Highstreet Asset Management
Investment Manager Review
February 17, 2009

EXECUTIVE SUMMARY

- On February 17, 2009 Stephen Foerster, Pat Loria, Michelle Loveland and Martin Bélanger met with the following Highstreet professionals from 9:00 a.m. to 11:30 a.m. at their London office:
  - Senior Management: Paul Brisson, President
  - Canadian Equity Team: Shaun Arnold
  - Research and Data Analysis: John McNair
  - Client Servicing: Janice Evans, Amy Gibbons
- Ranked “Hire” by Russell
- Even though its assets under management have declined since the last review, the firm is growing; they have won 13 new mandates since last year
- With the support of AGF, they have made significant investments technology; they’ve implemented Charles River (a front-office system) and a new portfolio construction system
- The stock market downturn is taking a toll on Highstreet. Assets under management have declined from $5.4 billion as of December 31, 2007 to $3.6 billion as of December 31, 2008
  - Considering that more than 90% of the firm’s assets are in Canadian equity mandates, it causes a shortfall in revenues of more than $5 million
  - The firm has not laid off any employees but they might have to if the S&P/TSX drops below 7,000
  - A hiring freeze is in place and expenses are carefully managed
- Highstreet has underperformed the benchmark by 3.1% in 2008
  - Most of the underperformance was due to stock selection and was concentrated in the fourth quarter
  - Poor selection in the Materials sector (they were underweight in Gold) accounted for most of the underperformance
  - Their underweight in small cap energy companies added some value in 2008
  - Poor stock selection in the financial sector also subtracted value in 2008; their underweight in CIBC and their overweight in RBC have hurt
- The firm still generates value added over the last four years (+0.5%), although they don’t meet their target value added of 2%
- There haven’t been any direct changes in investment personnel on our strategy since our last review:
  - Shaun Arnold is still the lead portfolio manager
  - They have added an analyst in the research and data management area
- Their investment process has not materially changed in recent years; they have a disciplined process and adequate risk controls in place
- Their model doesn’t include environmental, social or governance factors
- No issue with capacity on our strategy at this point; they currently have $3 billion under management and their capacity is between $5 to $7 billion

- Highstreet doesn't have any compliance issues; their fund is in compliance with the investment manager mandate, their offering memorandum and the pension and tax legislation; they're not currently facing any litigation and they have an adequate code of conduct
- The only negative developments at Highstreet since our last review are the market downturn, which is hurting them financially, and the imminent departure of Jeff Brown
  - The firm's loss in revenues hasn't impacted the management of our portfolio yet; however, should it continue Highstreet may have to lay off personnel involved with our portfolio
  - The departure of Jeff Brown is surprising considering that at our last review we were told that he was committed to lead the expansion of the U.S. equity business. Although Jeff was not involved with our strategy anymore, this might be an indication that other founding partners of Highstreet (Shaun Arnold, CIO and lead manager on our strategy and Rob Jackson, Chief Risk Officer) may leave in the near future. However, Shaun and Rob were not among the three initial partners and most likely didn't receive the same payout as a result of the sale to AGF. We need to keep monitoring this.

RECOMMENDATION

- Despite its underperformance in 2008, Highstreet remains a solid investment manager, with good investment staff and a disciplined investment process
- The firm's financial situation and potential loss of senior management have to be monitored, but they are low probability events at this point
- Given Russell's "Hire" recommendation and the overall quality of the firm, I don't recommend making any changes to our relationship with Highstreet Asset Management.

ORGANIZATION

- $3.6 billion in assets under management as of December 31, 2008, including $3.0 billion in their core Canadian equity product
- Assets are down from $5.4 billion as of December 31, 2007
- Most of the decline is due to the market downturn; Highstreet has gained 13 new clients since last year (for $1.5 billion in new assets) and has lost 2 clients
- UWO had $40.4 million with Highstreet as of December 31, 2008 ($41.4 million as of February 12, 2008)
- The decline in assets under management has had a significant impact on Highstreet
  - Considering that more than 90% of the firm's assets are in Canadian equity products, the loss of $1.8 billion in assets under management represent a loss of revenues of about $5 million
  - Based on AGF's 2008 financial statements, Highstreet had a profit of about $2.8 million for the fiscal year ended November 30, 2008
  - They are managing expenses carefully at the moment
  - Senior management took cuts on some of their benefits

