THE ABC PERSPECTIVE

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Investing in the New World

**"Change is the law of life.
And those who look only to the past or present
... are certain to miss the future."**

- John F. Kennedy

There have been many far-reaching economic, financial and lifestyle changes in the past half-decade that have transformed the investing environment. Due to factors such as technological innovation, advances in mobile and connectivity technology, and globalization, we are in the midst of a transformation into an asset-light, digital, and service-based economy.

This trend is resulting in an environment where intellectual property and brand names dominate, while hard assets such as industrial machinery, mining, and oil and gas properties are losing importance. It is our view that successful investing today will have to consider the new directional changes that are shaping the future. They include:

• The development and rapid growth of e-commerce, whereby many consumers and businesses are making the bulk of their purchases online. This can be best exemplified by comparing Amazon.com and struggling retailer Walmart, with Amazon.com now larger than Walmart by market capitalization. Roughly 25% of all US households are currently subscribed to Amazon Prime, the company's free-shipping subscription service, and this percentage is rising rapidly.

• The emergence of cloud computing is transforming the way businesses use technology. With companies aiming to become leaner and more efficient, cloud computing expenditures are expanding quickly. Bernstein Research forecasts that 60% of total IT spending growth in 2015 was spent on cloud computing and this will rise to 100% in 2018. Companies providing cloud computing services include ABC Funds' holdings, such as Microsoft, Amazon.com and Salesforce.com.

• Consumers, especially millennials, are shifting their media consumption habits. For instance, they are shunning cable television, which has hurt traditional TV operators, including Disney and 21st Century Fox. There is a tremendous opportunity to benefit from this shift by investing in digital entertainment options, such as Netflix and Electronic Arts.

• The aging baby boomer generation will be spending more and more on healthcare services and prescriptions each year. Businesses that provide medical equipment, technology, or create drugs will benefit significantly from this secular growth trend. Examples include ABC Funds' holdings, Becton Dickinson and Boston Scientific.

• Companies that have powerful brands and irreplaceable intellectual property, such as Nike, Kraft Heinz, and Activision Blizzard will thrive, due to their dominant market positions and ability to leverage their brands to grow sales.

Moreover, globalization has spurred a momentous business transformation that is having an incredible worldwide impact. For instance, China is in the process of converting from an industrial, export-driven economy into a consumer, service-driven environment. CNBC's Jim Cramer illustrated this point several weeks ago, stating that the Chinese economy does not want more buildings, coal or iron, rather, its consumers want Michael Jordan basketball shoes.

Looking ahead to the future, we must take heed of the transforming world economy and invest accordingly. Futhermore, with the US consumer accounting for approximately 2/3 of the total American GDP, we expect these directional changes to be important economic and investment drivers for 2016 and beyond.

Tom.

Economic Perspectives

The American Consumer: Driving 2016

There are many changes taking place in the global economy. This transformation is shifting business and consumer demand from asset-heavy investments toward more service-oriented sectors and industries where strong brand recognition and operational ease of e-commerce have become increasingly important. Combined with anticipated slow, but steady 2016 U.S. economic growth, we expect our four favoured investment sectors to perform relatively well this year. These sectors include consumer discretionary, financial services, healthcare, and technology. Furthermore, with improving employment and wage trends, low energy and commodity prices, subdued U.S. interest rate increases and continued Chinese economic deceleration, we expect the American consumer to become a key component of U.S. economic growth this year.

Investment Perspectives

New Influences on Stock Picking

There are many new factors presently influencing the common stock selection process. Firstly, last year's troublesome experiences with the numerous economic and political events, including the Greek financial crisis, Middle East turmoil, Ukraine, the collapse of oil and commodity prices, and the extraordinary stock market volatility, have swayed investors toward risk-off trades, a flight to safety and a desire for security liquidity. Additionally, with the increasing impact and continued growth of e-commerce, changing consumer purchasing habits, structural business shifts due to technological advances, and a growing cashless society, these influences are also providing new directions with regard to common stock selection. Furthermore, with the scarcity factor of growthy value stocks in an evolving new economy and a relatively low interest rate environment, we believe that investors will have to be increasingly imaginative, yet very selective this year.

