THE ABC PERSPECTIVE

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The Glass is Half Full

"For all the quarterly blips, the ups and downs on Wall Street and the back and forth between political parties, the American economy remains more or less on the same trajectory since the recovery began more than seven years ago: modest but consistent growth."

Nelson D. Schwartz
New York Times
October 2016

Looking back at the American macro investment environment very little has changed over the past several months. Investors have been worried about the health of the U.S. economy and have speculated when the U.S. Federal Reserve would initiate its next interest rate increase. Furthermore, adding to the general confusion, a fractious U.S. presidential election campaign has been fraught with nasty accusations and insinuations with very little specific discussion on economic and financial issues.

In spite of the investment uncertainty and price volatility, equity markets continue to climb a "wall of worry" and have been creeping higher in price. While many investors remain concerned and are firmly in the risk-off camp, we believe that the investment "glass is half full" rather than half empty. It is our view that many of the macro negatives are well-known and are currently priced in the equity markets. But this is not to say that securities markets won't be quite fickle between now and year end; they will. We believe, however, that the price trend will be upward-biased. More importantly, there are a number of positive factors, perhaps taken for granted, which continue to provide added stimulus toward rising stock prices, including:

- Record low short and long-term interest rates primarily due to very accommodative central bank policies. This subdued interest rate environment highlights the appeal of good quality, dividend-paying equities as an attractive asset class.

- High yielding common stocks with both earnings and dividend growth potential and, in a number of cases, offering yields greater than their respective bonds.

- Merger and acquisition activities have continued unabated with the ability of corporations to finance these takeovers in the public securities markets e.g. Suncor, TransCanada Corp., Keyera, and Inter Pipeline Ltd.

- Unexpected positive Q3/2016 corporate results of a number of large, influential companies such as Microsoft Corp., Bank of America, Netflix, Johnson & Johnson, Goldman Sachs and Morgan Stanley. This outperformance highlights the tenacity and opportunism of these companies operating in a murky economic environment. These results are probably a positive precursor of what these corporations could achieve in a better financial and political setting.

Looking ahead, with the conclusion of the November 8th presidential election campaign next month, we expect greater financial and investment clarity to appear. Additionally, this occurrence should provide increased American economic visibility, greater political stability and a more proactive U.S. Federal Reserve action. As a result, we expect increased investment transparency leading toward elevated investor confidence and improved equity performance.

Economic | Perspectives

Clearing the Air

Investors today are confronted with a number of short-term financial and political dilemmas which have forced many to the investment sidelines. The immediate prime concern is the too-close-to-call November 8th U.S. presidential election.

Although there are a number of other issues troubling the marketplace, such as, the indecisive U.S. Federal Reserve interest rate policy, oil prices and speculation on American and global economic growth, the U.S. presidential election has created significant investor angst. Consequently, many investors are postponing investment commitments until the resolution of the U.S. presidential election. Given that both presidential candidates offer meaningfully different economic and political policies and the election outcome appears to be so close, investors are sitting on pins and needles. This negativity, we believe, presents attractive investment opportunities as we sense once the election clears the air, equity markets should recover and move upward to year end.

Investment | Perspectives

Dividend-Paying Common Stocks: Relatively Attractive

Within the present investment spectrum of diverse asset classes including gold, base metals, real estate and fixed income securities, the one conspicuous, relatively attractive asset appears to be profitable, dividend-paying, free cash flowing common shares.

Although impacted by the current reluctance of investors to commit funds to these stocks, many offer comparatively high dividend yields of 3%-5%, growing cash flow and improving earnings. Also, on a relative basis, many of these shares appear to be very undervalued compared to record low-yielding short term paper and mid to longer term bonds. More importantly, aside from the yield attraction, many of these high quality shares offer earnings and dividend growth, capital gains potential as well as merger and acquisition activity.

Portfolio | Perspectives

Defensively Invested

We continue to favour common stocks as our prime investment holding relative to low-yielding short term paper and bonds. Over the past six months we have been upgrading our portfolio selections toward more liquid dividend-paying, free cash flowing common shares. Interestingly, and quite unusual, in a number of instances, these high yielding stocks are providing dividend yields greater than the bonds of their own companies.

