QUARTERLY REPORT | **Q1 2015**

MACKENZIE IVY FUNDS

Mackenzie
INVESTMENTS

Ivy Quarterly Report – March 2015

Patience, Discipline and Independent Thought

We're sometimes asked what it is we believe enables us to outperform over longer time periods. Although we have a strong team of driven and highly capable investors, so do many of our competitors. We believe that our key points of differentiation are patience, discipline and independent thought. Merriam-Webster's definitions of patience and discipline reads very much like the core of what we believe to be our competitive advantage.

Patience:

- The ability to remain calm and not become annoyed when waiting for a long time or when dealing with problems or difficult people
- Done in a careful way over a long period of time without hurrying
- Bearing pains or trials calmly or without complaint (Ed. Note: at least most of the time)
- Steadfast despite opposition, difficulty, or adversity

Discipline:

- Control that is gained by requiring that rules or orders be obeyed and punishing bad behavior
- A way of behaving that shows a willingness to obey rules or orders
- Training that corrects, molds, or perfects the mental faculties or moral character
- A rule or system of rules governing conduct or activity

Knowing what you can and cannot control is key to successful investing over the long-term. We believe that predicting the future direction of economies, stock markets, interest rates and currencies is impossible, so we don't try to. What we can do, is identify businesses that have strong competitive advantages and, importantly, have a strong corporate culture that gives us confidence that the company will continuously re-invest in their competitive advantage in order to ensure outperformance long into the future. These companies also have characteristics of patience and discipline.

Continuously reinvesting in your business for longer-term success requires that you resist the temptation to try and keep up with the herd over shorter time periods (e.g. by under-investing in your competitive advantage you will boost short-term growth and profitability at the expense of the future health of the business).

The same is true of marathon runners who choose an appropriate pace early on in order to ensure that they have enough strength and energy to last the whole race; their competitive advantage will become increasingly apparent as the race wears on. However, initially they may fall behind those with a shorter-time horizon, i.e. those who sprint right out of the starting gate. The problem is that it's an uncomfortable feeling to be underperforming, even for very short periods of time. Not only do you have to watch your shorter-term focused competitors race ahead of you, but the spectators start casting doubt on your ability to win the race; the further you fall behind, the more vocal, confident and antagonistic becomes the criticism.

When investing in a high-quality business, you need to think like a marathon runner and have the patience to allow the superior business model to play out over time. We don't try to make a quick buck by attempting to identify a catalyst that will suddenly propel the business forward. You also need to have the discipline to know when to invest in the shares of the business and when to sell them. Having pre-determined rules and reporting structures in place help to protect against your own investor emotions and enable you to sell high quality companies, for which you have a high regard, when their shares become too expensive, i.e. you can love the business, but not the stock. Sprinters of the investing world can certainly win over shorter time periods, but we believe having a marathon mindset of patience and discipline significantly increases your chances of outperforming over the long term.

Investing can be a terrifying business as it constantly deals with uncertainty and change. However, high conviction, in what you do and why, helps considerably in this regard. We believe that the key to high conviction is independent thought; independent from Wall Street analysts, from other managers at Mackenzie (for whom we have a very high regard), from company management (until we feel we really understand the business) and even from each other (until we've formulated an independent view).

The fear of being wrong often drives investors to seek out the opinions of others; we call this consensus investing. This works fine when everyone is of the same opinion and stocks, sectors or regions move as a result of self-fulfilling prophecies. However, these movements are rarely the result of fundamentals and having the conviction to focus on fundamentals rather than opinions can be trying when you're underperforming and those around you are questioning your decision-making. The high conviction that comes from independent thought is what enables you to steer the right course when the world throws at you what appear to be contradicting indicators.

But it's still not easy. When investing in equities there are obviously no guarantees for success, but if one can be patient, disciplined and think independently, then over time we believe that you are able to increasingly put the odds in your favour. It is our Ivy corporate culture that we believe leads to our long-term outperformance. Since the inception of the Mackenzie Ivy Foreign Equity Fund there have been 150 rolling ten-year periods (monthly) and the fund has outperformed the index 149 times[1].

