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# **Western Pension Plans Academic and Administrative Staff Pension Boards**

## **Annual Member Investment Update for 2020**

**May 2021**

# Disclaimer

This presentation material was created to educate and update members of the Western Pension Plans.

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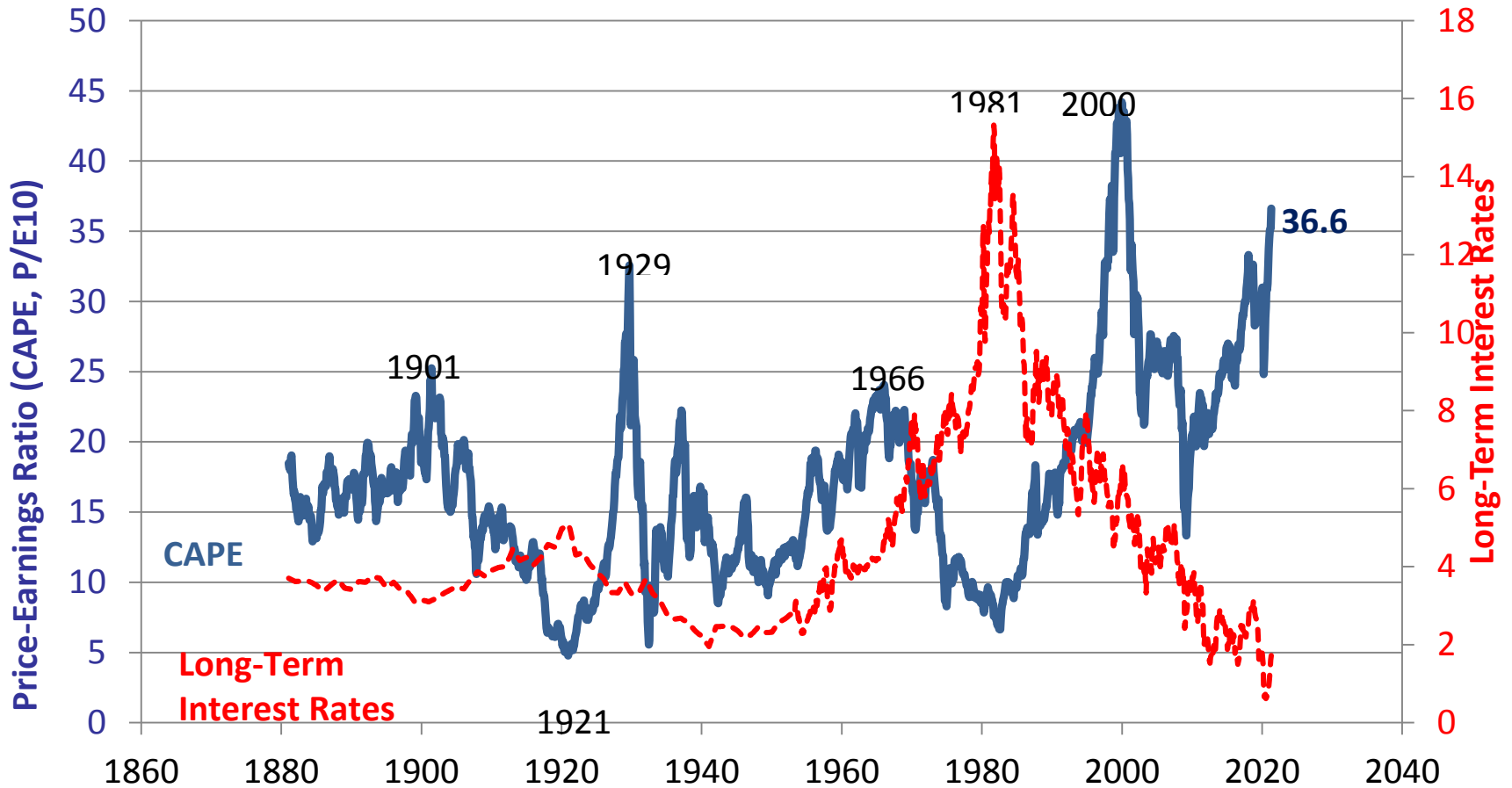
# Agenda