Portfolio Perspectives

Migrating to the United States

The U.S. economy continues to exhibit a slow, but steady growth pattern, versus a relatively weak resource-impacted Canadian business environment. Consequently, our ABC portfolios over the past year have been gradually increasing American equity exposure with relatively liquid, new economy, value common stocks. We believe that these fresh selections will provide good capital appreciation potential during 2016. Among some of the purchases we have made over the final three months of 2015 include: Boston Scientific Corporation, MasterCard Inc., The Home Depot, Visa Inc., General Electric Company, Nike Inc., The Kroger Co., Dave & Buster's Entertainment, Prudential Financial Inc. and Brunswick Corp. During the same period we liquidated Superior Industries International, Bank of Montreal, The T.D. Bank, Telus Corp, Carriage Services Inc. and Southwest Airlines Company.

ABC FUNDS

Favoured ABC American Common Stock Holdings

These favoured ABC American common stocks exemplify what we look for in a company. Each of these holdings are liquid, well-managed, operate in strong sectors and are well positioned for growth in 2016 and beyond.

Boston Scientific Corporation is a medical technology company that designs and manufacturers medical devices for use in various interventional treatments, such as heart and coronary disease. The company is in the midst of diversifying its product portfolio and creating innovative products in areas such as cardiology, endoscopy and urology. Boston is undergoing margin expansion through cost cutting. We see robust future growth ahead through both organic growth and acquisitions.

Nike Inc. is the well-known brand that designs, develops, markets, and sells athletic footwear, apparel, equipment, and accessories for men, women, and kids worldwide. Nike is an ABC Fund favourite for its excellent secular growth potential due to increasing demand for athletic wear worldwide. The company offers products in eight categories, including running, basketball, football, men's and women's training, sportswear, action sports, and golf under the NIKE and Jordan brand names. The company has consistently proven that it can grow its revenue and earnings in all regions from both expansion in the categories it serves as well as through market share gains. In its latest quarter, Nike reported exceptionally strong global demand, with orders in China up 31%. Nike is held in all of the ABC Funds.

Visa and Mastercard are known for their widely-used credit card brands. These financial-technology companies provide transaction processing and other payment-related products and services globally. Both companies are benefitting from the global growth of e-commerce and the declining use of cash and cheques. Continued adoption of payment technology by both consumers and merchants is hastening the process towards a cashless society. Increased consumer adoption in international markets combined with stronger American consumer spending should provide Visa and Mastercard with stable earnings, strong free cash flow and continued revenue growth. We own both stocks in all ABC Funds.

Apple Inc. is recognized for a number of world-class products including the iPhone, iPad, iMac, MacBook and its more recent Apple Watch. Apple was added to the ABC Funds due to its proven track record of stable earnings and revenue growth, very strong balance sheet, attractive valuation, and its potential to develop its service oriented offerings. We believe Apple has significant earnings power to provide shareholders with solid future returns. Apple Inc. is held in all of the ABC Funds.

The Home Depot, Inc. is the leading home improvement retailer and is benefitting from the continued recovery of real estate and home renovations in the United States. The company is experiencing very strong revenue growth largely due to its strategy of attracting not only the do-it-yourself consumer, but also a network of professional carpenters and homebuilders. Home Depot is one of the few retailers that hasn't been harmed by the rise of e-commerce, with a customer base and business model that values physical locations. With excellent management and superb earnings consistency, The Home Depot is held in all of the ABC Funds.

Becton Dickinson Inc.

Becton Dickinson Inc. is a medical technology company that specializes in providing medication management products to the healthcare industry. BD manufactures a variety of medical supplies, lab equipment, and diagnostics products, which include medical syringes, needles, dispensing systems and catheters. Headquartered in Franklin Lakes, New Jersey, the company was established in 1897 and has a long history of delivering stable, high quality results, exemplified by 44 consecutive years of dividend increases.

As the world leader in medication management and patient safety solutions, BD is well positioned to take advantage of the growing demand of healthcare products, since much of its output represents repeat business. Becton's customers include hospitals, clinics, doctor's offices, pharmacies and labs. While Becton is American, it is a multinational corporation with the majority of its sales outside the US, including 25% of sales from emerging markets. Due to aging populations around the world, BD is experiencing a steady, growing demand for its products globally.