Spending and Printing Your Way To Prosperity

For many years central banks have encouraged borrowing and spending at the expense of saving and investment. There are superficial short-term benefits to this as the additional spending temporarily boosts economic activity giving the illusion of a strong and healthy economy. Another way in which this policy supposedly generates economic growth is through the wealth effect where rising asset prices encourage additional spending. However, the wealth is illusory as asset prices are driven higher by excess credit and not by increasing productivity.

As central banks then try to remove the stimulus in the belief that economic growth will be self-sustaining (mission accomplished) the economy starts to sputter and buckle under the enormous debt burden accumulated under the borrow-and-spend policy. This is what happened with the housing boom and subsequent bust in the United States. Central banks have since gone one step further and resorted to printing money that encourages yet further debt accumulation and enables better serviceability of that debt. But as the excessive debt burden serves as an anchor on growth, capital tends to be consumed rather than invested, which further results in slower future growth.

Central banks cite a fear of deflation as justification for monetary stimulus, which serves to encourage society to spend money it hasn't earned, thus living far beyond its means and borrowing from the future. Rather than allow prices to reach a state of equilibrium as dictated by market forces (no one can know what that actual level should be), central banks intervene with reckless policies in an attempt to propel asset prices higher on the back of destabilizing levels of debt. Deflation can be good or bad, it depends why it's happening. Prices that fall because of increased productivity and innovation is a good thing. In fact, there are plenty of historical examples of strong economic growth during periods of deflation. However, there is a perceived wisdom that deflation is always evil and should be avoided at all costs. Of course, if you are a debtor (as most governments are) you prefer inflation as it decreases the real value of your obligations over time.

Again, consider a marathon runner as an analogy for the economy. When the runner encounters an incline the speed of the runner will naturally slow. Today's central banks would see this as unacceptable and insist that the runner maintain a pace that they deem appropriate. Naturally, this would quickly tire the runner and make it more difficult to win or even complete the race. When a runner is going down the other side of the hill their momentum would result in a faster pace, however the runner would make some effort to hold back a bit in order to ensure that they don't lose control going down the hill and perhaps stumble and fall.

Again, central banks see no issues with going at a breakneck pace as they're convinced they'll be able to pick up the pieces after the crash. They also apply this sort of thinking to the stock market, i.e. claim that they know when stocks are undervalued, but believe it's impossible to know when they are overvalued. It's an impatient, undisciplined attitude that sacrifices fundamentals and potential longer term success in the name of short-term gain. We believe that it's also a result of an unwillingness or inability of central banks to admit what they can and cannot control. It seems that they can't resist the intellectual challenge of attempting to steer the economy.

In his book *The Theory of Money and Credit*, first published over a hundred years ago, Ludwig von Mises warns against the dangers of attempting to use monetary policy as a tool for driving economic growth:

> "Attempts to carry out economic reforms from the monetary side can never amount to anything but an artificial stimulation of economic activity by an expansion of the circulation, and this, as must constantly be emphasized, must necessarily lead to crisis and depression. Recurring economic crises are nothing but the consequence of

[1] Source: Morningstar Direct, (November 1, 1992 – March 31, 2015).

attempts, despite all the teachings of experience and all the warnings of the economists, to stimulate economic activity by means of additional credit..."

"One of the goals of the reform suggested is to explode and to kill forever the superstitious belief that governments and banks have the power to make the nation or individual citizens richer, out of nothing and without making anybody poorer. The short-sighted observer sees only the things the government has accomplished by spending the newly-created money. He does not see the things the non-performance of which provided the means of the government's success. He fails to realize that inflation does not create additional goods but merely shifts wealth and income from some groups of people to others. He neglects moreover to take notice of the secondary effects of inflation: malinvestment and decumulation of capital."

Canada

Within Ivy, we seek to invest in what we believe are high quality growing businesses at reasonable valuations that generally share the following characteristics: a sustainable competitive advantage, a strong and well-defined corporate culture, and a history of positive financial results. By that definition, we select businesses for investment as opposed to sectors. In Canada, however, the high weighting of publicly-traded energy and financial companies in the S&P/TSX Composite (TSX) index warrants a comparison. At the end of the quarter, the Mackenzie Ivy Canadian fund was overweight consumer staples and health care, and underweight energy and financials. We also had a high weighting in U.S. and European equities. This composition served our unit holders well in the quarter, with the fund up 3.5%, outperforming the TSX index, which in turn was up 2.6%.

