Fund Selection Process

PRIVATE CLIENT SOLUTIONS

Mutual Funds & ETFs

Contents

Raymond James Ltd. Mutual Fund Focus List

Fund Selection Process

Summary

- This report identifies the core beliefs and philosophy that drives our fund selection process for the Raymond James Ltd. Mutual Fund Focus List ("Focus List"), which is a collection of best-in-class mutual funds among their respective category peers.
- The Focus List has been assembled in order to help take the guesswork out of selecting mutual funds. The List represents the culmination of our fund research capabilities and ongoing due diligence reviews.
- A fund must adhere to specific criteria and undergo thorough due diligence in order to be selected for the Focus List.
- The fund selection process is a multi-faceted approach that combines both quantitative and qualitative elements.

Core Beliefs and Philosophy

Objective and unbiased research - We have the freedom to select funds from the entire universe of Canadian mutual funds without restriction or bias towards a particular fund family. In addition, we do not receive special compensation from fund companies to promote their funds. These combined factors allow us to conduct fund research in an objective and unbiased fashion.

Art and Science - Investing is both an art and a science. Likewise, our fund selection process incorporates both qualitative and quantitative elements.

Investment Horizon - Much like the tale of the tortoise that beat the hare, we select funds that are most likely to generate strong long term results versus its peers and respective benchmark.

Sustainable Competitive Advantage - We favour funds that possess a distinct competitive advantage over other similarly managed products. We define a competitive advantage as an attribute of the fund's investment process that cannot be easily duplicated or imitated elsewhere and, in turn, enables the fund to outperform over the long term. There are a number of ways a fund can enjoy a competitive advantage. For example, the portfolio manager may retain an informational advantage through experience or by possessing a specialized skillset. Perhaps the fund benefits from extensive research capabilities such as a large team of experienced research analysts. Being the beneficiary of a sophisticated and well-equipped trading desk is another way a fund can have an edge over the competition.

Fund Selection Process

Step 1: Quantitative Screening

The first step of the fund selection process is to identify funds that are worth further consideration. But with over 6000 offerings to choose from, distilling the unwieldy Canadian mutual fund universe can be a daunting task. This is where our quantitative screening tools come into play. In essence, they help pinpoint well managed funds.

Mutual funds that screen well are those that have outperformed with relatively low volatility. In others words, we're looking for funds that exhibit strong risk-adjusted returns. The table to the right illustrates several metrics that we screen for. It is important to note that we analyze these risk-adjusted metrics on a rolling basis over multiple periods in order to mitigate end-date bias, which is an error that occurs when analyzing performance over a single time period.

Performance Risk Metrics

Alpha	Alpha is the value added by the manager as distinct from the market. We use the overall level of Alpha over time as an indicator of manager skill.
Rolling Alpha > 0	Indicates consistency of risk-adjusted outperformance over time in percentage terms. Must be well above 50%.
Up and Down Capture %	We look for funds that capture more market upside than market downside.
Omega	This is the ratio of "up" periods to "down" periods. We prefer funds with Omega at least 20% greater than the benchmark's.
Downside Volatility	When performance is negative, how negative does it get? We prefer funds with lower downside risk.
Maximum Drawdown	The peak to trough percentage decline of a fund's performance over a specified period of time. This metric helps determine a fund's risk profile and the magnitude of future drawdowns.
Sharpe Ratio	This ratio measures excess return per unit of standard deviation. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance has been.
Treynor Ratio	Similar to Sharpe ratio, Treynor measures excess performance as a unit of risk. Unlike Sharpe, Treynor uses market risk (i.e. beta) instead of security risk (i.e. standard deviation) as the base unit of risk.
Information Ratio	This ratio measures a fund's ability to generate excess returns relative to the standard deviation of its benchmark. A high ratio is achieved by producing strong returns and low volatility relative to the benchmark.

It is often the case that funds worth further consideration are those that don't pop up on our radar through the initial screening process (e.g. limited track record). As such, we rely on our experience and network of industry contacts to uncover these hidden gems.

Before we conduct any further analysis, we need to ensure that the fund's manufacturer or sub-advisor poses no reputation risk, is financially sound, follows strict internal risk controls, and is not embroiled in disciplinary matters with securities regulators.

Funds worth further consideration must also meet the following criteria:

- The portfolio manager or investment team has several years of lead portfolio management experience.
- Available for sale to new and existing unitholders.
- Competitively priced fees.

Step 2: Assessing Performance Drivers

Once a fund has been identified for further consideration and meets the above eligibility criteria, we analyze the fund's performance drivers. While portfolio managers would love to have you believe that their fund's five star rating or first quartile rankings are the manifestation of their investment acumen, there are many other factors outside the control of the portfolio manager that shape a fund's track record.

Investment style is a key consideration as it strongly influences a fund's returns. Investment style is defined as the overall strategy or theory that a money manager abides by when selecting securities. The two main investment styles are value and growth, both of which rotate in and out of favour for extended periods of time, consequently obscuring the validity of a fund's track record. For example, by simply focusing on price and earnings momentum, even the most inept growth manager was able to greatly outperform the majority of value managers during the late 1990s. However, when the tech bubble imploded and growth fell off the rails, the reverse became true; a number of mediocre value funds were able to outperform growth funds by merely sticking to their investment strategy.

In order to control for style differentiation, we compare a fund's performance to a customized peer group comprised of funds with similar investment styles. This way, we ensure that we're making apples to apples comparisons when assessing fund performance.

