



Cambridge Income Fund – A diversified approach to income

Robert Swanson joined Cambridge Advisors in September as Principal and Portfolio Manager. Bob is co-manager of Cambridge Canadian Asset Allocation Corporate Class and is providing guidance to the Cambridge team on asset allocation, portfolio construction and risk management. In addition, he is lead portfolio manager of the new Cambridge Income Fund and Cambridge Income Corporate Class.

With more than 27 years' investment experience, Bob is an ideal candidate to lead the new fund. At his previous firm, he was lead portfolio manager of several mutual funds with combined assets under management of \$20 billion and head of its Canadian asset allocation team. In the past two years, funds he managed won an impressive seven Lipper Fund Awards. In this interview, Bob discusses the new funds.

[Q] Bob, please describe the new fund.

SWANSON: Cambridge Income Fund is designed to provide a stable, sustainable income stream that is tax efficient. It's for investors who are seeking income with low volatility and downside protection. To achieve that, the fund has a broad, "go anywhere" mandate that allows us to invest in a diverse mix of income-generating securities from around the world. Most investors require higher yields than those provided by government bonds, and the fund's diversification by region and asset class allows us to seek higher yields while managing risk.

[Q] What is the general asset mix of the fund?

SWANSON: Our general target is 50% fixed income and 50% high-yielding equities. This includes an allocation of about 20% to convertible bonds, which have characteristics of both bonds and equities.

[Q] Can you tell us more about the high-yield equity holdings and your security selection process?

SWANSON: Currently, approximately 10% is allocated each to real estate investment trusts, preferred shares, high-yielding common shares, and infrastructure/utilities stocks. Across all sectors, the holdings are a mix of Canadian and global securities. At this point, the foreign holdings are primarily U.S. based, but we have identified some European securities with excellent yields. These opportunities have arisen because the sovereign debt crisis has driven down prices indiscriminately.

We employ a bottom-up security selection process, and pay particular attention to cash flow and a company's ability to service its fixed obligations. Companies are then ranked based on the strength of their ability to service both interest and dividends, and their capacity to increase dividends. These rankings are then compared to their dividend yields to determine the relative attractiveness of each security.

[Q] Tell us more about your bond holdings.

SWANSON: The bond portfolio consists of about 60% investment-grade and 40% high-yield corporate bonds. In the high-yield portion, there is nothing lower than BB or B-rated – so they are high quality for the category. The convertible bonds are not officially rated, but their quality level varies – with some being equivalent to investment grade and others can be considered high yield. Convertible bonds offer the potential upside of converting the bond into

equity at a fixed rate, while they provide protection on the downside through cash flow from the coupon payments.

[Q] What is the yield of the fund?

SWANSON: The gross yield on the portfolio is over 5%. The targeted payout on the trust version of the fund is three cents per unit per month, for a current yield of 3.6%. We want a sustainable payout and will try to avoid paying out return of capital. It's important to note that the fund has a forward contract, so that distributions are generally paid in the form of capital gains, providing a boost to investors' after-tax returns in non-registered portfolios compared to funds that provide distributions primarily in the form of interest income.

[Q] Are you hedging against currency fluctuations?

SWANSON: The fund's U.S. dollar exposure is about 50% hedged, and we drill down into the holdings to determine the level of hedging. We look at the companies' location, as well as the impact of a rising or falling Canadian dollar has on each sector and the individual companies in the portfolio.

[Q] What is your current outlook for income markets?

SWANSON: Canadian and U.S. government bonds are overpriced and providing yields below 2%, which doesn't even keep pace with inflation. At this point, I have no allocation to government bonds and believe that corporate bonds, especially high yield, are generally more attractive.

Canadian yield products also look expensive now, especially REITs. In the global search for yield, foreign investors have moved into Canada, adding to the strong domestic demand for these securities. In addition, corporate bond spreads are much narrower in Canada than they are elsewhere. All of this reflects that the fact that the Canadian economy is in good shape relative to many other developed markets and the bond market has been strong.

Overall, the valuations on equities are reasonable, although income-related equities are becoming more expensive. I like the preferred market because it offers a nice downside cushion and the stocks have higher yields.

In this environment, the most attractive opportunities for higher-yielding income investments are being found in non-traditional asset classes outside of the Canadian market. Cambridge Income Fund provides a way for Canadian investors to benefit from those opportunities.

