REPORT

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer
Date: October 20, 2020
Re: Overview of Global Fixed Income Mandate and Manager
Report: 20-029

1. RECOMMENDATIONS

It is recommended that:

1) The Board receive the report entitled Overview of Global Fixed Income Mandate and Manager for information.

2. SUMMARY

ONE Investment initiated a manager search for a manager for a Global Fixed Income Mandate in 2019 with input from ONE's Investment Advisory Committee (IAC), and the assistance of an investment consultant, AON. Manulife Asset Management was recommended as the manager for the Global Fixed Income Fund as a result of the process. This process was discussed at the May 20th ONE JIB meeting and ONE JIB approved the selection of investment managers for the Prudent Investment Program Funds, including Manulife Asset Management.

The mandate is intended to provide exposure to the universe of global fixed income investments, inclusive of emerging markets and high yield securities. The low interest rate environment and outlook for long term interest rates influenced the type of fixed income mandate chosen for the ONE Global Bond Fund. The mandate will use an 'unconstrained fixed income' approach, which is expected to produce higher returns than a traditional global fixed income mandate.

3. BACKGROUND

The ONE Global Bond Fund will leverage the mandate of an existing Manulife pooled fund

The ONE Global Bond Fund will hold a pooled fund to provide exposure to global fixed income securities. The two holdings in the ONE Global Bond Fund are anticipated to be the Manulife Investment Management Strategic Fixed Income Pooled Fund and residual cash. There is no immediate plan to transition to a separate mandate with the manager. Unlike the ONE Global Equity Fund, there are no tax efficiencies related to managing the mandate separately – withholding taxes would not be minimized using a separate account for the ONE Global Bond

Fund. Should the total assets in the ONE Global Bond Fund grow to sufficient levels the potential for a separate mandate can be revisited.

4. ANALYSIS

The IAC established priorities for selecting a Global Bond Fund manager

The IAC helped ONE Investment establish the following criteria for selecting the manager of the ONE Global Bond Fund:

1. A flexible and adaptive investment approach: Global Unconstrained Portfolio
2. A history of stable returns
3. A short duration for low interest rate sensitivity

These attributes were considered to be well-suited to the investment preferences and risk profile of municipal investors.

The Unconstrained Fixed Income approach was deemed to be a more advantageous approach rather than a traditional fixed income approach

The unconstrained fixed income mandate gives considerable latitude to the portfolio manager to actively manage the portfolio to add value. In a low interest rate environment, the returns that can be generated by 'clipping coupons' is limited. Additionally, there is limited room for interest rates to decline further, so there is very little potential for capital appreciation from long term bonds. The unconstrained approach is an active management approach where the manager uses a wide range of strategies to augment returns. This type of mandate tends to have exposures that are very dissimilar to the most major bond indices, and the manager uses both security selection to augment returns as well as top down strategies.

The manager provides exposure to a universe of securities and strategies that were previously unavailable to Municipal investors

The ONE Global Bond Fund is the largest of ONE JIB's pooled funds and should be considered a core offering for the Prudent Investment program. Gaining exposure to foreign bonds provides significant diversification benefits when compared to investing under the legal list. At the same time there is considerable opportunity to generate higher returns. The exposure to foreign currencies and the manager's active currency hedging strategy is just one example of an opportunity set that is not available under the legal list. Currency movements are heavily influenced by the dynamics of interest rates across countries. Active currency hedging could allow a fixed income manager to lock in a better yield while potentially insulating the investment from an offsetting movement in the currency. Exposure to foreign currencies is also an additional source of diversification for investors that is not available for investors only investing in Canadian securities.

The Fund also has meaningful exposure to high yield bonds and emerging market bonds that typically offer higher return potential. Exposure to the US bond market also provides opportunities that are not available in the Canadian bond market. The number of issues in the US is much larger, liquidity in the bond markets is much greater, and the type of fixed income products is much more diverse than is available within the Canadian fixed income universe.

The manager's approach is broadly diversified and relatively conservative in nature

The mandate invests across regions, countries, sectors and has exposure to a wide range of fixed income security types. Fixed income returns are heavily influenced by macro-economic factors, and these factors can vary across countries/regions and impact sectors of the economy differently. This implies that that there are some diversification benefits involved when investing in fixed income instruments globally. It also presents opportunities for the manager to add value by implementing trades where the investment manager has high conviction about the investment prospects

This mandate has relatively low interest rate sensitivity, with a 'duration' that typically is about 3.5 years. This means significant swings in interest rates have a limited impact on investment performance. The mandate also holds government securities, corporate bonds, and includes high yield bonds as well as investment grade bonds. The overall credit quality of the holdings is investment grade.

They have an active currency hedging strategy typically hedges greater than 50% of the portfolio back to the Canadian dollar. The interaction between international interest rates and currency movements means that a fully hedged approach may not be optimal. Hedging is used to reduce volatility and for diversification purposes but has also been used to enhance overall performance.

This product has a particularly low correlation to the Canadian government bonds, which implies good diversification benefits for the ONE JIB's prudent investment offering.

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