX Canada Universe Bond 3.7	MSCI ACWI NR CAD –27.7	S&P 500 TR USD 26.5	S&P 500 TR USD 15.1	MSCI World GR CAD –2.7	Russell 2000 TR CAD 13.8	MSCI EAFE GR CAD 31.6	MSCI ACWI NR CAD 13.5	Russell 2000 TR CAD 14.6	S&P 500 TR USD 12.1
	S&P/TSX Small Cap TR 0.9	MSCI EAFE GR CAD –28.8	MSCI ACWI NR CAD 14.3	MSCI EM GR CAD 13.0	MSCI ACWI NR CAD –5.1	MSCI ACWI NR CAD 13.6	MSCI ACWI NR CAD 31.0	S&P/TSX Composite TR 10.6	FTSE TMX Canada Universe Bond 3.5	S&P 500 TR CAD 8.1
	MSCI ACWI NR CAD –5.3	S&P/TSX Composite TR –33.0	MSCI EAFE GR CAD 12.5	S&P 500 TR CAD 9.1	S&P/TSX Completion TR –7.9	S&P 500 TR CAD 13.4	S&P/TSX Composite TR 13.0	FTSE TMX Canada Universe Bond 8.8	MSCI EM GR CAD 2.4	MSCI EM GR CAD 7.7
	MSCI EAFE GR CAD –5.3	S&P 500 TR USD –37.0	MSCI World GR CAD 11.1	MSCI ACWI NR CAD 6.8	S&P/TSX Composite TR –8.7	S&P/TSX Composite TR 7.2	S&P/TSX Completion TR 12.2	MSCI EM GR CAD 7.0	S&P 500 TR USD 1.4	MSCI World GR CAD 4.4
	MSCI World GR CAD –7.1	S&P/TSX Completion TR –38.8	Russell 2000 TR CAD 8.0	FTSE TMX Canada Universe Bond 6.7	MSCI EAFE GR CAD –9.5	S&P/TSX Completion TR 4.7	S&P/TSX Small Cap TR 7.6	S&P/TSX Completion TR 5.7	S&P/TSX Composite TR –8.3	MSCI ACWI NR CAD 4.1
	S&P 500 TR CAD –10.5	MSCI EM GR CAD –41.4	S&P 500 TR CAD 7.4	MSCI World GR CAD 6.5	MSCI EM GR CAD –16.1	FTSE TMX Canada Universe Bond 3.6	MSCI EM GR CAD 4.3	MSCI EAFE GR CAD 4.1	S&P/TSX Completion TR –10.0	FTSE TMX Canada Universe Bond 1.7
Worst	Russell 2000 TR CAD –16.5	S&P/TSX Small Cap TR –45.5	FTSE TMX Canada Universe Bond 5.4	MSCI EAFE GR CAD 2.6	S&P/TSX Small Cap TR –16.4	S&P/TSX Small Cap TR –2.2	FTSE TMX Canada Universe Bond –1.2	S&P/TSX Small Cap TR –2.3	S&P/TSX Small Cap TR –13.3	MSCI EAFE GR CAD –2.0

Asset Class
- S&P/TSX Composite TR
- S&P 500 TR USD
- S&P 500 TR CAD
- S&P/TSX Completion TR
- S&P/TSX Small Cap TR

Asset Class
- MSCI EM GR CAD
- MSCI EAFE GR CAD
- MSCI ACWI NR CAD
- MSCI World GR CAD

Asset Class
- Russell 2000 TR CAD
- FTSE TMX Canada Universe Bond

Source: Morningstar, Inc. Data as of 12/31/2016.

