

MFS Investment Management

Investment Manager Review

January 12, 2012

EXECUTIVE SUMMARY

- On January 12, 2012 Martin Bélanger met with the following MFS Investment Management professionals from 2:00 p.m. to 5:00 p.m. at their Boston office:
 - Sarah Donohue, Director, Relationship Management
 - Christopher Callahan, Senior Managing Director, North American Sales and Relationship Management
 - Michael Cantara, Institutional Portfolio Manager
 - Marcus Smith, Portfolio Manager
 - Erik Weisman, Fixed Income Portfolio Manager
 - Kevin Conn, Equity Research Analyst
 - Paul Skinner, Director of Global Equity Trading
 - Robert Flaherty, Vice President, Compliance
 - Robert Emsing, Vice President, Senior Risk Manager
- Ranked “Hire” by Russell.
- MFS manages 10% (target weight) of the Operating & Endowment Fund.
- Western had \$45.7 million with MFS as of November 30, 2011 and annualized investment management fees are 0.71% at that asset level.
- MFS investment style is bottom-up, growth-at-a-reasonable-price (GARP)
- MFS was hired on August 1, 2007.
- The Operating & Endowment Fund invests in a pooled fund managed by MFS.
- There has been a significant change to MFS corporate structure over the past 12 months as they have merged with McLean Budden. This merger should have minimal impact on the portfolio managed for the Operating & Endowment Fund.
- The International equity mandate managed by MFS posted a return of -5.18% year-to-date as of November 30, 2011, outperforming the MSCI EAFE Index by 4.06%. Since inception in August 2007, the portfolio has provided 5.06% of value added, annualized.
- There have been no changes to the lead portfolio managers on our portfolio. Marcus Smith and Daniel Ling are still both co-portfolio managers.
- MFS’ investment process has not changed.
- MFS is a signatory of the United Nations Principles for Responsible Investment. They integrate ESG factors in their analysis, most specifically governance.
- The Trust has \$595 million in assets under management and is not closed to new business. All international equity mandates managed by MFS have been fully re-opened for new business, after having been subject to a soft close from April 2006 to July 2011.
- MFS doesn’t have any major compliance issues.

RECOMMENDATION

MFS continues to outperform its benchmark. The International Equity Fund has outperformed its benchmark by 4.06% year-to-date as of November 30, 2011 and by 5.06% since inception in August 2007. The firm has a disciplined investment process and strong global research platform. There have been no personnel changes on our mandate. Given the above and Russell's "Hire" recommendation, I don't recommend making any changes to our relationship with MFS.

ORGANIZATION

- MFS is majority owned by Sun Life Financial, Inc., a publicly traded company listed on the Toronto Stock Exchange and the New York Stock Exchange.
- MFS had \$215 billion in assets under management as of November 30, 2011.
- Approximately half of their clients are institutional and half are retail.
- Western had \$45.7 million with MFS as of November 30, 2011.
- On November 8, 2011 McLean Budden became a subsidiary of MFS. Previously, McLean Budden was majority owned by Sun Life Financial, like MFS, and operated independently. The merger will create synergies as MFS had few Canadian products while McLean Budden was strong on the Canadian side but weaker in Non-Canadian equity and fixed income products.
- The main change will be MFS' implementation of its portfolio management structure into the McLean Budden organization. MFS typically has two co-portfolio managers and one institutional portfolio manager on each mandate. Previously McLean Budden managed portfolios using a team approach.
- MFS had 193 investment professionals as of November 30, 2011.

MFS INSTITUTIONAL TRUSTS (CANADA) INTERNATIONAL EQUITY FUND

Performance Analysis (%)

	Periods Ending November 30, 2011						
	QTD	3-Month	6-Month	YTD	1-Year	3-Year	Since Inception
Western	5.38%	0.12%	-10.45%	-5.18%	-0.78%	7.13%	-3.06%
MSCI EAFE	1.79%	-1.86%	-12.44%	-9.24%	-5.08%	3.03%	-8.12%
Value added	3.59%	1.98%	1.99%	4.06%	4.30%	4.10%	5.06%

- The fund has 74 names (as of September 30, 2011).
- Their investable universe is comprised of 750 to 850 stocks rated by the non-U.S. analyst team.
- MFS posted a return of -5.18% for the first 11 months of 2011, compared to -9.24% for its benchmark, the MSCI EAFE Index, for 4.06% of value added.