In a nutshell, our strategy has been to defensively invest our portfolios in solid, dividend-paying companies which we believe will perform comparatively well over the next year. In fact, a few of these selections including Fortis Inc., PepsiCo Inc., Stingray Digital, Honeywell International and Microsoft Corp. have recently increased their dividends bolstering their original purchase yields.

Five Favoured ABC Common Stock Holdings

As the third quarter of 2016 has come to an end, we remain optimistic with regard to our common stock selections. Below are five ABC Funds common stock holdings we have chosen to highlight. We believe these businesses are well positioned in their respective industries and have bright outlooks for the remainder of 2016 and beyond.

Brookfield Property Partners LP, owns, operates, and invests in commercial properties in North America, Europe, Australia, and Brazil. The company is diversified both geographically and in asset class with office and retail accounting for 60% and 31%, respectively while the remainder is invested in other assets. Two of its most familiar holdings are its 50% interest in London's Canary Wharf and a 34% stake in General Growth Properties, an operator of a commercial real estate portfolio. Brookfield Property Partners pays a 5% dividend, trades at a discount to its net asset value, and has potential to increase its value via higher rents, dividend increases and new development projects.

Six Flags Entertainment, is the world's largest regional theme park company with 18 parks across Canada, the United States and Mexico. Six Flags maintains a strong brand, and has been growing revenue and earnings through rising attendance and guest spending. The company stands to benefit from growth in the U.S. economy and higher consumer spending. Six Flags has innovative growth initiatives, such as virtual reality roller coasters. The company also plans to license its brand overseas, with parks expected to open in new countries including China, Vietnam, Dubai and Saudi Arabia. The management is capable and is returning cash to shareholders through an attractive dividend of 4.2%.

Alphabet Inc., the parent company of Google and its "other bets" segments, is best known for its search engine, YouTube video streaming and Android operating systems for the tablet and smartphone industry. Alphabet is a global leader in online and mobile advertising services. The company has shown solid execution and a culture of innovation, which has led to stellar sales and earnings growth, while generating strong free cash flow. Additionally, Alphabet has excellent future prospects, as it continues to better serve advertisers and takes market share from traditional ad service providers.

Emera Incorporated, a recent ABC Funds' stock purchase, Emera is an integrated utility business providing energy and services, and engaging in the generation, transmission, and distribution of electricity to customers. The company recently made a transformational acquisition with the purchase of TECO Energy Inc., which added three promising subsidiaries to their portfolio, while gaining new geographical exposure to New Mexico and Florida. Furthermore, due to Emera's high quality assets, the company is able to pay an attractive 4.5% dividend yield and invest in construction projects to facilitate future growth.

Inter Pipeline Ltd., operates in the industries of petroleum transportation, storage and natural gas liquids processing. Inter Pipeline strengthened and diversified its asset base with the recent purchase of two liquids extraction plants near Fort McMurray from Williams Companies. The company offers good value with its 5.5% dividend yield, backed by free cash flow generated from long term contracts, covering a wide range of oil and gas processing services. Additionally, Inter Pipeline has the potential to expand its pipeline network and other facilities, which could lead to further cash flow growth.

TransCanada Corporation

TransCanada, Canada's 2nd largest pipeline company, focuses on natural gas transmission and power services through its network of pipeline assets. TransCanada ships the majority of Western Canada's natural gas production to markets in Canada and the United States and has interests in power plants across North America.

We believe that TransCanada is a diamond in the rough within the energy sector and is an attractive investment opportunity for several reasons. Firstly, the company exhibits sound fundamentals, including a 3.7% dividend yield, a reasonable P/E ratio of 23x, and growing revenue and earnings. Moreover, the company has a strong balance sheet and significant free cash flow generation. These impressive financials are shielded from competition by large barriers to entry due to immense capital expenditure requirements and regulatory hurdles.

Secondly, TransCanada has an aggressive capital expenditure program that should reward investors in the coming years. The recent acquisition of Columbia Pipeline Group is a $13 billion transformational event that will add 24,000 km of pipeline capacity between northeast United States and the Gulf of Mexico. This will greatly increase TransCanada's ability to transport product south. Furthermore, the transaction will be accretive to earnings and revenue and has transformed TransCanada into a multinational corporation. TransCanada expects to grow through future acquisitions and has set aside $15 billion for near-term projects and another $45 billion for medium to long-term projects. Looking ahead, we believe that TransCanada's aggressive capital expenditure program should enable the company to significantly grow its dividend.