Exhibit 3 Five-Year Correlation Matrix

	Indicies	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1	S&P/TSX Capped Composite TR CAD														
2	S&P/TSX Completion TR	0.92													
3	S&P/TSX Composite Dividend TR	0.96	0.90												
4	S&P/TSX Small Cap TR	0.81	0.92	0.77											
5	S&P 500 TR CAD	0.23	0.10	0.19	-0.06										
6	Russell 2000 TR CAD	0.27	0.23	0.22	0.10	0.76									
7	MSCI ACWI NR CAD	0.39	0.25	0.33	0.11	0.94	0.66								
8	MSCI EAFE GR CAD	0.39	0.26	0.30	0.17	0.81	0.51	0.95							
9	MSCI EM NR CAD	0.49	0.43	0.50	0.30	0.42	0.24	0.63	0.61						
10	FTSE TMX Canada Universe Bond	0.07	0.06	-0.04	0.04	0.40	0.18	0.47	0.46	0.46					
11	FTSE TMX Canada All Government Bond	0.03	0.02	-0.07	0.01	0.39	0.16	0.46	0.45	0.43	1.00				
12	FTSE TMX Canada ST Bond	-0.04	-0.04	-0.14	-0.06	0.43	0.22	0.51	0.52	0.46	0.93	0.92			
13	FTSE TMX Canada LT Bond	0.11	0.09	0.01	0.08	0.38	0.17	0.45	0.44	0.45	0.99	0.99	0.87		
14	FTSE TMX Canada All Corp Bond	0.21	0.19	0.10	0.14	0.39	0.23	0.50	0.50	0.53	0.96	0.93	0.89	0.95	
15	FTSE TMX Canada Cdn Trsy Bill 91 Day	-0.11	-0.19	-0.19	-0.29	0.38	0.20	0.38	0.35	0.24	0.62	0.64	0.72	0.57	0.55

1 to .76 · .75 to .51 · .50 to .26 · .25 to 0 · 0 to –.24 · –.25 to –.49 · –.50 to –.74 · –.75 to –.100

Source: Morningstar, Inc. Data as of 12/31/2016.

Exhibit 4 Category Performance

Index	3-Month	YTD	1-Year	3-Year	5-Year	10-Year	15-Year
Canada 2025 Target Date Portfolio	-0.96	3.74	3.74	5.09	5.67	4.18	—
Canada 2030 Target Date Portfolio	-1.10	4.31	4.31	5.86	6.21	5.20	—
Canada 2035 Target Date Portfolio	0.00	5.48	5.48	5.75	7.23	5.67	—
Canada 2035+ Target Date Portfolio	0.67	6.24	6.24	6.62	8.98	5.78	—
Canada Asia Pacific Equity	-3.80	-1.71	-1.71	7.06	10.05	2.57	4.06
Canada Asia Pacific ex-Japan Equity	-6.41	-2.16	-2.16	5.49	8.04	3.77	5.92
Canada Canadian Dividend & Income Equity	4.63	17.35	17.35	6.16	8.39	5.19	7.65
Canada Canadian Equity	4.07	17.39	17.39	6.60	8.90	4.16	6.37
Canada Canadian Equity Balanced	2.77	12.03	12.03	5.74	7.58	4.10	5.53
Canada Canadian Fixed Income	-2.45	1.85	1.85	3.54	2.76	3.78	4.32
Canada Canadian Fixed Income Balanced	-0.49	4.55	4.55	4.35	4.83	3.69	4.10
Canada Canadian Focused Equity	4.21	12.56	12.56	6.62	9.99	4.05	6.54
Canada Canadian Focused Small-/Mid-Cap Equity	3.43	16.14	16.14	7.60	10.94	3.76	6.90
Canada Canadian Inflation-Protected Fixed Inc	-4.66	1.87	1.87	5.03	0.56	3.76	5.55
Canada Canadian Long Term Fixed Income	-7.66	1.18	1.18	6.27	3.11	5.20	6.12
Canada Canadian Money Market	0.07	0.27	0.27	0.34	0.40	0.86	1.24
Canada Canadian Neutral Balanced	0.92	7.87	7.87	5.43	6.60	4.42	5.61
Canada Canadian Short Term Fixed Income	-0.19	1.05	1.05	1.67	1.48	2.33	2.51
Canada Canadian Small-/Mid-Cap Equity	2.95	17.84	17.84	4.96	9.52	5.08	8.57
Canada Canadian Synthetic Money Market	—	—	—	—	—	—	—
Canada Emerging Markets Equity	-3.51	6.40	6.40	3.38	4.98	1.11	5.87
Canada Energy Equity	6.90	33.06	33.06	-3.44	-0.09	1.05	8.08
Canada European Equity	-0.68	-6.15	-6.15	3.64	11.07	1.60	3.24
Canada Financial Services Equity	12.65	11.74	11.74	10.28	15.15	1.52	4.72
Canada Floating Rate Loans	2.31	6.84	6.84	4.76	3.67	1.35	—
Canada Global Equity	2.30	3.32	3.32	8.37	12.88	4.01	4.09
Canada Global Equity Balanced	1.15	4.87	4.87	6.61	9.44	3.79	4.69
Canada Global Fixed Income	-1.92	1.89	1.89	4.84	4.18	4.10	3.31
Canada Global Fixed Income Balanced	-0.58	4.18	4.18	5.22	5.79	4.10	4.78
Canada Global Infrastructure Equity	-2.39	6.60	6.60	7.84	10.53	4.27	—
Canada Global Neutral Balanced	0.72	4.73	4.73	6.23	7.55	4.03	4.62
Canada Global Small-/Mid-Cap Equity	3.04	3.08	3.08	7.47	13.61	4.75	5.32
Canada Greater China Equity	-4.32	-1.63	-1.63	8.25	10.50	3.27	6.52
Canada High Yield Fixed Income	0.90	9.90	9.90	4.76	5.70	4.90	5.34
Canada International Equity	-0.38	-2.42	-2.42	4.84	10.98	0.99	2.97
Canada Natural Resources Equity	3.53	41.03	41.03	-1.43	-5.59	-2.09	7.96
Canada North American Equity	4.21	5.66	5.66	9.66	12.38	4.49	4.40
Canada Precious Metals Equity	-21.06	57.25	57.25	13.73	-8.25	-0.89	9.46
Canada Preferred Share Fixed Income	4.97	8.32	8.32	1.38	1.85	5.54	—
Canada Real Estate Equity	-2.84	1.02	1.02	11.90	12.69	2.87	8.12
Canada Short-term Target Date Portfolio	-0.74	2.75	2.75	4.18	4.85	3.80	—
Canada Tactical Balanced	0.73	6.01	6.01	4.55	6.43	4.02	6.34
Canada US Equity	4.56	5.85	5.85	12.39	16.64	5.97	3.89
Canada US Money Market	2.13	-3.20	-3.20	8.23	5.80	2.13	-0.21
Canada US Small-/Mid-Cap Equity	6.17	9.27	9.27	10.42	15.86	7.19	5.69

