January 28, 2022

Western Pension Plans Annual Investment Commentary (2021)

The following commentary was prepared by Western University on behalf of the Joint Pension Board for the year-ended December 31, 2021. 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 mysunlife.ca/western.

Market Summary
On several fronts, 2021 turned out to be as anticipated with strong economic recovery (GDP growth projected to be around 5.6% in the U.S. and 4.5% in Canada for 2021 – Source: BMO), improving labour market and upward pressure on bond yields. However, a number of stories didn't pan out as well, as we are still deep into the pandemic and inflation rates are reaching levels not seen in forty years.

The key question about inflation earlier in the year was whether it will be transitory or persistent. With the most recent inflation data showing a 7.0% annual increase in the U.S. and 4.8% in Canada as of December 31, there seems to be a consensus that it will be persistent.

Despite this volatile environment, equity markets generally reacted positively in 2021, buoyed by the economic recovery, as well as fiscal and monetary stimulus. Again in 2021, the U.S. led the way, with the S&P 500 returning 28.71% in U.S. dollars, slightly above the return in Canadian dollars of 27.61%, as the Canadian dollar appreciated against the U.S. dollar during the year. The Canadian stock market also did very well in 2021, posting a 25.09% return, as the economic recovery was beneficial for the Energy and Financials sectors, two of the largest sectors in the S&P/TSX. Performance was more modest elsewhere. Non-North American equity markets returned 10.32%, as measured by MSCI EAFE Index (Net). Emerging Markets struggled, posting a -3.37%, as measured by the MSCI Emerging Markets Index (Net). China's regulatory crackdown on some industries was a major headwind. Latin American and Far East regions also detracted.

Investment style was still a factor in 2021, although not nearly as much as in 2020. Value stocks (companies that are considered to be undervalued based on some metrics such as price-to-earnings ratio) had a very strong start of the year, as those types of companies were generally expected to benefit more from a reopening of the economy. However, the gap narrowed during the second half of the year due to setbacks to the recovery caused by spikes in COVID cases. In the U.S., growth stocks (companies that experience significant growth in revenues and earnings), slightly outperformed value stocks by about 1% for the year. However, in Canada value stocks outperformed growth stocks by about 21% (as measured by the return differential between the MSCI Canada Value Index and the MSCI Growth Index), as the strong performance of the Energy and Financials sectors, two sectors generally populated mostly by value stocks, had a major impact. The six equity options offered to members of the Western Pension Plans performed extremely well in this environment, returning between 13.77% and 28.06%, after all fees and management expenses taken into account.

As the market anticipated, bond yields went up in 2021. In Canada, the yield on 10-year bonds increased from 0.67% to 1.42%, while in the U.S. it went from 0.92% to 1.51%. As a result, fixed income returns were weak in 2021. The FTSE Canada Universe Bond Index, the main measure of the Canadian market, posted a return of -2.53% in 2021. Diversifying into corporate bonds and non-traditional fixed income securities was beneficial during the year as the Diversified Bond Fund returned -0.49%. Interest rate changes have a greater impact on bonds with a longer duration and as such, the FTSE TMX Long-Term Bond Index returned -4.61% last year. As the Bank of Canada left its policy rate at 0.25% for the entire year, the return on 91-Day T-Bills was nominal, with the FTSE 91-Day T-Bills Index returning 0.20% in 2021, compared to 0.86% in 2020. With the recent uptick in inflation, expectations are now that central banks will raise their policy rate much sooner than previously anticipated, maybe as soon at this spring. While these increases may hurt equity and fixed income returns, they will be positive for future money market returns.

Last year's commentary highlighted the benefits of building a diversified and resilient portfolio to navigate the current markets. This is still relevant. This posture allowed the investment options on the Western Pension Plans to mitigate the impact of poor returns posted by some segments of the market. The Western Pension Plans will remain well diversified by investment style, sector, geography and size. In addition, external managers that actively manage a segment of the Pension Plans will maintain the flexibility to position their portfolio where their research indicate they can find value for their investors. This approach should be well suited for anyone with a long-term investment horizon.

