June 21, 2012

Russell Research / Ranks and Commentary

GREYSTONE MANAGED INVESTMENTS INC.

PRODUCT: CANADIAN EQUITY

ASSET CLASS	GEOGRAPHIC EMPHASIS	CAP TIER	DURATION RANGE
Equity	Canada	Large Cap	-
STYLE	**SUBSTYLE**	**MARKET STATUS**	
Market-Oriented	-	Developed Markets	

ACTIVITY DATE	LOCATION	ACTIVITY TYPE	PURPOSE
13Jun2012	Regina, SK, Canada	Research - Manager Office	Product Review

OVERALL EVALUATION

1 2 **3** 4

Retain

We recommend that clients retain this manager.

Target Excess Return: 50 bp
Target Tracking Error: 350 bp
Time Period: > 4 years
Russell Assigned Benchmark: S&P/TSX COMP

Expected Performance Pattern

We expect Greystone Managed Investments Inc. (Greystone)'s Canadian Equity product to outperform the S&P/TSX Composite Index by roughly 50 basis points over longer annualized time periods (i.e. in excess of four years). Lower sector bets in the last couple of years have resulted in active risk trending lower since the start of 2009. As a result, we expect tracking error to remain around 350 basis points.

With it's growth emphasis, this product will struggle in falling markets where the value style of investing is more rewarded. It will perform best in markets that are trending higher but will struggle when the market is in transition or experiencing high volatility.

Manager Update

On June 13, 2012, Kathleen Baldwin and Kathleen Wylie met with Greystone Managed Investments Inc. (Greystone) for an annual on-site review to discuss a firm update and review of their Canadian Equity product. Greystone's performance has struggled during most of the last four years. They have reacted to this underperformance by making some minor changes to their portfolio construction discipline and incorporating Scott Linner's more centralized and formalized risk management

LOW 1 2 3 4 5 HIGH

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initiative into their process. We view these changes positively at the margin but continue to believe that if the volatile, macro-focused environment continues, Greystone's performance will lag. However, we have confidence in the long run that their emphasis on growth in earnings combined with their bottom-up stock selection and concentrated portfolios will add enough value over a 4-year time horizon to justify the "3-Retain" rank so we are reiterating the rank.

Greystone's security selection focuses on demonstrated earnings growth, earnings surprise and analyst's earnings estimate revisions. Surprise and revisions have not been rewarded in the market, which has hurt their performance. However, we continue to believe that their screening process causes them to lag the market since stocks will only show an improvement in ranking after a stock has appreciated in price or started to show improvements in earnings, estimate revisions or earnings surprise. This approach will work well in trending markets but in volatile markets or markets that are in transition, they will struggle.

In response to the challenging market and economic environment, Greystone has made some enhancements to their portfolio construction discipline, which are not significant but we consider them positive at the margin. We observed that sector bets have been trending down since early 2009 and Donnie highlighted that this was intentional. If a sector overweight or underweight relative to the benchmark increases to 400 - 500 basis points, they start to get concerned and will reign in the bet. They are also keeping the number of names more in the 40-45 number range whereas in the past, they were comfortable with a range of 35-45. The number of names is likely to stay above 40 now, which is where they have been for most periods since 2006 so this is not a material change.

In 2011, Scott Linner officially left the Canadian Equity team to lead a risk management initiative within Greystone. He had been informally running some risk analytics but Greystone decided to have him dedicated full-time. He has since centralized and formalized risk management. Previously, each team utilized different tools but there was no consistent approach. They adopted Axioma in the third quarter of last year and use that along with FactSet and CPMS. There are bi-weekly meetings, which are chaired by Rob Vanderhooft, where risk metrics of all equity products are analysed and discussed. As well, when they are contemplating making a change to the portfolio, they will now assess what the impact of that change will be on beta and volatility of the portfolio. Recognizing that there have been periods where there fund has underperformed significantly, they are now targeting portfolio beta to be in the range of 0.95 to 1.05; it has spiked as high at 1.12 in the past. So if a new stock adds too much to beta or volatility, they may add it at a lower weight. Incorporating the risk management into the portfolio construction discipline is expected to impact weights but is not expected to cause them to prevent them from adding a new name. Donnie believes that these process enhancements would have helped them weather difficult periods such as 2009, better. They did some testing and concluded that they would have still lagged the benchmark but by a smaller amount. We view the enhancements positively but do not believe they will have a significant impact on performance.