- Overall, most of the outperformance of the portfolio over the first nine months of 2011 can be attributed to stock selection.
- The currency effect has subtracted 70 bps to performance over the period.
- Stock selection in basic materials and technology contributed positively to performance during the period.
- On an individual stock basis, Linde AG, a German industrial gases and engineering company, Diageo PLC, a U.K. based producer of alcoholic beverages and Lawson Inc., a Japanese convenience store chain, have added the most value.
- Stock selection in special products and services detracted from overall performance.
- On an individual stock basis, ICICI Bank Ltd, an Indian bank, Esprit Holdings, a Hong-Kong based apparel manufacturer and Randstad Holdings, a Netherlands based temporary employment company, negatively contributed to performance during the period.
- In terms of sector positioning, their most significant overweights are in Consumer Staples, Retailing and Technology, while their most significant underweights are in Utilities & Communications, Health Care and Energy.
- In terms of country positioning, the portfolio is currently overweight in Europe ex-U.K., but underweight in the U.K. They are underweight Japan and Asia/Pacific ex-Japan. As of November 30, 2011, there was a 10.8% allocation to emerging markets.
- Most of the European companies they invest in are global companies with revenues coming from all over the world. For example, 1/3 of Nestlé's revenues come from emerging markets. Typically, European companies generate a larger proportion of their revenues from emerging markets than U.S. companies. The portfolio is underweight banks in Europe.
- Their top holdings as of November 30, 2011 included Linde AG, a German industrial gases and engineering company, Heineken NV, a Netherlands-based beer company, Nestlé SA, a Swiss food and nutrition company, HSBC Holdings PLC, a British banking and financial services company and LVMH Moët Hennessy Louis Vuitton SA, a French apparels and accessories company.

Investment Personnel

- There have been no changes to the team managing Western's mandate.
 - Marcus Smith and Daniel Ling are co-portfolio managers.
 - Michael Cantara is institutional portfolio manager.
- The research team has 52 equity analysts and 13 research associates
- The co-portfolio managers have access to a global research platform, with analysts based in Boston, London (U.K.), Mexico City, Singapore, Tokyo and Sydney (Australia).
- There are 8 global sector teams, organized by region and sectors.
- There seems to be a good working relationship between the portfolio managers and the analysts. Analysts are subject to a 360 review. Team leaders coordinate special research projects requested by portfolio managers.
- Overall, MFS has a strong team of investment professionals.

Investment Process

- Process hasn't changed: bottom-up growth-at-a-reasonable-price (GARP)
- MFS uses a bottom-up GARP investment process. The firm's investment philosophy is based on the following tenets:
 - Companies with above-average returns over the long term have the potential for compounded growth irrespective of economic conditions.
 - Stocks trading at a discount to their projected value have the potential for multiple expansion.
 - A long-term focus capitalizes on opportunities created by investors with shorter investment horizons.

Their investment process has the following steps:

1. *Idea generation*: MFS tries to identify companies by quality characteristics to determine the investment universe.
 2. *Fundamental research*: The focus is on high quality and valuation. MFS evaluates growth/return potential, assesses business risks and determines the appropriate valuation.
 3. *Portfolio construction*: At that state they try to narrow the universe by looking at names against buy criteria (free cash flow, sustainable growth, risk/return, relative valuation).
 4. *Final portfolio*: High conviction ideas with sustainable growth and return prospects. Portfolio with 60 to 80 holdings.
- They will sell a stock for the following reasons:
 - It has reached its valuation target.
 - They have identified better opportunities.
 - There has been a change in the company fundamentals.
 - MFS doesn't hedge currencies, although the Operating & Endowment Fund does hedge the currency.
 - They incorporate the impact of currency fluctuations in their investment process by understanding the impact of the currency on a company's earnings.
 - Environmental, Social and Governance Factors (ESG):
 - MFS is a signatory of the United Nations Principles for Responsible Investment.
 - Looking at ESG factors is part of their overall company analysis. They ensure that a company's governance is clearly spelled out.
 - They purchase research from third party vendors that provide an explicit ESG rating.

Risk Management

- MFS risk management process has three components.
 - At the security level, they strive to avoid blow-ups by selling the security if the investment thesis doesn't materialize.
 - They diversify the portfolio. Key risk controls include:
 - 60 to 80 holdings in the portfolio.
 - The average position size is generally between 1% and 2%.
 - The maximum position size at the time of purchase is the greater of 5% of the fund or 1.5 times the security's weight in the benchmark.