Great West Life (GWO) is currently our largest position in the Mackenzie Ivy Canadian and Mackenzie Ivy Canadian Balanced funds. Over the quarter, shares of Great West Life were up 9% while its peers, Sun Life and Manulife, were down 7% and 3%, respectively. Although there were a number of contributing factors to the outperformance, including GWO's earlier than expected dividend increase, improvements within its US asset manager and the underwhelming performance of its peers, we believe that the bifurcation is in part owing to interest rate sensitivity.

Life insurance companies' (Lifecos') earnings are positively correlated with interest rates and concern over "lower-for-longer" rates weighed on the sector as rates fell in the quarter. Although lower rates present a headwind for all lifeco's, GWO has a higher proportion of fee based business (less interest rate sensitive) and is better able to match its invested capital with the duration of its liabilities, which provides a hedge on fluctuating rates. Although the lower sensitivity is a double-edged sword, providing less upside in a rising rate environment, GWO's defensive nature has served investors well since interest rates began declining more than seven years ago. We value the company's conservative approach to underwriting and take comfort in its track record of superior returns in mature markets.

In contrast to the negative headwinds experienced by lifecos from the current low interest rate environment, the "lower-for-longer" outlook has benefited **Brookfield Asset Management** (BAM), as its long-life cash flowing assets are discounted back at a lower rate. Brookfield has been our top performing Canadian stock over the past quarter and year, up 17% and 52%, respectively. We believe that the fundamentals of the business continue to look quite attractive.

In 2015, we expect the company to significantly enhance its already robust liquidity position, as it launches a number of successor funds on the back of strong performance from its existing line-up. Last year, Brookfield was able to grow its fee-bearing capital by 20% to $89 billion and in 2015 the company expects to launch new funds on the back of strong investment performance, representing a second consecutive year of approximately 20% growth in its asset management capital.

While this additional capital is expected to provide greater fee income, it may also allow Brookfield to bid for sizeable assets where few other players can compete, providing it with opportunities to generate attractive returns. In addition, the new capital positions the company to capitalize on market downturns, such as the one we're currently seeing in the global energy market. While there is valuation risk in the event of a market downturn, such a situation may benefit long-term shareholders as Brookfield has historically used these periods to its advantage and its current liquidity position gives it the flexibility to continue to be able to do so in the future.

Due to the strong performance of GWO and BAM, we trimmed both positions during the quarter.

During the quarter we added a number of new positions, including **Canadian Western Bank** and **ShawCor Ltd.**, in both Mackenzie Ivy Canadian and Mackenzie Ivy Canadian Balanced funds.

Ivy Quarterly Review (cont'd)

Canadian Western Bank (CWB) is a smaller Canadian bank focused on commercial, real estate, and equipment lending. It's known for its disciplined and consistent lending practices, secured by easily-marketed collateral, which results in higher recovery rates in the event of impairment. This behaviour has contributed to lower historical loss and impairment rates throughout multiple cycles. We believe that management will continue to adhere to its disciplined lending practices throughout the cycle, giving the company a strong base to weather the current environment.

CWB has a higher regional presence in Alberta than its larger Canadian peers, but is more diversified by product line, geography, and sector than its name suggests. The indirect exposure to energy-dependent economies is not insignificant, but the direct lending exposure to energy-weighted companies is less than 4%. We acknowledge the near-term regional economic headwinds facing the company, but we are comfortable in our view that these conditions are cyclical and expect they will return to a more normalized level in due course.

We consider CWB to be a high-quality business, with a strong operating culture, and enviable financial characteristics. In our opinion, the share price of CWB unfairly discounts the favourable characteristics of the underlying business. This is a good example of the stock market reflecting short-term emotion that is not consistent with our view of the long-term value of CWB, which provided us with an opportunity to build a long-term position.

