

# Middlefield Canadian Income

Initiation of coverage

Equity income from diversified portfolio

Investment companies

**Middlefield Canadian Income (MCT) invests in a broad selection of primarily Canadian and selected US equities, aiming to generate a high level of sustainable dividends and long-term capital growth. The fund is traded on the Main Market of the London Stock Exchange. MCT is benchmarked against the S&P/TSX Composite High Dividend index, but the managers are not constrained by its composition. The fund currently has significant exposure to the pipelines, power & utilities, real estate, financials and energy sectors. MCT pays a regular dividend of 1.25p per quarter; its current dividend yield is 5.4%.**

4 October 2016

**Price** 93.3p  
**Market cap** £100m  
**AUM** £150m

NAV\* 109.5p  
 Discount to NAV 14.9%

\*Including income. As at 30 September 2016.

Yield 5.4%

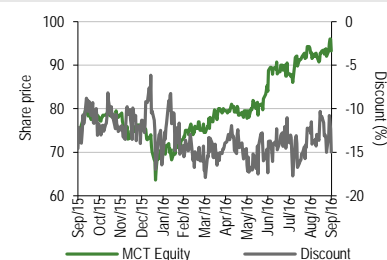
Redeemable participating preference shares in issue 107.0m

Code MCT

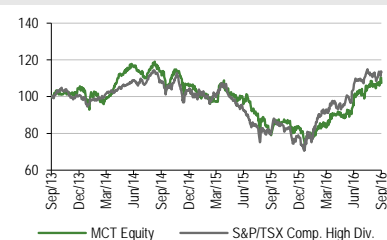
Primary exchange LSE

AIC sector North America

## Share price/discount performance



## Three-year cumulative perf. graph



52-week high/low 96.0p 63.6p

NAV\*\* high/low 109.5p 75.9p

\*\*Including income.

## Gearing

Gross\* 20.0%

Net\* 15.5%

\*As at 30 September 2016.

## Analysts

Mel Jenner +44 (0)20 3077 5720

Sarah Godfrey +44 (0)20 3681 2519

[investmenttrusts@edisongroup.com](mailto:investmenttrusts@edisongroup.com)

[Edison profile page](#)

**Middlefield Canadian Income is a research client of Edison Investment Research Limited**

12 months ending	Share price (%)	NAV (%)	S&P/TSX Comp. High Dividend (%)	S&P/TSX Comp. (%)	FTSE World (%)
30/09/12	26.4	17.3	14.6	11.5	17.7
30/09/13	0.4	5.4	6.2	2.3	19.0
30/09/14	13.8	11.0	8.6	10.6	11.9
30/09/15	(30.6)	(18.9)	(25.8)	(18.3)	0.8
30/09/16	36.0	35.6	40.4	35.9	31.2

Note: Twelve-month rolling discrete £-adjusted total return performance.

## Investment strategy: Diligent stock-selection process

Fund managers Dean Orrico and Rob Lauzon actively manage MCT's portfolio, investing in companies with strong fundamentals and reasonable valuations that offer sustainable income with the prospect of long-term capital growth. The majority of the fund is held in Canadian equities, along with US equities that offer exposure to areas underrepresented in Canada. There is also an allocation to fixed-income securities, which provide an element of stability to the portfolio. Third-party resources are utilised to provide input on particularly complex areas of the market such as healthcare and energy. MCT's currency exposure is not hedged.

## Market outlook: Improving Canadian economy

The Canadian stock market has experienced a significant upward move during 2016, although leadership has been narrow: the materials sector has outperformed other sectors by a wide margin led by gold stocks, as the commodity has rallied during a period of stock market volatility. Going forward, it is possible that market leadership will broaden. The Canadian economy is improving, in part due to a recovery in the oil price. In contrast to some other developed economies, in its latest update, the IMF increased its Canadian GDP growth forecast for 2017.

## Valuation: Discount wider than historic averages

During 2015, MCT's share price discount to NAV widened due to a period of weak commodity prices and a slowing Canadian economy. The current discount of 14.9% is wider than the average of the last 12 months and wider than the averages of the last three, five and 10 years. There is potential for the discount to narrow if MCT outperforms its benchmark for a meaningful period or if investor demand for Canadian equities increases. MCT pays a regular quarterly dividend of 1.25p; the annual dividend of 5.0p equates to a yield of 5.4%.

### Exhibit 1: Fund at a glance

#### Investment objective and fund background

MCT's objective is to provide a high level of sustainable dividends and long-term capital growth via investment primarily in Canadian and selected US equities. It is benchmarked against the S&P/TSX Composite High Dividend index in sterling terms and is a member of the FTSE All-Share index.

#### Recent developments

- 18 August 2016: Half-year results ending 30 June 2016. NAV TR of 20.8% versus benchmark TR of 35.7%.
- 7 July 2016: Declaration of 1.25p quarterly dividend.
- 28 April 2016: Annual report ending 31 December. NAV TR of -11.8% versus benchmark TR of -24.1%.

#### Forthcoming

AGM	May 2017
Final results	April 2017
Year end	31 December
Dividend paid	Apr, Jul, Oct, Jan
Launch date	July 2006
Continuation vote	Last in May 2013, none going forward.

