



# REPORT

To: ONE Joint Investment Board  
From: Keith Taylor, Chief Investment Officer, ONE Investment  
Date: September 4, 2024  
Re: Fund Manager Performance Report Q2 2024  
Report: ONE JIB 2024-056

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## 1. RECOMMENDATIONS

It is recommended that the Board:

1. Confirm that its members have reviewed the Fund Manager Performance Reports for Q2 2024 provided in the Resource Library.
2. Receive the report.

## 2. SUMMARY

This report summarizes the performance of the ONE Investment Prudent Investment Funds for the second quarter of 2024, including a brief overview of contributing factors.

The ONE Investment pooled fund performance saw modest gains for fixed income funds in the quarter, while equity-oriented pooled funds had modestly negative performance. Returns for all five funds over the last 12 months were positive, with equity funds showing significantly stronger returns than fixed income funds.

	Quarter	1 Year
ONE Canadian Equity Fund	-0.8%	14.6%
ONE Global Equity Fund	-0.5%	12.7%
ONE Canadian Corporate Bond Fund	0.9%	4.5%
ONE Canadian Government Bond Fund	1.1%	3.8%
ONE Global Bond Fund	0.2%	4.3%

### 3. BACKGROUND

#### **ONE JIB and ONE Investment have a responsibility to review the performance of the investment managers**

As outlined in ONE JIB's Policy for Reviewing External Fund Managers, ONE Investment is to report to ONE JIB on a quarterly basis, identifying any issues arising from the quarterly review of the external investment managers. The report is to include a summary of the positioning of the mandates, information on investment performance, an explanation of the drivers of performance, and commentary to explain the performance and market context.

#### **The performance of global fixed income markets was mixed in the second quarter of 2024 while equity markets were modestly higher**

During the second quarter of 2024, equity markets posted modest gains, while the performance of fixed income markets was mixed. While the overall global equity markets were up about 3%, equity market performance varied considerably by market. The strongest returns were experienced in large-capitalization technology stocks, and weakness was seen in small-capitalization stocks. The breadth of equity market strength was narrow, especially in the US equity markets, with only a handful of stocks having strong performance, leading to strong index returns, while the rest of the US equity market experienced weaker returns. Canadian fixed income markets performed better than most other bond markets, with performance aided by rate cuts by the Bank of Canada.

#### **Most major central banks have either started to cut interest rates or are poised to start cutting rates**

Inflation pressures, which have been a concern in major global economies over the last few years, continue to abate, and there are increasing signs of economic growth moderating. In the second quarter, the Bank of Canada was the first of the major global central banks to start cutting interest rates, with the overnight lending rate declining by 0.25% to 4.75%. It made a further 0.25% after quarter-end. The European Central Bank also cut interest rates by 0.25% in the quarter, while the Bank of England made a similar interest rate cut in July.

It is widely expected that the US Federal Reserve (Fed) will start cutting interest rates later in the year, as there have been increasing signs that the US labour markets are showing signs of softening, but as the United States continues to show greater economic strength than many other countries, the Fed has not yet needed to start cutting rates.

#### **The performance of large capitalization technology companies had a significant impact on overall market performance, with more tepid results experienced in the broader equity markets**

The markets continue to focus on a handful of stocks that have been the major factor driving the overall performance of the US equity markets. These stocks, known as the Magnificent-7 stocks (Microsoft, Apple, Nvidia, Alphabet, Amazon, Meta and Tesla) have had spectacular performance over the last year as investor interest in Artificial Intelligence

has peaked, leading to returns for this group of stocks that exceed 50%. As they collectively represent more than 30% of the S&P 500 index, their returns have made a significant contribution to the overall performance of the index. Strong performance combined with heavy weighting in the index has led to a situation where their performance can dominate the performance of the rest of the US equity market.

In the quarter, the Magnificent-7 stocks were up an average of 16.9%, while the US equity markets excluding the Magnificent-7 stocks were actually down about 1.5%. The only reason the US equity markets were able to produce a positive return of about 4% is because these seven stocks delivered more than 100% of the overall US equity market performance in the quarter. This suggests that there is very narrow breadth in the market movements, so if a manager has light exposure to these seven stocks, they are likely to underperform.

As the US represents roughly half of the global equity market, these seven stocks collectively account for over 15% of the overall global equity markets, and their strong returns explained the bulk of the returns in the global equity markets also.

#### 4. ANALYSIS

**The ONE Canadian Equity Fund's returns were -0.8% in the quarter, consistent with modestly weaker Canadian equity markets.**

Canadian equity markets were slightly weaker in the quarter, with the ONE Canadian Equity Fund producing returns of -0.8% in the quarter, following two successive quarters of very strong returns. The performance of global equity markets was generally mixed, with weakness seen in continental European and many Asian equity markets.

While overall returns were weak in the Canadian equity markets, the Materials sector was particularly strong, being the best-performing sector in the quarter with returns of 7.4%. Prices for industrial metals like copper, aluminium, and zinc moved higher, while precious metals showed strength too, with gold hitting an all-time high in the quarter. This bolstered the performance of mining stocks, but the fund was able to only partially participate in the sector's strength in the quarter. The ONE Canadian Equity Fund is designed to have light exposure to commodity-related companies, as they tend to have more volatile performance than the rest of the Canadian equity market. The fund typically has half the exposure to commodity-related sectors versus the broader Canadian equity market. This positioning is unhelpful when the Materials or Energy sectors are very strong but is designed to dampen the volatility of returns.

