REPORT

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: February 25, 2025
Re: Fund Manager Performance Review Q4 2024
Report: ONE JIB 2025-014

1. RECOMMENDATIONS

It is recommended that the Board:

1. Receive the report.
2. Confirm that its members have reviewed the Fund Manager Performance Reports for Q4 2024 provided in the Resource Library.

2. SUMMARY

This report summarizes the performance of the ONE Investment Prudent Investment Funds for the fourth quarter of 2024, including a brief overview of contributing factors. The ONE Investment pooled fund performance had mixed results in the quarter, with fixed-income funds having weaker returns than equity portfolios. All five funds produced notable investment gains over the last 12 months, with equity funds experiencing significantly stronger returns than fixed-income funds. Economic activity in the United States (US) remained robust in the quarter, leading to expectations for the US Federal Reserve rates to be revised lower, leading to higher long-term bond yields. This and uncertainty about changing political leadership in the US were two prominent themes that affected capital markets in late 2024.

As all client holdings of ONE Investment pooled funds will be liquidated as part of the transition to the OCIO Offering in the first quarter of 2025, the ONE Investment pooled funds will close and reporting of performance for these mandates will not be required in the future.

	Quarter	1 Year
ONE Canadian Equity Fund	3.3%	20.9%
ONE Global Equity Fund	1.5%	11.2%
ONE Canadian Corporate Bond Fund	0.1%	4.6%
ONE Canadian Government Bond Fund	0.5%	4.4%
ONE Global Bond Fund	-1.1%	3.9%

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, identifying any issues arising from the quarterly review of the external investment managers. The report is to include a summary of mandate positioning, information on investment performance, and an explanation of the drivers of performance, with commentary to explain the performance and market context.

Strength in 'Magnificent-7' stocks led US equity markets higher in the quarter

In the fourth quarter of 2024, large-capitalization technology stocks reasserted their market leadership, with the 'Magnificent-7' stocks (Microsoft, Apple, Nvidia, Alphabet, Amazon, Meta, and Tesla) outperforming the broader US equity market. This development marked a reversal from the trend observed in the third quarter when these stocks marginally underperformed the S&P500.

The Magnificent-7 stocks continued to significantly impact overall market performance, collectively rising by 67.3% in 2024. The Magnificent-7 stocks represent about one-third of the S&P 500's weight by market capitalization, so their performance had an outsized influence on overall index performance. These seven stocks accounted for over half of the S&P 500's 25% return for the year. This continued the trend of narrow market breadth, where smaller stocks did not fully participate in the strength of the broader market.

The US election resolved political uncertainty, but new policies could create more economic uncertainty

The US elections in November 2024 resolved the uncertainties about political leadership in the US, with the Republicans gaining a majority in both the Congress and Senate and Donald Trump being elected President. This was perceived to be favourable for financial markets, as the policy regime is expected to be more favourable for Wall Street and the business community. The aggressive policy changes and unorthodox approach expected of the newly re-elected president may create additional uncertainties that affect the economy, interest rate policy and the financial markets in the USA and globally. In particular, the prospects of new US tariffs on imports could trigger a trade war that may have significant adverse economic effects globally.

The Interest rate outlook in the US changed in the quarter in response to continued signs of economic strength

The US Federal Reserve started lowering its policy rate later than other major global central banks, with a 50-basis point cut in September. At that time, there were signs that elevated inflation levels were being contained, and there was concern that economic activity was starting to moderate. It was broadly expected that the Federal Reserve would cut rates aggressively through 2025. After the rate cut, economic data indicated that the labour market remained tight and inflation figures had stopped improving. This led to a change in the US interest rate outlook, where fewer rate cuts are now expected in 2025. Long-term bond yields also rose in the quarter, with the US 10-year bond rising 79 bps, closing the year at 4.57%, as shown in Chart 1 below. This led to US long-term bond yields increasing more than yields rose in other countries, significantly impacting exchange rates. The US dollar appreciated between 6% to 12% versus other major economies, as shown in Chart 2 below.