  - They haven't laid off anyone but they have instituted a hiring freeze; they have a critical value of 7000 for the S&P/TSX below which they will have to lay off employees
- Highstreet is still 80% owned by AGF and 20% by Highstreet employees
- Since last year, the number of Highstreet employees who are shareholders of the firm increased from 10 to 19
  - The firm made the decision to offer ownership to each of the firm's 40 employees
  - AGF will provide interest free loans
- Highstreet launched a 130/30 product for the Canadian Equity market last year; the fund only has seed money at the moment
- They also created a 130/30 product for the U.S. market, based on a client request
- Jeff Brown, who was on sabbatical from August 2008 to January 2009, is thought to be planning to retire by March 2009
- Doug Crocker, Highstreet's Chief Risk Officer and one of the six original partners, retired as expected, effective September 30, 2008; he was be replaced by Rob Jackson who has been working with Doug for about 12 years
- We announced last year that Highstreet would be managing three new mutual funds for AGF: Global High Income Fund, Global Balanced High Income Fund and Canadian All Cap Fund; these three funds were closed because of lack of interest
- Currently Highstreet manages only three products for AGF, which they also manage for their institutional clients: Canadian Small Cap, Canadian Growth and U.S. Equity
- Highstreet has hired a two investment professionals in recent months in the research and data management area: Robert Yan, Manager, Investments and Steve Duench, Analyst, Investments
- From a client relationship point of view, Janice Evans, Vice President, Investments is now responsible for our account at UWO. Previously Lina Bowden was in charge of the account. Lina now focuses on foundations while Janice is responsible for institutions, such as pensions and endowments.
- Highstreet has recently implemented the Charles River front-office system, which should help from a compliance point of view
- They recently implemented a new portfolio construction system (PCS); this system integrates their risk, transaction costs and rank propensity analysis (likelihood of a stock being ranked a buy) and is expected to reduce turnover and costs
- Highstreet is planning to upgrade its fund accounting in the coming months
- Paul Brisson provided an update on Highstreet's business continuity plan:
  - They did a "live" test in 2008; everyone was asked to work from home
  - They will establish an alternate location in 2009, with the help of AGF

CANADIAN EQUITY MANDATE

Performance Analysis

	Periods Ended Dec 31, 2008					
	Q4 2008	**One Year**	**Two Years**	**Three Years**	**Four Years**	**Since Inception**
Highstreet Canadian Equity	-25.1%	-36.1%	-14.0%	-4.8%	2.2%	4.7%
S&P/TSX	-22.7%	-33.0%	-14.2%	-4.8%	1.7%	3.8%
Value Added	-2.4%	-3.1%	+0.2%	0.0%	+0.5%	+0.9%

- The fund has 49 names (as of January 31, 2009); the Fund will typically hold between 40 and 60 stocks
- Their investable universe is comprised of the S&P/TSX and any company with a market capitalization greater than $500 million
- Highstreet doesn't meet anymore its pooled fund performance standard of outperforming the S&P/TSX by 200 basis points over a four-year rolling period a; maintaining a moderate risk level compared to the benchmark is still met though (portfolio volatility should remain between 80% and 120% of the portfolio)
- The fund underperformed by 3.1% in 2008
    - Most of the underperformance was due to stock selection and was concentrated in the fourth quarter
    - Poor selection in the Materials sector (they were underweight in Gold) accounted for most of the underperformance
    - Their underweight in small cap energy companies added some value in 2008
    - Poor stock selection in the financial sector also subtracted value in 2008; their underweight in CIBC and their overweight in RBC have hurt
- Positive contributors to the performance of the portfolio in 2008 include:
    - Barrick Gold
    - Canadian Oil Sands Trust
    - Nortel Networks (not owning the stock)
- Negative contributors to the performance of the portfolio in 2008 include:
    - Goldcorp (not owning the stock)
    - Kinross Gold (underweight)
    - Teck Cominco
- Teck Cominco is an example of a stock that had an extremely poor performance in 2008 (-88%); we asked Shaun Arnold to explain their investment thesis on the stock and whether or not the stock was removed from the portfolio; he answered that the stock was removed from the portfolio because it failed one of the model risk criteria; the risk-adjusted return of the stock fell in the bottom 20% of the portfolio, which triggers and automatic review; their review identified some significant cash flow issues.
- The size of an active position is based on the following considerations:
    - Benchmark weight
    - GVQ+R score (the higher the score, the higher the active position)
    - Transaction costs