#### Capital structure

Ongoing charges	1.06%
Net gearing	15.5%
Annual mgmt fee	0.70% of average NAV
Performance fee	None
Fund life	Indefinite
Loan facilities	See page 10

#### Fund details

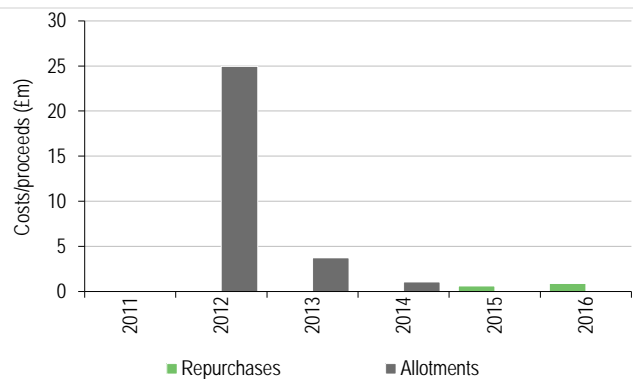
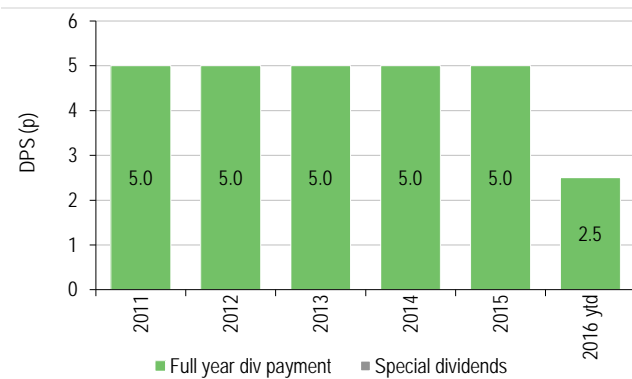
Group	Middlefield Group
Managers	Dean Orrico and Rob Lauzon
Address	First Canadian Place, Toronto, Ontario, Canada, M5X 1A6
Phone	+1 416 362 0714
Website	<a href="http://www.middlefield.com">www.middlefield.com</a>

#### Dividend policy and history

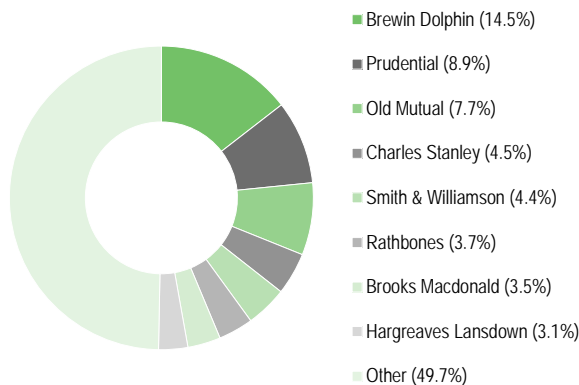
Dividends of 1.25p are paid quarterly in April, July, October and January.

#### Share buyback policy and history

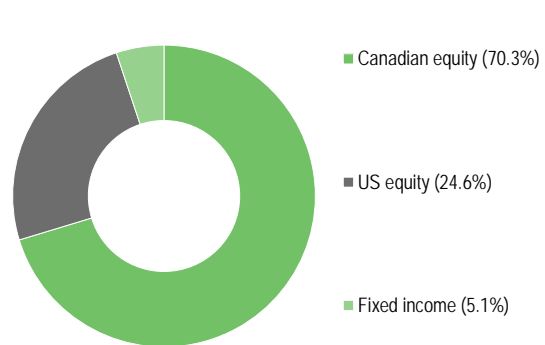
MCT has redeemable participating preference shares in issue (see page 10).



#### Shareholder base (as at 31 July 2016)



#### Asset mix (as at 30 September 2016)



#### Top 10 holdings (as at 30 September 2016)

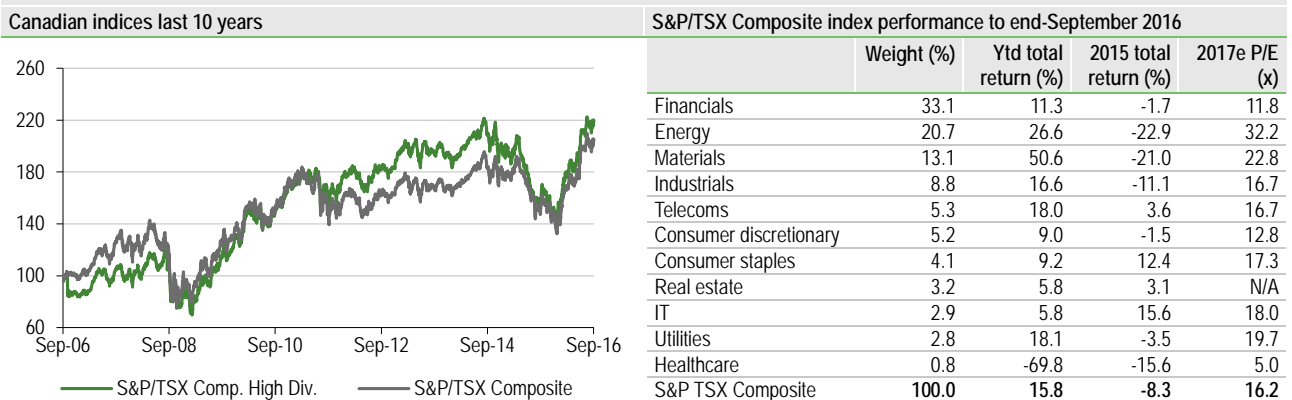
Company	Country of listing	Sector	Portfolio weight %	
			30 September 2016	30 September 2015**
Vermilion Energy	Canada	Energy	4.1	N/A
Enbridge	Canada	Pipelines	4.1	N/A
Chartwell Retirement Residences REIT	Canada	Real estate	3.9	3.6
Energcare	Canada	Consumer discretionary	3.8	N/A
Brookfield Property Partners	Canada	Real estate	3.8	4.2
H&R REIT	Canada	Real estate	3.6	N/A
JPMorgan Chase	US	Financials	3.5	3.5
Microsoft	US	Technology	3.4	N/A
CF industries	US	Materials	3.2	N/A
Pembina Pipeline	Canada	Pipelines	3.2	N/A
<b>Top 10</b>			<b>36.5</b>	<b>38.3</b>