In the 12-month period ending June 30, 2024, the ONE Canadian Equity Fund generated returns of 14.6%, outperforming the benchmark by over 2%. The strength of these results was supported by strong stock selection, with the performance of a few fund holdings making a significant contribution. Celestica Inc., Atkinsrealis Group, and Fairfax Financial, which each represent about 3% of the fund, had returns of 307%, 71%, and 59% over the last 12 months. Sector allocation detracted from performance in the 12-month period

primarily due to a large underweight exposure to the Energy sector, which was among the strongest sectors of the market.

**The ONE Global Equity Fund had returns of -0.5% in the second quarter as fund holdings were not able to participate in the key themes driving global equity markets higher**

The ONE Global Equity Fund's returns were slightly weaker in the second quarter, with returns of -0.5%, underperforming its benchmark by about 4%. The global equity markets posted modestly positive returns in the second quarter, but the performance was mixed across the different regions. Positive gains were seen in the US, UK, and certain Asian equity markets, but negative returns occurred in many other equity markets, including Canada and continental Europe.

The key factor explaining fund underperformance in the quarter related to the fund's lower exposures in the Information Technology sector, which was the best performing sector of the market in the quarter. The fund has light exposure to this sector, being about 10% underweight relative to its benchmark. Stock selection within this sector also trailed the returns of the broader sector. Not owning any semiconductor stocks or Apple accounted for about half of the fund's underperformance relative to the benchmark.

With the strong performance of Magnificent-7 stocks and weaker performance from the rest of the market, a lack of exposure to a few of these stocks can have a large performance impact. The fund has exposure to only three of these companies, Microsoft Corp., Amazon.com Inc., and Alphabet Inc., and was only able to partially participate in the strength of the Magnificent-7, leading to underperformance relative to the benchmark.

Over the 12-month period ending June 30, 2024, the fund's returns were 12.7%. These returns were also weaker than the broader global equity markets, as the fund's holdings and allocations were not able to fully participate in some of the most favourable themes affecting global equity markets. The fund performance over the 12-month period was affected by similar themes that affected quarterly results. Limited exposure to the mega-cap Magnificent-7 meant the fund did not fully participate in their strength. While the manager is known for its strong stock selection skills with its focus on fundamentals and prospects, the market does not always reward this in the short term. As Warren Buffet has noted, 'In the short term, the market is a popularity contest, but over the long term, it is a weighing machine', suggesting that strong fundamentals are rewarded over the long term. While the recent underperformance should merit closer monitoring, it is expected considering the market movements and the manager's approach.

**The ONE Investment fixed income funds had positive returns in the quarter with Canadian fixed income funds performing better than the ONE Global Bond Fund**

The global fixed-income markets were mixed in the second quarter of 2024, with Canadian bonds tending to have stronger performance as the Bank of Canada cut interest rates in the quarter. The ONE Canadian Corporate Bond Fund, the ONE Canadian Government Bond, and the ONE Global Bond Fund produced returns of 0.9%, 1.1%, and 0.2%, respectively, in the quarter. All three funds generated positive returns over the twelve-month period ending June 30, 2024, with returns of 4.5% for the ONE Canadian Corporate

Bond Fund, 3.8% for the ONE Canadian Government Bond Fund, and 4.3% for the ONE Global Bond Fund.

The rate cut by the Bank of Canada lowered short-term rates, but the long end of the yield curve was slightly higher. This twisting of the yield curve meant that it had a negligible impact on the performance of the ONE Canadian Government Bond Fund and the ONE Canadian Corporate Bond Fund. With the duration positioning of both funds being very similar to the benchmark, total returns for these two funds were largely a reflection of “carry” (the income received on the bonds held). The prospects of further rate cuts provide the potential for returns to be augmented by capital gains in the coming years.

The performance of the ONE Global Bond Fund was effectively in line with benchmark returns in the quarter. Global bond markets had relatively flat returns in the quarter, as did the returns from the fund. Bond yields tended to be higher in most regions during the quarter, which was a negative factor affecting performance, but as the fund has a duration 1.8 years lower than its benchmark, this helped performance relative to the benchmark. Currency hedges generated losses in the quarter, with a performance impact of similar magnitude to the duration positioning. The net effect was that fund performance was in line with benchmark performance. The fund typically has currency hedges in place to reduce foreign exchange risk and currently has about 80% of currency exposure hedged back to the Canadian dollar.

Investment-grade credit spreads were relatively stable during the quarter, hovering a bit below their long-term average, while high-yield bond spreads declined marginally. Overall, corporate bonds tended to perform better than Treasury bonds during the quarter, which made a small positive contribution to the returns of all three funds.

## **5. CONCLUSION**

The review of manager performance for the second quarter of 2024 did not identify any significant performance issues of concern, but the underperformance of the ONE Global Equity fund merits close monitoring. While the equity funds had slightly negative performance in the quarter, the fixed income funds made modest gains. The overall equity market returns in the US continue to be dominated by a handful of mega-cap technology firms with spectacular performance, which has led to notable deviations in returns for the ONE Global Equity Fund versus its benchmark.

In fixed-income markets, the outlook for interest rate cuts remains the most important theme, as many major central banks have already started cutting rates and more cuts are expected. While the ONE Investment fixed income-oriented pooled funds generated modest returns in the quarter, further rate cuts may help augment overall investment returns in the near future.

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