It is noted that TransCanada has faced some regulatory obstacles associated with its American Keystone XL project. On the other hand, TransCanada's Energy East Pipeline project could be very lucrative, but will be under review over the next two years. Due to these delays, we believe that TransCanada will continue to grow through acquisitions, growing its influence and economic power by buying into strategic locations and expanding its pipeline capacity.

Thirdly, the company has been consistently increasing its dividend. As an example, TransCanada has steadily grown its dividend over the past 15 years with a CAGR (Compound Annual Growth Rate) of 7%. Moreover, the company is targeting a CAGR of 8-10% through 2020 due to its planned growth initiatives. We believe that TransCanada's cash flows are relatively diversified, offering a safe stream of dividends compared to its peers.

Overall, it is our opinion that TransCanada is a high quality, Canadian infrastructure play with North American gas pipeline assets, natural gas storage, crude pipelines, and energy generation. With solid growth plans, strong management, a reasonable valuation, prudent acquisitions, and an expanding dividend, we believe that TransCanada is an excellent investment opportunity for the long term.

Mastercard Inc.

MasterCard is a technology company that specializes in providing transaction processing products and services in more than 150 countries. Its main business includes authorization, clearing and settlement as well as processing cross-border and currency conversion transactions. MasterCard primarily earns its revenue from assessment fees charged to its customers on the gross dollar volume and the number of transactions that are processed through its network. Quite simply, as consumers use their credit cards and spend more money, MasterCard grows its revenue.

MasterCard operates a highly desirable business for several reasons. Firstly, the payment network industry has low competition levels with very few participants. The large majority of transactions are processed through Visa and MasterCard, with only a few smaller players such as UnionPay in China and American Express. The industry is very difficult for new entrants and smaller players to compete. Attempts by competitors to enter the industry have consistently failed, most recently being the Merchant Customer Exchange in 2012 on behalf of some of the largest U.S. retailers. MasterCard and Visa both have well-established, well-known global brands that are accepted by most merchants. Consumers also place much trust in the brand, with MasterCard consistently rated as one of the world's top brands. The company has retained its advantage by being one of the most innovative companies in the payments processing sector.

The quality of the business and its deep economic moat can be exemplified by MasterCard's high margins. The company experiences 100% gross margins, and generated a net income margin of 39.4% last year, which is significantly higher than the broad market.

Looking forward, we expect MasterCard will see strong, consistent growth each year due to the expansion of electronic payments. There is currently a global shift from paper-based forms of payments such as cash and cheques to electronic payments. Being a dominant player in the space positions MasterCard to benefit from the secular shift away from paper towards digital platforms. Additionally, the growth of online transactions and ecommerce are assisting this trend. As more people use credit cards and spend more money, MasterCard will continue to generate higher revenue through the assessment fee it charges its customers. There is significant room for this trend to continue as most transactions are still based on cash, particularly in emerging markets.

Finally, the free cash flow profile of the business is very strong. MasterCard operates a high margin business, which requires very little sustaining capital expenditures. Consequently, operations produce large free cash flows which the company is able to use for share buybacks. In fact, MasterCard repurchased over $3 billion of shares in the past year. Moreover, Mastercard pays a small dividend of 0.7%.

Overall, MasterCard operates a high-quality business which produces growing, predictable, sustainable and recurring cash flow. As the global transition from paper-based payments to electronic payments continues, MasterCard should be a prime beneficiary.

FULLY MANAGED FUND

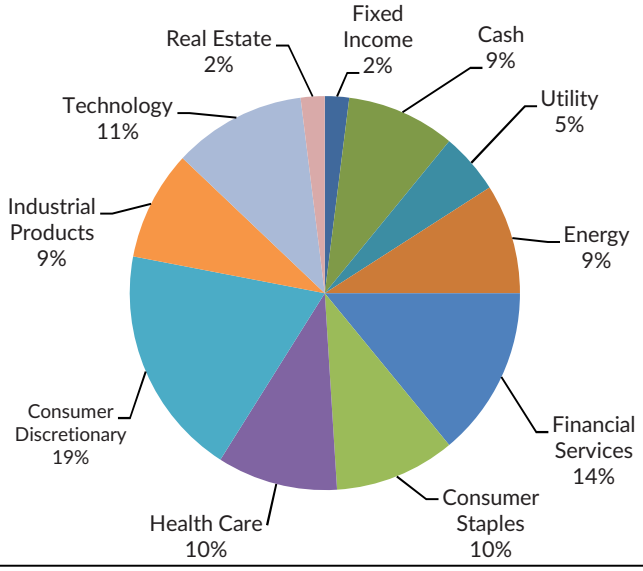
INVEST YOUR MONEY
WHERE WE INVEST OURS

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.

