January 28, 2021

Western Pension Plans Annual Investment Commentary (2020)

The following commentary was prepared by Western University on behalf of the Joint Pension Board for the year-ended December 31, 2020. A full description of the investment options, along with performance history, is available to members within their Sun Life Plan Member account. Members may log in at sunlife.ca/western.

Market Summary

If someone fell asleep at the beginning of 2020 and woke up on December 31, they would probably think that the financial markets had a solid and uneventful year. Most asset classes posted positive returns and although equities did not do as well as in 2019, some markets, including the U.S. and emerging markets, experienced double digit returns. Fixed income returns were also surprisingly high, given the low interest rate environment at the beginning of the year, with major bond indexes from across the world posting returns approaching 10% (see below for a more detailed overview of fixed income returns).

However, the year was anything but boring. Everyone has been impacted by COVID-19 in some way or another. The world economy is expected to contract by 4.9% in 2020 (source: IMF) and stock markets from all over the world took a beating. From its peak on February 20, 2020 to its trough on March 23, 2020, the S&P/TSX Composite Index lost 37%. Similar returns were experienced elsewhere.

Yet, from March 24 onward, the world equity markets staged a remarkable rally. The U.S. posted strong returns again with a 18.40% return in local currency for the full year, as measured by the S&P 500 Index. As the Canadian dollar appreciated against the U.S. dollar in 2020, the S&P 500 total return in Canadian dollar was lower at 16.32%. Emerging Markets equities also did very well with a 16.62% return, as measured by the MSCI Emerging Markets Equity Index. Canadian and Non-North American developed equity markets posted more modest returns with 5.60% and 6.38%, respectively. We should point out that this recovery was extremely uneven, as the markets experienced a significant divergence between growth and value stocks. Many growth stocks (companies that experience significant growth in revenues and earnings) benefited tremendously from the stay at home orders triggered by the pandemic, while value stocks (companies that are considered to be undervalued based on some metrics such as price-to-earnings ratio) did poorly. Growth stocks outperformed value stocks by more than 35% in the U.S. in 2020 (as measured by the return differential between the Russell 3000 Growth Index and the Russell 3000 Value Index). This divergence in investment style impacted the Western Pension Plans, with all underlying growth managers outperforming their benchmark and all value managers underperforming. This highlights the need to properly diversify a portfolio. The six equity options offered to members returned between 4.03% and 16.24%, after all fees and management expenses taken into account.

Despite starting the year at a low level, interest rates further dropped in 2020 because of the various measures taken to stimulate the economy, in response to the pandemic. The FTSE Canada Universe Bond Index, the main measure of the Canadian market, posted a return of 8.68% in 2020. Unfortunately, corporate bonds were negatively impacted in 2020 and it hurt the performance of the Diversified Bond Fund, which nevertheless returned a respectable 5.30%. Interest rate changes have a greater impact on bonds with a longer duration and as such, the FTSE TMX Long-Term Bond Index returned 11.62% last year. As the Bank of Canada cut its key interest rate from 1.75% to 0.25% early in the year, the return on 91-Day T-Bills was negatively impacted, with the FTSE 91-Day T-Bills returning 0.86% in 2020, compared to 1.61% in 2019. As the expectations for central bank rate increases are fairly low, money market returns should be subdued for the foreseeable future.

So where does that leave us as we are entering 2021? Investment experts are split regarding the direction of the stock market. Some argue that the market is susceptible to a correction, due to its extreme valuation, irrational behaviour by retail investors and more initial public offerings than in 2000 during the "tech bubble". On the other hand, some argue that the market is not due to a correction soon because although some stocks are significantly overvalued, the broader stock market is not, risk-free interest rates are now at a record low and justify a premium for the stock market and we are not observing the level of leverage or financial imbalances generally associated with bubbles bursting. So what should investors do? Given the obvious uncertainty surrounding the market, building a diversified and resilient portfolio is the best way to handle the various environments that the future will bring.

A summary of market performance by asset class follows:

Annualized returns (in Canadian dollars) for the periods ending December 31, 2020

Market index	1 year return	3 year return	5 year return
Cash/Money Market Funds			
FTSE TMX 91-Day T-Bill	0.86%	1.30%	0.99%
Bonds			
FTSE TMX Universe Bond	8.68%	5.61%	4.19%
FTSE TMX Long Term Bond	11.90%	8.15%	6.77%
FTSE TMX Short Term Bond	5.29%	3.42%	2.26%
BC Global Aggregate Bonds - Hedged	5.33%	4.57%	4.00%
Equities			
S&P/TSX Composite	5.60%	5.74%	9.33%
S&P 500 - Unhedged	16.32%	14.81%	13.24%
S&P 500 - Hedged	15.79%	12.35%	13.87%
MSCI ACWI SMID	14.12%	8.80%	9.71%
MSCI EAFE	6.38%	5.37%	6.12%
MSCI ACWI	14.77%	11.26%	10.92%
MSCI Emerging Markets	16.61%	7.16%	11.28%
Canadian versus U.S. Dollar	2.04%	-0.40%	1.69%

What's New

One change took place during 2020. On June 26, 2020, Arrowstreet Capital took over as the manager of the Global Small-Mid Cap mandate of the Diversified Equity Fund. The mandate was previously managed by BlackRock on an interim basis in a passive strategy, following the termination of Franklin Templeton in 2019.