Source: Morningstar, Inc. Data as of 12/31/2016. Return ranking over three-month period.

Exhibit 5 Largest Mutual Fund Performance

Name	Morningstar Category	Fund Size (Millions CAD)	Morningstar Overall Rating	% Category Rank 1-Yr	3-Yr	5-Yr	10-Yr	15-Yr
RBC Select Conservative Portfolio Sr A	Canada Fund Global Neutral Balanced	23,224,938,361	★★★	53	57	81	54	37
RBC Select Balanced Portfolio Sr A	Canada Fund Global Neutral Balanced	22,774,514,521	★★★★	42	28	27	44	29
RBC Bond Sr A	Canada Fund Canadian Fixed Income	17,085,148,671	★★★★	33	16	28	29	51
RBC Canadian Dividend Sr A	Canada Fund Canadian Dividend & Income Equity	17,771,154,661	★★★★	38	29	20	41	38
TD Canadian Bond - I	Canada Fund Canadian Fixed Income	15,346,828,320	★★★	72	48	65	39	21
Fidelity Monthly Income Series A	Canada Fund Canadian Neutral Balanced	13,685,630,358	★★★★	61	53	46	14	—
TD Canadian Core Plus Bond - A	Canada Fund Canadian Fixed Income	12,870,183,036	★★★	52	53	43	—	—
TD Mgd Income Portfolio I	Canada Fund Canadian Fixed Income Balanced	9,817,999,978	★★★	97	51	43	80	61
Manulife Monthly High Income Adv	Canada Fund Canadian Neutral Balanced	8,754,007,111	★★★★★	72	10	5	21	3
PIMCO Monthly Income A	Canada Fund Global Fixed Income	9,450,266,839	★★★★★	6	38	6	—	—
CI Signature High Income	Canada Fund Tactical Balanced	8,625,545,097	★★★★	47	46	43	16	15
Manulife Strategic Income Adv	Canada Fund High Yield Fixed Income	8,562,704,329	★★★★	91	28	32	12	—
RBC Monthly Income Sr A	Canada Fund Canadian Neutral Balanced	8,175,131,905	★★★	16	41	72	40	17
CI Income Class A	Canada Fund Global Fixed Income Balanced	7,971,278,672	★★	64	91	85	—	—
TD Monthly Income - I	Canada Fund Canadian Neutral Balanced	7,930,920,418	★★★★	3	16	28	26	5
Fidelity Canadian Balanced Series A	Canada Fund Canadian Neutral Balanced	7,338,961,301	★★★★	81	23	29	22	28
TD Comfort Balanced Port - I	Canada Fund Global Neutral Balanced	7,506,493,087	★★	27	63	78	—	—
RBC Select Growth Portfolio Sr A	Canada Fund Global Equity Balanced	7,389,409,888	★★★	45	30	41	53	36
TD Global Low Volatility A	Canada Fund Global Equity	7,010,751,768	★★★	34	21	53	—	—
TD Dividend Growth - I	Canada Fund Canadian Dividend & Income Equity	7,205,212,805	★★★★	20	23	20	48	31
TD Short Term Bond - I	Canada Fund Canadian Short Term Fixed Income	6,320,409,413	★★★★	74	54	55	28	16
TD Mgd Inc & Mod Growth Port I	Canada Fund Global Neutral Balanced	6,370,965,506	★★	81	61	68	80	73
Fidelity Canadian Asset Allocation B	Canada Fund Canadian Equity Balanced	5,892,894,999	★★★	84	57	86	53	52
RBC Global Corporate Bond Adv	Canada Fund Global Fixed Income	7,157,594,507	★★★★	11	58	54	17	—
