meritage PORTFOLIOS®

Q&A

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General Features

What does Meritage mean?

Meritage, a blend of "merit" and "heritage", is the combination of the finest portfolio managers and individual funds representing a heritage of consistent performance over the long term.

How many types of portfolios are there?

There are 15 different portfolio types with varying asset allocation mixes and benchmarks. In addition, four out of the 15 portfolios are also offered in a Corporate Class structure.

Why 15 different portfolios?

The Meritage Portfolios® offer a robust line-up composed of five investment funds. These five funds seek to provide the investor with capital appreciation. Also, since the requirement for income should not drive the risk level, six income portfolios are also offered. They feature the same general fixed income/equity asset allocations as the investment line-up, with a focus on income producing funds. Finally, four other funds complete the line-up, a Canadian Equity fund, a Global Equity fund, an International Equity fund and a U.S. Equity fund.

How many different funds are comprised in the portfolios?

20 to 30 stand-alone funds are included in the program with an optimal number of funds per portfolio.

How many partners are involved in the Meritage Portfolios®?

The Meritage Portfolios® include funds from eleven different fund companies, which are all large and well-known financial institutions:

- Beutel, Goodman & Company Ltd
- Capital Group
- CI Investments
- Dynamic Funds
- Fidelity Investments Canada Ltd
- Invesco Ltd
- Mackenzie Investments
- Manulife Mutual Funds
- RBC Global Asset Management
- TD Asset Management Inc.

Why are the portfolios made up of only third-party funds?

Although National Bank offers an impressive line-up of mutual investment funds, we wanted to optimize both the objectivity and transparency of the selection and the due diligence processes by choosing only third-party funds. By doing so, we are sure to avoid all possible conflicts of interests.

What is the rebalancing target?

The Meritage Portfolios® are rebalanced on an ongoing basis in order to fit the initial selection and to prevent overexposure to any specific asset category. If a specific fund's market value deviates by more than 2.5% from its original target, we will proceed in rebalancing the portfolio. We will also rebalance the portfolios when a specific asset class deviates by more than 5% from its target allocation.

What are the distribution rates?

Trust Portfolios

The Meritage Investment and Pure equity portfolios have a variable distribution rate. These distributions are made up of dividends, interest income and capital gains. They are automatically reinvested in additional units.

The Meritage Income portfolios have a fixed distribution target that is set and reviewed annually to account for market conditions. The distributions consist of dividends, interest income, capital gains and return of capital. Monthly distributions are paid in cash. Special year-end distributions are automatically reinvested in additional units.

Corporate Class Portfolios

Except for the T Series, the distribution rate of the Corporate Class Portfolios is variable and consists of common dividends and capital gains dividends. Year-end distributions are automatically reinvested in additional units.

T Series securities have a fixed distribution target that is set and reviewed annually to account for market conditions. The distributions consist generally of return of capital. Monthly distributions are paid in cash. Special year-end distributions of common dividends and capital gains dividends are automatically reinvested in additional securities.

What is the distribution frequency?

Trust Portfolios

Meritage Pure Equity Portfolios: Annually

Meritage Investment Portfolios: Quarterly

Meritage Income Portfolios: Monthly

Corporate Class Portfolios

T Series: Monthly and annually

All other Series: Annually

Are the portfolios currency-hedged?

No, the Portfolios are not currency-hedged. However, portfolio managers of the underlying funds are able to hedge their foreign currency exposure strategically or tactically, as is the case for the Manulife Canadian Investment Fund, the CI Signature Dividend Fund, the Mackenzie Cundill Value Fund, the RBC O'Shaughnessy US Value Fund and the RBC Global High Yield Bond Fund.

What is the difference between Trust Portfolios and Corporate Class Portfolios?

When you buy a mutual fund, you purchase units if the mutual fund is a trust, or shares if the mutual fund is a corporation. The main difference between mutual funds that are trusts and mutual funds that are corporations is how your investment is taxed, which may be important if you're investing outside of a registered plan.