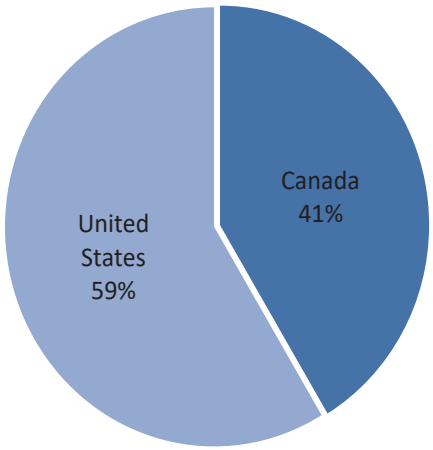
Top Ten Holdings

- Stingray Digital Group Inc.
- Exco Technologies Ltd.
- Broadcom Ltd.
- Uni-Select Inc.
- Loblaw Companies Ltd.
- CCL Industries Inc., Class B
- Microsoft Corp.
- Becton, Dickinson and Co.
- MasterCard Inc., Class A
- Algonquin Power & Utilities Corp.

Sector Allocation



Geographic Breakdown



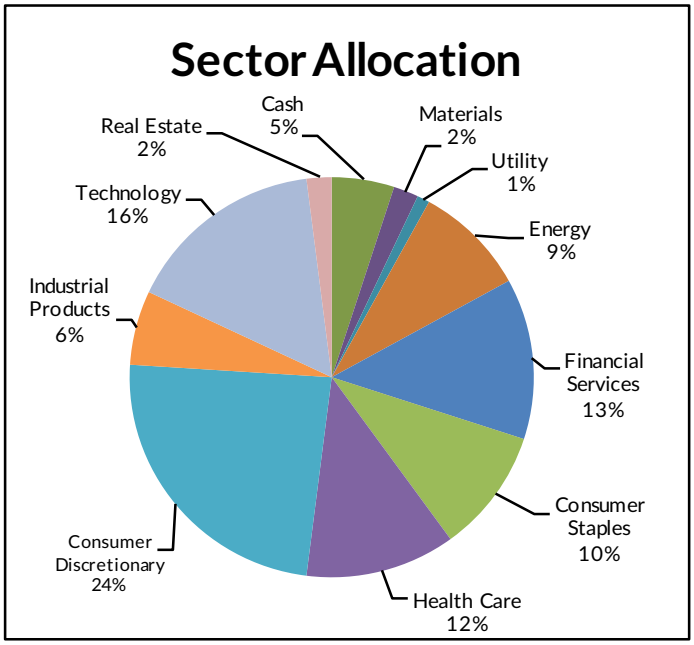
FUNDAMENTAL VALUE FUND

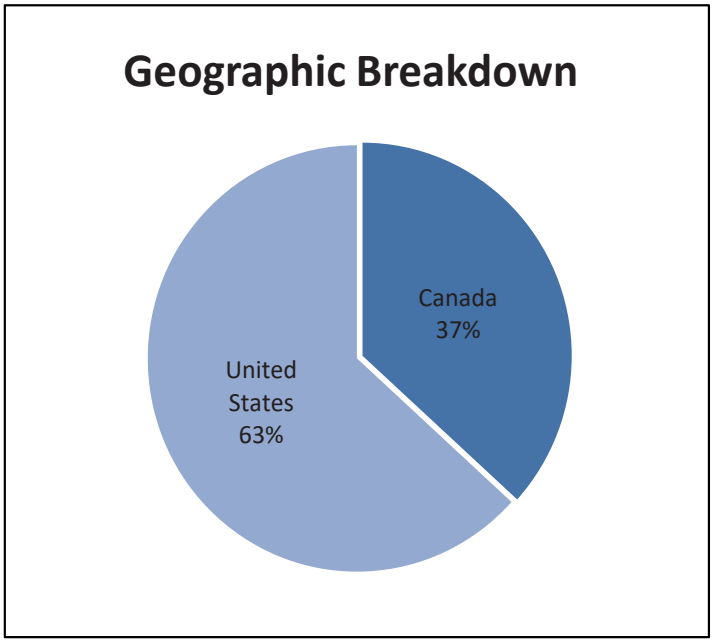
INVEST YOUR MONEY
WHERE WE INVEST OURS

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
- Stingray Digital Group Inc.
