Review of Diversified Equity Fund

Goal: Optimize the Diversified Equity Fund by increasing its expected return and/or reducing its volatility.

Strategy:

1) Capture sources of additional return

A number of asset classes are expected to generate, in the long-term, higher returns than developed large cap public equity markets, which make up most of the Diversified Equity Fund. These include:

- Smaller companies
- Emerging markets
- Private equity

2) Add diversifiers to the portfolio to lower the risk of the portfolio

Various strategies offer lower risk and low correlation compared to the broader market. These strategies will help counterbalance the additional volatility brought by the strategies used to capture additional return. These strategies include:

- Real estate
- Infrastructure
- Low-volatility strategy

Other Review Items:

1) Review the asset mix of the fund
2) Review the currency hedging strategy of the fund
3) Review manager line-up and active vs. passive strategy
4) Review the historical performance of the fund

Implementation

Tasks	Timeline
• Review goals and objectives • Review composition of Diversified Equity Fund and compare to similar fund of funds equity products • Review historical performance • Review preliminary Russell research	October / November 2011
Review the addition of new asset classes: • Small cap • Emerging markets • Low volatility strategies • Alternatives o REITs o Listed infrastructure o Private equity	November 2011 / February 2012
Optimize asset mix	March 2012
Manager search	April / May 2012
Fund approval	June 2012

Background:
The Diversified Equity Fund was launched in February 1978. Of the 15 investment options offered by the Western Retirement Plans, it is the one that has the most assets. As at June, 2011 the fund had $486 million in assets, or 43.7% of all assets of the Retirement plans. The fund was last modified in October 2008 when a 17.5% allocation to global equity was made. The new strategies were funded by a reduction in U.S. equities.

Asset Mix:
The Diversified Equity Fund is currently constructed as follows:

Investment Manager	% of the Fund	Asset Class	Manager Style
Greystone Managed Investment	10.0%	Canadian Equities	Active-Growth
Connor, Clark & Lunn Investment Management	10.0%	Canadian Equities	Active-Core
Beutel, Goodman & Company	10.0%	Canadian Equities	Active-Value
State Street Global Asset Management	17.5%	U.S. Large Cap Equities – Hedged	Passive
State Street Global Asset Management	2.5%	U.S. Mid Cap Equities	Passive
PanAgora Asset Management	2.5%	U.S. Small Cap Equities	Active-Core
Pyramis Global Advisors	15.0%	International Equities	Active-Growth
AllianceBernstein Capital Management	15.0%	International Equities	Active-Value
Harris Associates	8.75%	Global Equities	Active-Value
T. Rowe Price	8.75%	Global Equities	Active-Growth

Regional Asset Mix

Region	Weight
Canada	30.0%
U.S.	22.5%
EAFE	30.0%
Global	17.5%

The next two tables compare the composition of the UWO Diversified Equity Fund with that of a universe of 27 target-risk or lifecycle funds with the most aggressive equity allocation of their fund family.

	Breakdown (Equity Only)					
	Average	Median	Max	Min		Diversified Equity Fund
Canadian equity large cap	44.1%	41.4%	72.2%	27.7%		30.0%
Canadian equity small cap	3.9%	3.5%	15.5%	0.0%		0.0%
Non-Canadian equity large cap	45.4%	45.0%	66.7%	27.8%		65.0%
Non-Canadian equity small & mid cap	2.7%	0.0%	17.1%	0.0%		5.0%
Alternative investments	3.9%	0.0%	26.8%	0.0%		0.0%

	Expanded Breakdown (Equity Only)					
	Average	Median	Max	Min		Diversified Equity Fund
Canadian equity	44.1%	41.4%	72.2%	27.7%		30.0%
U.S. equity	13.6%	14.1%	33.3%	0.0%		17.5%
EAFE equity	12.5%	12.7%	33.3%	0.0%		30.0%
Global equity	16.1%	11.5%	64.7%	0.0%		17.5%
Emerging markets equity	3.0%	0.0%	14.8%	0.0%		0.0%[1]
Small & Mid Cap	6.6%	5.0%	31.1%	0.0%		5.0%
Real estate	2.0%	0.0%	10.0%	0.0%		0.0%
Infrastructure	1.1%	0.0%	9.6%	0.0%		0.0%
Commodity	0.7%	0.0%	7.6%	0.0%		0.0%

The most obvious observations are:

- The Canadian large cap equity allocation is low compared to peers
- The EAFE large cap equity allocation is high compared to peers
- The U.S. and global large cap equity allocations are in line with peers
- The direct emerging market s exposure is low compared to peers
- The overall direct small and mid cap exposure is in line with peers, although it's smaller for Canada
- There's no exposure to alternative investments

The Diversified Equity Fund is mostly invested in medium to large capitalization companies. The simplistic market capitalization that we report is 95% large cap, 2.5% mid cap and 2.5% small cap.