Interestingly, Becton Dickinson transformed itself when the company made the highly accretive acquisition of rival CareFusion for $12.6 billion in 2015. This acquisition is proving to be advantageous to BD for several reasons. Firstly, CareFusion sells products that are highly complementary to Becton Dickinson's portfolio. For example, some of CareFusion's products include infusion pumps, automated dispensing, and patient identification and monitoring equipment; CareFusion's dispensing systems can be used to pump drugs through the catheters sold by BD.

After acquiring CareFusion's product portfolio, BD is now fully equipped to handle every procedure of medication management including preparation, dispensing, administration, and monitoring. This gives Becton Dickinson incredible scale and allows the company to be a one-stop shop for hospital procurement needs. Moreover, as hospitals seek to cut operational costs and improve quality, we believe they can reduce expenses and increase efficiency by purchasing from a single, diversified supplier. This places BD in a preferred position since many of Becton's competitors lack the wide range of products that BD now offers.

In addition to strengthening its product offering, Becton Dickinson expects to extract both cost and revenue synergies from the CareFusion acquisition over the next few years. On the cost side, BD management plans to integrate the two businesses and to cut costs in manufacturing and overhead, while keeping research and development spending relatively intact. Management believes that cost reductions will enable BD to save approximately $350M annually by 2018. In addition, Becton plans to realize revenue synergies by cross-selling CareFusion products through BD's extensive marketing networks.

Although BD has a large emerging market presence of 25%, CareFusion sells relatively little globally. This expansion could be a huge windfall for CareFusion, since BD sells medication-management products to over 4,000 hospitals in China alone. Consequently, Becton will be able to use its dominant position with these international customers to cross-sell CareFusion products. More importantly, BD has already begun to register CareFusion products within China and expects to start seeing product sales beginning in 2017. While China's economic growth is slowing, Chinese demand for medical goods is still very strong and could become a huge CareFusion revenue driver for the balance of this decade.

Overall, we see great opportunity for Becton Dickinson, as it operates in a stable, low-volatility industry; at the same time, we expect strong growth from healthcare sector expansion, CareFusion synergy benefits and opportunistic tuck-in acquisitions.

Microsoft Corporation

Microsoft Corporation develops, licenses and supports a wide range of software products and services. The company is most notable for its enterprise software including its operating system products, business solution applications, and its prominent office software. Microsoft's Windows operating system and its Office Suite software are among the most widely used computer software packages in the world. Most recently, the company has become a leader in cloud-based solutions, which provide customers with software, services and content over the Internet by way of shared computing resources located in centralized data centres.

We believe that Microsoft offers a remarkable investment opportunity. Firstly, the company trades at an 18.0x forward price earnings multiple and has a 2.7% dividend yield. We believe that Microsoft's valuation is very attractive given the company's virtual monopoly in office software, wide profit margin, free cash flow yield of over 6.5%, and its strong growth potential of its new cloud-based solutions business. We believe that Microsoft's revenues and earnings should grow as its business segments continue to expand propelling Microsoft from a stable, slow-growing utility into a technology titan on the same scale as Amazon or Google.

Secondly, Microsoft has an industry dominant position in office software. For instance, the company licenses its world-class Windows operating system to businesses and customers for personal use. Moreover, the company's Office Suite software is used extensively by both businesses and individuals across the globe. Despite these two segments having a lower growth profile, both generate a significant amount of free cash flow, which Microsoft is using to fund dividends, manage its share buyback plans and also to finance its growth initiatives.

Thirdly, under new CEO Satya Nadella, Microsoft's growth projects continue to outperform and are expanding. Most visibly, the company's cloud-based solution business, Azure, has been a breakout success.

Cloud computing is the process of using a network of servers on the Internet to store, manage, and process data rather than on a single computer. This technology has been growing exponentially as businesses continue to outsource data storage and processing, and Microsoft's Azure has become an acknowledged leader in this new venture. For instance, in the next several years, we believe that Azure could advance to 5% of Microsoft's total revenue.