    - Risk profile of the security
    - Other holdings in the portfolio
- Portfolio turnover was about 60% in 2008, but increased towards the end of the year
    - Typically 60%-65% of the portfolio rarely turns over (2 to 4 years), 20%-25% turns over once a year and about 10% turns over more frequently
- Shaun Arnold described the changes made during the fourth quarter of 2008:
    - They identified that although they outperformed in up markets about 69% of the time, they only outperformed in down markets about 31% of the time and their underperformance during down markets cost them about 25 bps
    - They made several changes to the portfolio to enable them to outperform during down markets
    - They removed 9 names from the portfolio during the fourth quarter and added 13 stocks
- Since the beginning of 2009, they have reduced their exposure to Energy and Financials and have increased their exposure to Telecom and Materials

Investment Personnel
- Since the last review, no changes in investment personnel as they relate to our strategy
    - Shaun Arnold is still the lead portfolio manager
    - Fred Steciuk and Melanie Blue are the secondary portfolio managers on our account
    - Shaun’s time is now approximately allocated as follows:
        - 50% portfolio management
        - 35% client servicing and sales
        - 15% managing the team
    - They have added two investment professionals in research and data analysis in recent months: Steve Duench (who was there during our last review) and Robert Yan
- No personnel turnover on the Canadian equity team
- Doug Crocker, Chief Risk Officer, retired at the end of September 2008; he was be replaced by Rob Jackson

I mentioned last year that, although Doug Crocker’s retirement was a surprise, the probability of seeing other founding members leave the firm was a low probability event. Unfortunately, Jeff Brown is expected to retire soon. Jeff was not involved on our strategy anymore though.

Investment Process
- Process hasn’t changed: bottom-up growth-at-a-reasonable-price
- The firm ensures that growth characteristics (earnings growth rate) and quality characteristics (re-investment rate, which is the growth rate of assets based on reinvested earnings) are higher than those of the S&P/TSX and that valuation characteristics (P/E ratios) are lower than those of the S&P/TSX. Volatility is expected to be in line with the market.
- Each company is issued a report where 14 characteristics are rated

- Growth characteristics (including trailing earnings growth, prospective earnings growth, earnings surprise and earnings revisions) account for 40% of the overall rating;
- Value characteristics (including P/E and P/B ratios) account for 20% of the overall rating;
- Quality characteristics (including reinvestment rate and return on equity) account for 20% of the overall rating; and
- Risk characteristics (including volatility and risk-adjusted returns) account for 20% of the overall rating.

- If the overall grade falls below C- (bottom 50% of securities) or if any of the growth or risk characteristics fall in the bottom 20%, a position is automatically highlighted for review
- They review management actions through the documents they produce (e.g. financial statements), but they don’t talk to management
- They use earnings estimates made by street analysts
- Environmental, Social and Governance Factors:
    - Their model doesn’t include any environmental, social, and governance factors
    - If an ESG factor impacts the financial performance of the firm, their risk management discipline and their fundamental analysis overlay will probably identify it
    - Their proxy voting is done with the intent of maximizing investment performance

Risk Controls

- They use a proprietary statistical-based model for risk management that is fully integrated with portfolio construction
- Their risk management process focuses on the following risk metrics:
    - They study the last 75 days of stock price movement and extrapolate how the portfolio will react
    - Risk-adjusted return (M^2)
    - Semi-variance
- Sector weights are allowed to deviate from the benchmark weights by 7%

Research Agenda

- We met with John McNair, Senior Vice President and Head of Investment Research
- Their research protocol was formalized in 2005; Jeff Brown and Doug Crocker (then CIO and CRO) did a review of best practices of quantitative managers
- Each strategy is reviewed every three years, or sooner if the CIO/CRO request it, if a 2 standard deviation event occurs or if it’s a new product
- The Canadian Equity strategy is up for review in the summer of 2009
- They review 4-year rolling annualized returns of the strategy and on a risk-adjusted basis and compare with the benchmark (S&P/TSX) to ensure strong returns and risk profile
- They review the distribution of returns to ensure that the probability weighted gains are greater than the probability weighted losses
- They ensure that extreme losses and gains are similar to the benchmark; based on value at risk (48 months of returns)

- The bull/bear capture must be appropriate for the strategy; for a core strategy, the bear capture ratio must be smaller than the bull capture ratio at all time
- They backtest returns using portfolio constraints and incorporating transactions costs
- The Canadian Equity strategy was reviewed for the last time in 2006; although they investigated several changes, they didn't make any modifications to the model
- They get their ideas for research from several sources: brokers, Highstreet investment professionals, academics, industry conferences, quantitative management journals, etc.
- For 2009 the priorities are as follows:
  - Canadian Core GVQ+R (UWO's strategy)
  - U.S. Small Cap Core GVQ+R
  - 130/30 GVQ+RR
- They hope to be able to transfer some of the findings from the recent review of the U.S. Equity Core product to the Canadian Equity Core product

Capacity

- Capacity is not an issue now; they currently have about $3.0 billion in their Canadian Equity Pooled Fund and they have determined that their capacity is about $5 to $7 billion.