When is it more beneficial to invest in Corporate Class Portfolios?

In general, there is a potential for increased tax-efficiency when investors hold Corporate Class Portfolios in their non-registered accounts.

Who should consider investing in Corporate Class Portfolios?

- Affluent investors who have maximized their RRSP and TFSA contributions, and who have additional liquidities to invest.
- Retired investors who wish to maximize their eligibility to government benefits by reducing their level of taxable investment income.

What are some of the benefits of investing in Corporate Class Portfolios?

Compound growth

Deferred taxation of portfolio conversions combined with tax-efficient distributions over many years allow you to get the most out of your investment.

Security conversion

Corporate class portfolios allow you to shift assets from one corporate class portfolio to another without triggering any immediate capital gains tax. This benefit provides you with the flexibility to be invested in the portfolio that is most in line with your objectives, at any time.

Tax-efficient distribution

You can transition from the accumulation phase to the payout phase within the corporate class structure without triggering a tax event. In addition, the T Series provides tax-efficient monthly distributions, consisting mainly of return of capital[1].

What is a T Series?

The T Series is an income solution for investors looking for a stable, monthly, tax-efficient alternative to drawing down capital from their portfolio. The T Series features a fixed monthly distribution rate which is generally made up of return of capital, which is a tax-efficient source of income that reduces the adjusted cost base while maintaining the investor's participation in the market's growth[1].

1. Reimbursed capital is not taxable, but it will reduce your average cost base, which can result in a larger capital gain (or a smaller capital loss) when you ultimately dispose of your investment.

Fund Selection Process

How are the funds selected?

The funds that are part of the Meritage Portfolios® are chosen using the Select Rating System®,[2], which is a multi-stage, quantitative fund selection process designed by the Meritage Portfolios® team of investment specialists.

1. The Screening Process: the funds are screened to meet specific criteria

- **Availability of fund complexes:** all fund companies must be available for partnership for such a wrap program.
- **Performance history:** all funds must have a minimum of 3 years existence.
- **Fund structure:** all funds must be in an *81-102 mutual fund structure*.
- **Capacity:** all funds must be open for new purchases, have no restrictions and sufficient mid-term capacity.
- **Fund Series, structure and mandates:** all packaged wraps, fund-of-funds, index funds and funds with an index-like mandate are eliminated.
- **Style classification:** the funds are divided into value, blend and growth using the Morningstar holdings-based classification and according to the statistical correlation of the funds to style indices during rising and falling markets.
- **Fund size:** all funds under a certain size in assets (depending on the asset class) are eliminated. Out of over 5,000 funds in the Morningstar Direct database, approximately 250 made this initial screening.

2. The Quantitative Analysis: the funds are analyzed using a proprietary quantitative model

- Value added by portfolio manager performance analysis (Jensen's alpha)
- Returns by unit of risk analysis (Treynor and Sharpe ratios)
- Downside risk analysis
- Other observations: holding-based style consistency, correlation between funds, downside and upside capture ratios, validation of management team continuity, additional qualitative data provided by Aon Hewitt.

2. The Select Rating System® is a registered trademark of National Bank of Canada, used under license by National Bank Investments Inc.

3. The Final Selection: final selection processes validated and monitored by Aon Hewitt

Optimal investment portfolios are constructed and various considerations are made in order to optimize the selection process. To that end, correlation coefficients, style diversification and the fund's behaviour under various market conditions are all examined closely in order to achieve this desired result.

What is Aon Hewitt's role?

Aon Hewitt was asked to review our Select Rating System®. The consulting firm validated our screening criteria, quantitative model and final selection processes. Aon Hewitt is not only part of the due diligence process but will also review any major changes made to the portfolios.

Who is Aon Hewitt?