Source: Middlefield Canadian Income, Edison Investment Research, Bloomberg, Morningstar. Note: \*REIT is real estate investment trust. \*\*N/A where not in September 2015 top 10.

## Market outlook: Broader leadership, stronger economy

While there are divergences in performance over shorter periods, as shown in Exhibit 2 (left-hand side), over the longer term the S&P/TSX Composite High Dividend index has performed broadly in line with the S&P TSX Composite index. Both indices have rallied significantly from the lows in early 2016, as a result of firming commodity prices and the outlook for an improving Canadian economy. As shown in Exhibit 2 (right-hand side), during 2016 Canadian stock market leadership has been narrow; materials has been the best performing sector by a wide margin followed by energy; these two sectors now make up around one-third of the S&P TSX Composite index. Looking forward, it is possible that stock market leadership could broaden.

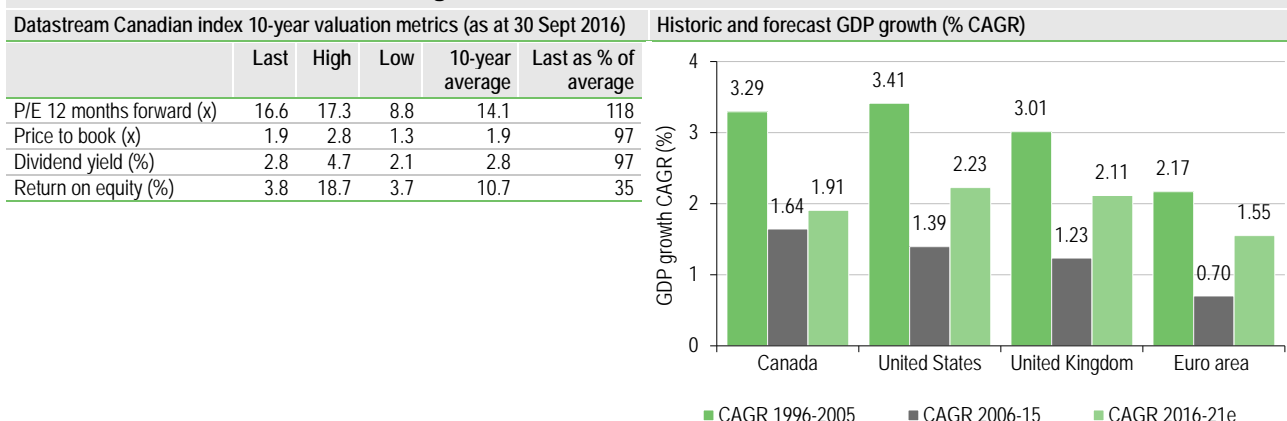
**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, Edison Investment Research

As a result of the recent rally in the stock market, the earnings valuation metric of Canadian equities, represented by the Datastream Canadian index in Exhibit 3, left-hand side, is looking full. The 12-month forward P/E ratio is towards the high end of the 10-year range and is c 20% above the average over this period. However, the price-to-book ratio and dividend yield are broadly in line, and the return on equity, while having recovered from the depths of the global financial crisis, remains 65% below the 10-year average, suggesting scope for companies to boost their profitability.

**Exhibit 3: Market valuation and GDP growth**



Source: IMF WEO (April 2016), Thomson Datastream, Edison Investment Research

Exhibit 3 (right-hand side) shows the International Monetary Fund (IMF) April 2016 World Economic Outlook GDP growth. The US is Canada's largest trading partner, and has higher projected growth than Canada, the UK and Europe. It should be noted that in its July WEO update, which occurred after the result of the UK's European referendum, the IMF revised down UK and European 2017

estimated growth by 0.9pp and 0.2pp respectively, while increasing 2017 growth estimates for Canada by 0.2pp to 2.1%; it maintained its US 2017 outlook at 2.5%. The Canadian economy is benefiting from a higher oil price, which troughed in February 2016, having experienced a period of weakness since mid-2014. In this environment, investors may be attracted to a fund with diversified exposure to Canadian and selected US equities, focused on companies generating sustainable income with the potential for long-term capital growth.

## Fund profile: Diversified North American exposure

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Middlefield Canadian Income - GBP PC (MCT) is the initial (sole) protected cell of Middlefield Canadian Income PCC (protected cell company). It is managed by the Middlefield Group, an investment company with c C\$4.5bn of assets under management, with offices in Toronto, Calgary, San Francisco and London (UK). MCT is incorporated in Jersey and its shares are traded on the Main Market of the London Stock Exchange. It aims to provide shareholders with a high level of dividends and long-term capital growth from a diversified portfolio of primarily Canadian and US equities. Investments are focused on companies with good fundamentals, proven management teams, strong balance sheets and sustainable dividends. The portfolio typically holds 40-50 holdings; there are currently 53 including six debt instruments.

