

Report to the Joint Pension Board

Northwater Capital Management Inc. Annual Review - Follow up Information

Background

At the Joint Pension Board (“JPB”) meeting of December 17, 2008 the members of the JPB board met with representatives of Northwater Capital Management Inc. (“Northwater”) for Northwater’s annual review¹.

As a result of this review Northwater undertook to provide the JPB with some further information. The purpose of this report is to document the information provided to the JPB by Northwater subsequent to the December 17th meeting.

Northwater was asked to provide the following information:

Item 1: Tracking Error in “B” Equity Funds

A larger than expected tracking error related to the “B” funds was identified and discussed at the annual review meeting. Northwater was asked to provide a numerical example to demonstrate the application of their explanation of the tracking error. The reason given to the JPB for the tracking error was that “ the difference was mainly due to the impact of future trades related to capital transactions in September 2008”.

Item 2: Staffing and Indexes Inquiries

- a) Details of Northwater clients gained and lost including related assets since the last review meeting in 2007;
- b) Information on staff turnover, including names and reasons for departure; and
- c) Information on the Dow Jones indexes, in particular, the current spreads and the impact of the Washington Mutual default.

The following information was provided By Northwater:

Item 1) Tracking Error in “B” Funds:

- email dated January 23, 2009 from Kai Wang together with spreadsheet, forwarded to the JPB members on January 29, 2009 (Appendix A & Attached - spreadsheet)

Item 2) Staffing and Indexes Inquiries:

- emails dated December 17th, and 19th, 2008 from Mohammed Khaki, forwarded to JPB members on December 19, 2008 (Appendix B)

¹ Please refer to the Joint Pension Board Minutes December 17, 2008

Other Information on the Staffing at Northwater:

On January 15th, 2009 Martin Belanger forwarded to the JPB members an email regarding the new additions to the UBS Global Asset Management (“UBS”) from Marcel Larochelle which advised that Stephen Foote previously a Vice President at Northwater had joined the UBS Canadian Team. (Appendix C)

Enclosures:

Appendix A & Attachment

Appendix B

Appendix C

Submitted by: Andrea Magahey

Date: January 30, 2009

From: Martin Belanger [mailto:mbelang7@uwo.ca]
Sent: Tuesday, January 27, 2009 5:14 PM
To: A. Birch; J. O'Brien; L. Wickman; Louise Koza; M. Loveland; Pat Loria; S. Finlayson; S. Foerster; Stephen Hicock
Cc: Dunbar, Craig; Krys Chelchowski; Ann Jones
Subject: FW: UWO Funds Tracking Error

Hello all,

As discussed, here's some additional explanation regarding the tracking error of the Northwater U.S. Equity Hedged Fund B. It's related to the reorganizing of the Diversified Equity Fund we did back in September. We made a \$9.5 million contribution to a fund that had only \$7 million in assets. Even though the markets went down by only 0.22% after the contribution was made it translated into a \$20,000 loss on the \$9.5 million contribution. That \$20,000 loss is the reason why the fund had large tracking error.

See the attached spreadsheet for more details.

Let me know if you have any questions.

Thanks,

Martin Bélanger
Associate Director, Retirement Plans
Phone: (519) 661-2111 ext. 80314
Fax: (519) 661-4104

From: Kai Wang [mailto:kwang@northwatercapital.com]
Sent: January 23, 2009 10:17 AM
To: Martin Belanger
Cc: Mohamed Khaki; Spike Quach; Heather Broughton
Subject: RE: UWO Funds Tracking Error

Hi Martin,

Thank you for your question.

For Q3 2008, the NDF US Equity fund had an implantation of -0.20% while the NDF US Equity B trailed the futures model by 0.45%. The difference can mostly be explained by futures trades in the NDF US Equity B fund due to significant subscriptions at the end of month.

Here is what happened in NDF US Equity B in September. The portfolio started September with about C\$7 million. At the end of September, UWO transferred investments from S&P 500 unhedged mandates to this portfolio. (There were not any other capital transactions in the month.) The total transfer-in (capital inflow) is about C\$9.5 million. As the result, the portfolio purchased 160 S&P 500 E-Mini contracts at 1171.56563 on September 30. Since the E-Mini contract settlement price for that day was 1169.0000, it resulted in a mark-to-market loss of more than C\$20,000. In %, the loss subtracted 0.30% to the portfolio. This 0.30% explained the major

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tracking difference between the A and B funds. For detailed calculation, please see the attached spreadsheet.