Market Overview

- They expect that earnings will continue to be revised down, especially in the energy and materials sectors

Trading

- Currently, about 40%-50% of trades are done using an algorithm or dark pools
- It takes them typically one or two days to get out of a stock; some stocks take up to 5 days though
- Vidis Vaiciunas, Vice President, Head of Trading can provide some insight on liquidity to initiate transactions in the portfolio
- They believe that La Caisse de Depot's forced selling in the fall had a significant impact on the market; investors deleveraging also had an impact; because Highstreet invests in large cap Canadian stocks that are typically fairly liquid, they were negatively impacted
- Highstreet new securities lending program was discussed:
  - The team was doing some securities lending when they were at London Life, they hadn't done it yet at Highstreet because they didn't have enough assets
  - They see securities lending as a potential source of revenues at very low risk
  - The collateral is high quality Government securities
  - The program was just recently initiated
- Highstreet made some changes to their Offering Memorandum; these changes can potentially impact UWO's monthly cash flow process. These changes are as follows:
  - They require a five-day notice for redemptions
  - For redemptions in excess of $1 million, they reserve the right to request a one-month notice

- Paul Brisson and Janice Evans confirmed that there would not be any problems with UWO's monthly cash flow process due to the size of the Canadian Equity strategy, even for redemption requests in excess of $1 million.

COMPLIANCE

- Paul Brisson, President and Chief Compliance Officer answered questions about compliance
- Highstreet is in compliance with:
    - Investment manager mandate
    - Highstreet Offering Memorandum
    - Highstreet Conflict of Interest Policy
    - Pension Benefits Act
    - Income Tax Act and qualified investments
    - Standard of Professional Conduct
    - Suppression of Terrorism
- Highstreet or its employees are not facing major or minor litigation
- They haven't had a regulatory review by the Ontario Securities Commission since 2005
- Employees have to comply annually with a Code of Conduct
- Employees have to invest their assets over $50,000 in Highstreet funds
- Access people (portfolio managers) have to have their personal trades pre-approved and their account statements sent to Paul Brisson, Chief Compliance Officer; permission will be granted only if Highstreet doesn't own the security
- Gifts received by employees have to be declared if they're above $150
- They use soft dollars; they represent about 10% of commissions

THE UNIVERSITY OF WESTERN ONTARIO RETIREMENT PLANS
Highstreet Asset Management
Meeting Agenda

Date: February 17, 2009
Meeting time: 9:00 AM to 12:00 PM
Location: 244 Pall Mall Street, Suite 200, London, Ontario

UWO Attendees:

Michelle Loveland, Prof. Management & Organizational Studies
Pat Loria, Information Technology Services
Martin Bélanger, Associate Director, Retirement Plans

ORGANIZATION:
- Introduction – relationship review
- Discuss any meaningful change to your corporate structure since the last review
- Review changes in assets under management
- Discuss clients gained and lost
- Overview of new products
- Discuss updates your business continuity plan, if any

INVESTMENT PERSONNEL:
- Introduction to key personnel on our mandates
- Discuss personnel turnover

REVIEW OF UWO PORTFOLIOS:
- Performance overview
- Attribution analysis
- Portfolio characteristics
- Overview of investment process and changes to investment philosophy, if any; please provide examples of stocks added that meet your investment criteria
- Buys/Sells for the year
- Detractors/contributors to performance
- Top 10 holdings
- Describe how you measure and control portfolio investment risk
- Report how you integrate environmental, social and governance factors in your investment process and the impact on your portfolio and investment strategy.
- Market outlook

RESEARCH:
- Overview of research agenda

COMPLIANCE:

- Confirm that all investments managed by Highstreet Asset Management on behalf of UWO are in compliance with the terms and conditions of the Investment Manager Mandate and in compliance with all applicable laws
- Describe any material litigation to which your firm, key personnel or the funds have been party over the past year
- Describe any material issue raised as a result of recent regulatory reviews
- Confirm that your key investment personnel complies with an appropriate code of ethics