Chart 1 – US yield curve – yields for long-term bonds rose in quarter

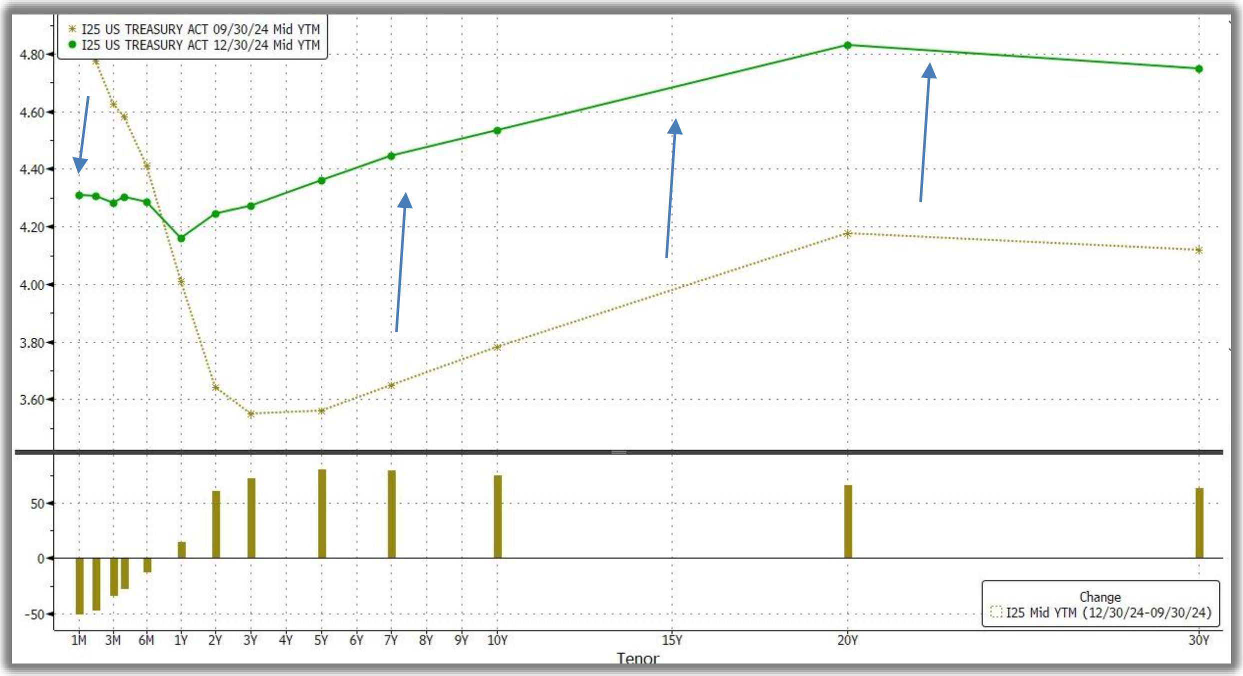

Chart 2 – Currency movements – USD strong against all major currencies

4. ANALYSIS

The ONE Canadian Equity Fund had returns of 3.3% in the fourth quarter, bringing full year 2024 returns to 20.9%

The Canadian equity markets had modest gains in the fourth quarter after several quarters of strong returns. The ONE Canadian Equity Fund typically holds 30 - 35 companies in the fund, offering more targeted exposure than the broader S&P/TSX equity index. This means that security selection can significantly influence fund returns. Large fund holdings, such as MDA Space and Atkinsrealis Group, which had returns of 69.9% and 38.8%, respectively, had a significant positive impact on performance. Stock selection within the Information Technology sector weighed on fund performance, as holdings in CGI and Open Text had weaker performance than the rest of the sector or the broader market returns.

Fund returns were 20.9% for the full year, reflecting the strength experienced in the Canadian equity market in 2024. Specific stock selection choices by the manager influenced the full-year performance. The fund, for example, had no exposure to TD Bank, which was down about 6% last year, while other Canadian banks had average returns of about 30%. The fund also held no Shopify and could not benefit from the 48% returns it generated during 2024. Allocation across the Canadian equity market sectors had minimal overall effect on performance, either during the quarter or over the full year.

The ONE Global Equity Fund returns were 1.5% in the fourth quarter, with the fund producing returns of 11.2% during 2024

The ONE Global Equity Fund generated returns of 1.5% in the fourth quarter of 2024, while the broader global equity markets were up more than 5% in the quarter. The investment manager employs a strategy emphasizing bottom-up security selection, targeting companies with strong management, sustainable competitive advantages, and attractive valuations. However, current market conditions do not favour this approach, resulting in short-term underperformance. This underperformance was particularly pronounced in the US equity market, where the Magnificent-7 stocks accounted for over half of the S&P 500's impressive 25% return in 2024. While the fund does have some exposure to three of these stocks, its light exposure limited its participation in the upside. In periods with extremely narrow leadership and strong momentum, the manager’s quality at the right price investment style has been challenged to keep pace. Despite achieving respectable full year returns of 11.2%, the fund's performance remains well below its benchmark. This theme affects all active managers, with most global and US mandates underperforming benchmarks in 2024.

ONE Investment fixed income funds had mixed performance in the quarter but stronger returns for the full year

The changing interest rate environment contributed to weaker performance in fixed-income markets as longer-term bond yields rose. While recurring income from fixed income should have a positive contribution to returns, falling bond yields offset this, leading to flat bond market returns. The ONE Canadian Corporate Bond Fund, the ONE Canadian Government Bond, and the ONE Global Bond Fund had returns of 0.1%, 0.5%, and -1.1%

in the quarter. All three funds generated stronger returns over the 2024 calendar year, with returns of 4.6% for the ONE Canadian Corporate Bond Fund, 4.4% for the ONE Canadian Government Bond Fund, and 3.9% for the ONE Global Bond Fund. These full year returns are consistent with the current yield environment.

Currency movements influenced the ONE Global Bond Fund's returns in the quarter. Although the strength of the US dollar benefitted returns from US dollar bonds, the fund has approximately 87% of its currency exposure hedged back to the Canadian dollar. Losses on the currency hedges had a large negative effect on performance. Heavy exposure to US corporate credit and high-yield bonds performed well in the quarter as credit spreads were slightly tighter.

5. CONCLUSION

The review of manager performance for the fourth quarter of 2024 did not identify any significant concerns, but the ONE Global Equity fund continues to experience notable underperformance compared to its benchmark. The changing US interest rate outlook led to falling bond prices and mixed quarterly returns for the ONE Investment fixed-income pooled funds, but over the full year, returns were stronger. Equity markets had good returns in the fourth quarter, leading to strong returns for the full year, especially for the ONE Canadian Equity Fund.

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