Performance

We consider Greystone to be a GARP manager in the market-oriented universe although some consider them growth. However, whether performance is compared to the market-oriented universe or the growth universe, they have struggled for most of the last four years. Some of their most challenging quarters relative to the benchmark were in very difficult active management environments (i.e. Q3 2011, Q1 2011, Q2 201 and Q1 and Q2 2009) but they lagged the median market-oriented and median growth manager in those periods as well so their underperformance cannot be blamed solely on their style being out of favour. We understand why they underperformed in the those periods but the magnitude of underperformance was more than we would have expected. As well, the fourth quarter of 2011 was a favourable active management environment and they lagged the benchmark by 110 basis points. Their high weight in gold was a key detractor of performance in that quarter. If Greystone continues to underperform in good active management environments,

LOW ① ② ③ ④ ⑤ HIGH

we will revisit the rank.

For the one-year period ending March 31, 2012, the Canadian Equity portfolio returned -14.1%, which was roughly 435 basis points behind the S&P/TSX Composite return of -9.8% and 515 basis points behind the median market-oriented manager and roughly 215 basis points behind the median growth manager return.

They have lagged the benchmark in every calendar year except 2010 since 2008 so their longer-term numbers are poor. Their 4- and 5-year annualized returns ending March 31, 2012 were roughly 350 and 320 basis points behind the S&P/TSX Composite returns, respectively. Relative to the median market-oriented manager, they lagged by roughly 345 and 310 basis points over the same periods, respectively and lagged the median growth manager by roughly 260 and 230 basis points.

Investment Staff ① ② **③** ④ ⑤

Donnie MacKay has been heading the Canadian Equity team since 2004; we believe that Donnie is capable and motivated.

In addition to Donnie, Rod Balkwill and James Baldwin are considered portfolio managers and are senior members of the team. Previously, Scott Linner was a key member of the team but has shifted responsibilities to an investment risk initiative that Greystone announced they are undertaking in February 2011. As a result, James Baldwin has returned to the Canadian Equity team after focusing on U.S Equities since 2008. As well, Heather Greenman, Mark Scollan and Curtis Runge are focused on Canadian Equity research. We have been sufficiently impressed by Rod and James but our confidence rests with Donnie, who remains the key decision-maker.

We have had concern over the years about the level of experience on the team; we are less concerned now that all members have many years of experience. Still, our opinion of the team overall is that they are still average in terms of investment abilities relative to peer managers.

Organizational Environment ① ② ③ **④** ⑤

Greystone is based in Regina and is one of the prairies' largest multi-product investment counselors with branch offices in Edmonton and Winnipeg. There was ownership reorganization in 1999 which included Greystone merging with Mentor Capital Management in Winnipeg. Roughly 70% of the firm is still owned by the employees, with the vast majority of Greystone's investment professionals owning a piece; three institutional investors own the remainder of the firm.

We believe that Greystone as an organization is strong and considerably less susceptible than peers to disruptive staff turnover; the only significant departure was by Tim Frostad in 2004; there have been no other key departures from the firm since then other than a couple of retirements by non-investment professionals. We continue to believe that the firm's culture and compensation arrangements should ensure relative stability. Firm-wide assets under management are roughly $34 billion so the firm is financially stable.

Frank Hart joined the firm in March 2010 as President mainly to focus on the operational aspects of the firm. Rob Vanderhooft is still the CEO and CIO and more focused on the investment side of the business. Most of Frank's background is management consulting and as he indicated last year, he has not made any significant changes other than in infrastructure.

