REPORT

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: September 14, 2021
Re: Fund Manager Performance Review – Q2 2021
Report: ONE JIB-019-21

1. RECOMMENDATIONS

It is recommended that the Board:

1. Receive the report.

2. SUMMARY

This report summarizes the performance of the ONE Investment Prudent Investment funds for the second quarter of 2021. It is intended to provide a brief overview of performance and contributing factors.

While the equity funds had quite strong performance in the quarter, the returns of the fixed income mandates were negatively affected by changes in interest rates in the quarter, leading to mixed results among the three fixed income funds.

3. BACKGROUND

The ONE JIB and ONE Investment have a responsibility to review the performance of the investment managers and to ensure they are comfortable with how the mandates are being managed as outlined in the Policy for Reviewing External Fund Managers. On a quarterly basis the CIO provides a summary of his observations about performance of the Funds.

4. ANALYSIS

The ONE Canadian Equity Fund had returns of 5.5% in the quarter

The Canadian equity market continued to perform strongly, outperforming US and global equity markets in the quarter. The Fund's performance, while strong in absolute terms, lagged the returns of its performance benchmark by about 3% in the quarter. Sector allocation choices and security selection choices by the manager both contributed to this underperformance. This brings the return on this fund since inception a year ago to 35.7%, which reflects the strength in the recovery of the equity markets after the pandemic-related sell off last year.

While the fund had an overall exposure to the Information Technology sector that was broadly similar to the benchmark, the underexposure to Shopify was a key reason for its relative underperformance. The fund has a half-weight to Shopify relative to the benchmark, and it returned over 30% in the quarter.

Another more notable issue that detracted from performance was a large overweight exposure to the healthcare sector. The Fund's single holding in the sector, Bausch Health, had returns of negative 8.8%, as it gave back some of the strong gains achieved in the first quarter.

Stock selection in the Consumer Staples sector detracted from performance, as Saputo and Maple Leaf Foods had negative returns. The largest positive contributor to performance was Gildan Activewear; the fund has a 4% weight to this holding that appreciated more than 19%. Security selection in the financial sector also made a positive contribution to relative performance.

The ONE Global Equity Fund had returns of 6.6% in the quarter

The Fund had strong performance, outperforming its benchmark by about 1% in the quarter as equity markets continued to rally and hit all-time high levels. Thematically, the overall performance of the global equity markets was driven by strength in US equities and large market capitalization stocks. The market rally was broad based. Most sectors generated single digit returns in the quarter, except for the utilities sector, which had negative returns. The Fund has generated returns from inception of 16.3%.

Sector allocation of the Fund did not make a meaningful impact to the performance of the Fund relative to its benchmark. Allocation to the industrials sector detracted from relative performance, which was entirely offset by a positive impact of the zero allocation of the Fund to the utilities sector.

The Fund's outperformance in the quarter was a result of strong security selection, especially in the industrials and financials sectors. Most other sectors also made positive contributions, with the major exception being the Information technology sector where security section detracted from performance. The Fund's holdings in the technology sector collectively underperformed both the benchmark and the technology sector returns of the benchmark, though a few large holdings within the technology sector did perform well.

The performance of several large fund holdings had a strong positive impact on overall performance, especially in the technology sector where Alphabet Inc. (Google) and Microsoft Corporation performed well. The Fund's largest holding, Wolters Kluwer NV, which operates as a global information services and solutions provider, also had strong performance. Collectively the performance of these three holdings, which represent 11.5% of the fund, contributed 1.75% to overall fund returns.

The Global Bond Fund returned 1.1% in the quarter

The Global Bond Fund's returns were strong considering the market environment, outperforming its benchmark, which had marginally negative returns in the quarter. The Fund's returns were nearly identical to the benchmark on a fully hedged basis.

Currency management was the single largest contributor to performance with the Fund, as the Fund was 83% hedged to the Canadian dollar. The Canadian dollar strengthened versus most major currencies in the quarter, so the currency hedge locked in returns that would have otherwise been eroded by the currency movements. The size of the currency hedge declined marginally during the quarter.

Duration positioning had a negative impact on relative performance due to the much shorter duration of the Fund. The Fund gained less benefit from declines in longer-term interest rates in the quarter than its benchmark did.

The Fund's heavy exposure to high yield bonds was a positive contributor. High yield bonds performed well relative to higher credit quality bonds. The manager's high yield holdings are concentrated in the higher rated, less speculative, high yield securities. BB rated bonds outperformed higher rated bonds in the quarter.

Credit spreads expanded dramatically last year in response to the unfolding pandemic and have contracted in several successive quarters as investors have become more willing to accept credit risk. The credit spreads have already recovered to pre-pandemic levels and are closer to longer-term valuation trends than they were a year ago.

The Canadian fixed income funds had returns of -0.1% and 0.8% in the quarter

The ONE Canadian Government Bond Fund had a negative return of 0.1% in the quarter, while the ONE Canadian Corporate Bond Fund generated a positive return of 0.8%. The net performance numbers for both Funds were slightly below their respective benchmarks.

The Funds are both positioned to have slightly lower duration than their benchmarks, and as longer-term bond yields declined in the quarter, the Funds gained less benefit from falling rates than their benchmarks. In terms of absolute performance, the much longer duration of the ONE Canadian Corporate Bond Fund allowed it to benefit more from falling long term interest rates, which explains its stronger absolute returns in comparison to the ONE Canadian Government Bond Fund.

Both Funds continue to have heavier corporate bond exposure than their benchmarks, allowing them to have higher recurring yields than their benchmarks. The exposure to corporate credit has been reduced somewhat over the last nine months as credit spreads have compressed from very wide levels to levels more in line with historical norms.

5. CONCLUSION

The performance of the ONE Prudent Investment Funds in the quarter was characterized by very strong equity returns and more muted returns from the fixed income mandates. Staff reviewed manager performance for the quarter and did not identify any major performance issues that warrant concern.

Drafted by: Keith Taylor, Chief Investment Officer
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