However, more importantly, Microsoft's new business endeavours are not only related to computer software development, but also to new business diversifiers. A recent example is Microsoft's expansion into entertainment with the company's acquisition of the popular video game franchise, Minecraft. Microsoft is also experimenting with virtual reality and 3D technology, which it hopes to integrate with its Xbox and Minecraft businesses.

Lastly, Microsoft has very strong fundamentals. The company has an extraordinarily strong balance sheet and expanding free cash flow. Although, we do not think that a balance sheet and cash flow profile alone should necessarily move a stock price higher, we do believe that Microsoft's balance sheet should continue to fund its business operations and bankroll future growth initiatives.

In summation, it is our belief that Microsoft has positioned itself as a remarkable, liquid value play with boundless growth potential due to its unique ability to fund, like a commercial bank, numerous new technology diversifiers and innovation.

ABC Fully-Managed Fund

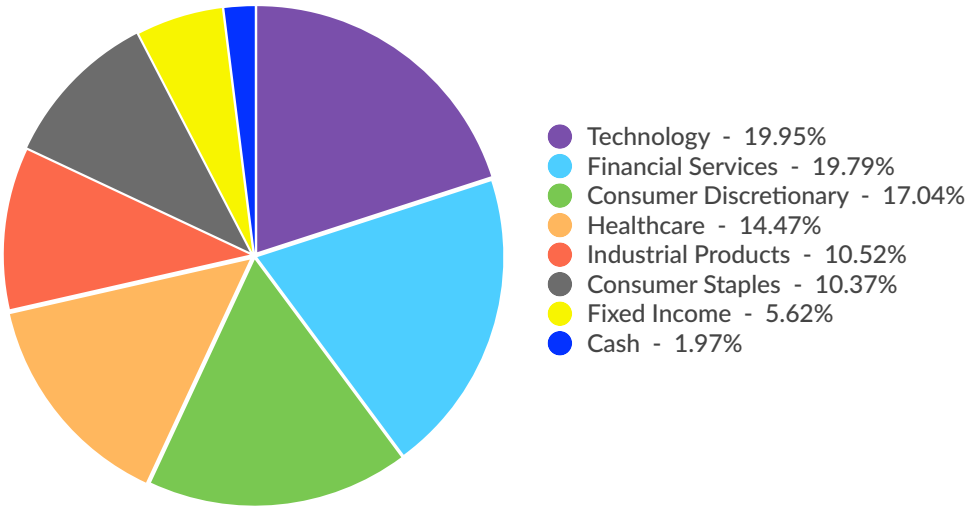
December 31, 2015

ABC Fully-Managed Fund is a diversified Canadian balanced fund. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canadian and American equity and fixed income securities. While our long-term asset mix target is 50% fixed income and 50% North American equities, in practice, our portfolio mix of stocks versus bonds is quite flexible to take advantage of periodic investment opportunities.

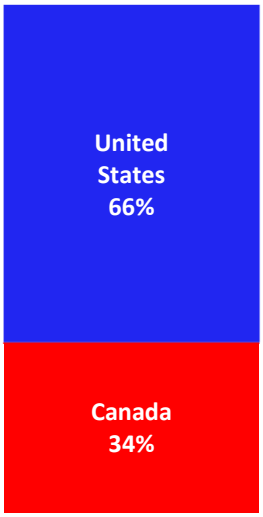
Top Ten Holdings

- Echelon Financial
- Exco Technologies
- Uni-Select Inc.
- Loblaw Companies
- Microsoft Corp.
- Avago Technologies
- Fortress Paper 6.5% CV Deb.
- The Home Depot Inc.
- PepsiCo Inc.
- General Electric Co.