RBC European Equity Sr A	Canada Fund European Equity	6,172,595,156	★★★	96	76	27	66	81
RBC Balanced Sr A	Canada Fund Canadian Neutral Balanced	5,804,350,149	★★★	52	42	57	86	72
TD Comfort Balanced Growth Portfolio - I	Canada Fund Global Neutral Balanced	6,005,456,342	★★★	24	46	53	—	—
Beutel Goodman Canadian Equity Class B	Canada Fund Canadian Equity	6,186,392,573	★★★★	45	51	19	—	—
Sentry Canadian Income A	Canada Fund Canadian Focused Equity	5,786,729,318	★★★★★	74	25	32	4	—
Investors Real Property A	Canada Fund Misc–Income and Real Property	5,413,325,000	—	—	—	—	—	—
Scotia Canadian Dividend A	Canada Fund Canadian Dividend & Income Equity	5,655,562,141	★★★★	74	10	15	39	48
Dynamic Strategic Yield Sr A	Canada Fund Global Neutral Balanced	5,036,349,957	★★	80	86	90	—	—
TD Income Advantage Portfolio - I	Canada Fund Canadian Fixed Income Balanced	5,007,132,692	★★★	59	76	83	42	—
EdgePoint Global Portfolio Series A	Canada Fund Global Equity	5,895,243,203	★★★★★	2	2	2	—	—
RBC Canadian Short Term Income Sr A	Canada Fund Canadian Short Term Fixed Income	5,196,681,184	★★★	72	60	59	52	50
CI Signature Income & Growth	Canada Fund Global Neutral Balanced	5,051,981,119	★★★	16	69	45	25	6
TD Comfort Balanced Income Portfolio - I	Canada Fund Canadian Fixed Income Balanced	4,991,494,227	★★★	41	60	52	—	—
RBC Global Bond Sr A	Canada Fund Global Fixed Income	5,670,864,266	★★★	29	56	64	63	35
Mawer International Equity A	Canada Fund International Equity	4,897,964,896	★★★★★	49	7	15	4	4
TD Mgd Balanced Growth Port I	Canada Fund Global Neutral Balanced	4,688,535,167	★★★	78	48	31	74	63
Mackenzie Ivy Foreign Equity A	Canada Fund Global Equity	4,512,542,606	★★★★	73	62	62	11	21
TD Canadian Equity - I	Canada Fund Canadian Focused Equity	4,921,444,292	★★	8	70	84	59	51
CI Cambridge Canadian Eq Corp Cl W	Canada Fund Canadian Focused Equity	4,675,322,316	—	—	—	—	—	—
PH&N US Multi-Style All-Cap Equity A	Canada Fund US Equity	4,693,620,802	★★★	49	29	40	—	—
CIBC Monthly Income	Canada Fund Canadian Neutral Balanced	4,428,959,473	★★	16	94	89	87	36
CI Select Income Managed Corp Class A	Canada Fund Global Fixed Income Balanced	4,346,491,790	★★	72	94	92	—	—
PH&N High Yield Bond D	Canada Fund High Yield Fixed Income	4,177,169,500	★★★★★	5	23	20	7	5
TD Dividend Income - I	Canada Fund Canadian Equity Balanced	4,370,946,938	★★★★	18	16	27	29	3
BMO Dividend A	Canada Fund Canadian Dividend & Income Equity	4,402,107,000	★★★	86	24	30	65	52
Fidelity NorthStar Sr A	Canada Fund Global Small/Mid Cap Equity	4,245,006,926	★★★★	87	23	23	41	—
Desjardins Canadian Bond	Canada Fund Canadian Fixed Income	3,426,663,538	★★	92	68	88	86	85