ShawCor Ltd. is a global leader in the oil & gas pipe-coating business, with a focus on offshore pipe coating for natural gas. It has maintained this leadership position over many years, leading to large, but lumpy increases in both revenue and earnings. Underpinning this leadership position is technological excellence, a strong track record of execution, and a worldwide presence of coating facilities. Most importantly to us, the business is supported by a strong management team and a disciplined approach designed to achieve high and consistent returns on invested capital.

Beyond its global pipe-coating business, ShawCor also generates meaningful income from its North American oil & gas services business, specifically in pipeline integrity (making sure pipelines are structurally sound) and flex-pipe composite pipes used to connect wells to infrastructure.

These businesses are expected to weaken cyclically with the decline in drilling activity due to the current oil price environment, but over the longer term, are expected to grow rapidly with high rates of return on incremental capital. ShawCor possesses a strong balance sheet and in the event of a sustained downturn, has the capability to take advantage of consolidation opportunities as it did in 2008–2009. We recognize the near-term headwinds facing the company due to the current oil price environment, but believe that the decline in the company's share price was overdone, leading to an attractive entry point for long-term shareholders.

United States

Our view on the US market has been cautious and remains so. We continue to monitor the fall-out from lower energy prices and a higher US dollar, which in combination have led to a fairly dynamic environment. That may be a good thing as the associated uncertainty may provide some opportunities in an otherwise limited environment. We've had some early indicators of slowed growth in the industrial side of the U.S. economy from both the stronger US dollar and weaker energy prices but don't yet have a sense whether there has been much of an offsetting benefit for consumers from lower gas prices. As a result, we have taken a "wait and see" approach – valuations are not attractive and we see more harm than good coming from stepped-up global central bank liquidity efforts.

U.S. companies are stretching to grow earnings through the usual late-cycle antics, which often have a balance sheet element to them, including M&A and debt-financed share buybacks. More creative accounting efforts have also been among the favourites. In our view, majority of these efforts are long-term value destroying and our companies usually stay out of the fray, but not completely, so we have to remain vigilant. We also believe we're seeing a more pronounced disconnect in share price movements with companies that can provide greater opportunity for the dream of rapid unrelenting growth or "value-creating" activities like "balance-sheet optionality" and other Wall Street tales.

Europe

European markets climbed dramatically during the quarter following the much anticipated quantitative easing (QE) program that was announced by the European Central Bank in late January in an attempt to counteract the deflation that has taken hold in the region. Ivy's European holdings slightly trailed the market to start the year. Normally we would expect to underperform by a greater degree in very strong markets buoyed by central bank actions, but this past quarter happened to coincide with some strong earnings releases from a few of our larger holdings, which benefited the performance and helped narrow the gap.

The mid-teen rise (a bit less in CAD) in the market over the past three months significantly increased the gap between valuations and business fundamentals. Since the end of 2010, according to Bloomberg, European earnings have compounded at a rate of -5.8% per year while sales have grown at an anemic 2.3%. At the same time the market has climbed at a rate of 12.6%. In our opinion such divergences are clearly unsustainable, although the timing and the path of convergence are uncertain. Cash levels in our portfolios reflect this disconnect between stock prices and underlying fundamentals.

With regards to the QE program, our thoughts are that when interest rates are already at 0.05% and weak demand offers little incentive for companies to invest, it's difficult to see how going "all in" with QE will achieve the theoretical objective of encouraging banks to lend and businesses and consumers to spend. Lack of liquidity is not the issue that needs to be fixed.

We don't try to predict the actions of central banks, nor their effects. Our job is to sift through the noise and stay focused on investing in great companies at reasonable valuations. If prices rise beyond what is justified by business performance as a result of central bank actions, our job becomes more difficult and requires a higher level of patience.

The first quarter of every year is quite busy with a full slate of full year results to review, company management visits, and often a due diligence trip to Europe.