FMF Sector Allocation



Geographic Breakdown



ABC Fundamental-Value Fund

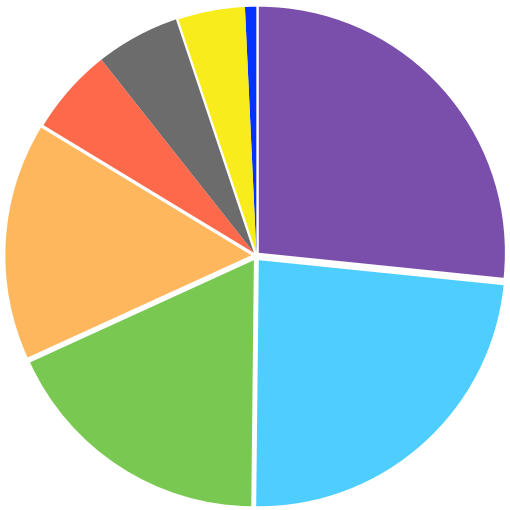
December 31, 2015

ABC Fundamental-Value Fund seeks out fundamentally attractive North American equities. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canadian and American equity securities. Our extensive "value research" style attempts to ferret out North American equities with appealing valuations. With these discerning selections we cobble a diversified portfolio of all-capitalization North American value stocks. When fully invested and having discovered new, fundamentally attractive securities, our sell discipline forces us to cull our portfolios to liquidate the most expensive holdings.

Top Ten Holdings

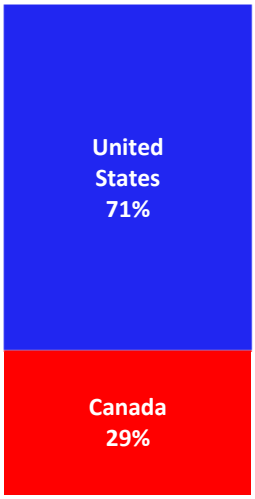
- Exco Technologies
- Alphabet Inc.
- Activision Blizzard
- Uni-Select Inc.
- Polaris Materials
- Echelon Financial
- Microsoft Corp.
- The Home Depot Inc.
- Nike Inc.
- Becton Dickinson Inc.

FVF Sector Allocation



- Consumer Discretionary - 26.62%
- Technology - 23.55%
- Financial Services - 18.01%
- Healthcare - 15.50%
- Consumer Staples - 5.68%
- Industrial Products - 5.51%
- Materials - 4.39%
- Cash - 0.74%

Geographic Breakdown



ABC American-Value Fund

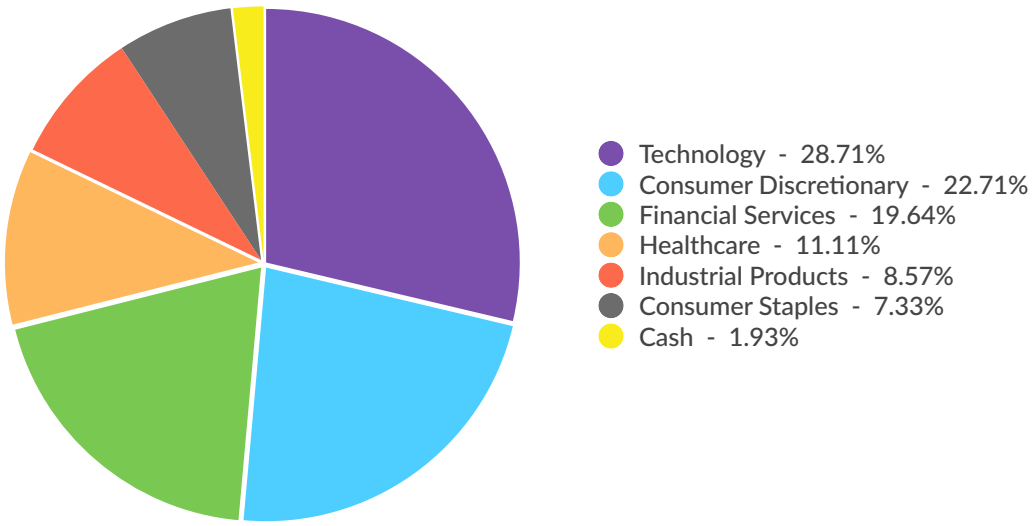
December 31, 2015

ABC American-Value Fund searches out fundamentally attractive American common shares. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of American equity securities. While using the same investment techniques as our two Canadian ABC Funds, the American market due to its sheer size provides us with extensive value opportunities.