LOW ① ② ③ ④ ⑤ HIGH

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Security Selection ① ② **③** ④ ⑤

The product's selection methodology combines the key growth and valuation factors that have historically proven successful in the Canadian equity marketplace. The majority of Greystone's attention is spent on finding companies with high market-relative, sustainable earnings growth and momentum characteristics – their focus on these characteristics is appealing although not as unique compared to peers as it once was. Companies within Greystone's portfolio also typically require positive earnings, with low industry-relative forward price/earnings ratios. Despite their focus on valuations, they tend to lag during periods when growth stocks are de-emphasized.

Price momentum is a small weight within the screening process, and our view previously was that it existed more as a check on their ideas than a key criterion for purchases but it does appear to have enough of an impact on ranking of stocks that it is impacting portfolio decisions. Greystone admits that their ranking process often results in them purchasing names late since they wait for confirmation of earnings and momentum characteristics. Our view overall is now that Greystone's security selection process is average compared to peers so we have lowered the ranking.

Research ① ② **③** ④ ⑤

With six professionals contributing to Canadian equity research, including Donnie, the team is sufficiently deep compared to peers although their level of experience is average.

Research is a combination of internal and external analysis, with sell-side analyst models and earnings estimates used extensively as a complement to Greystone's own industry and company specific research. Our view is that their research is in-depth but does not differentiate them relative to peers.

Despite Greystone's physical location, we believe they have excellent access to company management teams as well as street analysts stemming from the size of the firm. We view that positively.

Asset Allocation ① ② ③ ④ ⑤

The objective of this product is to remain fully invested, with cash balances being a residual of portfolio turnover. As a result, we are not assigning a rank to this category.

Sell Decision ① ② **③** ④ ⑤

The product's sell discipline typically requires a formal review by the covering analyst to confirm if the original investment thesis is still intact, or if a shorter-term negative event or price weakness is the result of a fundamental problem with the company. Greystone's focus on short-term earnings factors should help them to exit positions more effectively than peers but the use of their ranking methodology can result in them selling late out of names that drop in ranking. We did see some evidence during the recent market environment that Greystone has been more decisive in their sell discipline by selling out of companies that have experienced any disappointments in their fundamentals more quickly but our view overall is that their sell discipline is average compared to peers.

Portfolio Construction ① ② ③ **④** ⑤

Greystone's capitalization bets are moderate and historically, their sector- and stock-level bets have been aggressive compared to other managers and the largest source of tracking error. However, sector bets have been trending lower the

LOW ① ② ③ ④ ⑤ HIGH

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last couple of years, which has resulted in lower active risk according to Axioma Analytics. They had been intentionally reducing the sector bets, which was reinforced by Scott's focus on risk management. As well, they are targeting the number of names to be more in the 40-45 range so at the high end of their previous range of 35-45 in an effort to reduce volatility in the fund. As a result, active bets have trended down but are still above the average of peer managers. We continue to believe that the portfolio is still concentrated in their highest-conviction ideas, which is positive compared to peers. Greystone is also more focused on beta now so will pay closer attention to the impact that an individual name may have on portfolio beta and standard deviation. The net effect of more focus on risk management is on the weights of names but not name turnover. We view their attention to risk management favourably but need to monitor the direct impact on the portfolio closely.

Implementation ① ② ③ ④ ⑤

Implementation of ideas is efficient with Donnie MacKay officially having the final say as the Canadian Equity team leader although it is a team approach generally.

Despite Greystone's low turnover (roughly 30% per annum), large-cap biased strategy, we believe that growth in assets under management over the years has resulted in some implementation problems. This has resulted in increased time to make portfolio changes, even when buying and selling the most liquid stocks in the Index.

In March 2008, Greystone closed this strategy to new assets but are still accepting cash flows from existing clients. AUM in this product has dropped from $13 billion to $8.5 billion, which we still think it too high; we prefer they close the product to all cash flows.

We have had in-depth discussions with the head trader at Greystone, Jeff Robertson, and have a high opinion of his abilities and insight with respect to trading.

LOW ① ② ③ ④ ⑤ HIGH

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Important Legal Information

LOW ① ② ③ ④ ⑤ HIGH