Source: Morningstar, Inc. Data as of 12/31/2016. Return ranking over three-month period.

Exhibit 6 Largest ETF Performance

Name	Morningstar Category (Canada Fund)	Fund Size (Millions CAD)	Inception Date	Morningstar Overall Rating	% Category Rank YTD	3-Yr	5-Yr	10-Yr	15-Yr
iShares S&P/TSX 60	Canadian Equity	12,533,782,064	9/28/99	★★★★	24	25	54	42	21
iShares Core S&P 500 (CAD-Hedged)	US Equity	3,904,369,680	5/24/01	★★	22	86	81	63	61
BMO S&P 500 ETF (CAD)	US Equity	3,038,543,846	11/14/12	★★★★★	37	7	—	—	—
iShares Core S&P/TSX Capped Composite	Canadian Equity	2,766,788,388	2/16/01	★★★	25	41	70	45	23
iShares Canadian Universe Bond	Canadian Fixed Income	2,326,719,662	11/20/00	★★★★	58	14	30	14	10
BMO Aggregate Bond ETF	Canadian Fixed Income	2,310,049,598	1/19/10	★★★★	50	11	28	—	—
iShares Canadian Short Term Bond	Canadian Short Term Fixed Income	2,246,027,229	11/20/00	★★★★	54	27	30	3	1
iShares 1-5 Year Laddered Corp Bd Comm	Canadian Short Term Fixed Income	1,977,539,974	2/25/09	★★★★	27	12	9	—	—
BMO S&P/TSX Capped Composite ETF	Canadian Equity	1,811,860,192	5/29/09	★★★	25	40	67	—	—
BMO Laddered Preferred Share ETF	Preferred Share Fixed Income	1,782,716,197	11/14/12	★	79	100		—	—
iShares Canadian Corporate Bond	Canadian Fixed Income	1,716,683,438	11/6/06	★★★★★	15	16	9	4	—
iShares Canadian Select Dividend	Canadian Dividend & Income Equity	1,557,774,603	12/19/05	★★★	8	72	56	49	—
BMO Covered Call Canadian Banks ETF	Financial Services Equity	1,342,780,381	1/28/11	★★	8	57	80	—	—
iShares S&P/TSX Canadian Pref Share Comm	Preferred Share Fixed Income	1,327,504,944	4/10/07	★★	84	85	73	—	—
iShares S&P/TSX Capped REIT	Real Estate Equity	1,321,340,615	10/17/02	★★★	2	97	100	8	—
BMO Short Corporate Bond ETF	Canadian Short Term Fixed Income	1,308,424,527	10/20/09	★★★★	21	9	7	—	—
iShares MSCI EAFE CAD-Hedged	International Equity	1,285,702,656	9/6/01	★★★	5	51	40	45	58
BMO US Dividend ETF (CAD)	US Equity	1,273,995,680	3/19/13	★★★★★	1	1	—	—	—
BMO Low Volatility Canadian Equity ETF	Canadian Equity	1,265,337,868	10/21/11	★★★★★	81	1	1	—	—
BMO Mid Corporate Bond ETF	Canadian Fixed Income	1,215,527,334	1/19/10	★★★★★	11	4	4	—	—
BMO MSCI EAFE ETF	International Equity	1,164,817,714	2/10/14	—	38	—	—	—	—
iShares S&P/TSX Capped Financials	Financial Services Equity	1,153,441,476	3/23/01	★★★★	18	67	63	1	1
BMO Mid-Term US IG Corp Bond ETF (CAD)	Global Fixed Income	1,150,522,681	3/19/13	★★★★★	47	3	—	—	—
Vanguard Canadian Aggregate Bond ETF	Canadian Fixed Income	1,143,150,284	11/30/11	★★★★	61	10	29	—	—