Cambridge Income Fund Q&A

[Q] With that in mind, can you summarize all of the benefits of this fund?

SWANSON: The fund offers a stable income stream and an attractive yield. As with all of the funds managed by Cambridge, it has a strong focus on providing downside protection. Stability is provided by the broad diversification of both securities and income-related asset classes within the fund. Investors benefit from the flexible mandate, which is not tied to any benchmark, sector or geographic constraints. This allows us to seek out the most attractive high-yield opportunities available. With interest rates at historically low levels, we have to be more creative in the companies and securities in which we invest. We can also be very nimble in managing the fund and respond to changing market conditions – when interest rates start rising, for example.

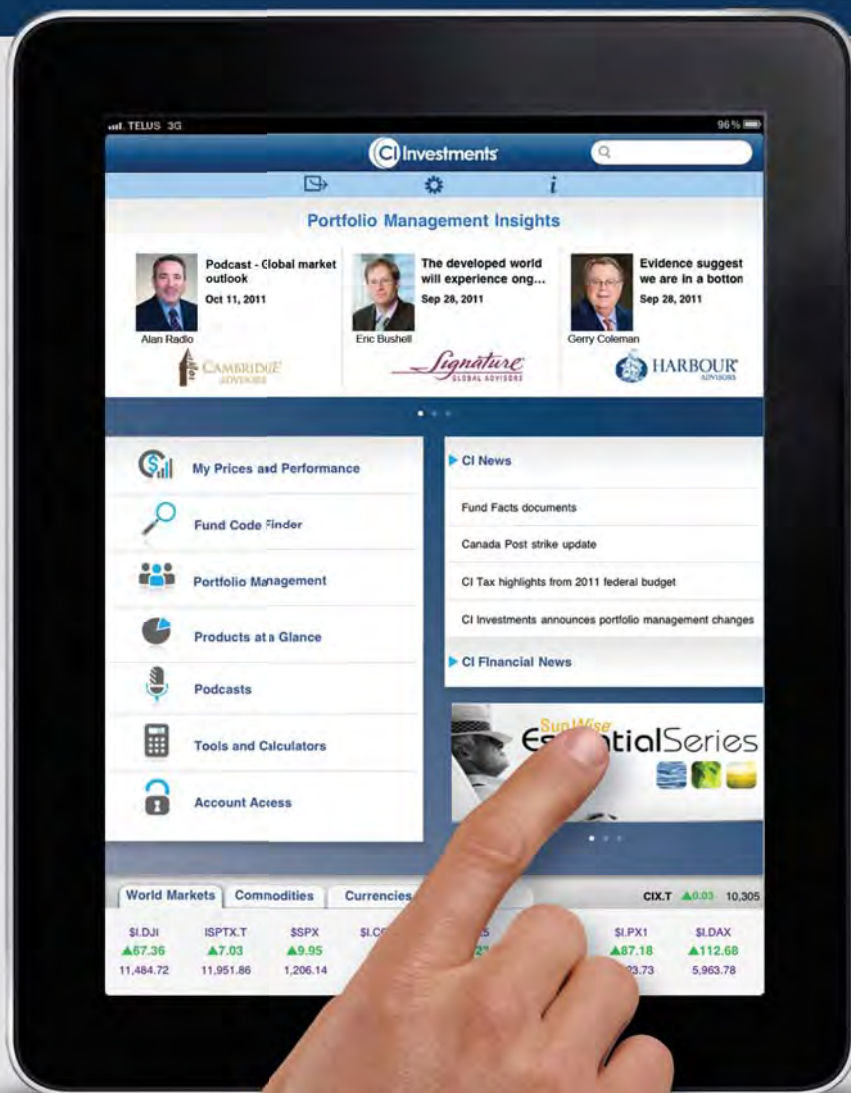
[Q] Any other reasons why investors should buy this fund?

SWANSON: As mentioned, the income stream is tax efficient for non-registered investors. In addition, there is currency hedging. Along with the exposure to a diverse portfolio of global high-yield securities with active management of holdings and asset allocation, Cambridge Income Fund has a combination of benefits that most Canadian investors cannot duplicate on their own. It provides income investors with the proven expertise of the Cambridge team in security selection and asset allocation.

Thank you, Robert.



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