During the quarter we met with the CEO of **Syngenta SA**. Syngenta is a leader in the development of crop protection chemicals and seeds for farmers. Their industry is highly variable and complex, dependent on the unpredictable forces of weather, pests, and disease. This variability underscores Syngenta's strengths: 1) the breadth of their product line, and 2) their global presence. These strengths allow Syngenta to meet the changing nature of demand, without undue reliance on certain crops or regions. The company is R&D-intensive and our conversation with the CEO focused on how the management team is structuring the organization to deliver innovation to their customers at a low cost, particularly in emerging markets, while decentralizing authority to capitalize on local opportunities.

Aggreko PLC is a holding that is going through a managerial transition and we were pleased to be able to sit down with their new CEO to discuss the business. Aggreko is the global leader in the provision of temporary power, for everything from rock concerts to grid failures, and has been an Ivy holding for about a year and a half. The company's competitive moat derives primarily from its scale – they are multiple times the size of any competitor – which allows for low cost production and high fleet utilization.

This moat is supported by a very strong corporate culture, obsessed with customer service and return on capital. Our discussion made it clear that the new CEO appreciates the importance of the culture and instinctively thinks in return-on-capital terms, a surprisingly rare trait in business leaders but one that we value highly at Ivy. So while it is still early days in this transition, this conversation was an encouraging starting point as we continue to assess what effect the managerial change may have on the business both from a strategic and cultural perspective.

Finally, we spent the last week of March in the UK and Italy, meeting with management of some interesting potential investments, as well as current holdings – **Admiral Group PLC**, **Abcam PLC**, and **De'Longhi Spa**. **Abcam** has been a holding in Mackenzie Ivy European since last fall, so is one of the newer names in the portfolio. A global leader in the development and sale of research antibodies for scientists, Abcam has built a strong competitive position with its catalogue of over 100,000 antibodies that is supported by an extensive and open data library which helps customers choose the most appropriate product for their experiments.

Abcam is a relatively rare example of a company with a founder/CEO who willingly stepped aside when he realized he was not the best person to bring the company to the next level in its growth and development. We met with the new CEO and discussed the management transition, the protection of the corporate culture, and his strategy for future growth, which capitalizes on Abcam's strengths while including an element of customer focus that is uncommon in the industry. This discussion left us with confidence that the business is in capable hands.

Far East

Far East markets generally appreciated in the first quarter, led once again by mainland Chinese markets. The Shanghai Composite Index has doubled over the past year, driven by excess liquidity, fund flows out of the property market and into stocks, and expectations about the benefits of further government stimulus. The exuberance has more recently spread to Hong Kong markets, where more relaxed rules about onshore-offshore fund flows has led to record trading volumes at the start of the second quarter.

Japan continued its ascent, driven by continued expansion of the monetary base and the presence of some very large buyers, most notably the Government Pension Investment Fund (the pension fund for Japanese public sector employees) and Bank of Japan. Australian markets appreciated modestly while Korean markets made up for some of the weakness experienced in the previous quarter. Currencies, while exhibiting some volatility, ended the quarter relatively flat to where they began.

At Ivy, we tend to stay away from making broad-based market calls that are short-term in nature. Our bottom-up approach focuses on finding high-quality businesses that we think can generate strong returns over time, and patiently waiting for the right price at which to buy these businesses. While there are a number of high quality companies on our radar in the Far East, it is generally very difficult to find good value in the current environment, unless one makes aggressive assumptions about future growth and the cost of capital. We are not willing to take this leap – after all, a great company, bought at an unattractive valuation, can turn out to be a poor investment.

During the quarter, we fully exited our position in **Shinhan Financial Group** by removing it from the Mackenzie Ivy Foreign Equity (it had been removed from the Mackenzie Ivy Global Balanced during the last quarter). We still believe Shinhan is a well run, high-quality Korean bank. The company has historically had much better underwriting standards than its peers, enjoys low cost funding due to its large deposit base, and has made some astute transformational, counter-cyclical acquisitions in the past.

We have, however, become increasingly concerned about the state of the Korean economy; household debt levels are among the highest of any developed nation, and the economy remains heavily dependent on exports (specifically, to China). The government has recently taken aggressive measures to offset export weakness, largely through interest rate reductions and looser home ownership criteria. These actions are expected to provide a temporary boost to the economy, but could make it more vulnerable to a shock in the future.