[1] The Diversified Equity Fund has some exposure to emerging markets through its EAFE and global equity exposure. As of August 31, 2011 it represented about 3.4%.

Using Russell's detailed market capitalization methodology, the breakdown as at June 30, 2011 was as follows[2]:

	Canadian Equities		EAFE Equities		Global Equities	
	UWO	S&P/TSX	UWO	MSCI EAFE	UWO	MSCI World
Large Cap	56.7%	57.1%	59.1%	62.3%	65.0%	73.0%
Mid Cap	28.7%	26.9%	35.4%	34.9%	34.2%	22.4%
Small Cap	14.5%	15.8%	4.5%	2.5%	0.6%	1.9%

Foreign Currency Exposure:

- 50% of the portfolio is exposed to foreign currency fluctuations.

Active/Passive Management:

- 80% of the portfolio is actively managed and 20% is passively managed

Risk/Return Profile:

Annualized Returns (net of fees) as of August 31, 2011

	1-Yr	2-Yr	3-Yr	4-Yr	5-Yr	10-Yr
Diversified Equity Fund	6.05%	3.80%	-3.44%	-5.15%	-1.67%	2.41%
Benchmark	8.36%	5.73%	-1.95%	-3.88%	-1.74%	2.06%
Value Added	-2.30%	-1.92%	-1.49%	-1.28%	0.06%	0.35%

Annualized Volatility as of August 31, 2011

	1-Yr	2-Yr	3-Yr	4-Yr	5-Yr	10-Yr
Diversified Equity Fund	11.50%	11.65%	17.73%	16.22%	14.90%	13.46%
Benchmark	10.76%	11.16%	17.38%	15.93%	14.57%	13.14%
Difference	0.74%	0.49%	0.34%	0.29%	0.32%	0.32%

[2] The market capitalization breakdown is defined by Russell as follows:

	Canadian Equity	U.S. Equity	International Equity	Global Equity
Large Cap	$15.9 B and above	$52.4 B and above	$21.8 B and above	$21.8 B and above
Mid Cap	$4.0 B - $15.9 B	$5.5 B - $52.4 B	$3.2 B - $21.8 B	$3.2 B - $21.8 B
Small Cap	Under $4.0 B	Under $5.5 B	Under $3.2 B	Under $3.2 B

New or Alternative Investment Options

Product	Description
1. Real Estate a. REITs b. Private real estate fund	• Direct real estate investing involves purchasing income producing properties. Properties typically fall in one of four classes: office, residential, industrial and retail. • The characteristics of direct real estate ownership can be replicated by investing in property company equities and real estate income trusts.
2. Infrastructure a. Publicly traded companies b. Limited Partnership	• Investing in infrastructure involves taking ownership in roads, utilities, transport, water, ports, railroads, communication systems, etc. • This can be done by purchasing the physical assets (through a limited partnership) or by investing in companies generating a significant portion of their revenues through their ownership of infrastructure assets.
3. Private equity a. Through ETFs b. Private Partnership	• Private equity involves investing in companies' securities, through a negotiated process. • It can be done directly through a limited partnership or by investing in publicly traded companies active in the private equity market. An exchange-traded fund (ETF) investing in a basket of private equity firms also exist. The PowerShares Listed Private Equity Portfolio replicates the Red Rocks Capital Listed Private Equity Index℠, which includes more than 30 U.S. publicly listed companies with direct investments in more than 1,000 private businesses.
4. Low volatility strategy	• This type of strategy typically has low sensitivity to market movements and thus provides stronger relative performance in down markets • The strategy can either be constructed by focusing on companies with low leverage and that operate in stable businesses; or by focusing on shares that are less volatile
5. Smaller companies	• Smaller companies are expected to outperform larger companies over the long-term, albeit with higher volatility
6. Emerging Markets	• Emerging markets now represent

Product	Description
	approximately 13% of the world market capitalization. • Arguments in favour of emerging markets include[3]: o Engine of growth for global economy o Attractive investment opportunities for companies located therein o Good demographic factors o Emerging middle class o Enormous pool of cheap labour o Stronger financial positions • Arguments against emerging markets include: o Stronger GDP growth doesn't necessarily imply stronger stock market performance o Greater volatility o Increasing correlation with developed markets over time o Higher transaction costs and lower liquidity

[3] Source: Mercer.