Top Ten Holdings

- Alphabet Inc.
- Activision Blizzard
- Microsoft Corp.
- Avago Technologies
- Nike Inc.
- The Home Depot Inc.
- Wells Fargo & Co.
- Visa Inc.
- General Electric Co.
- First Republic Bank

AVF Sector Allocation



Geographic Breakdown

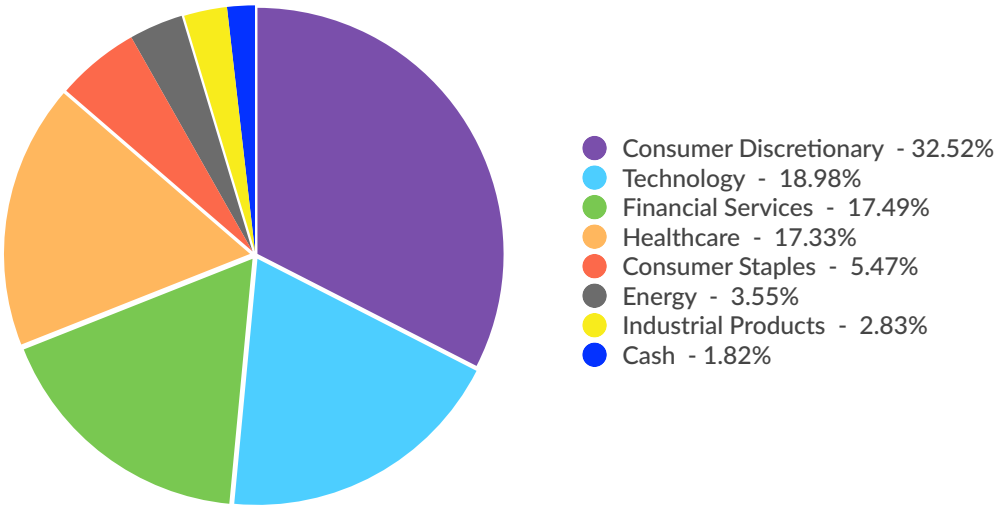
ABC North American Equity Fund
December 31, 2015

ABC North American Equity Fund searches out fundamentally attractive Canadian and American stock exchange-listed common shares. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canadian and American equity securities. This closed-end fund has maximum flexibility to invest in a diversified mix of value securities. The country and asset mix, as well as currency exposure, can vary and has no set limits. The portfolio, ordinarily, will have a mix of 40 to 50 holdings.

Top Ten Holdings

- Echelon Financial
- Electronic Arts Inc.
- Uni-Select Inc.
- Brunswick Corp.
- Stingray Digital Group
- Boston Scientific Corp.
- Becton Dickinson Inc.
- Celgene Corp.
- Petrowest Corp.
- Visa Inc.

NAEF Sector Allocation



Geographic Breakdown

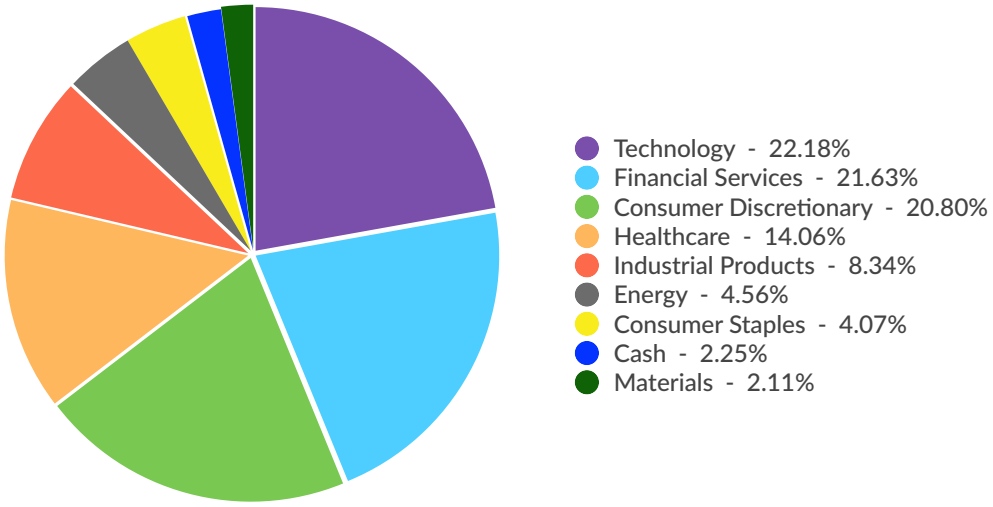
ABC Global Equity Fund
December 31, 2015

ABC Global Equity Fund is a "go-anywhere in the world" equity fund with unlimited investment flexibility. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canada and American equity securities with a bias to international exposure.