BMO S&P 500 Hedged to CAD ETF	US Equity	1,117,859,158	5/29/09	★★	23	86	82	—	—
iShares S&P/TSX Capped Energy	Energy Equity	1,101,009,816	3/19/01	★★★	21	47	53	92	83
iShares S&P/TSX Cdn Div Aristocrats Comm	Canadian Dividend & Income Equity	1,087,757,727	9/8/06	★★★★	25	47	49	17	—
Horizons S&P/TSX 60 ETF	Canadian Equity	1,075,801,334	9/13/10	★★★	22	23	51	—	—
BMO High Yld US Corp Bd Hdgd to CAD ETF	High Yield Fixed Income	1,075,309,141	10/20/09	★★★	17	80	40	—	—
Vanguard Canadian Short-Term Corp Bd ETF	Canadian Short Term Fixed Income	1,041,804,353	11/2/12	★★★★	21	8	—	—	—
BMO S&P/TSX Equal Weight Banks ETF	Financial Services Equity	1,011,558,539	10/20/09	★★★	1	13	67	—	—
Vanguard S&P 500 ETF	US Equity	1,003,427,173	11/2/12	★★★★★	35	6	—	—	—
Horizons Active Preferred Share ETF Comm	Preferred Share Fixed Income	1,002,516,002	11/22/10	★★★	50	56	37	—	—
iShares 1-5 Year Laddered Govt Bd Comm	Canadian Short Term Fixed Income	949,063,527	1/31/08	★★★	81	33	36	—	—
iShares Core S&P 500	US Equity	826,157,007	4/10/13	★★★★★	39	6	—	—	—
PowerShares 1-5 Yr Lad InvGr CorpBd ETF	Canadian Short Term Fixed Income	800,177,768	6/15/11	★★★★★	22	6	6	—	—
Vanguard Canadian Short-Term Bond ETF	Canadian Short Term Fixed Income	798,738,564	11/30/11	★★★★	54	24	28	—	—
Vanguard US Total Market ETF	US Equity	782,448,888	8/1/13	★★★★	31	8	—	—	—
iShares S&P/TSX Global Gold	Precious Metals Equity	773,720,575	3/23/01	★★	81	87	88	95	100
BMO Equal Weight US Banks ETF	Financial Services Equity	757,142,118	2/10/14	—	12	—	—	—	—
BMO Low Volatility US Equity ETF (CAD)	US Equity	751,948,144	3/19/13	★★★★★	51	1	—	—	—
iShares Core MSCI EAFE IMI	International Equity	740,701,047	4/10/13	★★★★	42	21	—	—	—
BMO Canadian Dividend ETF	Canadian Dividend & Income Equity	738,903,039	10/21/11	★★	8	72	78	—	—
Vanguard FTSE Canada All Cap ETF	Canadian Equity	716,567,537	8/2/13	★★★	21	46	—	—	—
iShares US Dividend Growers(CAD-Hdg)Comm	US Equity	664,099,483	9/13/11	★★	1	80	85	—	—
iShares Diversified Monthly Income	Canadian Fixed Income Balanced	618,602,976	12/19/05	★★★★	1	55	57	4	—
BMO Short Federal Bond ETF	Canadian Short Term Fixed Income	581,214,386	10/20/09	★★★	88	50	56	—	—
BMO Mid Provincial Bond ETF	Canadian Fixed Income	579,702,148	3/19/13	★★★★★	62	4	—	—	—
iShares US High Yield Bond CAD-Hedged	High Yield Fixed Income	572,031,360	1/21/10	★★★	22	70	55	—	—
BMO US High Dividend Covered Call ETF	US Equity	542,775,674	2/10/14	—	26	—	—	—	—