Also, we have seen examples in the past where the government has tried to stimulate domestic demand through policy tinkering, only to back-track a short time later due to economic over-heating and excessive asset price inflation. Despite its underwriting prudence, Shinhan would not be immune to these risks. Shinhan's valuation is still attractive as it trades below book value, but it is difficult for us to see how the company will be able to generate returns in excess of its cost of capital given the low interest rate environment and weak economic outlook. Taking these factors together, we feel the potential rewards of owning Shinhan do not outweigh the risks at this time.

We also exited our position in **L'Occitane** during the quarter, due largely to valuation. L'Occitane had been a holding in the Mackenzie Ivy Global Balanced since mid 2013.

As we alluded to last quarter, we initiated a position in **Amcor** during the end of Q4/start of Q1 in Mackenzie Ivy Foreign Equity, Mackenzie Ivy Global Balanced, Mackenzie Ivy Canadian, and Mackenzie Ivy Canadian Balanced funds. Amcor is an Australian-based packaging company; it is the global leader in flexible packaging, rigid plastics packaging, and tobacco packaging. Amcor is truly a global business, as the vast majority of its revenues come from outside Australia, and many of its customers are multi-national food, beverage, and tobacco companies.

Amcor's management has engineered an impressive turnaround since 2005, highlighted by a re-focusing and high-grading of the product portfolio, significantly improved capital allocation, a sharp focus on return on capital, and a reinvigorated culture that supports high levels of customer service and operational efficiency. We believe Amcor's competitive advantage is rooted in its scale, good long-term track record with customers, and global operating footprint.

Amcor offers a compelling mix of business stability and growth potential – the majority of its revenues come from the food, beverage, tobacco, and healthcare industries, and the company has good organic and acquisition-driven growth opportunities in emerging markets. We had the opportunity to meet with management in March, and came away from the meeting with an even greater level of confidence in the company's competitive advantage and corporate culture.

The Mackenzie Ivy Team

Top row, left to right: **Hussein Sunderji,** Portfolio Manager (Far East equities); **Matt Moody,** Portfolio Manager (European equities); **Robert McKee,** Portfolio Manager (US equities); **Paul Musson,** Head of Mackenzie Ivy Team and Portfolio Manager; **Richard Walke,** Senior Investment Analyst (European equities). Bottom row, left to right: **Adam Gofton**, Senior Investment Analyst (US equities); **Graham Meagher**, Senior Investment Analyst (Canadian equities); **James Morrison**, Senior Investment Analyst (Canadian equities); **Zain Shafiq**, Investment Analyst (Canadian equities).

Disclosures:

As at April 30, 2015	1 year	3 year	5 year	10 year	15 year	20 year	Since inception	Inception date
Mackenzie Ivy Canadian Balanced Fund	7.61%	10.19%	8.41%	4.34%	5.11%	7.10%	6.85%	Oct-1992
Mackenzie Ivy Canadian Fund	7.79%	12.15%	9.83%	4.27%	4.92%	6.92%	7.20%	Oct-1992
Mackenzie Ivy European Class	4.57%	14.35%	10.36%	6.04%	–	–	6.23%	Nov-2002
Mackenzie Ivy Foreign Equity Fund	12.13%	15.25%	11.69%	6.67%	5.65%	7.93%	8.07%	Oct-1992
Mackenzie Ivy Global Balanced Fund*	11.49%	13.55%	10.32%	5.98%	3.24%	5.01%	4.92%	Nov-1993

All fund returns refer to Series A.

*On May 15, 2001, the Fund changed its mandate from pursuing long-term capital growth consistent with preservation of capital by investing primarily in large-cap stocks, securities carrying above-average investment ratings, government guaranteed securities, cash equivalents or gold-driven instruments, to pursuing long-term capital growth by balancing current income and capital appreciation. It now invests primarily in stocks of companies that operate globally and in bonds of governments and corporations around the world. The portfolio managers have the flexibility to hold any proportion of stocks and fixed income securities they feel is appropriate, however the portfolio is generally balanced. The Fund's former strategies also sought to concentrate investment in six particular market regions. The past performance before this date was achieved under the previous objectives and strategies.

GENERAL INQUIRIES

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