- Market Environment
- Diversified Equity Fund
- Diversified Bond Fund
- Rest of platform
- Inflation
- Interest rates

# 2020 Market Environment

- Positive returns for most asset classes in 2020
- Uneven year, with large stock market declines in February-March followed by a significant rebound due large fiscal and monetary stimulus
  - The S&P 500 dropped by 35% between February 19 and March 23 and ended the year with an 18.40% return in local currency
  - The S&P/TSX dropped by 37% between February 19 and March 23 and ended the year up by 5.60%
- Significant divergence in returns between value and growth stocks
  - Growth stocks outperformed value stocks by 35% in the U.S.
  - Value stocks started to rebound in November with positive news around vaccines
- Strong fixed income returns because of interest rate declines
  - FTSE Canada Universe Bond Index returned 8.68% in 2020
- Money market securities yielding next to nothing
- Historically high stock market valuations
  - Cyclically-Adjusted Price-to Earnings or CAPE ratio in the U.S. just reached 36.6, its highest level since the tech bubble
- Economies reopening
  - GDP Growth forecasts for 2021 of 6.3% for World, 6.5% for U.S. and 6.0% for Canada, according to Capital Economics
- Inflation?

# Historical Stock Market Valuations



Source: Robert Shiller

# Strong Absolute Returns in 2020

Asset Class	Investment Fund	2020
<b>Balanced Portfolios</b>	Balanced Growth	10.06%
	Balanced Income	7.45%
<b>Equity</b>	Diversified Equity	11.81%
	Canadian Equity	5.10%
	Non-North American Equity	4.03%
	US Equity-Hedged	15.58%
	US Equity-Unhedged	16.24%
	Socially Responsible Global Equity	14.37%
<b>Fixed Income and Cash</b>	Diversified Bond	5.30%
	Long Term Bond	11.62%
	Canadian Bond	8.49%
	Money Market	0.74%

# Diversified Equity Fund

## 2020 Attribution Analysis

Fund	Weight	Fund Return	Benchmark Return	Contribution to Return
Diversified Equity Fund - Benchmark		11.81%	11.36%	11.36%
WindWise U.S. Managed Volatility	10%	-3.95%	18.76%	-2.27%
AB Canada International Value Equity	8%	0.06%	6.38%	-0.51%
Oakmark Global Equity LP	12%	10.64%	14.78%	-0.50%
Beutel Goodman Fundamental Canadian Equity	15%	2.53%	5.60%	-0.46%
Investment Management Fees				-0.39%
Oakmark one-month lag				-0.07%
S&P 500 Benchmark (Hedged to C\$)	10%	15.76%	15.76%	0.00%
MFS International Equity II	8%	9.44%	6.38%	0.24%
CC&L Canadian Equity Q Growth	15%	8.06%	5.60%	0.37%
William Blair Emerging Markets Leaders	5%	26.39%	16.23%	0.51%
Arrowstreet Capital LP Global Small Cap I	5%	27.59%	14.29%	0.67%
T. Rowe Price Global Equity	12%	41.58%	14.78%	3.22%
Rebalancing / other				-0.36%
Diversified Equity Fund				11.81%



# Diversified Bond Fund

## 2020 Attribution Analysis

Fund	Weight	Fund Return	Benchmark Return	Contribution to Return
Diversified Bond Fund - Benchmark		5.49%	7.91%	7.91%
AB Canada Core Plus Advanced Bond	38.1%	4.19%	8.68%	-1.71%
AB Global Plus	26.5%	4.92%	5.33%	-0.11%
BlackRock Canada Universe Bond	25.4%	8.59%	8.68%	-0.02%
Romspen Mortgage Investment Fund	10.0%	5.42%	5.29%	0.01%
Investment management fees				-0.29%
Benchmark difference / rebalancing / other				-0.30%
Diversified Bond Fund				5.49%

