Highstreet Asset Management
Investment Manager Review
February 2, 2010

EXECUTIVE SUMMARY

- On February 2, 2009 Stephen Foerster, Jim Loupos and Martin Bélanger met with the following Highstreet professionals from 9:00 a.m. to 12:00 p.m. at their London office:
  - Paul Brisson, President and CEO
  - Shaun Arnold, CIO
  - Melanie Blue, Vice President, Investments
  - John McNair, Senior Vice President, Head of Investment Research
  - Janice Evans, Vice President, Investments
  - Amy Gibbons, Manager, Client Service
  - Scott Creek, Vice President, Information Services
  - Rob Jackson, Chief Risk Officer
  - Vidis Vaiciunas, Vice President, Head of Trading
- Ranked “Hire” by Russell
- Highstreet manages 25% of the Canadian Equity Fund and 7.5% of the Diversified Equity Fund
- UWO had $53.3 million with Highstreet as of December 31, 2009 and annualized investment management fees are 0.28% at that asset level
- Highstreet investment style is bottom-up, growth-at-a-reasonable price
- Highstreet was hired on July 9, 2003
- The Retirement Plans invest in a pooled fund managed by Highstreet
- The stock market rebound has helped Highstreet bring its asset back to $5.4 billion, the same level they had at the end of 2007; they have also gained $1.2 billion in new business in 2009
- As a result, Highstreet has removed its hiring freeze; they have added some entry level personnel in 2009
- The firm has now fully implemented a new front-office system (trading) and new portfolio construction system
- Highstreet has increased the ownership among its employees; there are now 35 employees owning a total of 20% of Highstreet
- Highstreet has underperformed the benchmark by 2.9% in 2009
  - Most of the underperformance was concentrated in the period from March 9 to May 31, 2009 when low quality and high volatility stocks have outperformed high quality stocks; the portfolio underperformed by 4.8% during that period
  - Poor stock selection in the Energy sector has particularly hurt
  - Highstreet outperformed during the rest of the year
- The firm still generates value added since inception (+ 0.4%) although they don’t meet their target value added of 2% over four-year rolling periods (-0.6%)
- 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 one professional to the research team
- Their investment process has not materially changed in recent years; they have a disciplined process and adequate risk controls in place and I view positively the research they're conducting on risk overlays
- The Investment Research, an area of weakness according to Russell, has improved since our last review. The addition of new staff and a new backtesting engine should improve the quality of research. The research topics presented don't seem to differentiate the firm from its peers significantly though.
- Their model doesn't include environmental, social or governance factors
- No issue with capacity on our strategy at this point; they currently have $4.8 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
- Highstreet has an adequate business continuity plan
- The situation at Highstreet is much more positive than last year as there haven't been any negative developments
    - The firm's revenues seem to be back to their pre-crisis level
    - They haven't experienced any personnel loss
    - They have completed significant changes to their systems

RECOMMENDATION

- Despite its underperformance in 2009, Highstreet remains a solid investment manager, with good investment staff and a disciplined investment process
- The firm's research, especially in the area of risk management, is improving
- The firm's financial situation is now more stable and I don't anticipate key personnel losses in the near future
- 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
- However, 2009 highlighted a weakness to the UWO Canadian Equity Fund. All four managers in the portfolio focus (to various degrees) on high quality companies that do well in a "normal" environment. When an irrational market occurs, such as 2008 and 2009, they tend to underperform. The Joint Pension Board needs to continue to have a discussion on optimizing the Canadian Equity Fund. Having four very similar managers to cover the Canadian market is sub-optimal as it generates higher investment management fees and it leads to larger underperformance when the managers' companies of choice (high quality ones) are out of favour.

ORGANIZATION

- $5.4 billion in assets under management as of December 31, 2009, including $4.8 billion in their core Canadian equity product
- Assets are now back where they were at the end of 2007; the hiring freeze that was instituted in the fall of 2008 has been removed
- Highstreet has gained $1.2 billion in new business in 2009

- They gained 9 clients and lost 2 last year (one in their Dividend Fund and one in their core Canadian equity mandate)
- UWO had $53.3 million with Highstreet as of December 31, 2009
- Highstreet is still 80% owned by AGF and 20% by Highstreet employees; there's currently no intention to increase the size of the employee ownership
- Since last year the number of Highstreet employees who are shareholders of the firm increased from 19 to 35
    - Every employee is offered ownership after one year of service, subject to availability of shares
    - AGF provides interest free loans for employees to purchase shares
    - The price paid is a multiple of the past four quarters of earnings
    - The firm's 14 investment professionals own approximately half of the total employee ownership
- Last year Highstreet launched a 130/30 product for the Canadian Equity market; the fund has since been closed due to the difficulty in shorting the Canadian market
- Last year they also created a 130/30 product for the U.S. market, based on a client's request; they're still working on it and there won't be any money in it for the next six months
- They also launched a Canadian short term bond fund and a conservative balanced fund (40% equities / 60% fixed income), based on clients' requests
- Highstreet has recently achieved SEC registration in the U.S.; Highstreet uses AGF infrastructure to do business in the U.S. (AGF has offices in Boston, Dublin and Hong Kong)
- Currently Highstreet manages three separate products for AGF, which they also manage for their institutional clients: Canadian Small Cap, Canadian Growth and U.S. Equity; there has been no change since last year
- Highstreet has hired three professionals in supporting roles in recent months; two financial analysts working in the back office and one information system analyst
- There has been no change to our relationship manager, Janice Evans, Vice President, Investments is still responsible for our account at UWO
- Highstreet is planning to upgrade its back office management system in the coming months, with the assistance of AGF; the new system will offer a more robust data management system and streamlined performance and attribution capability
- Paul Brisson and Scott Creek provided an update on Highstreet's business continuity plan:
    - They did a "live" test in November 2009; everyone was asked to work from home
    - They established an alternate location in Mississauga