Following shareholder approval in February 2015, the investment limit for securities listed outside a Canadian exchange was increased from 20% to 40%. A new restriction was introduced, allowing 10% of the fund to be invested in securities listed outside Canada and the US. These new rules allow the manager greater freedom to invest in sectors that are underrepresented in Canada, potentially leading to higher total shareholder returns via greater diversification. Other investment restrictions include a maximum 10% exposure to a single issuer, a maximum 50% of the portfolio in the top 10 holdings and a maximum of 10% invested in unquoted securities (although in practice, none are held due to their lack of liquidity). Currency exposure is not hedged. Gearing up to 25% of gross assets is permitted; it is typically in a range of 0% to 20%.

MCT is managed by Dean Orrico (since fund inception) and Rob Lauzon (since May 2016). The board monitors the performance of the fund through a variety of indicators including NAV and share price performance, the level of share price premium/discount to NAV and the level of dividends and ongoing charges. MCT is benchmarked against the S&P/TSX Composite High Dividend index.

## The fund managers: Dean Orrico and Rob Lauzon

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### The managers' view: Interest rates – lower for longer

Lead fund manager Dean Orrico suggests that we are living in a period of “interesting times”. Normally, following the Q2 earnings season in September/October, stock markets are volatile. However, the manager suggests that this year the situation could be exacerbated by uncertainties surrounding the US election, the timing of US interest rate hikes and Brexit, which he is not convinced the market has really shaken off. He believes that as details emerge of how and when the UK will leave the European Union, stock market volatility is likely to increase and the exit will be a long, drawn-out process.

These overhangs and uncertainties are coupled with tepid growth in developed economies. The US is one of the strongest, but is growing at less than 2% per annum; modest growth in non-farm payrolls suggests there is no substantial US wage growth. He believes that the Federal Open Market Committee (FOMC) will keep interest rates relatively low, and if they are raised soon, a lot of this is already priced into the stock market. Stock prices could dip briefly following news of an increase, but interest rate rises will be gradual at best. He believes that the stock market could

withstand a 25bp rise, whether later in 2016 or beyond, and that economic growth and other issues are a headwind to FOMC action. In Europe and the UK, Brexit and continuing European problems mean that interest rates in the region will remain low. The manager believes that the Canadian economy is well positioned for 2017, supported by a weaker currency versus the US dollar and rising energy prices. He is comfortable owning securities that benefit from low interest rates, which has created the backdrop for the shape of the current portfolio.

Six to seven years ago, energy was a large percentage of MCT's portfolio. Exposure has come down as more and more non-energy companies have initiated dividends, leading to greater diversification within the portfolio. This was followed by a correction in the energy market, meaning the weighting came down even further. More recently the oil price has bottomed, reaching c \$26/bbl in early 2016, and has now stabilised around \$45/bbl. The manager expects the oil price to edge higher to a \$45-60/bbl range over the next 18 months. The challenging period for energy companies means there are now very few with a high yield, but there is a subset that is paying attractive yields and can maintain and grow dividends with oil in the \$45-60/bbl range. The gas price has also bottomed off the lows of sub-\$2/mcf and the manager expects it to move higher over the next 12-24 months.

## Asset allocation

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### Investment process: Top-down and bottom-up considerations

Managers Dean Orrico and Rob Lauzon follow a combination of top-down and bottom-up investment processes aiming to invest in a broad portfolio of actively managed Canadian and US equity income securities generating total returns in excess of the benchmark S&P/TSX Composite High Dividend index. Orrico chairs the Middlefield Group investment committee that oversees all the mandates for Middlefield funds. The committee meets at least weekly; discussions encompass the outlook for markets including interest rates, monetary accommodation and favoured developed market exposure – a key consideration is the outlook for the Canadian versus the US economy. The committee provides information to the Middlefield portfolio managers regarding their asset allocation decisions, while the individual managers are responsible for populating the funds. Orrico is the lead fund manager of MCT and along with Lauzon is assisted on a day-to-day basis by Mike Foley, who is an analyst focusing on bottom-up research on individual stocks and sectors. He provides input to the two managers, who select the stocks for inclusion in the portfolio.

The pervasive theme in the portfolio is equity income. There are only subsets of companies in the North American markets that pay dividends; potential investments are screened and are limited to those companies that are paying or have a history of growing their dividends. Occasionally, the managers may purchase a company that is not yet paying a dividend, but which is expected to in the near future. Currently, 100% of the portfolio is invested in companies that have a history of paying a dividend, and substantially all have guided that dividends will increase over time. Typically, portfolio companies have dividend yields higher than 2% and investment decisions are contingent on them having an attractive relative valuation.

Screens are used extensively in the bottom-up stock selection process – dividend yield is first; however, high-yield companies are not automatically included in the portfolio. Lead manager Orrico has been running income portfolios for more than 20 years and says he understands the pitfalls of reaching for yield. He is more comfortable investing in a company with an attractive business paying a 2.5% dividend yield than a 'bad' company paying a much higher yield. There is a company in the portfolio on a 7-8% yield, but Orrico argues that the stock is mispriced. Potential investments are also screened for balance sheet strength; excessive debt is viewed as an impediment to the payment of dividends – a company needs a comfortable level of free cash flow to cover dividends. Other metrics include a focus on the payout ratio after the deduction of sustainable capex.