In addition, the Joint Pension Board spent a significant amount of time in 2020 reviewing the Diversified Equity Fund, with the support of Mercer, the plan's investment consultant. Changes are expected to be implemented in early 2021 and involve an overall shift to managers with global mandates, a reduction in the Canadian equity exposure, the removal of currency hedging on the U.S. equity allocation, an increased exposure to Emerging Markets and an increase in active management.

A summary of the assets by fund and manager follows:

Western Pension Plan as at December 31, 2020

Investment fund	Funds managed ($millions)	% of fund	% of total assets	Fund asset class	Manager style
MONEY MARKET FUND					
Sun Life Global Investments (Canada)	$61.4	100.0%	4.8%	cash	active
SUN LIFE GDIA					
Sun Life Global Investments (Canada)	$9.8	100.0%	0.8%	cash	n/a
DIVERSIFIED BOND FUND					
Romspen Investment Corporation	$44.6	13.9%	3.5%	commercial mortgages	active
BlackRock Asset Management Canada	$81.0	25.3%	6.4%	domestic bonds	passive
AB (AllianceBernstein)	$194.0	60.7%	15.2%	domestic and foreign bonds	active
	$319.5	100.0%	25.1%		
CANADIAN BOND FUND					
BlackRock Asset Management Canada	$19.7	100.0%	1.5%	domestic bonds	passive
LONG TERM BOND FUND					
BlackRock Asset Management Canada	$23.2	100.0%	1.8%	domestic bonds	passive
SOCIALLY RESPONSIBLE EQUITY FUND					
MFS Investment Management	$18.3	100.0%	1.4%	global equity	active-value
DIVERSIFIED EQUITY FUND					
Connor Clark & Lunn Financial Group	$94.7	14.8%	7.4%	domestic equity	active-growth
Beutel, Goodman & Company	$94.2	14.7%	7.4%	domestic equity	active-value
State Street Global Advisors	$63.6	9.9%	5.0%	US large-cap equity (hedged)	passive
State Street Global Advisors	$62.2	9.7%	4.9%	US low volatility	passive - managed volatility
Arrowstreet Capital Global Small Cap	$32.2	5.0%	2.5%	global small-mid cap equity	active-core
T.Rowe Price	$75.6	11.8%	5.9%	global equity	active-growth
Harris Associates	$86.7	13.5%	6.8%	global equity	active-value
MFS Investment Management	$49.8	7.8%	3.9%	international equity	active-growth
AB (AllianceBernstein)	$50.4	7.9%	4.0%	international equity	active-value
William Blair & Company	$31.8	5.0%	2.5%	emerging markets equity	active-growth
	$641.2	100.0%	50.3%		
CANADIAN EQUITY FUND					
Connor Clark & Lunn Financial Group	$32.5	49.6%	2.6%	domestic equity	active-growth
Beutel, Goodman & Company	$33.0	50.4%	2.6%	domestic equity	active-value
	$65.5	100.0%	5.1%		
US EQUITY HEDGED FUND					
State Street Global Advisors	$40.1	100.0%	3.1%	US equity (hedged)	passive
US EQUITY UNHEDGED FUND					
BlackRock Asset Management Canada	$47.6	100.0%	3.7%	US equity	passive
NON-NORTH AMERICAN FUND					
MFS Investment Management	$13.65	49.9%	1.1%	international equity	active-growth
AB (AllianceBernstein)	$13.69	50.1%	1.1%	international equity	active-value
	$27.3	100.0%	2.1%		
LIQUIDATING TRUST	$0.0	100.0%	0.0%		
CASH IN PLAN ACCOUNTS	$0.0	n/a	0.0%		
TOTAL PENSION	$1,273.6	100.0%	100.0%		
BALANCE INCOME FUND* (70% DBF + 30% DEF)	$71.9		5.6%		
BALANCE GROWTH FUND* (70% DEF + 30% DBF)	$328.3		25.8%		

*These assets are included in the Diversified Bond Fund and the Diversified Equity Fund totals.

OVERALL PLAN ASSET MIX	
Cash	5.6%
Bonds & Mortgages	28.5%
Equities	66.0%