# 2020 Performance

## Balanced Funds

	2020 Returns
Balanced Income Fund	7.45%
<i>Benchmark</i>	9.33%
Value added	-1.89%
Balanced Growth Fund	10.06%
Benchmark	10.72%
<i>Value added</i>	-0.66%

# 2020 Performance - Other Funds

<b>FIXED INCOME &amp; CASH</b>	<b>2020</b>
<b>Money Market Fund</b>	0.74%
<b>FTSE 91-Day T-Bills</b>	0.86%
<b>Value added</b>	-0.12%
<b>Canadian Bond Fund</b>	8.49%
<b>FTSE Universe Bond</b>	8.68%
<b>Value added</b>	-0.19%
<b>Long Term Bond Fund</b>	11.62%
<b>FTSE Long-Term Bond</b>	11.90%
<b>Value added</b>	-0.28%

<b>EQUITIES:</b>	<b>2020</b>
<b>Socially Responsible Equity Fund</b>	14.37%
<b>MSCI ACWI</b>	14.77%
<b>Value added</b>	-0.40%
<b>Canadian Equity Fund</b>	5.10%
<b>S&amp;P/TSX</b>	5.60%
<b>Value added</b>	-0.50%
<b>US Equity Hedged Fund</b>	15.58%
<b>S&amp;P 500 Hedged</b>	15.79%
<b>Value added</b>	-0.21%
<b>US Equity Unhedged Fund</b>	16.24%
<b>S&amp;P 500 Unhedged</b>	16.32%
<b>Value added</b>	-0.08%
<b>Non-North American Equity Fund</b>	4.03%
<b>MSCI EAFE</b>	6.38%
<b>Value added</b>	-2.35%

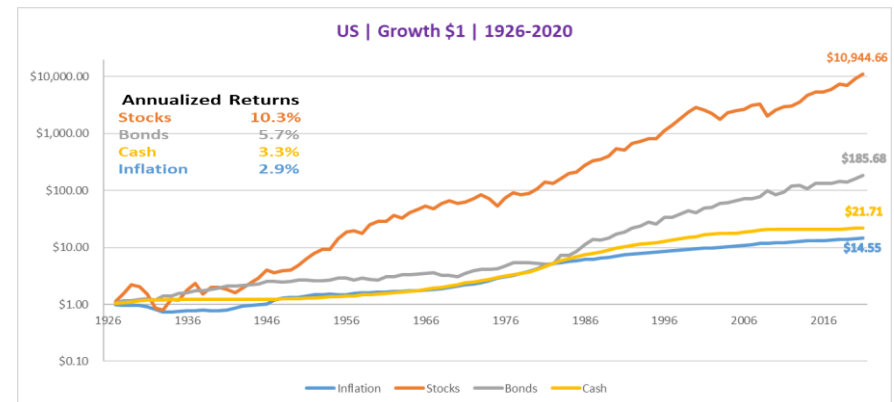
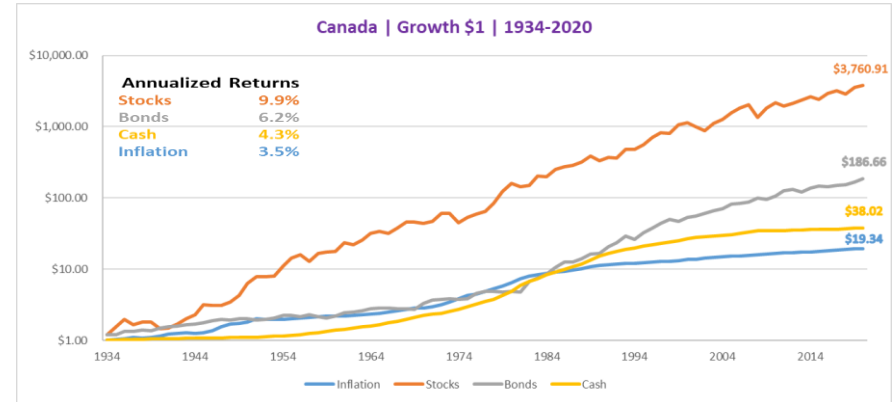
# Inflation?