A summary of market performance by asset class follows:

Annualized returns (in Canadian dollars) for the periods ending December 31, 2021

Market index	1 year return	3 year return	5 year return
Cash/Money Market Funds			
FTSE TMX 91-Day T-Bill	0.17%	0.88%	0.91%
Bonds			
FTSE TMX Universe Bond	-2.53%	4.23%	3.32%
FTSE TMX Long Term Bond	-4.53%	6.39%	5.27%
FTSE TMX Short Term Bond	-0.93%	2.45%	1.87%
BC Global Aggregate Bonds - Hedged	-1.38%	3.72%	2.95%
Equities			
S&P/TSX Composite	25.09%	17.52%	10.05%
S&P 500 - Unhedged	27.61%	22.82%	17.06%
S&P 500 - Hedged	28.29%	24.49%	17.13%
MSCI ACWI SMID	15.25%	15.95%	11.19%
MSCI EAFE	10.32%	10.62%	8.25%
MSCI ACWI	17.53%	17.29%	13.04%
MSCI Emerging Markets	-3.37%	8.09%	8.57%
Canadian versus U.S. Dollar	0.41%	2.28%	1.15%

Responsible Investing Update

This year's commentary includes for the first time a responsible investing update. Although it is the first official update on responsible investing to plan members, the Joint Pension Board has been active on the subject for a significant amount of time. The Joint Pension Board included language about environment, social and governance (ESG) factors in the plans Statement of Investment Policies and Procedures beginning in 2007. In 2008, a socially responsible investment option was added to the investment lineup. A questionnaire on ESG practices was sent to all external managers in 2014 and a discussion about ESG factors and responsible investing was added to all manager review meetings beginning in 2016. In 2021, the Joint Pension Board totally revamped its ESG questionnaire to reflect best practices in the industry by introducing more quantitative measures to facilitate manager engagement and by expanding the questioning in areas like climate change and diversity, equity and inclusion. As of now, 12 of the 13 external managers on the Western Pension Plans are signatories of the Principles for Responsible Investment (PRI). The Joint Pension Board responded to engagement from members on climate change and sustainability and has renewed its focus in this area.

In 2021 Western Staff supporting the Joint Pension Board and the Board's investment consultant, Mercer, proceeded to measure the carbon footprint of the portfolio. Following the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), Western measured the following metrics[1] for the Western Pension Plans as of December 31, 2019 and as of December 31, 2020:

- Weighted-average carbon intensity (WACI)
- Carbon emissions per dollar invested
- Potential emissions from fossil fuel reserves

Those measurements are only the start of a discussion and will assist the Joint Pension Board in monitoring and identifying:

- Carbon emissions hot-spots and potential climate risks
- Exposure and holdings that merit further engagement with external managers
- A baseline from which to track future progress and report to stakeholders

The metrics are complex and the Joint Pension Board is evaluating how to responsibly share them with plan members, ensuring the information is relevant, complete, balanced, clear, and understandable. At this time, we are able to share the following general comments and will prepare to share more detail at the Annual Member Update Meetings in spring 2022.

Overall, most actively managed investment options have carbon footprint metrics that are generally more attractive than their benchmark, while index funds are in line with their benchmark as expected. Other findings include:

- As expected, given the large weight of the Energy sector in the Canadian stock market, the Canadian Equity Fund has the highest exposure to carbon-intensive companies (as measured by the WACI), while the Non-North American Equity Fund has the lowest
- Furthermore, the Canadian Equity Fund has the highest exposure to companies owning fossil fuel reserves, while the Socially Responsible Equity Fund has the lowest
- Top emitters across all funds were exclusively within Utilities, Materials, Industrials and Energy sectors

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[1] For more information on the calculation of those metrics, please consult the document *Implementing the Recommendations of the Task Force on Climate-Related Financial Disclosures*, pp. 43-44.

- All public equity funds had significantly lower carbon footprint metrics compared to 2019, while the Diversified Bond Fund has higher carbon footprint compared to 2019

The analysis of these results will shape the Joint Pension Board future initiatives, notably regarding engagement with external managers.

What's New

A few changes were implemented in 2021 as a result of the review of the Diversified Equity Fund. At a high level, the changes involve shifting the management of the portfolio to a more global approach through the following decisions:

- An overall shift to managers with global mandates
- A reduction in the "home country bias" by reducing the fixed allocation to Canadian equity
- The removal of currency hedging on the U.S. equity allocation
- Increased exposure to Emerging Markets
- Increased active management

More specifically, the following changes were made:
In January 2021, the Fiera Oakmark Global Canada Pooled Fund, the BlackRock CDN MSCI ACWI ex-Canada Index Fund and the Fidelity Global Low Volatility Strategy were added to the Diversified Equity Fund. The SSgA (Windwise) U.S. Managed Volatility Fund and the Oakmark Global Equity Limited Partnership were removed. The currency hedging on the strategy indexed to the S&P 500 was removed gradually throughout the year and the management of that strategy was transferred from State Street Global Advisors to BlackRock. Finally, in November 2021, CC&L was appointed to manage an Emerging Markets Equity strategy.