Source: Morningstar, Inc. Data as of 12/31/2016.

Exhibit 7 Largest Foreign Equity Funds

Name	Morningstar Category	Fund Size (Millions CAD)	Inception Date	Morningstar Overall Rating	% Category Rank 1-Yr	3-Yr	5-Yr	10-Yr	15-Yr
TD Global Low Volatility F	Canada Fund Global Equity	7,010,751,768	11/28/11	★★★★	24	6	31	—	—
EdgePoint Global Portfolio Series F	Canada Fund Global Equity	5,895,243,203	11/17/08	★★★★★	1	1	1	—	—
Mawer International Equity A	Canada Fund International Equity	4,897,964,896	11/9/87	★★★★★	49	7	15	4	4
PH&N US Multi-Style All-Cap Equity F	Canada Fund US Equity	4,693,620,802	6/25/10	★★★★	42	17	21	—	—
Mackenzie Ivy Foreign Equity A	Canada Fund Global Equity	4,512,542,606	10/16/92	★★★★	73	62	62	11	21
Quadrus Mackenzie Ivy Foreign Equity H	Canada Fund Global Equity	4,512,542,606	7/12/16	—	—	—	—	—	—
Fidelity NorthStar Sr F	Canada Fund Global Small/Mid Cap Equity	4,245,006,926	10/31/02	★★★★★	71	11	9	7	—
Capital Group Global Equity-Canada F	Canada Fund Global Equity	4,169,024,322	11/1/02	★★★★★	34	7	5	7	—
iShares Core S&P 500 (CAD-Hedged)	Canada Fund US Equity	3,904,369,680	5/24/01	★★	22	86	81	63	61
Investors US Large Cap Value C	Canada Fund US Equity	3,855,635,999	1/27/62	★★★	15	62	66	79	58
Trimark Fund SC	Canada Fund Global Equity	3,853,214,435	9/1/81	★★★★	35	13	19	31	17
TD Emerald International Equity Index	Canada Fund International Equity	3,773,813,999	7/12/95	—	—	—	—	—	—
Epoch Global Equity - I	Canada Fund Global Equity	3,682,116,572	1/4/94	★★	97	81	33	76	72
RBC US Dividend Sr F	Canada Fund US Equity	3,422,324,919	10/29/01	★★★★	39	16	33	27	1
MDPIM US Equity Pool	Canada Fund US Equity	3,136,076,421	8/28/00	★★★	54	30	31	65	73
BMO S&P 500 ETF (CAD)	Canada Fund US Equity	3,038,543,846	11/14/12	★★★★★	37	7	—	—	—
Sentry US Growth and Income F	Canada Fund US Equity	2,758,932,015	5/31/11	★★★★	62	34	23	—	—
RBC Emerging Markets Equity Sr F	Canada Fund Emerging Markets Equity	2,707,666,372	12/23/09	★★★★★	64	4	1	—	—
Mawer US Equity A	Canada Fund US Equity	2,697,382,908	12/10/92	★★★★★	52	22	14	13	19
Mackenzie Cundill Value A	Canada Fund Global Equity	2,573,841,576	12/31/74	★★	7	94	72	73	18
Fidelity Small Cap America Sr B	Canada Fund US Small/Mid Cap Equity	2,529,597,403	4/5/94	★★★★	95	36	7	18	31
RBC Global Dividend Growth Sr A	Canada Fund Global Equity	2,445,271,536	12/29/00	★★★	96	46	28	64	61
Mawer Global Equity A	Canada Fund Global Equity	2,392,993,934	10/22/09	★★★★★	77	10	6	—	—
AGF Global Dividend Series F	Canada Fund Global Equity	2,280,841,506	8/20/07	★★★★	37	7	23	—	—
RBC Global Equity Focus F	Canada Fund Global Equity	2,221,768,423	4/28/14	—	72	—	—	—	—