Other factors that impact relative returns include sector and country weightings, currency exposure, and market capitalization. With respect to balanced funds, the largest determinant of a fund's success is its asset mix. In fact, academic studies have shown that approximately 90% of the variability in performance can be attributed to asset allocation. The implications of this on balanced funds are huge. That's because balanced funds abide by different asset mix policies but their returns are often compared to one another on an indiscriminate basis. As a result, a slight difference in its asset mix policy will determine whether a fund is a first quartile hero or fourth quartile laggard. As such, we don't put too much stock in relative performance metrics when assessing the performance of balanced funds.

Given that returns are heavily influenced by the aforementioned factors, we utilize holdings-based and style-based attribution techniques to determine how much value (i.e. alpha) the portfolio manager brings to the table. This also provides us with a better understanding of the strategy's risks, the consistency of management's investment approach, and whether outperformance is sustainable.

Step 3: Qualitative Assessment

After assessing the fund's returns and performance drivers, we require the portfolio manager to complete a detailed investment strategy questionnaire. Key aspects of the questionnaire include a synopsis of the manager's investment philosophy and process, a description of the fund's risk controls, and other material facts concerning the fund. Below is a sample set of questions from the questionnaire:

- Describe how the investment team is structured in terms of research and management responsibilities?
- List all departures and additions to the investment team over the past 12 months.
- How is the portfolio manager's compensation aligned with unitholders of the fund?
- Has there been any material change to the fund's investment strategy over the past 12 months?
- What is your buy and sell discipline?
- How does the fund behave throughout a full market cycle?
- What distinguishes the fund from its closest competitor?
- What areas within the investment process require improvement?

It is mandatory that we interview the portfolio manager or investment team via conference call or face-to-face. The portfolio manager interview is an invaluable step of the fund selection process. That's because it provides us with insights that cannot be gleaned from analyzing the fund's performance or portfolio holdings.

The portfolio manager interview is structured much like a behavioural job interview, based on the belief that behavioural patterns that are identified during the meeting provide a good indication of conduct that happens behind the scenes.

In our experience, we have found that successful portfolio managers are those who are honest, passionate about investing, resolute, business-savvy, self-effacing, and competitive. They are calculated risk takers, knowing when to take chances in order capture investment opportunities. They draw upon multiple educational disciplines that allow them to process information in a unique fashion. Lastly, they are independent thinkers, inclined to forge their own path rather than succumb to herd mentality.

Step 4: Investment Thesis and Portfolio Strategy

After thoroughly analyzing all aspects of the fund, we formulate an investment thesis that answers the following question: What is the fund's sustainable competitive advantage? As discussed earlier, a competitive advantage is an attribute of the fund's investment process that cannot be easily duplicated or imitated elsewhere and, in turn, enables the fund to outperform over the long term. In order for a fund to be selected to the Focus List, we must be able to identify and clearly articulate a fund's competitive advantage.

We also consider macro-economic factors, valuations, and the relative attractiveness of an asset class when selecting funds. In addition, it is important to consider how well a fund fits into a diversified portfolio.

Step 5: Monitoring and Ongoing Due Diligence

All funds on the Focus List are monitored on a continuous basis.

Performance is reviewed monthly. We will contact portfolio managers of funds whose returns vary dramatically from their benchmark or category average, asking the manager to explain the fund's performance variance in detail. While we would not remove a fund based on short-term underperformance, it's imperative that we understand why a fund's returns are lagging. We are equally concerned with funds that exhibit exceptionally strong performance as this may be an indication that the portfolio manager is assuming too much risk to generate excess returns.

A fund can be removed from the Focus List at any time. We would consider removing a fund for any of the following reasons:

1. If the fund experiences an adverse material change (e.g. manager departure, change in strategy, etc.).
2. If we determine that a comparable fund possesses better investment potential.
3. If our investment thesis no longer holds true (e.g. overestimate a manager's competitive advantage).

ETFs

Passive ETFs- For passive ETFs that track an index, we rely primarily on quantitative metrics that measure how well an ETF replicates its benchmark. While cost (lower is better) is a large driver and an important part of the selection process, there are a number of other metrics that we consider. Tracking Error measures how closely an ETF tracks its benchmark, e.g. a tracking error of 0% means that it perfectly tracks the index. As the number gets higher, the more the ETF differs from the index. Some ETFs may be slightly cheaper, but have issues tracking the benchmark for whatever reason and we seek to deliver returns as close to the index as possible when investing in this type of ETF. Security lending rebates are another area we look at. Security lending is fairly simple and can help generate extra returns for investors. In essence, the manufacturer holds thousands of shares of stocks which back the ETF. If there is a short-seller who wants to borrow any of those stocks, they can post collateral and pay the ETF a fee for doing so. The ETF manufacturer can then pass these fees onto the investor of the ETF to enhance the returns. However, some companies will pay all of these fees out, while some will keep a portion for the house. Repaying a larger portion of the security lending fee helps offset some of the cost. As a result, the lowest cost ETF may not always be on the Focus List if another ETF in the passive universe is delivering closer index returns for any of the reasons mentioned above.

Factor and Active ETFs- For factor and active ETFs, the exact same selection process is employed as mutual funds (outlined above).

Important Investor Disclosures

Disclosure: Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund &

ETF investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all dividends and do not take into account sales, redemptions, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds & ETFs are not guaranteed, their values change frequently and past performance may not be repeated. Member – Canadian Investor Protection Fund.