CANADIAN EQUITY MANDATE

Performance Analysis

	Periods Ended Dec 31, 2009					
	Q4 2009	**One Year**	**Two Years**	**Three Years**	**Four Years**	**Since Inception**
Highstreet Canadian Equity	3.9%	32.2%	-8.1%	-0.7%	3.3%	9.3%
S&P/TSX	3.9%	-35.1%	-4.9%	-0.2%	3.9%	8.9%
Value Added	0.0%	-2.9%	-3.2%	0.5%	-0.6%	+0.4%

- The fund has 57 names (as of December 31, 2009); the Fund will typically hold between 40 and 60 stocks
  - The number of holdings has gone up since last year because small cap stocks are ranking higher in their model
- 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 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 2.9% in 2008
  - Most of the underperformance was due to stock selection mostly in the Energy sector
  - An underweight in Financials has added value; stock selection in Financials (overweight the banking sector and underweight Manulife) also added value
  - Most of the underperformance was concentrated in the period from March 9 to May 31, 2009 when low quality and high volatility stocks have outperformed high quality stocks; the portfolio underperformed by 4.8% during that period
  - The best performing stocks of 2009 had bottom returns during the fourth quarter of 2008, weak balance sheets and a weak risk/adjusted return profile
  - Highstreet did underperform during the fourth quarter of 2008, which may seem inconsistent with their explanations as to why they also underperform in 2009
  - Shaun Arnold explained that they underperformed in Q4 2008 for two reasons:
    - The risk metrics that had been good historically at rotating the portfolio to less risky areas didn't work
    - The correlation among stocks went to record levels; only high yields, cash and gold added value, which is not consistent with their mandate
  - The portfolio outperformed by 0.8% from January 1 to March 9 and by 0.5% from May 31 to December 31, 2009
- Positive contributors to the performance of the portfolio in 2009 include:
  - Potash Corp.
  - Petro-Canada (good growth profile and low valuation)
  - National Bank
- Negative contributors to the performance of the portfolio in 2009 include:
  - Nexen Inc.

  - Suncor Energy Inc. (no earnings growth, higher beta)
  - Bombardier Inc.
- During the fourth quarter of 2009 the portfolio matched the benchmark return (3.9%); although the market was more rational in October and November, some macro events added volatility in early December
- The portfolio currently has a large exposure to the banking sector; the risk/return profiles of the banks is attractive and the weight of the banking sector is addressed during their fundamental analysis overlay
- Portfolio turnover was 65% in 2009
  - It's in line with the long run but higher than the last five year average
- 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
- The portfolio performance is measured relative to backtested data; if the results are out of line, a review of the portfolio manager will follow
- The portfolio performance is also compared to a peer group; a review of the model will be done if the portfolio underperforms

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
    - 40% managing the team and other CIO related duties
    - 10% client servicing and sales
  - The research team now has 5 individuals; Caleb Zimmerman, a software developer, recently moved from information services to the research team
- No personnel turnover on the Canadian equity team

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 (80% to 120% of S&P/TSX volatility).
- 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 earnings growth, estimate revisions or risk adjusted return 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
- The fundamental analysis overlay includes a deeper analysis of earnings to make sure that they are sustainable in the long run
- 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

- Their risk control process includes the following:
    - A monthly presentation is made to Paul Brisson, CEO and Rob Jackson, Chief Risk Officer to ensure that the portfolio characteristics are consistent with the mandate
        - They made sure that the portfolio managers were aware of the disconnect between the model and observed results in recent months
    - The Chief Risk Officer reviews all the portfolios on a weekly basis
    - A quarterly presentation is made to the Board of Directors of Highstreet
- They use a proprietary statistical-based model for risk management that is fully integrated with portfolio construction
- They ensure that portfolio risk is controlled through:
    - Volatility ratio bands
    - Sector/market cap exposures
        - Sector weights are allowed to deviate from the benchmark weights by 7%
    - Security limits
- Their risk management process focuses on the following risk metrics for individual securities:
    - They study the last 75 days of stock price movement and extrapolate how the portfolio will react
    - Risk-adjusted return (M^2)
    - Semi-variance
    - Value-at-Risk
- Their initiatives to improve risk management will include the following in 2010:
    - Risk budgeting rollout for balanced mandates

  - Implied volatility (through the option market) research and implementation
  - Enhanced scenario analytics (through purchase of risk metrics by AGF)
  - System enhancements (back office management system)
- Overall, Highstreet risk controls are adequate and they seem to place more emphasis than their peers on the development of risk management metrics that they overlay to the portfolio. This research differentiates them from their peers and helps in generating value added.