- Inflation is a rise in the overall price level of goods and services in the economy.
- Concerns that large fiscal and monetary stimulus may cause inflation rates to increase
- Inflation increase transitory in some markets and due to rebound in energy, tax changes and supply shortages (Europe)
- May persist in other markets (U.S.) due to large stimulus
- Relatively stronger banking sector, lower household debt and deglobalization more likely to produce inflation than policies implemented after GFC
- Federal Reserve moved from a 2% inflation target to targeting an average of 2% over time
- Some consensus among economists is that inflation is about to rebound, but still remain low by historical standards

# Dealing with Inflation

- Members' decisions
  - Choose investments expected to outpace inflation
  - Stocks, bonds and cash have all outperformed inflation since 1934 in Canada and 1926 in the U.S
  - Unlikely for bonds and cash to produce positive real returns if inflation were to spike
  - Stocks tend to outpace inflation in the long run, but could be negatively impacted by inflation over the short to medium term

Yields as of April 15, 2021		
	Canada	U.S.
91-Day T-Bills	0.09%	0.02%
10-Yr Bonds	1.45%	1.57%
30-Yr Bonds	1.89%	2.26%



Source: Bank of Canada, Morningstar, Canadian Institute of Actuaries

# Dealing with Inflation

- Managers' decisions
  - Adjust sector exposure

Sector Performance During Periods of Rising CPI Inflation		
S&P 500 Sector	% Cases Outperforming	Median Return
Energy	77.8%	13.9%
Communication Services	66.7%	9.5%
Health Care	55.6%	3.3%
Consumer Staples	55.6%	7.7%
Information Technology	44.4%	-4.4%
Industrials	44.4%	10.5%
Materials	44.4%	6.4%
Consumer Discretionary	33.3%	12.5%
Utilities	33.3%	5.7%
Financials	22.2%	-9.0%
S&P 500	N/A	9.8%
Source: Ned Davis Research		

# Dealing with Inflation

- Cash
- Real return bonds (TIPS)
- Commodities
- Gold
- Floating-rate notes

## Inflation (+)

- Real estate
- Infrastructure
- Value and cyclical equities
- Real return bonds (TIPS)
- Commodities
- Gold
- Floating-rate notes

## Economic Growth (-)

- Cash
- Government bonds
- High quality corporate bonds

## Economic Growth (+)

- Developed markets equities
- Developed markets corporate bonds

## Inflation (-)

# Dealing with Rising Interest Rates

- Bonds are negatively impacted when interest rates go up.
- Stocks are also typically negatively impacted when rates go up, but the relationship is not as straightforward.
  - More expensive to borrow: consumers have less disposable income to spend and companies pay more in interest expenses, which both contribute to negatively impact earnings.
  - Higher interest rates increase the level of the discount rate used to value companies. Sectors where profits are expected to be realized later in the future, such as information technology are more negatively impacted by an increase in interest rates.
  - If interest rate increases are a signal that Central Banks are about to put the breaks on the economy, it is a negative news.
  - If an increase in interest rates is perceived as an improvement in market expectations, equities will tend to go up.
  - Level of interest rates, in addition to direction, matters

Mitigating Solutions		
Members	Managers	Outside of Pension Plans
Reduce fixed income allocation	Overweight Financials (tend to do better when interest rates increase)	Create a deposit laddering strategy.
Reduce the duration of the portfolio (Cash < Canadian or Diversified Bond < Long-Term Bond)	Overweight corporate bonds (would benefit from credit spreads tightening) and add a global bond component.	
	Overweight value stocks	



# Thank You

- If you have questions about pension plan investments, please email [mbelang7@uwo.ca](mailto:mbelang7@uwo.ca)