Prior to investment, the managers meet with the management of potential portfolio holdings, either face to face or via a call to discuss areas not covered in public documents; trying to gain a better understanding of their strategies. When meeting with an energy company, for instance, discussions centre on their dividend policy (whether it will be maintained or increased), how capital is being allocated between different projects, how this ties in with MCT's macro view of commodity prices, and plans for the level of debt and what the proceeds will be used for. It is important to have an understanding of the potential internal rates of return for capital allocation projects and whether this will lead to higher future dividend growth. Discussions with industrial companies may include an assessment of the competitive environment, new product pipelines, management succession planning and control procedures in place – MCT's managers do not want nasty surprises from financial misstatements.

The managers believe that interest rates will remain low for the foreseeable future. Hence, there is significant demand for stable cash flow-producing businesses like oil & gas pipelines and REITs, which they consider attractive. However, they typically invest in companies with market caps above C\$1bn; liquidity is viewed as very important as the managers want the ability to reduce exposure quickly if a permanent impairment is identified at a company.

MCT's research goes beyond using screens, with third-party resources used for areas of the market that are seen as too complex for a generalist portfolio manager. Healthcare is a very complex industry, where current issues include debates surrounding predatory drug pricing, the Affordable Care Act and its impact on Medicaid and hospitals. MCT works on an exclusive basis with third-party firms (meaning it is the only Canadian money manager these firms work with), which provide insight and views on complicated industries. In healthcare, MCT uses Sector & Sovereign Research (SSR), whose co-founder Dr Richard Evans is a highly regarded, ex-Sanford Bernstein analyst with a proprietary method to analyse the drug pipelines of big pharma companies.

In the energy sector, MCT works with Groppe, Long & Littell, which has a proprietary methodology to forecast oil and gas prices. This is tough to accomplish accurately, as the industry has a lot of moving parts. As a result of shale production in recent years, the US is now as large an energy producer as Saudi Arabia. Orrico argues that people did not see the change coming because they did not understand the oil production technology.

There are team members at Middlefield covering other parts of the market, such as the energy/infrastructure team based in Calgary. If MCT's managers decide they want to increase exposure to these sectors, they will speak to the team to understand their top picks in these areas.

Some companies have had uninterrupted inclusion in the portfolio since MCT's inception, such as Canadian oil & gas producer ARC Resources. If the managers believe that companies are properly run and pass the screens, there is no reason to sell, even during periods of stock market gyrations. Macro views may drive portfolio activity – for example, if the managers decide that oil is out of favour, they might reduce the oil weighting from 20% to 5% of the portfolio, and so what is a 3% individual holding may now become a 1% position. High-quality companies are likely to be trimmed rather than sold as it is hard to predict a turnaround in investor sentiment.

The largest risk control in place is diversification of the portfolio via sector and securities. Sector diversification was historically difficult given the dominance of the oil and gas stocks among the dividend payers, but there is no longer oversized sector exposure; no more than 20-25% of the portfolio is invested in a particular sector. The investment policy requires that no holding in the portfolio should have a lower than 1% weighting, as this would not be meaningful to performance. A maximum position size is typically 4.0-4.5%; any position sizes higher than this are a result of the outperformance of a particular investment rather than a willingness to hold a position >4.5% of the portfolio. The larger-cap focus of the fund also acts as a risk control, as larger caps are typically less volatile and more liquid. There are no private companies in the portfolio given their illiquidity.

## Current portfolio positioning

As at end-September 2016, the top 10 positions accounted for 36.5% of the portfolio, a modest decrease in concentration from 38.3% at end-September 2015. One of the largest holdings in the fund is Chartwell Retirement Residences REIT. Floated in 2003, it is now the largest retirement home operator in Canada by a factor of two, operating across the spectrum from nursing, to assisted living to life care. MCT has held a position in Chartwell for a very long time. The company had growing pains in its early years as a public company but has thrived since Brent Binions, one of the company's founders, became CEO. It expanded operations in the US when the Canadian and US currencies were at par, but sold the business as the outlook for growth deteriorated. By then the US dollar had strengthened against the Canadian dollar, so the sale was viewed as an astute move. Chartwell has low levels of debt and a stable dividend. It can grow organically or via accretive acquisitions. It has a variety of retirement homes under development, which should generate high internal rates of return; this is a differentiating feature versus other REITs, which tend to buy fully developed, fully leased properties. The manager considers that if an institution wanted to get into the retirement property segment, Chartwell itself may become a takeover candidate.

Another large holding within the portfolio is Canadian pipeline company Enbridge; it is one of the highest-quality pipeline companies in North America. It has a current market cap of c C\$55bn and has recently announced the acquisition of US company, Spectra Energy (pre-bid market cap c \$25bn). If approved, the merger will create the largest North American energy infrastructure company. There was a favourable investor reaction to the deal; Enbridge's stock actually rallied from C\$52 before the deal to C\$59 on the news, so this was indicative of the market's positive view of the transaction. Enbridge is already a dominant player in the industry, shipping oil from Canada to the US, and is looking to expand, with a significant pipeline of new projects that will be built out over time.

**Exhibit 4: Asset mix as at 30 September 2016 (% unless stated)**

Asset	Portfolio end-September 2016	Portfolio end-September 2015	Change (pts)
Canadian equity	70.3	53.7	16.6
US equity	24.6	37.9	-13.3
Fixed income	5.1	8.4	-3.3
	100.0	100.0	

Source: Middlefield Canadian Income, Edison Investment Research

Up to 40% of the portfolio may be invested outside Canadian equities. This allows exposure to businesses that are underrepresented in Canada. Over the past 12 months the percentage of the portfolio invested in the US has declined. Exposure had been increased due to a challenging Canadian economy since the beginning of the oil price slump in summer 2014; however, the Canadian economy has stabilised as the oil price has rallied. The manager believes that sentiment towards Canadian equities will continue to improve given a better domestic economy and economic and political instability in other developed markets such as the UK and Europe.

