REPORT

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: May 11, 2021
Re: Fund Manager Performance Review – Q1 2021
Report: 21-027

1. RECOMMENDATIONS

It is recommended that the Board:

1. Receive the Investment Fund Manager Performance Review Q1 2021 report for information.

2. SUMMARY

This report summarizes the performance of the ONE Investment Prudent Investment Funds in the first quarter of 2021.

The equity funds produced positive returns in the quarter, while all three of the fixed income funds had negative returns in the quarter.

The report provides a short explanation of the reasons for each fund's performance.

3. ANALYSIS

The ONE Canadian Equity Fund returned 9.7% for the quarter

The ONE Canadian Equity Fund produced another period of very strong performance, gaining 9.7% in the quarter. This comes on the back of very strong performance in the two previous quarters, resulting in a 28.6% return since inception on July 2, 2020. The cyclical nature of the Canadian equity market means it tends to outperform other equity markets during an economic recovery. This has tended to benefit Fund performance as global equity markets recover from a significant pandemic-related selloff in the first half of 2020.

The energy sector performed well in the quarter because of a 20% increase in crude oil prices. Additionally, the financial sector performed strongly, up close to 14%, as banking equities benefitted from a steepening yield curve (i.e., long-term interest rates rising more than short-term rates). The Fund, by design, has lower exposure to these sectors relative to the performance benchmark, limiting its participation in the gains in these two sectors. The materials sector was the weakest performer in the quarter, with returns of about -7%. The Fund's allocation to this sector was significantly lower than the benchmark, mitigating its impact on performance.

The health care sector, the smallest sector of the Canadian equity market, had a significant contribution to overall fund performance. The investment manager had only one holding in this sector, Bausch Health Companies Inc., which represented 5.1% of the Fund. This equity responded to strong results and improving prospects with an increase over 50%. Magna International, which is the largest holding in the Fund (weight 5.3%), announced a joint venture with LG Electronics and several technology and electric vehicle announcements related to its contract manufacturing business. These positive developments helped Magna produce returns of 22.8%, which also had a strong positive impact on overall Fund returns.

The ONE Global Equity Fund gained 2% in the quarter

The ONE Global Equity Fund produced returns of 2.0%, modestly underperforming its benchmark in the quarter. Returns since inception rose to 9.0%. These returns reflect the ongoing recovery that has bolstered global equity markets in recent months. As confidence in an economic recovery mounts, equities continue to perform well.

The ONE Global Equity Fund's performance in the quarter was driven largely by five of the Fund's 62 equities. The five equities that contributed the most to Fund performance in the quarter had returns ranging from 15% to 31%. The five equities that detracted the most from performance had returns between -4 and -9%.

Strong returns in the consumer discretionary and information technology sectors made a positive contribution to Fund performance. While the Fund had an underweight exposure to the communication services sector, its holding in this sector produced strong returns of 11.4%, well exceeding sector returns, leading to a positive contribution to relative performance. Exposure to the information technology sector was broadly similar to its representation in the benchmark, with Fund holdings producing returns of 4%, notably better than the sector returns of the benchmark. The best performing sector in the quarter was the energy sector, which rose in response to crude oil prices, moving 20% higher. As the Fund has no exposure to the energy sector, it did not benefit from this trend, negatively impacting returns relative to its benchmark.

The rise in longer-term interest rates in the quarter led to a steeper yield curve that helped the performance of banking equities but had a mixed impact on certain other holdings. The selloff in bonds that happened in response to a perceived recovering economy, accelerated the rotation out of the "stay-at-home" equities (i.e., companies that thrived during the downturn), and toward more economically sensitive sectors. Many cyclical, value-oriented, and lower-quality businesses that had previously been negatively impacted by the pandemic fared well in the first quarter. The manager's approach does not emphasize these types of equities.

All three fixed income funds had negative returns for the quarter

The financial markets responded positively to the roll out of COVID-19 vaccines across the globe and were also encouraged by notable improvements in economic indicators. While neither the pandemic nor its negative economic consequences have been resolved, the outlook has improved significantly. Financial markets have started to anticipate the economic recovery, which has stoked some inflationary concerns. As a result, interest rates have moved higher, especially for longer-maturity bonds. Bond prices moved lower in the quarter as a result. It should be noted that major global central banks continue to target very low policy rates (i.e., very short-term interest rates) to accommodate the recovering economy. This has led to a steeper yield curve. For example, in Canada the 10-year yield increased 86 bps to 1.22%, while the two-year yield rose 5 bps to 0.24%.

The ONE Canadian Corporate Bond Fund, which has a relatively long maturity profile (with a duration of 5.4 years), had returns of -3.4% in the quarter. Its performance was weaker than the ONE Canadian Government Bond Fund (-0.9% return) and the ONE Global Bond Fund (-1.4% return), primarily due to the shorter duration of these two Funds (2.4- and 3.3-years duration respectively).

The Canadian fixed income funds were positioned to have slightly lower interest rate sensitivity than their benchmarks, and hence the movement in interest rates had a much less pronounced impact on relative performance of these two Funds.

The ONE Global Bond Fund has a maturity profile that is much shorter than its benchmark. Its duration is less than half the level of its benchmark, making it much less responsive to the rising rates. While the Fund still had negative returns in the quarter, this positioning helped mitigate the downside relative to its benchmark.

Currency hedging had a positive impact on performance of the ONE Global Bond Fund

The ONE Global Bond Fund uses currency hedge positions to help mitigate the impact of foreign currency movements on performance. The Fund has an active currency hedging policy, which allows the manager to diminish the amount of currency risk in the Fund. Currently the Fund's foreign currency exposure is only 18% and the Canadian dollar represents 82% of the exposure (down from 89% in the previous quarter). The impact of currency management was the largest contributor to the performance for the ONE Global Bond Fund during the period, as major currencies, including the US dollar, euro and Japanese yen, all weakened against the Canadian dollar. The hedges mitigated most of the negative impact of a stronger Canadian dollar.

Bond markets in the Asia-Pacific region held up the best during the quarter, while European and North American fixed-income markets posted larger declines. On a sector basis, government bonds declined the most, reflecting their greater interest-rate sensitivity, while high-yield corporate bonds were the best performers. While the manager remains positive on the long-term economic recovery, given the inherent risks in the short-term, they believe it is important to strike a balance between yield/risk and quality, stability, and liquidity.

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.

4. CONCLUSION

The overall performance of the ONE Prudent Investment Funds saw positive returns from equities and modestly negative returns from fixed income. These results reflect the improving economic outlook and rising interest rates.

Drafted by: Keith Taylor, Chief Investment Officer
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