- Uni-Select Inc.
- Alphabet Inc., Class A
- Microsoft Corp.
- MasterCard Inc., Class A
- Loblaw Companies Ltd.
- Becton, Dickinson and Co.
- Aetna Inc.
- Nike Inc.





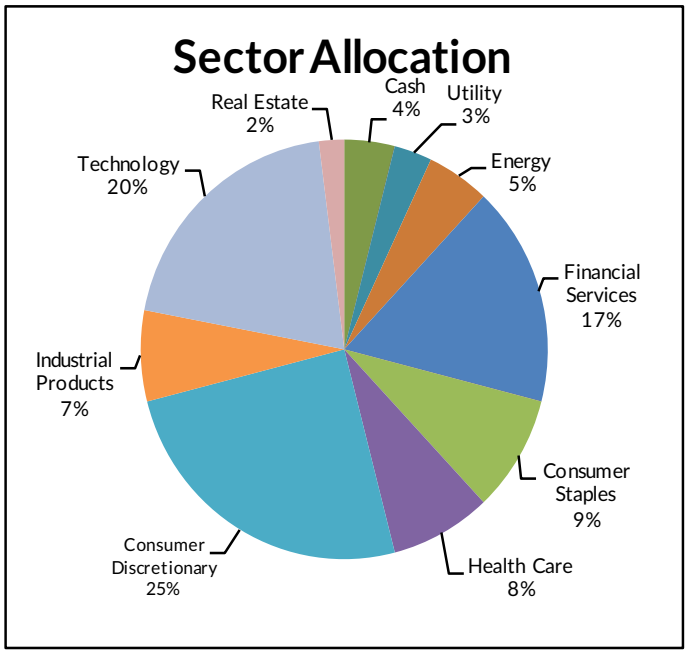
AMERICAN VALUE FUND

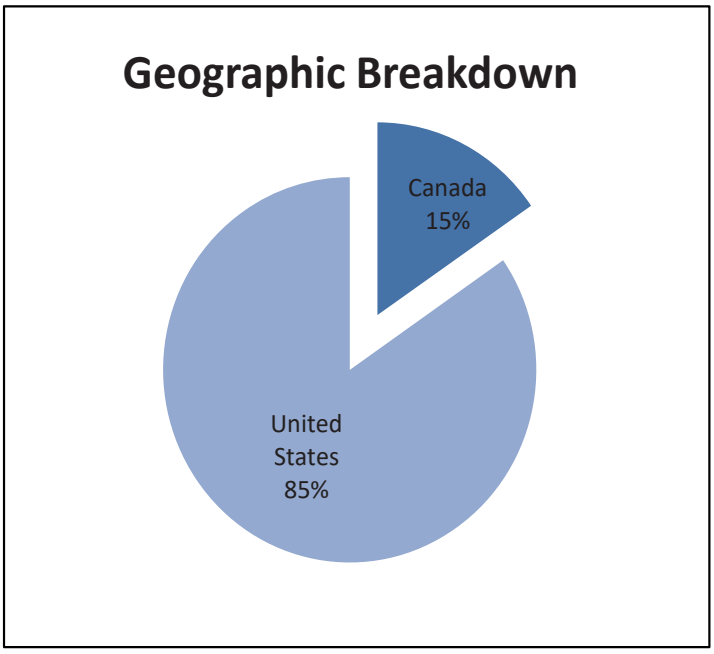
INVEST YOUR MONEY
WHERE WE INVEST OURS

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

- Broadcom Ltd.
- Alphabet Inc., Class A
- Microsoft Corp.
- O'Reilly Automotive Inc.
- Amazon.com Inc.
- Visa Inc., Class A
- NVIDIA Corp.
- Nike Inc.
- MasterCard Inc., Class A
- Apple Inc.





