

Educators Balanced Fund

Fund Review

For the quarter ended June 30th, The Educators Balanced fund returned -1.14%, and its benchmark, comprised of 45% DEX Universe Index, 40% S&P/TSX Composite TR and 15% MSCI World Index C\$, returned -1.00%.

Fixed income returns were positive through the second quarter as the trend towards higher interest rates reversed. Corporate sector returns slightly underperformed the broad index return of 2.48% over the quarter with a return of 2.43%. The corporate sector returns were led by the Infrastructure, Energy, and Industrial sectors, while the Communications sector lagged. We believe that the added yield the fixed income component produces due to its significant overweight in credit coupled with our rigorous, disciplined investment approach, will provide downside protection in this uncertain environment.

The second quarter S&P/TSX Total Return Index performance was led by the Telecommunications, Healthcare and Consumer Staples sectors, while the Materials, Energy and Information Technology, sectors were leading detractors. The top five overall contributors to performance were: Tourmaline Oil, Equinox Mineral, CN Rail, Magna International and First Quantum. In the quarter, we modestly reduced weight in the Materials sector, as the stocks had performed well and enabled us to take profits. We added weight in both the Energy and Financial sectors, continuing to emphasize companies with solid earnings growth, reasonable valuations and good upside potential. We introduced several new names to the Fund, including: Calfrac Well Services, Celtic Energy, Baytex Energy, Crescent Point Energy in the Energy sector, CAE in the Industrial sector, Thomson Reuters in the Consumer Discretionary sector and CGI Group in the Information Technology space. We sold positions including: Shaw Communications, Cameco, and Research in Motion.

Investment Strategy

No material changes are seen in the overall asset mix for the Fund, although we continue to look for additional foreign names to add to the portfolio. The fixed income portion of the portfolio will continue to maintain its core overweight position in corporate bonds and asset backed securities. The Fund remains positioned for continued, but modest, economic growth in 2011 and beyond. We expect that stocks with solid fundamentals will continue to be market leaders and that this kind of an environment represents a good underpinning for fund performance, going forward.

Market Outlook

The second quarter saw a reversal in the general outlook for the economy, due to heightened fears of a global economic slowdown, sovereign debt issues and inflation concerns. The first significant trigger of the downturn in market sentiment was attributed to the earthquake and tsunami in Japan during the first quarter, which created a significant, yet temporary, global supply chain disruption. The impact was magnified, due to the release of additional weaker economic statistics worldwide. Weak growth numbers and consumer confidence in Europe, higher interest rates in China, and, more recently, a sluggish ISM Manufacturing benchmark in the U.S., all point to a slower economic environment. The European sovereign debt issue resurfaced during the second quarter, after many believed it had resolved itself in 2010. When progress implementing fiscal restraint measures slowed, the EU and IMF had to step in again to take more corrective action. Notwithstanding these concerns, we believe that these country specific issues will be resolved, but not without further enhancing volatility in the market.

Within North America, three issues remain significant. First, consensus GDP growth estimates have been lowered from 3% down to 2.5%. We see this as confirmation that we are in a sustained lower growth environment, not a double dip recession. Secondly, higher levels of inflation during the second quarter have led both economists and bond market participants to anxiously anticipate when the Central Bankers will start hiking interest rates. Lastly, the labour picture remains weak. The unemployment rate in the US crept back over the 9% level in April, while in Canada, the employment picture has improved at a better pace. This, in our view, is the single biggest challenge to the overall North American economic recovery picture. With the combination of all three aforementioned issues, we believe that market growth will remain subdued for the near-term. We continue to see both strong reported and expected earnings growth in 2011 and 2012, although we acknowledge that the growth is decelerating relative to the last few years.

Takeaways

The Educators Balanced Fund provides a complete solution for investors. The fund provides active asset allocation between fixed income and equity investments, as well as across sectors and geographies in response to changes in the broader market. The team has a strong sell discipline and approaches the investment acquisition and divestment process rigorously. Capital preservation and above average earnings growth remain a key focus.