- The Emerging markets weight will generally be less than 15% of the portfolio.
- Country and sector weights are unconstrained.
- Risk reviews are performed every six months.
 - The review involves senior management at MFS, including the CIO and the Head of the Quantitative Group.
 - They try to understand the bets taken.
 - They review the portfolio characteristics.
 - They ensure that the growth profile of the portfolio is confirmed.
 - They review capacity issues.
 - They review internal systems.

Capacity

- The MFS International Equity Fund is now re-open for new assets after having been subject to a soft close from April 2006 to July 2011. MFS defines a soft close as limiting substantially asset flows into new separate accounts while accepting smaller new flows into institutional commingled vehicles as well as flows from existing clients.
- MFS employs a combination of quantitative and qualitative techniques to help measure and manage capacity.
- Quantitative factors include the following:
 - They forecast product capacity based on the number of days trading volume.
 - They consider holdings that overlap across multiple MFS products.
 - They monitor investment style and transaction costs on an ongoing basis to ascertain whether asset inflows have caused unintended style shifts and whether increasing assets are making the strategy more expensive to implement.
- Qualitative factors include the following:
 - They consider portfolio manager style and input on capacity.
 - Anticipated portfolio manager non-investment responsibilities that would be created by new business are considered.

Trading

- I met with Paul Skinner, Director of Global Equity Trading.
- MFS has trading desks in Toronto, London and Boston. The Boston trading desk has night shift. Overall trading is done around the clock.
- The main goal of the trading desk is to achieve best execution.
- An independent review on trading costs is conducted on a regular basis and presented to the board.
- They use dark pools and other alternative venues. Approximately 40% of the trading is done electronically.
- They use soft dollars to pay for proprietary research.
- Overall, MFS seems to have adequate trading practices.

COMPLIANCE

- MFS employs 49 professionals in its compliance department.

- MFS has a proprietary compliance system called “DIVA” that is used to ensure compliance with investment guidelines.
- MFS has an adequate Code of Ethics.
 - 85% of MFS employees are considered access persons.
 - They need to pre-clear every personal trade they make.
 - They need to provide a quarterly certification.
 - All employees must report personal holdings and provide brokerage account statements.
- MFS, nor any of its employees, are currently involved in any major litigation.
- The Securities and Exchange Commission conducted an onsite review for the last time in 2008. There were no major findings to report.
- A review was conducted by the Financial Industry Regulatory Authority (FINRA) in 2011 to review MFS’ activities as a broker-dealer. They haven’t received the final comments yet.
- MFS is also regulated by the Office of the Superintendent of Financial Institutions in Canada through its relationship with Sun Life and by the Ontario Securities Commission because of the merger with McLean Budden.
- Conflicts of interests are in MFS policies and procedures, which deal with soft dollars, proxy voting and personal trading:
 - Outside business activities are reviewed.
 - There are no conflict of interest to report.
- The MFS Institutional Trusts (Canada) International Equity Trust Fund was compliant with its own investment policy and was compliant with all applicable laws.
- MFS has received SSAE-16 and SAS-70 reports for audit of its internal controls.
- Overall MFS has adequate compliance processes in place.

AGENDA

12 Jan 2012

Kirwan Room, 24th Floor

Host: Sarah Donahue, *Director, Relationship Management, Canada*

MFS Investment Management
500 Boylston St.
Boston, MA 02116

University of Western Ontario

Martin Belanger, *Director, Investments*

2:15 p.m. – 2:30 p.m.	Welcome and Introduction Sarah Donahue, <i>Director, Relationship Management, Canada</i>
2:30 p.m. – 3:10 p.m.	MFS Institutional Trusts (Canada) International Equity Fund Discussion Michael Cantara, <i>CFA, Investment Officer, Institutional Equity Portfolio Manager</i>
3:10 p.m. – 3:30 p.m.	MFS International Equity Strategy and Positioning Marcus Smith, <i>Investment Officer, Director of Equity – Asia, Equity Portfolio Manager</i>
3:30 p.m. – 4:00 p.m.	Global Outlook Erik Weisman, <i>Investment Officer, Fixed Income Portfolio Manager</i>
4:00 p.m. – 4:20 p.m.	MFS Equity Research Analyst Perspective Kevin Conn, <i>Investment Officer, Equity Research Analyst</i>
4:20 p.m. – 4:40 p.m.	MFS Trading Overview Paul Skinner, <i>Investment Officer, Director of Global Equity Trading</i>
4:40 p.m. – 5:00 p.m.	MFS Compliance and Legal Discussion Robert Flaherty, <i>CPA, Vice President, Compliance Officer</i> Robert Emsing, <i>Compliance Officer</i>
5:00 p.m.	Wrap Up Sarah Donahue