As shown in Exhibit 4, a small percentage of the portfolio is invested in fixed-income securities. This provides an element of stability to the fund over time. There are currently six holdings, the largest of which is Quebecor 6.625%, due on 15 January 2023.

A recent new holding in the portfolio is US major pharma company Bristol-Myers Squibb, added after conversations with SSR. Its Opdivo drug failed in a trial as a first-line treatment for lung cancer, and its stock price fell significantly. The market believed this was a permanent impairment, but SSR's proprietary analysis suggests it will be a short-term phenomenon; the belief is that, in combination with other treatments, the drug will be effective over the longer term. The manager believes that it may take a quarter or two before Bristol-Myers Squibb's share price recovers.

Another recent purchase is National Bank of Canada. It is one of the six major Canadian banks, trading at a discount to its peers on both a forward P/E multiple and price-to-book basis. It has an

attractive dividend yield of 4.7%. There were concerns about its energy loan book; however, as the industry has now stabilised, this has proved to be a non-issue. Therefore, loan loss reserves will likely come back into earnings, which will provide a tailwind to the stock price. When interest rates do rise, National Bank's profitability will improve due to higher net interest margins.

US-listed fertiliser stock, CF Industries, has also been added to the portfolio at a dividend yield of 5%. The manager expects the fertiliser market to trough over the next 12-24 months and the industry is consolidating – Potash Corporation has recently announced its intention to merge with Agrium. CF has undergone a massive capacity expansion programme, which is now essentially complete. This should lead to higher free cash flow generation that can be returned to shareholders either via share repurchases or higher dividends.

**Exhibit 5: Portfolio sector exposure vs benchmark (% unless stated)**

	Portfolio end- Sept 2016	Portfolio end- Sept 2015	Change (pts)	Index weight	Active weight vs index (pts)	Fund weight/ index weight (x)
Pipelines, power & utilities	21.2	9.6	11.6	25.4	-4.2	0.8
Real estate	19.7	10.7	9.0	14.0	5.7	1.4
Energy	14.5	0.9	13.6	4.9	9.6	3.0
Financials	12.6	25.9	-13.3	30.3	-17.7	0.4
Materials	7.6	5.3	2.3	9.4	-1.8	0.8
Industrials	5.1	13.9	-8.8	1.0	4.1	5.1
Bonds & conv. debentures	5.1	8.4	-3.3	0.0	5.1	N/A
Consumer discretionary	4.2	7.7	-3.5	3.9	0.3	1.1
Healthcare	3.6	4.0	-0.4	0.0	3.6	N/A
Technology	2.9	4.8	-1.9	0.9	2.0	3.2
Consumer staples	2.2	8.4	-6.2	0.3	1.9	7.3
Other	1.3	0.4	0.9	0.0	1.3	N/A
Telecommunications	0.0	0.0	0.0	10.1	-10.1	0.0
	100.0	100.0		100.0		

Source: Middlefield Canadian Income, Edison Investment Research

Looking at sector exposure in Exhibit 5, the four largest comprise c 70% of the portfolio. These sectors represented c 50% 12 months ago and include significant dividend-paying stocks; exposures are tilted depending on the manager's macro views.

REITs represent the largest individual industry exposure within the portfolio; the focus is on large, liquid issuers that have a dominant market position. The industry is a beneficiary of continued low interest rates and is experiencing a positive demand/supply balance. Real estate is typically viewed as a commodity (negatively affected by too much supply or too little demand); however, with limited supply available and strong demand, industry fundamentals are attractive. Even if interest rates do rise, the manager believes that REITs will continue to perform well, as higher interest rates are an indication of an improving economy, which will mean higher rents, leading to higher free cash flow and dividends. In addition, since the beginning of September 2016 real estate (previously a subset of financials) has had its own Global Industry Classification Standard (GICS) level 1 category, which will require some portfolio managers to add exposure to the sector.

Over the last 12 months, exposure to the industrials sector has been reduced. This includes the sale of Magna (auto parts). Shares were purchased a number of years ago across several Middlefield funds. There has been a recovery in North American auto sales, which are now running at a seasonally adjusted annual rate of c 17m; the manager thinks the number could plateau at this level. Also, there is now more discussion about self-drive vehicles, which adds an element of the unknown to the industry.

Consumer discretionary exposure has also been reduced. MCT still has holdings in Gildan (leisure wear) and Enercare (consumer services), which have been in the portfolio for some time. The position in Starbucks was sold; it was purchased for its attractive valuation and well-known brand. However, the manager did not expect near-term upside in the stock and used the sale proceeds to invest in a higher-conviction position.

