REPORT

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: February 17, 2021
Re: Investment Manager Quarterly/Annual Review
Report: 21-008

1. RECOMMENDATIONS

It is recommended that the Board:

1. Receive the Investment Manager Quarterly/Annual Review report for information.

2. SUMMARY

This report summarizes the performance of the respective ONE Investment Prudent Investor funds. All Prudent Investor funds produced positive returns in the quarter.

This report primarily focuses on performance in the fourth quarter, but also includes annual performance information. The report provides a short explanation of the reasons for each fund's performance.

3. ANALYSIS

Canadian equities continued to produce strong returns

The Canadian Equity Fund produced another quarter of very strong performance, gaining over 11% in the quarter. Security selection had a strong positive impact, allowing the Fund to outperform the market. One key driver was the exposure to the consumer discretionary sector, where the manager had a large overweight exposure achieved primarily via exposure to two stocks, Magna International and Gildan Activewear. These two stocks had stellar performance in the quarter, up 48.9% and 36.6% respectively, which significantly enhanced overall Fund performance.

The financial sector, which is the largest segment of the Canadian equity market, performed very well in the quarter. While the absolute performance of the Fund's holdings in the financial sector was good, the notable underweight exposure to the sector had a negative impact on relative performance.

The Fund's large overweight exposure to the consumer staples sector detracted from performance, as this was the weakest sector of the market in the quarter. Security selection within the consumer staples sector was good, helping to offset most of the negative performance of the sector.

The Fund continues to have light exposure to the materials and energy sectors. While the energy sector performed well in the quarter, materials performed poorly. The underweight exposure to these sectors reflects the Fund's mandate, which attempts to reduce portfolio risk by limiting exposure to cyclical commodity-driven investments.

Stock markets witnessed a large rotation away from growth and technology companies, which led markets most of the year, preferring value names and cyclical industries, which had been laggards. The portfolio remains balanced across defensive and pro-cyclical exposures, with a strong quality bias.

The overall performance of the fund since inception on July 2, 2020 was a gain of 17.2% as the equity markets continued to recover from a precipitous drop in late March due to the Covid-19 pandemic. The manager outperformed its benchmark by about 4% since inception. This strong market performance reflects optimism returning to the marketplace but is also a result of monetary policy. The liquidity that central banks injected into the economy earlier in the year is helping to push markets higher, while lower interest rates imply higher equity valuations.

Canadian fixed income – high quality focus of fund limited upside potential
The portfolios continue to have a heavy exposure to high credit quality bonds. However, this overweight exposure was reduced meaningfully during the fourth quarter, following the strong rallying within credit markets. The Canadian Government Bond Fund and the Canadian Corporate Bond Fund generated modest returns of about 0.3% and 0.6%, respectively, in the fourth quarter, slightly outperforming their benchmarks.

The Canadian fixed income funds are focused on very high credit quality bonds, with no exposure to BBB rated or high yield bonds. Lower credit quality bonds tended to perform much better in the quarter, which the funds were not able to benefit from. This positioning is not an active choice by the manager but is reflects the investment mandates. The Canadian Government Bond Fund and the Canadian Corporate Bond Fund's investment guidelines were initially designed to mirror similar investment portfolios available under the legal list, which precluded investment in BBB rated bonds. ONE JIB's New Products Committee will have the opportunity to revisit these mandates later in the year and may consider modifying the mandates to potentially include lower credit quality Canadian bonds.

The manager continues to maintain a generally positive outlook as they believe global central banks will continue to support markets and the rollout of vaccines should accelerate economic activity through 2021. However, credit spreads shifted dramatically during 2020. They increased substantially last March in reaction to the pandemic. Spreads contracted as the panic in the markets subsided over the course of the year, leading to strong performance from corporate bond exposure. Credit spreads have now narrowed to a level below the long-term averages. In response to this, the manager has trimmed credit exposure in the fourth quarter but still retaining heavy exposure to corporate credit. In the quarter the manager increased exposure to Canadian sovereign debt as a result.