NORTH AMERICAN EQUITY FUND

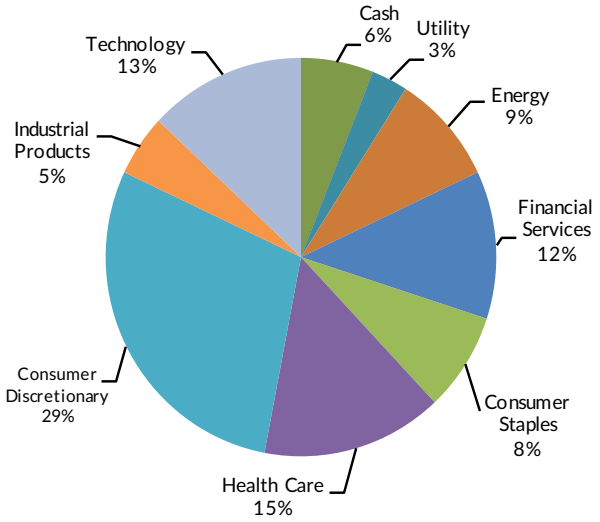
INVEST YOUR MONEY
WHERE WE INVEST OURS

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.

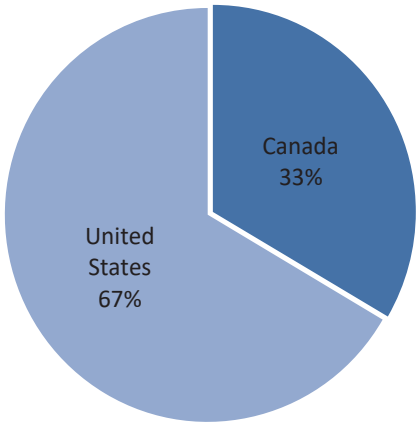
Top Ten Holdings

- Boston Scientific Corp.
- Amazon.com Inc.
- Stingray Digital Group Inc.
- Brunswick Corp.
- Visa Inc., Class A
- Uni-Select Inc.
- Becton, Dickinson and Co.
- Skyworks Solutions Inc.
- Loblaw Companies Ltd.
- Facebook Inc.

