

January 29, 2018

Western Pension Plans Annual Investment Commentary (2017)

The following commentary was prepared by Western University on behalf of the Joint Pension Board for the year-ended December 31, 2017. A full description of the investment options, along with performance history, is available to members within their Sun Life Plan Member account. Members may log in at sunlife.ca/western.

Market Summary

Following a volatile 2016, 2017 turned out to be calmer, with fewer major geopolitical events. However, escalating tensions between the U.S. and North Korea and turmoil in oil producing countries had an impact on the price of oil. Fortunately, the election of a pro-European President in France and the re-election of Angela Merkel in Germany eased some of the political tensions.

On a backdrop of positive economic outlook, strong employment and signs of inflation, central banks around the world have started the process of removing monetary accommodation and reducing their balance sheet, which will translate into higher interest rates. In the U.S. the Federal Reserve raised its key rates by 25 basis points on three occasions: March 15, June 14 and December 13. In Canada, the Bank of Canada raised its key interest rate by 25 basis points twice, on July 12 and September 6, its first increases in nearly seven years.

Equity markets around the world reacted positively to the strong economic outlook and interest rate increases. Most markets posted very strong returns, led by Emerging Markets, which achieved a 28.70% return in 2017, as measured by MSCI Emerging Markets Index. U.S. and international markets (non-North American) also posted good returns. The S&P 500 Index posted a 21.83% total return in local currency, which translated into 13.83% in Canadian dollars, due to the appreciation of the loonie. Non-North American Equity markets rebounded spectacularly in 2017, after a dismal -2.00% return in 2016, with a 17.36% return. After a slow start, Canadian equities finished the year strong and posted a respectable 9.10% total return for the year. The environment was more favourable to active managers, with almost every investment manager on the Western Plans outperforming their benchmark. Unfortunately, as a result of these very strong returns, equity markets have become more expensive and future returns should be more muted. The Shiller cyclically adjusted price-to-earnings ratio (CAPE), a frequently quoted measure of stock market valuation, was at 33.19 at the beginning of 2018, well above its historical median of 16.16 and higher than the level reached prior to the 1929 stock market crash. The only time in history it has been higher was prior to the bursting of the tech bubble in 2000, an indicator that assets may be over-valued.

Despite the trend toward interest rate normalization from interest rate hikes by the U.S. and Canadian central banks, fixed income markets fared relatively well. The FTSE TMX Canada Universe Bond Index, the main measure of the Canadian bond market, posted a return of 2.52%. The FTSE Long Term Bond Index did even better, with a 7.03% return. In the U.S. we have started to see a flattening of the yield curve (a flattening of the yield curve occurs when the difference between long term and short term bond yields decreases), as yields on 2-year U.S. Treasuries increased by close to 70 basis points, while yields on 10-year Treasuries went down roughly four basis points. An inverted yield curve is generally a precursor of a recession, although the curve is not inverted at this time. Regarding money market rates, we are starting to see a turnaround, as central banks are raising their key interest rate. The FTSE 91-Day T-Bill returned 0.56% in 2017. With the Bank of Canada's key rate at 1.00% and 3-month Bankers' Acceptance rates at 1.48% at the end of 2017, money market rates should improve in 2018.

A summary of market performance by asset class follows:

Annualized returns for the periods ending December 31, 2017

Market index	1 year return	3 year return	5 year return
Cash/Money Market Funds			
FTSE TMX 91-Day T-Bill	0.56%	0.57%	0.72%
Bonds			
FTSE TMX Universe Bond	2.52%	2.56%	3.01%
FTSE TMX Long Term Bond	7.03%	4.42%	4.65%
FTSE TMX Short Term Bond	0.08%	1.23%	1.70%
BC Global Aggregate Bonds - Hedged	2.60%	2.64%	3.39%
Equities			
S&P/TSX Composite	9.10%	6.59%	8.63%
S&P 500 - Unhedged	13.83%	14.37%	21.24%
S&P 500 - Hedged	21.16%	10.85%	15.73%
MSCI ACWI SMID	16.50%	13.61%	17.53%
MSCI EAFE	17.36%	11.17%	13.48%
MSCI ACWI	16.44%	12.81%	16.63%
Canadian versus U.S. Dollar	5.14%	-3.15%	-4.87%

What's New

After the successful transition of custody and recordkeeping of assets to Sun Life Financial in 2016, 2017 was a quieter year for the pension plans in terms manager changes.