For more details concerning those changes, please consult
https://www.uwo.ca/hr/form_doc/pension/doc/investment/def2021.pdf

A summary of the assets by fund and manager follows:

Western Pension Plan as at December 31, 2021

Investment fund	Funds managed ($millions)	% of fund	% of total assets	Fund asset class	Manager style
MONEY MARKET FUND					
Sun Life Global Investments (Canada)	$51.5	100.0%	3.7%	cash	active
SUN LIFE GDIA					
Sun Life Global Investments (Canada)	$11.9	100.0%	0.8%	cash	n/a
DIVERSIFIED BOND FUND					
Romspen Investment Corporation	$47.5	14.3%	3.4%	commercial mortgages	active
BlackRock Asset Management Canada	$83.6	25.3%	6.0%	domestic bonds	passive
AB (AllianceBernstein)	$199.9	60.4%	14.3%	domestic and foreign bonds	active
	$331.0	100.0%	23.7%		
CANADIAN BOND FUND					
BlackRock Asset Management Canada	$16.5	100.0%	1.2%	domestic bonds	passive
LONG TERM BOND FUND					
BlackRock Asset Management Canada	$17.8	100.0%	1.3%	domestic bonds	passive
SOCIALLY RESPONSIBLE EQUITY FUND					
MFS Investment Management	$23.9	100.0%	1.7%	global equity	active-value
DIVERSIFIED EQUITY FUND					
Connor Clark & Lunn Financial Group	$75.2	10.2%	5.4%	domestic equity	active-growth
Beutel, Goodman & Company	$74.5	10.1%	5.3%	domestic equity	active-value
BlackRock Asset Management Canada	$73.4	9.9%	5.3%	ACWI-ex Canada	passive
BlackRock Asset Management Canada	$73.6	10.0%	5.3%	US equity	passive - managed volatility
Arrowstreet Capital Global Small Cap	$37.1	5.0%	2.7%	global small-mid cap equity	active-core
T.Rowe Price	$92.1	12.5%	6.6%	global equity	active-growth
Fiera Capital Oakmark	$92.4	12.5%	6.6%	global equity	active-value
Fidelity Investments	$72.9	9.9%	5.2%	global equity	low volatility
MFS Investment Management	$36.7	5.0%	2.6%	international equity	active-growth
AB (AllianceBernstein)	$37.0	5.0%	2.6%	international equity	active-value
William Blair & Company	$37.1	5.0%	2.7%	emerging markets equity	active-growth
Connor Clark & Lunn Financial Group	$36.7	5.0%	2.6%	emerging markets equity	active-core
	$738.6	100.0%	52.9%		
CANADIAN EQUITY FUND					
Connor Clark & Lunn Financial Group	$40.2	50.2%	2.9%	domestic equity	active-growth
Beutel, Goodman & Company	$39.8	49.8%	2.8%	domestic equity	active-value
	$80.0	100.0%	5.7%		
US EQUITY HEDGED FUND					
State Street Global Advisors	$53.1	100.0%	3.8%	US equity (hedged)	passive
US EQUITY UNHEDGED FUND					
BlackRock Asset Management Canada	$42.4	100.0%	3.0%	US equity	passive
NON-NORTH AMERICAN FUND					
MFS Investment Management	$15.12	49.8%	1.1%	international equity	active-growth
AB (AllianceBernstein)	$15.22	50.2%	1.1%	international equity	active-value
	$30.3	100.0%	2.2%		
TOTAL PENSION	$1,397.1	100.0%	100.0%		
BALANCE INCOME FUND** (70% DBF + 30% DEF)	$69.2		5.0%		
BALANCE GROWTH FUND** (70% DEF + 30% DBF)	$393.6		28.2%		

OVERALL PLAN ASSET MIX	
Cash	4.5%
Bonds & Mortgages	26.1%
Equities	69.3%

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