Sector Allocation



Geographic Breakdown



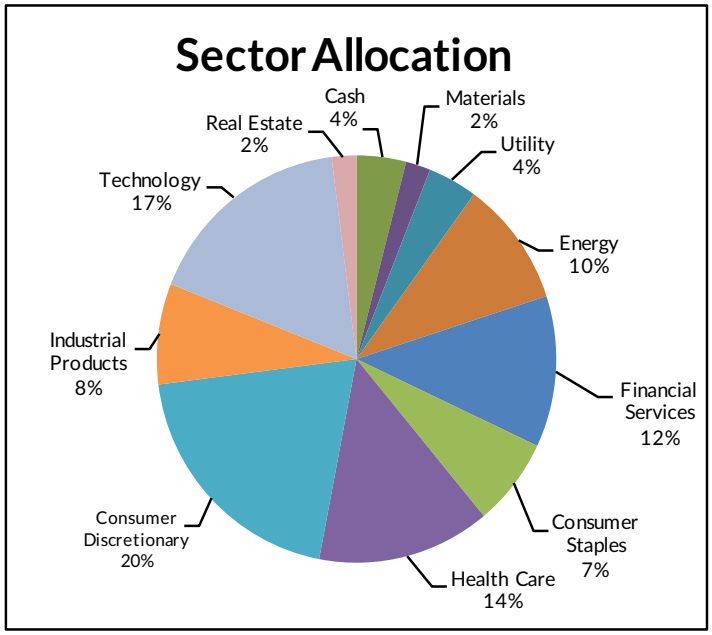
GLOBAL EQUITY FUND

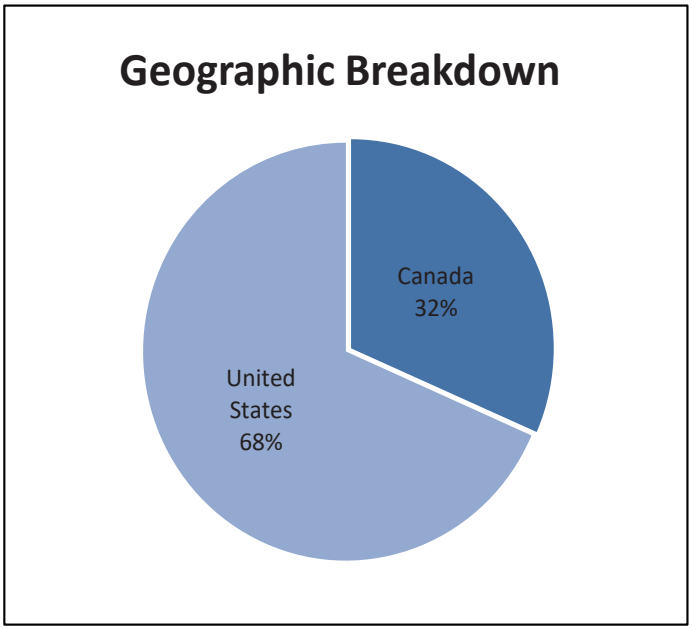
INVEST YOUR MONEY
WHERE WE INVEST OURS

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

- Exco Technologies Ltd.
- Broadcom Ltd.
- Adobe Systems Inc.
- Six Flags Entertainment Corp.
- MasterCard Inc., Class A
- Becton, Dickinson and Co.
- Aetna Inc.
- Boston Scientific Corp.
- Apple Inc.
- Alonquin Power & Utilities Corp.





ABCFunds™

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Unexpected Positive Company Performance

Over the past several weeks a number of Q3/2016 corporate earnings results have been announced. Given the gloomy global macro-economic, financial and political atmosphere where people have been fixated on the negatives of Brexit, CETA ratification, a turbulent U.S. presidential election campaign and the uncertain U.S. Federal Reserve interest rate policy, many investors have fully-expected the worst.

Interestingly, although there has been the odd company disappointment there have been a significant number of very positive corporate earnings and revenue surprises, which in any other macro circumstance would reinvigorate equities. The fact is that while the general trend of improving corporate results in today's tough economic environment, might not immediately gratify investors, it is, however, setting a positive path for future company results and common share outperformance.

The current murky macro setting has placed a cloud over many investors who have likely put off investment decisions temporarily. On the other hand, this skeptical outlook has likely forced businesses to become more innovative, cost-conscious and opportunistic. The resulting corporate proactivity has spawned attractive merger and acquisition purchases in a record low interest rate environment producing accretive business results. Furthermore, in a number of instances, these transactions have enabled successful public company financings such as Inter Pipeline Ltd., Suncor Energy Inc., and TransCanada Corp.

In summation, we offer the following comments:

- The importance of today's difficult financial environment is that it is providing well-managed/assertive companies with the opportunity to take advantage of a gloomy situation to achieve unexpected positive corporate results

- The current challenging business environment has led to reasonable cost-cutting and innovation to create positive company earnings surprises

- The global uncertainty offers numerous opportunistic and accretive merger and acquisition situations which not all companies are willing to undertake today. This circumstance provides excellent opportunities for enterprising business innovators

- Although unexpected positive company performance may not be immediately recognized in a difficult securities market, it does set the stage for continued outperformance and future share price appreciation.

Irwin Michael, CFA

Administrative Information

- There are units of the ABC North American Equity Fund & ABC Global Equity Fund available for purchase. Contact our office for more information.

- Purchase requests must reach our office by the last business day of the month and redemption requests (for our open funds) must reach our office no later than ten business days before the last business day of the month.

- Clients that are invested in our closed-end funds are able to redeem their reinvested distribution units on a monthly basis. **Also, you can participate in the annual 10% redemption right if you provide the completed form by November 30 for a December 30 transaction date.** If you need assistance with either of these options, please do not hesitate to contact our office.

- All cheques are to be made payable to RBC Investor Services.

- All client requests are to be directed to ABC Funds.

- We continue to request that clients assist in updating their "Know Your Client" forms. This information is a regulatory requirement to assess the suitability of our various ABC Funds to individual client's needs.

- RBCITS is the custodian of the ABC Funds and is responsible for providing account statements to all our clients. We ask that you retain these statements for your records as there may be additional costs for retrieving historical data.

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18 King Street East, Suite 1010 Toronto, Ontario M5C 1C4 Telephone: (416)365-9696 Toll Free: 1-888-OPEN ABC Fax: (416)365-9705
Web site: www.abcfunds.com Email: info@abcfunds.com