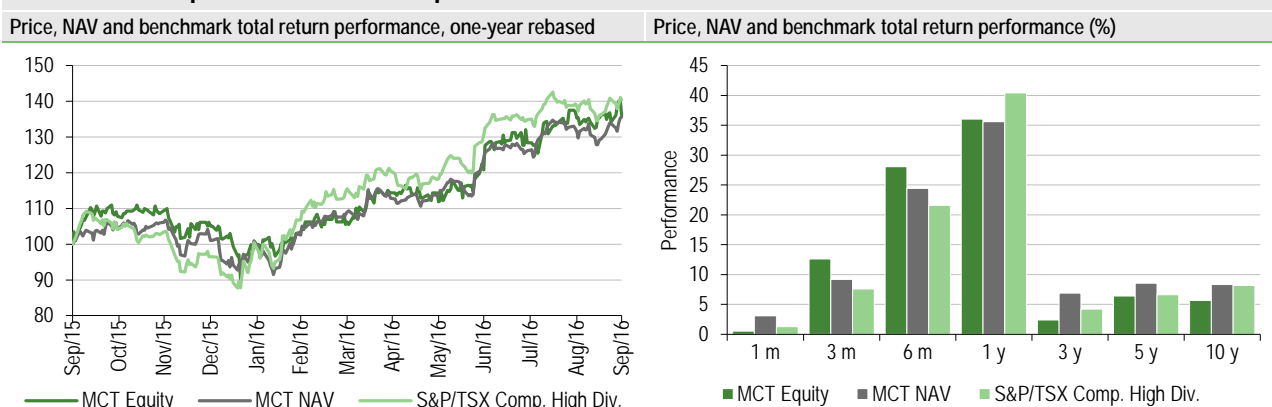


The telecommunications sector is a significant percentage of the benchmark, but is absent from the portfolio, a stance the managers have maintained for several years. The sector has performed well in 2016 in a volatile market environment as investors have sought defensive exposure, but Orrico stresses that his concerns remain. He views the stocks as very expensive, and competition is increasing as the government is focused on bringing new entrants into the market, which creates risks for the incumbents.

## Performance: Outperformance over medium/long term

MCT's absolute returns have been very strong over the last six months (Exhibit 6, right-hand side), partially due to the weakness of sterling following the result of the UK's EU referendum. Over this period, its share price and NAV total returns of 28.1% and 24.4% compare to the benchmark's total return of 21.6%. Given the uncertainty around Brexit, sterling is unlikely to appreciate any time soon, which provides some support to MCT's NAV.

**Exhibit 6: Fund performance to 30 September 2016**



Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Looking at relative returns in Exhibit 7, MCT's NAV has outperformed the benchmark S&P/TSX Composite High Dividend index over three, five and 10 years. It has also outperformed the broader S&P/TSX Composite index over five and 10 years. MCT's NAV total return has outperformed the FTSE All-Share index over one and 10 years and is broadly in line over three years.

**Exhibit 7: Share price and NAV total return performance, relative to index (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to S&P/TSX Comp. High Div.	(0.7)	4.7	5.4	(3.1)	(5.2)	(1.1)	(21.0)
NAV relative to S&P/TSX Comp. High Div.	1.8	1.5	2.3	(3.4)	7.8	9.5	1.7
Price relative to S&P/TSX Composite	(1.3)	5.0	6.2	0.1	(12.6)	(2.7)	(15.3)
NAV relative to S&P/TSX Composite	1.2	1.8	3.1	(0.2)	(0.6)	7.7	9.0
Price relative to FTSE World	(0.9)	4.0	8.8	3.7	(27.5)	(34.3)	(26.3)
NAV relative to FTSE World	1.6	0.9	5.7	3.4	(17.6)	(27.3)	(5.1)
Price relative to FTSE All-Share	(1.1)	4.5	13.5	16.4	(11.4)	(19.3)	(1.4)
NAV relative to FTSE All-Share	1.4	1.3	10.2	16.1	0.8	(10.7)	27.0

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-September 2016. Geometric calculation.

Looking at relative performance over five years, Exhibit 8 illustrates the 9.5% outperformance of MCT's NAV over this period. There have been periods of volatility such as during the second half of 2015; the manager comments that this is largely a result of currency fluctuations given that the fund does not hedge its currency exposure. Orrico also suggests that trading activity has made a positive contribution to the performance of the portfolio.

**Exhibit 8: NAV performance relative to benchmark over five years**

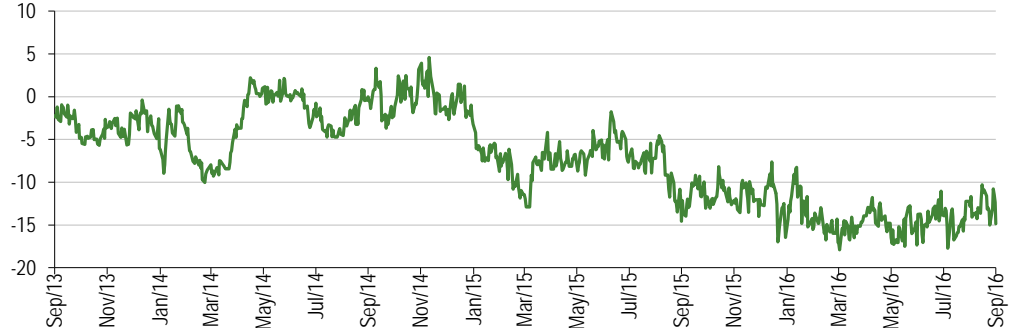


Source: Thomson Datastream, Edison Investment Research

## Discount: Widening trend since end of 2014

MCT's current share price discount to cum-income NAV of 14.9% is wider than the 13.4% average of the last 12 months (range of 7.6% to 17.9%) and is wider than the averages over the last three, five and 10 years of 7.2%, 4.2% and 6.0% respectively. Over the course of 2015, the discount widened following weaker commodity prices and a slowing Canadian economy. There is scope for the discount to narrow if MCT generates a significant period of outperformance versus the benchmark, or if investor demand for Canadian equities increases.