In March 2017, the Joint Pension Board altered the Canadian equity mandate which is offered on a standalone basis and forms part of the Diversified Equity Fund. Greystone Managed Investments was terminated and the investment in Connor, Clark & Lunn Investments' (CC&L) Canadian Q Core strategy was repositioned to its Canadian Q Growth strategy. The Greystone assets were split equally between the existing Canadian equity strategy managed by Beutel Goodman & Company and the newly implemented CC&L Canadian Q Growth strategy.

In June 2017, a fixed income strategy managed by AB (formerly AllianceBernstein) which accounts for about 38% of the Diversified Bond Fund was transferred to another strategy, also managed by AB. The latter fund is expected to generate higher returns by allocating more to non-Canadian bonds, corporate bonds, high yield bonds and emerging markets debt, without significantly increasing the risk of the portfolio. Given the low return environment we are experiencing, the Joint Pension Board felt it was a reasonable approach.

A summary of the assets by fund and manager follows:

Investment Fund Management Summary as at December 31, 2017

Investment fund	Funds managed (\$millions)	% of fund	% of total assets	Fund asset class	Manager style
MONEY MARKET FUND					
Sun Life Global Investments (Canada)	\$53.3	100.0%	4.4%	cash	active
TARGET DATE FUNDS					
State Street Global Advisors	\$12.9	100.0%	1.1%	domestic bonds	active-duration constrained
DIVERSIFIED BOND FUND					
Romspen Investment Corporation	\$37.1	12.1%	3.1%	commercial mortgages	active
BlackRock Asset Management Canada	\$79.2	25.8%	6.6%	domestic bonds	passive
AB (AllianceBernstein)	\$114.0	37.2%	9.5%	domestic bonds	active
AB (AllianceBernstein)	\$76.2	24.9%	6.3%	foreign bonds	active
	<u>\$306.4</u>	<u>100.0%</u>	<u>25.5%</u>		
CANADIAN BOND FUND					
BlackRock Asset Management Canada	\$13.6	100.0%	1.1%	domestic bonds	passive
LONG TERM BOND FUND					
BlackRock Asset Management Canada	\$14.4	100.0%	1.2%	domestic bonds	passive
SOCIALLY RESPONSIBLE EQUITY FUND					
MFS Investment Management	\$8.7	100.0%	0.7%	global equity	active-value
DIVERSIFIED EQUITY FUND					
Connor Clark & Lunn Financial Group	\$95.6	15.2%	7.9%	domestic equity	active-growth
Beutel, Goodman & Company	\$94.9	15.1%	7.9%	domestic equity	active-value
State Street Global Advisors	\$64.3	10.2%	5.4%	US equity large-cap (hedged)	passive
State Street Global Advisors	\$63.6	10.1%	5.3%	US equity low volatility	passive - managed volatility
Franklin Templeton Investments	\$31.2	5.0%	2.6%	global small-cap equity	active-value
T.Rowe Price	\$75.4	12.0%	6.3%	global equity	active-growth
Harris Associates	\$73.5	11.7%	6.1%	global equity	active-value
MFS Investment Management	\$50.1	8.0%	4.2%	international equity	active-growth
AB (AllianceBernstein)	\$50.3	8.0%	4.2%	international equity	active-value
William Blair & Company	\$31.2	5.0%	2.6%	emerging markets equity	active-growth
	<u>\$630.1</u>	<u>100.0%</u>	<u>52.4%</u>		
CANADIAN EQUITY FUND					
Connor Clark & Lunn Financial Group	\$33.4	50.2%	2.8%	domestic equity	active-growth
Beutel, Goodman & Company	\$33.2	49.8%	2.8%	domestic equity	active-value
	<u>\$66.6</u>	<u>100.0%</u>	<u>5.5%</u>		
US EQUITY HEDGED FUND					
State Street Global Advisors	\$32.1	100.0%	2.7%	US equity (hedged)	passive
US EQUITY UNHEDGED FUND					
BlackRock Asset Management Canada	\$35.6	100.0%	3.0%	US equity	passive
NON-NORTH AMERICAN FUND					
MFS Investment Management	\$14.46	49.9%	1.2%	international equity	active-growth
AllianceBernstein	\$14.52	50.1%	1.2%	international equity	active-value
	<u>\$29.0</u>	<u>100.0%</u>	<u>2.4%</u>		
CASH IN PLAN ACCOUNTS					
	<u>\$0.0</u>	<u>n/a</u>	<u>0.0%</u>		
TOTAL PENSION					
	<u>\$1,202.8</u>	<u>100.0%</u>	<u>100.0%</u>		
BALANCE INCOME & GROWTH FUNDS**					
	\$316.9				

OVERALL PLAN ASSET MIX

Cash	5.1%
Bonds	28.2%
Equities	66.7%

**These assets are included in the Diversified Bond Fund and the Diversified Equity Fund totals.