Within corporate bonds, the exposure was lowered across industries. Financials were the largest reduction, largely through selling bank positions. Energy was also reduced following the recent strong performance of that industry. Corporate positioning remains highly selective. The manager tends to target bonds with a higher average yield than the benchmark, while also maintaining the flexibility to add to risk during episodes of volatility. Finally, with interest rates suppressed, the ability to add value through active duration and yield curve positioning is limited. Therefore, duration is being managed to keep it close to benchmark levels.

The Canadian Government Bond Fund has produced returns of approximately 1% since inception on July 2, 2020, which exceeded the performance benchmark. The Canadian Corporate Bond Fund is up about 1.3% in the same period, also outperforming its benchmark. The performance in the third and fourth quarters were thematically very similar, being driven primarily by tightening credit spreads on a portfolio that is biased towards corporate credit. With credit spreads already below the historical average, it is less likely that this overweight allocation to credit will continue to bear fruit.

The Global Bond Fund had returns of 2.9% in the quarter helped by currency and credit exposure
The Fund produced returns of 2.9% in the fourth quarter and 4.7% since its inception on July 2, 2020. Over both periods the performance exceeded its performance benchmark (on both a hedged and unhedged basis).

The improvement in credit markets in the quarter helped the performance of the Global Bond Fund. In March 2020, investors reacted to the news of a global pandemic by reducing risk, leading to a selloff in equities and lower credit quality bonds. This resulted in a dramatic widening of credit spreads, which peaked in March. Credit spreads have since contracted for three consecutive quarters and now are below the historical average. The Fund's overweight exposure to corporate credit benefitted from this trend. In terms of credit exposure, the manager's most notable overweight exposure is in BBB and BB rated bonds with significant underweight exposure to bonds rated A or above. The fund has no exposure to bonds rated below CC. This positioning has allowed the Fund to benefit from tightening credit spreads while avoiding exposure to the more speculative tiers of high yield bonds.

Currency management made a meaningful contribution to Global Bond Fund's performance, driven by an underweight to the US dollar, Euro, and Japanese yen, which weakened against the Canadian dollar. At quarter end, the Canadian dollar represented 88.5% of the currency exposure of the Fund, reflecting the active currency hedging that the Fund employs. Evaluated against an unhedged benchmark, currency management was the largest contributor to relative performance, followed very closely by asset allocation choices. Yield curve positioning had little impact on performance, while security selection had a minor negative impact on performance.

The Global Equity Fund's 3% return in the fourth quarter was adversely affected by security selection
The positive market backdrop helped the Global Equity Fund appreciate approximately 3% in the

quarter. Strong returns in the fund's holdings in the consumer discretionary and information technology sectors made a significant contribution to returns. The manager's allocation choices across other sectors were less of a driver of performance than the choice of individual securities. Security selection in the quarter had a significant negative impact on relative performance. Several holdings simply did not participate in the market rally, while peers in similar industries/sectors performed better. This meant that relative performance lagged behind the benchmark.

The manager focuses on wealth-creating businesses, excellent management teams, and stocks priced at a discount to intrinsic value, all of which should lead to solid returns over the long term. This approach is intended to provide meaningful downside protection in weak markets but tend to not fully capture the upside in rising markets. The weak relative performance in the quarter reflects the manager's investment approach, which simply was not fully rewarded in the quarter.

The absolute performance of the fund since inception has been quite strong, with returns of about 6.8%. While the fund's performance lagged behind the benchmark in the 4th quarter, its performance in the 3rd quarter was similar to the benchmark. The Chief Investment Officer suggests that significant performance deviations from the benchmark in any one quarter should not be a concern if the manager is adhering to its investment approach and guidelines but suggests that the ONE JIB monitor the performance more closely in coming quarters due to the magnitude of the underperformance (almost 600 basis points) in the fourth quarter.

The investment managers adhered to their investment management agreements
Each investment manager has certified that they managed the mandates in accordance with their investment management agreement since inception on July 2, 2020. Neither the Chief Investment Officer nor the Chief Compliance Officer have identified any issues with the investment managers at this time.

4. CONCLUSION

Investment performance in the fourth quarter and since inception has been positive for all Prudent Investment Funds.

Drafted by: Keith Taylor, Chief Investment Officer
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