Research Agenda

- We met with John McNair, Senior Vice President and Head of Investment Research
- The research team now has five members with the recent addition of Caleb Zimmerman
- 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
- At our last review we discussed that the Canadian Equity strategy would be up for review in the summer of 2009
- It took longer than initially expected because they decided to improve their backtesting engine; they feel that their new backtest engine is more robust than the one provided by CPMS
- They are now targeting the end of March 2010 to complete the review
- They review 4-year and 2-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 2010 the priorities are as follows:
  - Canadian Core GVQ+R currently under way (UWO’s strategy)
  - U.S. Small Cap Core GVQ+R
  - Canadian Growth G+R
- 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
- Their research initiatives will focus on the following:
  - Inflection point analysis

        - Highstreet’s model does not work well when the market changes direction quickly and when it is irrational; their research in this area will try to improve the model under irrational markets
    - Risk overlay
        - Several risk management projects (see Risk Controls section) are being undertaken by the Chief Risk Officer, including implied volatility, integrating macro factors, etc.
    - Risk budgeting for Balanced mandates
    - Style bias
        - Valuation metrics, such as price-to-cash flows, will be reviewed
    - I am encouraged to see the changes made to the research area. The additional staff and the new backtesting engine will improve the quality of the research conducted. The research topics presented look average compared to the rest of the industry and many of them are only at an exploratory stage (e.g. integration of macro factors).

Capacity

- Capacity is not an issue now; they currently have about $4.8 billion in their Canadian Equity Pooled Fund and they have determined that their capacity is about $5 to $7 billion.

Trading

- We met with Vidis Vaiciunas, Vice President, Head of Trading
- We discussed their trade management system
- They use all venues available to trade
    - For liquid stocks they trade directly on a traditional exchange
    - They use alternative trading systems, including “dark pools”
        - In Canada they don’t use LiquidNet but they use all the other dark pools
    - They use peer-to-peer networks
- They use the following methods to trade:
    - Direct market access and algorithms
    - Traditional broker execution
    - Combination of above
- Highstreet reviews its brokers and transaction costs every six months
- Their broker selection is based on the following criteria:
    - Demonstrated execution ability
    - Access to multiple liquidity venues
    - Technology
    - Communication methods and skills
    - Services and research
    - Back office settlements
- They look at the following criteria to measure best execution:
    - Multiple trading venues
    - Price, speed and certainty of execution
    - Prevailing market conditions

    - Displayed and non-displayed liquidity
    - Client instructions and policies
    - Settlement process and efficiency
    - Costs of execution (commissions and fees)
    - Compliance with procedure and policies
- Vidis believes that dark pools will be used more frequently in the future; regulatory changes are in the works; predatory and high frequency trading have increased the cost of trading
- Vidis can provide some insight on liquidity to initiate transactions in the portfolio
- Highstreet provided an update on their securities lending program:
    - The program is done through RBC Dexia
    - They look at the creditworthiness of all the borrowers
    - The process is transparent and does not generate a significant amount of revenues

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 2004; there were no issues at the time
- Employees have to comply annually with a Code of Conduct
- Employees have to invest their assets over $150,000 in Highstreet funds
- Currently, 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 a security is not in play, i.e. Highstreet is not trying to buy or sell the security
- By the end of the year no personal trading will be allowed
- Highstreet or its employees are not in a conflict of interests
- They use soft dollars to purchase data and software; they make sure that the expenditures comply with regulation; they review the expenditures annually and it requires CFO approval to add a new expenditure
- Overall Highstreet believes that its compliance process has improved because of its SEC approval

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

Date: February 2, 2010
Meeting time: 9:00 AM to 12:00 PM
Location: 244 Pall Mall Street, Suite 200, London, Ontario

UWO Attendees:

Stephen Foerster, Prof. Richard Ivey School of Business
Jim Loupos, Internal Audit
Martin Bélanger, Director, Investments

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 PORTFOLIO:

- 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
- Discuss changes made to the portfolio
- Detractors/contributors to performance
- 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.
- Discuss portfolio positioning

RESEARCH:

- Review of models and systems
- Portfolio construction
- Overview of research agenda
- Provide timeline of past changes to the model

TRADING:

- Overview of trading systems and methodology
- Execution analysis
- Discuss total trading costs
- Discuss broker/dealer selection
- Discuss stock exchange selection

COMPLIANCE:

- Provide an overview of your compliance processes
- 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
- Confirm that any conflict of interest or potential conflict of interest involving Highstreet or key investment personnel has been disclosed