A subsidiary of Aon Corporation, the leading global provider of risk management services, insurance and reinsurance brokerage, and human resources consulting. With more than 62,000 employees located in 500 offices in over 120 countries, Aon Corporation also employs 450 consultants dedicated to investment management and 90 analysts specialized in evaluating portfolio managers, developing selection processes and regularly updating investment portfolios databases.

What can trigger a change of funds in the portfolios?

In addition to a continuous oversight of the Canadian universe of mutual funds, a due diligence committee meets quarterly to closely examine the individual funds, their performance and any changes which may affect their future behaviour. For example:

- Changes in the investment mandate, capping or closing of a fund, etc.
- Portfolio management departures
- Specific evaluations or reviews from Aon Hewitt
- A significant drop in the ranking according to the Select Rating System®

Are constraints or mandate modifications imposed to portfolio managers of individual funds?

We have chosen all funds for their above-average long-term risk-adjusted return and value added, which is in great part due to sector and geographical deviations from indices. Although all portfolios are monitored very closely, no mandate change or constraints will be imposed on the underlying fund managers.

Why aren't the funds all rated 5 Stars by Morningstar?

The Morningstar star-rating system puts a strong emphasis on the funds' short- and medium-term performance. As such, the star rating of the funds will vary periodically as the fund managers' management styles fall in and out of favour throughout the different market cycles. For example, a value style manager will likely see his fund's star rating drop during a multi-year market rally driven by commodity prices. The portfolio manager's skill and ability to deliver a strong performance in the long-term would not be questioned in such an environment, as he/she may demonstrate their ability to outperform in the next market cycle when growth managers would be at a disadvantage. In striving to achieve the best risk and return tradeoffs, the Meritage Portfolios® were made up of the best blend of the best funds, some of which may or may not be currently rated 5 Stars by Morningstar.

Portfolios Characteristics and Asset Categories

What is the type of asset allocation in the portfolios?

The Meritage Portfolios® asset allocation is strategic. The maximum deviation from the target allocation for the underlying funds is 2.5% and 5% for the asset classes. When the ranges are breached, the portfolios are automatically rebalanced. This widely used approach has been proven very effective for achieving long-term performance.

Why isn't the asset allocation tactical?

The tactical allocation is made within the mutual investment funds of the portfolios. Each underlying portfolio manager is free to make tactical asset allocation decisions to countries, sectors or even asset classes.

Why are there a limited number of funds in the portfolios?

There are a limited amount of funds because of a phenomenon called "diworsification" which is the process of adding funds to a portfolio in such a way that the risk/return attributes are worsened. Investing in too many assets with similar correlations can result in an averaging effect where risk is at its lowest level and additional assets reduce potential portfolio returns as well as the chances of outperforming the benchmark.

Fees and Operations

What is the inception date of the funds?

September 25, 2007 for the International Equity and American Equity Portfolios and September 25, 2006 for the 12 other portfolios. Corporate Class Portfolios were launched in March 2011.

What series are available?

For the Trust and Corporate Class Portfolios, two series are available for purchase: F Series and Advisor Series (with front load, low load and back load options). In addition, the T Series is available for the Corporate Class Portfolios.

What is the minimum initial investment for the funds?

$5,000

What is the minimum for subsequent investments?

$50

What is the minimum initial investment for Systemic Investment Plans (PAC)?

$5,000

What is the minimum subsequent investment amount for Systemic Investment Plans (PAC)?

$25

What is the minimum investment for Systemic Withdrawal Plans (AWD)?

$10,000 down to $5,000

What is the minimum Systemic Withdrawal Plans (AWD) payment amount?

$50

How can I see the individual funds comprised in my portfolio?

Since Meritage offers a simple funds-of-funds structure, only one position appears on the account statement. However, fund fact sheets are available monthly on the Meritage website, which contain performance updates on all underlying funds. Also, a newsletter is produced quarterly and sent with the account statement.

NATIONAL BANK INVESTMENTS

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