My understanding is that Northwater targets to execute this type of futures trades at a cash market close in order to get prices closer to fair values. The actual transaction prices may be different from futures settlement prices. When cash flow amounts (subscriptions and redemptions) to a portfolio are not significant compared to the portfolio size, the difference between transaction prices and settlement prices does not have big impact to a portfolio implementation. However, for the situations with significant cash flows like in this case, when the subscription amount is even larger than the total size of the portfolio, this price difference may give rise to a relative big implementation.

If you have any further questions on this, please let me know.

Regards,

Kai Wang
416-360-2091

From: Martin Belanger [mailto:mbelang7@uwo.ca]
Sent: January-22-09 8:49 AM
To: Kai Wang
Subject: UWO Funds Tracking Error

Hi Kai,

At the annual review meeting we had with Northwater, we had a discussion on the larger tracking error of the "B" funds compared to the original funds. The reason that was given to us was that "This difference was mainly due to the impact of futures trades related to capital transactions in September 2008". Mohamed asked me to follow up with you. Can you please provide us with a numerical example that clearly demonstrates what you mean by that?

Thanks,

Martin Bélanger
Associate Director, Retirement Plans
Support Services Building, Room 5100
London, Ontario N6A 3K7
Phone: (519) 661-2111 ext. 80314
Fax: (519) 661-4104
Email: mbelang7@uwo.ca

Please Note:

Human Resources has moved to Room 5100 Support Services Building, The University of Western Ontario, London, ON N6A 3K7.

Appendix A – Attachment pg. 1/1

NDF US Equity B

September 2008 beginning NAV	C\$	7,176,068
S&P 500 E-Mini purchased on 9/30/08 due to new subscriptions		
A. Number of contracts		160
B. Purchase price	US\$	1,171.56563
S&P 500 E-Mini settlement price on 9/30/08	US\$	1,169.00
S&P 500 E-Mini multiplier		50
Mark-to-market on those E-Mini contracts	US\$	-20,525.04
Fx		1.0632
Mark-to-market on those E-Mini contracts	C\$	-21,822.22
Impact of the MTM on portfolio tracking		-0.30%

From: Martin Belanger [mbelang7@uwo.ca]
Sent: December 19, 2008 3:42 PM
To: A. Birch; J. O'Brien; L. Wickman; Louise Koza; M. Loveland; Pat Loria; S. Finlayson; S. Foerster; Stephen Hicock
Cc: C. Ann Jones; Andrea Magahey; Cara Dakin; Deirdre Chymyck
Subject: FW: [Spam?] RE: ABCP spreads over BAs
Hello all,

Some agenda items were not covered by Northwater at the last Joint Pension Board meeting. A follow-up email was sent with the following questions:

- 1) Can you please discuss in details clients gained and lost since the last meeting, including assets
- 2) Discuss personnel turnover since the last review meeting; please include names and reasons for departure
- 3) Please provide more information about the Dow Jones CDX indexes. For example, what is the current spread, what level of default has been experienced (What's the impact of Washington Mutual defaulting?)

In addition, with reference to the question that Louise asked about the tracking error, I also asked Northwater to provide us with a numerical example that clearly demonstrates what they mean by "This difference was mainly due to the impact of futures trades related to capital transactions in September 2008".

See the answers to the first three questions below. The tracking error question will be answered next week when the analyst is back from vacation.

Let me know if you have any questions.

Martin Bélanger
Associate Director, Retirement Plans
Phone: (519) 661-2111 ext. 80314
Fax: (519) 661-4104

From: Mohamed Khaki [mailto:mkhaki@northwatercapital.com]
Sent: December 19, 2008 2:58 PM
To: Martin Belanger
Cc: Stephen Foote; Kai Wang; Carol Ellis; Ikoza@uwo.ca
Subject: [Spam?] RE: ABCP spreads over BAs

Hello Martin:
The following is the requested information since the last meeting at our offices in December 2007:

- 1) Can you please discuss in details clients gained and lost since the last meeting, including assets

No clients gained

8 clients redeemed: 4 pooled fund clients (\$160 million), 2 segregated clients (\$183 million), 1 Hedge Fund client (\$ 4 million), 1 client \$458 million bond exposure
Martin, an obvious point I did not make at the meeting was that the assets and exposures under management also were down in the most recent year due to the dramatic move in the markets.

2) Discuss personnel turnover since the last review meeting; please include names and reasons for departure

The professionals turnover in the Synthetic Investment Team was as follows:
Benita Warmbold, left to join Canada Pension Plan Investment Board
Jim Sinclair, left to join Ontario Ministry of Finance
David Marleau, left to join OMERS

In addition the head count was reduced by 15 other staff during 2008 due to restructuring. None of these were involved in managing the mandates Northwater is running for UWO.

3) Please provide more information about the Dow Jones CDX indexes. For example, what is the current spread, what level of default has been experienced (What's the impact of Washington Mutual defaulting?)

