

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: November 17, 2021
Re: Fund Manager Performance Review – Q3 2021
Report: ONE JIB-O47-21

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 third quarter of 2021, including a brief overview of contributing factors.

Equity markets were strong in July and August, which was largely offset by weakness in September. While the ONE Global Equity Fund outperformed its benchmark, the ONE Canadian Equity Fund underperformed.

While major global central banks have yet to increase policy rates, interest rates in the financial markets increased slightly, which provided a headwind for the performance of fixed income investments. The performance of the Funds as of September 30th is summarized below:

Performance by Fund

	Quarter	1 Year
ONE Canadian Equity Fund	-2.2	25.9
ONE Global Equity Fund	3.9	16.9
ONE Canadian Corporate Bond Fund	-0.3	-1.2
ONE Canadian Government Bond Fund	0.0	0.1
ONE Global Bond Fund	0.4	4.0

3. BACKGROUND

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 observations about the performance of the Funds.

4. ANALYSIS

Weakness in equity markets in September largely erased earlier gains during the quarter as market sentiment changed

While the performance of equity markets in July and August was strong, it was weaker in September as market sentiment became more negative. Concerns about slowing growth, supply chain bottlenecks, rising inflation, and the potential for a more accelerated timeline for central banks to raise interest rates weighed on equity markets globally.

The Canadian Equity Fund had returns of -2.2% in the quarter

While Canadian equity markets saw some strength during the quarter, the market finished the quarter relatively unchanged. The Canadian Equity Fund underperformed the broader Canadian equity market during the quarter, with returns of negative 2.2%. Over the last year the Fund has performed very well, with returns of 25.9%.

Allocations to the Consumer Staples and Consumer Discretionary sectors were key contributors to the underperformance of the Fund in the quarter. The Fund has a large overweight exposure to the Consumer Discretionary sector, which had a negative impact on performance due to the sector's weakness in the quarter, declining by about 9%. Security selection within the Consumer Staples sector also negatively affected performance. The Fund had no exposure to Loblaws and George Weston, the two best performing stocks in the sector, while it had an overweight exposure to Saputo Inc., which declined over 12%.

The worst performing sector in the Canadian market during the quarter was the Health Care sector. The Fund has a significant overweight allocation to the sector, represented by a single stock, Bausch Health, with a holdings weight of 5%. This holding had returns of -2.9% in the quarter which, although negative, outperformed the broader sector. The sector declined almost 20% because of sharp declines in the prices of marijuana-related equities.

The Global Equity Fund had returns of 3.9% in the quarter

The Global Equity Fund outperformed its benchmark with returns of 3.9% in a period when returns for the broader global equity markets were closer to 1%. Over the last 12 months the Fund has achieved returns of about 17%. These returns are expressed in Canadian dollars, and the translation of foreign currency returns into Canadian dollar returns had a meaningful positive impact on performance. Currency movements in the last quarter contributed 1.4% to the Fund's returns in the quarter, primarily as a result of a stronger US dollar in the period. The manager does not hedge foreign currency exposure.

Security selection by the investment manager had a positive contribution to performance in the quarter. Holdings in the information technology and industrial sectors had strong positive impacts on performance. As widespread optimism in equity markets over the past year gave way to more caution, the portfolio outperformed its benchmark as many higher-quality companies tended to perform well. The manager's investment style, which focuses on fundamentals and investment quality, was rewarded in the quarter.

One holding that had a strong impact on performance was Aon Plc., a financial services company. This holding, which represents 3.4% of Fund holdings, had returns of 22.6% during the quarter. This rally followed the cancellation of a merger agreement with Willis Tower Watson that had raised antitrust concerns.

Chinese-related companies were an area of concern for many investors during the quarter. The Chinese government has been increasing market adverse regulatory measures on a number of industries. Chinese-related equities were negatively affected by this effort. The ONE Global Equity Fund does not presently hold any Chinese equities, which was a factor that helped the performance of the Fund relative to its benchmark.

The two Canadian Fixed Income Funds had returns of zero percent and negative 0.3% in the quarter with rising bond yields detracting from performance in the quarter

Bond yields rates nudged slightly higher in the quarter, which had a negative impact on the prices of existing bond holdings in the funds. The ONE Corporate Bond Fund, which is more sensitive to changes in interest rates than the other ONE fixed income pooled funds, produced a negative return of 0.3% in the quarter. Over the last year this Fund has produced returns of negative 2.2%.

The ONE Canadian Government Bond Fund is less sensitive to changes in interest rates, due to the shorter average maturity of the bonds held in the fund. While the bonds in this Fund generated income in the period, the weakness in bond prices offset this, leading to returns of zero percent in the quarter. Over the last 12 months the ONE Canadian Government Bond Fund had returns of negative 0.6%.

The ONE Global Bond Fund produced returns of 0.4% the quarter despite higher bond yields

The ONE Global Bond Fund was able to generate positive returns of 0.4% in the quarter despite a headwind of rising bond yields. The Fund has been able to generate positive returns of 3.1% over the last 12 months, outperforming its benchmark. These results are encouraging considering the backdrop that has generally been less favorable for bonds.

Currency movements had a modest positive impact on performance. The ONE Global Bond Fund has a variable currency hedging policy, and currently has 88.5% of its foreign currency exposure hedged against the Canadian dollar. While the strength of the US dollar had a strong positive impact on the Canadian dollar denominated returns of US holdings, the currency hedges of the Fund significantly reduced this positive impact on performance. While the currency hedge detracted from performance in the quarter, it has had a strong positive impact on Fund performance over the last 12 months.

The heavy exposure to US high yield bonds helped overall Fund performance in the quarter. While US Treasuries had flat to slightly negative performance in the quarter, US high yield bonds tended to have modestly positive performance. Allocation to emerging markets US dollar high

yield bonds also helped performance, driven by one key investment choice. The Fund has no exposure to Chinese high yield bonds, which were much weaker in the quarter after Evergrande Group, a large Chinese real estate company, missed a debt payment deadline. The absence of Chinese high yield bond exposure helped Fund performance in the quarter.

Global-oriented funds performed better than Canadian-focused funds in the third quarter

The ONE Global Bond Fund and the ONE Global Equity Fund were the best performing holdings within the ONE JIB investment Outcomes, both producing positive returns in the quarter. As these two holdings are the largest components of the Investment Outcomes, their performance led to overall positive returns in all of the Outcomes in the quarter, despite mixed performance across other ONE pooled funds in the quarter. As noted above, currency movements contributed to the positive performance of these global funds.

5. CONCLUSION

The CIO has reviewed manager performance in the third quarter and did not identify any major performance issues that warrant concern. The performance of the ONE Prudent Investment Funds in the quarter was more modest than in previous quarters, as the rally in equities paused. News of supply chain bottle necks and rising short term inflation indicators has dampened the performance of equity markets and led to slightly higher bond yields.

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