**Exhibit 9: Share price premium/discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

The authorised share capital of MCT is split between two management shares, each valued at £1, and an unlimited number of redeemable participating preference shares. The fund is able to issue or repurchase these preference shares without shareholder approval. During the first six months of 2016, 1.05m redeemable participating preference shares were repurchased at an average price of 77.71p; there are currently 107.0m of these shares outstanding and a further 17.6m shares held in treasury, which in the future may be sold to satisfy market demand, up to a maximum of 10% of the issued share capital at the time of the last AGM.

MCT has an on-demand credit facility agreement with the Royal Bank of Canada up to a maximum of the lesser of C\$65m or 25% of its total assets. The rate of borrowing is either prime minus 0.35% or banker's acceptances plus a stamping fee of 0.60%. The use of gearing is strategic; the level is

increased when the manager considers that equities are attractively valued and reduced when valuations are unappealing. In the first six months of 2016, the level of net gearing ranged from 6.9% to 19.3%; it was 15.5% at the end of September 2016. In recent years the yearly average level of gearing has increased from 4.6% in FY12 to 18.8% in FY15. Gearing is partially offset by fixed-income exposure in the portfolio (c 5% at end-September 2016).

Middlefield Group, the investment manager, is entitled to a management fee of 0.7% of net assets, payable quarterly in arrears. In FY15, the fees were split between capital and revenues in a ratio of 60:40. Prior to June 2013, the management fee was 0.867%. In FY15, ongoing charges of 1.06% of average NAV compared to 1.10% in the prior year.

## Dividend policy and record

MCT pays regular quarterly dividends of 1.25p per share in April, July, October and January. Based on the current share price, the annual dividend of 5.0p is equivalent to a dividend yield of 5.4%. In the absence of unforeseen circumstances, the board intends to maintain the annual dividend at its current level supported by dividend and interest income from the portfolio investments.

## Peer group comparison

Exhibit 10 shows a select peer group of closed-end funds selected for their exposure to Canadian equities. MCT's NAV total return is above the peer group average over one, three, five and 10 years. Over both one and 10 years, it ranks second out of seven and six funds respectively. In terms of risk-adjusted returns, as measured by the Sharpe ratio, MCT's NAV total return is above the average over one year, while in line over three years. MCT's discount is narrower than the peer group average, its ongoing charge is lower and its dividend yield is broadly in line with the selected group, which includes funds both with and without an income mandate. It has the highest gearing in the selected peer group.

**Exhibit 10: Selected peer group as at 9 September 2016 (£ adjusted)**

% unless stated	Market cap (£m)	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Middlefield Canadian Income	98.5	29.0	16.7	38.8	104.8	0.7	0.0	(12.6)	1.1	No	122	5.4
Blue Ribbon Income Fund	125.8	35.0	3.7	19.1		0.9	(0.3)	(1.1)	1.8	No	100	8.2
Canadian General Investments	220.0	26.2	18.4	34.7	63.1	0.4	0.0	(29.9)	1.6	No	118	3.5
Canoe EIT Income	592.4	28.8	16.8	20.2	81.1	0.8	0.0	(11.9)	1.4	No	106	11.3
Economic Investment Trust	320.0	21.1	25.4	75.6	63.6	0.3	0.2	(26.4)	0.4	No	100	0.2
Mint Income Fund	48.1	23.8	(10.1)	(1.8)	73.3	0.2	(0.8)	(4.3)	1.6	No	118	6.9
United Corporations	660.7	25.6	37.3	87.3	112.5	0.6	0.4	(24.5)	0.5	No	100	0.9
<b>Average</b>	<b>295.1</b>	<b>27.1</b>	<b>15.5</b>	<b>39.1</b>	<b>83.1</b>	<b>0.5</b>	<b>0.0</b>	<b>(15.8)</b>	<b>1.2</b>		<b>109</b>	<b>5.2</b>
<b>Fund rank in sector</b>	<b>6</b>	<b>2</b>	<b>5</b>	<b>3</b>	<b>2</b>	<b>3</b>	<b>5</b>	<b>4</b>	<b>5</b>		<b>1</b>	<b>4</b>

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## The board

There are currently five members of the board of MCT, four of whom are independent of the manager. Chairman Nicholas Villiers (appointed at the fund's inception) had a 19-year career with RBC Group, focusing on mergers and acquisitions. Prior this he was joint managing director of Delcon Financial. He is domiciled in Switzerland and is currently chairman or director of a number of companies. Raymond Apsey (appointed at the fund's inception) has extensive experience at the management level of the offshore finance industry. He resides in Jersey and is currently chairman of a number of investment companies listed on the London, Irish and Channel Islands stock

exchanges. Philip Bisson (appointed at the fund's inception) has a background in the trust industry; he is currently treasurer of the Jersey Association of Trust Companies. He is domiciled in Jersey and is also the managing director of the Philean Trust Company. After serving in the US Army, Thomas Grose (appointed in 2012) followed a career in finance including at Stock Market Index International, a company that he established in the UK to promote proprietary research to financial institutions. The fifth member of the board is non-independent, Dean Orrico: the lead manager of MCT is president of Middlefield International, responsible for overseeing the creation and ongoing management of Middlefield's investment funds. He has more than 20 years' experience in the financial services sector. Apart from a period between 2010 and 2012, Orrico has been on the board since the fund's inception.

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