The following is a table showing the various reference indices in the restructuring proposal, and the distance to the triggers. As far as the default of the underlying credits, the data is not available. However, as we have mentioned before, the average attachment point is 17% - i.e. the loss to the super senior tranche (to which the Trusts are exposed) would occur after a 100% loss to 17% of the underlying investment grade credits.

I trust that the above is satisfactory.

I have asked Kai Wang to respond to your question on the tracking from Capital Transactions when he gets back from his vacation next week.

Best regards,
Mohamed

Mohamed Khaki ASA CFA
Vice President
Northwater Capital Management Inc.
(416)-365-2508 / 1-800-422-1867
mkhaki@northwatercapital.com

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From: Martin Belanger [mailto:mbelang7@uwo.ca]
Sent: December 17, 2008 3:43 PM
To: 'Mohamed Khaki'
Subject: RE: ABCP spreads over BAs

Thanks Mohamed. Do you have the current spreads of the various CDS indices?

Martin Bélanger
Associate Director, Retirement Plans
Phone: (519) 661-2111 ext. 80314
Fax: (519) 661-4104

From: Mohamed Khaki [mailto:mkhaki@northwatercapital.com]
Sent: December 17, 2008 3:33 PM
To: Mohamed Khaki; mbelang7@uwo.ca
Cc: Ikoza@uwo.ca; Heather Broughton; Carol Ellis
Subject: RE: ABCP spreads over BAs

Hello All:
Just to clarify, the numbers quoted are actual trading levels. Therefore, ABCP are trading at 130 to 150 over BAs. For comparison sake, Treasuries are at 75 to 85 bps.
Regards,
Mohamed

From: Mohamed Khaki
Sent: Wednesday, December 17, 2008 3:27 PM
To: 'mbelang7@uwo.ca'
Cc: Louise Koza (lkoza@uwo.ca); Heather Broughton; Carol Ellis
Subject: ABCP spreads over BAs

Hello Martin;

At the meeting, there was a question as to the spreads that bank sponsored ABCP was trading at. While the spreads had come in from where they were last year, they have widened more recently. BAs are currently trading at 140 to 150 bps and ABCPs are at 270 to 300 bps. I would appreciate you passing along this information to the other members of the Committee.

Best regards,
Mohamed
Mohamed Khaki ASA CFA
Vice President
Northwater Capital Management Inc.
(416)-365-2508 / 1-800-422-1867
mkhaki@northwatercapital.com

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From:

Martin Belanger

To:

A. Birch; J. O'Brien; L. Wickman; Louise Koza; M. Loveland; Pat Loria; S. Finlayson; S. Foerster; Stephen Hicock;

cc:

Dunbar, Craig; Krys Chelchowski; Ann Jones;

Subject:

FW: UBS Global Asset Management - Additions to Canadian team

Date:

January 1, 4501 12:00:00 AM

Hello all, Here's another departure from Northwater. Martin Bélanger Associate Director, Retirement Plans Phone: (519) 661-2111 ext. 80314 Fax: (519) 661-4104 -----Original Message----- From: UBS-Global-AM-Canada@ubs.com [mailto:UBS-Global-AM-Canada@ubs.com] Sent: January 15, 2009 4:22 PM To: mbelang7@uwo.ca Subject: UBS Global Asset Management - Additions to Canadian team We are pleased to announce that Stephen Foote, CFA has joined UBS Global Asset Management as Executive Director, Institutional Business Development. Most recently, Stephen was Vice-President, Global Head of Marketing, Client Service and Analytics for Northwater Capital Management. Prior to that, Stephen was an investment consultant with Mercer Investment Consulting. Stephen will be based in our Toronto office, reporting to me. Working with the other members of our Client Relationship Management team, Stephen will bring to our Canadian clients the breath of our global capabilities, including our innovative solutions for defined benefit pension plans. Please feel free to contact Stephen directly at 416-681 5171 or stephen.foote@ubs.com. We are also pleased to announce that Steven Ko has joined our Canadian equity team as an Associate Analyst. Steven worked for our firm as an intern in 2007 and, since completion of an MBA, has held investment banking research positions at Blackmont Capital and Canaccord Adams. Steven has completed the educational requirements of the CFA program and will make an immediate contribution to our research team across several sectors and particularly within the small cap space. Steven will be based in our Toronto office and report to Duncan Mathieson, Head of Canadian Equities.

Regards, Marcel Larochelle, CFA, FSA, FCIA Managing Director, Head of Canada UBS Global Asset Management (Canada) Inc. 161 Bay Street, Suite 3900 Brookfield Place P.O. Box 618 Toronto, ON M5J 2S1 Tel: 416-681-5205 Visit our website at <http://www.ubs.com>