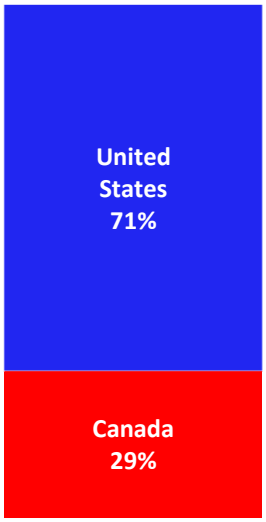
Top Ten Holdings

- Echelon Financial
- Exco Technologies
- Activision Blizzard
- East West Bancorp
- Petrowest Corp.
- Avago Technologies
- First Republic Bank
- O'Reilly Automotive Inc.
- Equitable Group
- Six Flags Entertainment Corp.

GEF Sector Allocation



Geographic Breakdown



ABC FUNDS

The New Economy

Over the past ten years many far-reaching changes have occurred with regard to the North American economy. Take merchandising for example. A decade ago a person might drive to a mall, hunt for a parking spot, browse through several floors of shops, make a purchase and then fight the traffic to return home. Today, consumers' shopping habits have shifted substantially.

Specifically, with expanding e-commerce, consumer purchasing trends have been transformed tremendously. Largely led by the millennials who want to quickly seek high quality goods and services at the lowest price, on-line retailing via mobile handheld devices has enabled 24-7 retailing to migrate from the classic, full-priced bricks and mortar retail shop to the time-saving internet. Furthermore, with the continued ease of online shopping, combined with no-charge shipping and absence of customer lineups, the 2016 consumer can comparison shop from the comfort of his home without the concerns of inclement weather or lack of shopping mall parking. Retailing has and will continue to make incredible advances via technology, innovation and integration. Moreover, with the expectation of increased competition and margin pressure, many retailers will be stuck with unnecessary square footage, as they attempt to create unique product offerings through enhanced online marketing technology.

The revolution in retailing is spreading to other business sectors as the new economy takes over from the old. Traditional banking, via bank tellers and the extensive branch system, virtually on every street corner, is reorganizing as well. Banks are now cost-cutting as digital banking becomes more prevalent. It is expected that branches will consolidate and a number will close with fewer employees necessary as banking attempts to become more efficient, profitable and relevant.

As the new year progresses we expect continued technological advances, structural modifications, and aggressive cost cutting across all North American businesses. Companies will have to make major transformations to remain competitive so as to match the expanding influence of e-commerce. These changes will likely result in more mergers, acquisitions, consolidations and terminations. Consequently, with these important new economy trends in place, we have strategically positioned our ABC portfolios to opportunistically benefit from a continuation of e-commerce growth in the future.

Irwin A. Michael, CFA

Administrative Information

- All cheques are to be made payable to RBC Investor Services.
- All client requests are to be directed to ABC Funds.
- Unitholders of all our funds, with the exception of the FVF & AVF, within non-registered accounts will receive T3 tax slips by the end of March as there were distributions in 2015. Unitholders of FVF & AVF will not receive T3 tax slips for 2015.
- T4s will be mailed out mid-February.
- The Capital Gains/Losses Report for redemptions made in 2015 is included with your December 31, 2015 statement.
- Contribution slips for RRSP contributions made in 2015 will be mailed at the end of January 2016.
- Contribution slips for RRSP contributions made in the first 60 days of 2016 will be mailed at the end of March 2016.
- The RSP contribution deadline for 2015 contributions is February 29, 2016. All contributions must reach our office no later than this date.
- If you wish to receive future newsletters and/or annual financial statements electronically, please call or email our office.

This newsletter is published by I.A. Michael Investment Counsel Ltd. and the ABC Funds
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