TD Emerald US Market Index (Cdn$)	Canada Fund US Equity	2,080,507,000	7/17/97	—	—	—	—	—	—
Mawer Global Small Cap A	Canada Fund Global Small/Mid Cap Equity	2,036,830,201	10/2/07	★★★★★	64	12	4	—	—
RBC Private US Lg Cap Cr Eq Pool Sr F	Canada Fund US Equity	1,936,336,635	10/27/08	★★★★	65	22	18	—	—
CI Cambridge Global Eq Corp Cl F T5	Canada Fund Global Equity	1,935,775,762	12/31/07	★★★★	3	36	9	—	—
CI Black Creek Global Leaders Class D	Canada Fund Global Equity	1,846,345,159	4/26/00	★★★★★	19	20	3	5	26
RBC US Equity Sr A	Canada Fund US Equity	1,780,375,977	7/29/66	★★★	56	65	73	78	76
Fidelity American Eq Sr F	Canada Fund US Equity	1,732,408,884	10/31/02	★★★★	94	8	5	45	—
Investors Global C	Canada Fund Global Equity	1,717,430,000	10/20/86	★★★	73	63	52	69	46
TD US Blue Chip Equity - I	Canada Fund US Equity	1,661,330,997	10/31/96	★★★★	95	42	12	17	55
RBC O'Shaughnessy US Value Sr A	Canada Fund US Equity	1,646,218,203	11/4/97	★★	18	97	87	84	8
MD Growth Investments Limited	Canada Fund Global Equity	1,583,062,054	7/1/69	★★★	49	47	23	60	52
Renaissance U.S. Equity Income	Canada Fund US Equity	1,568,005,294	9/16/13	★★★★★	10	4	—	—	—
RBC Select Aggressive Growth Port Sr A	Canada Fund Global Equity	1,522,858,322	1/22/07	★★★	30	54	66	—	—
Templeton Growth Ltd A	Canada Fund Global Equity	1,519,429,683	11/29/54	★★	52	65	31	64	57
Epoch International Equity - F	Canada Fund International Equity	1,503,685,721	9/10/13	★★★	86	47	—	—	—
Fidelity NorthStar Cl F	Canada Fund Global Small/Mid Cap Equity	1,497,353,950	10/31/02	★★★★★	70	10	10	9	—
Epoch U.S. Blue Chip Equity D	Canada Fund US Equity	1,491,794,372	4/26/16	—	—	—	—	—	—
Mackenzie US Mid Cap Growth Cl M	Canada Fund US Small/Mid Cap Equity	1,491,781,573	11/8/02	★★★★	43	30	31	1	—
Quadrus Mackenzie US Mid Cap Gr Cl Q	Canada Fund US Small/Mid Cap Equity	1,491,781,573	11/8/02	★★★★	50	56	46	16	—
RBC QUBE Low Volatility US Eq Ser F	Canada Fund US Equity	1,442,058,688	11/19/12	★★★★★	27	3	—	—	—
Manulife Global Equity Class F	Canada Fund Global Equity	1,431,384,128	11/2/09	★★★★★	73	14	5	—	—
Trimark Global Endeavour	Canada Fund Global Equity	1,403,432,668	6/8/93	★★★★	63	29	21	16	—
Investors US Dividend Growth A	Canada Fund US Equity	1,401,054,000	1/8/07	★★★	24	68	58	—	—
TD International Growth - F	Canada Fund International Equity	1,336,809,919	9/6/06	★★★	86	68	56	52	—
iShares MSCI EAFE CAD-Hedged	Canada Fund International Equity	1,285,702,656	9/6/01	★★★	5	51	40	45	58

Source: Morningstar, Inc. Data as of 12/31/2016.

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