Pension News

UBC FACULTY PENSION PLAN | Third Quarter 2012 Edition

Time to reassess market returns

The following article, "Time to reassess market returns," was published in the Vancouver Sun in August 2012. We are reprinting this article with permission solely for the interest of our members. The opinions expressed are those of the author and do not necessarily reflect the opinions of the FPP trustees, management or staff.

For investors and savers, today's financial environment must rank among the least rewarding in half a century, if not longer.

In the major advanced economies - the United States, Canada, Japan, the United Kingdom and most of continental Europe - the "policy" interest rates set by central banks are at or near all-time lows. This translates into almost non-existent returns for savers who squirrel away money in bank accounts, GICs and money market funds.

The same is true for the buyers of government bonds; 10-year yields in Canada and the U.S. now hover under two per cent. With inflation projected to be at or above two per cent, this means investors in government bonds who hold to maturity are on track for negative real (that is, after-inflation) returns. Despite this counterintuitive picture, there is no lack of demand for the sovereign debt of creditworthy issuers.

Far from being a positive sign, the peculiar behaviour of the bond market reflects gloom about prospects for the global economy. While 10-year government bonds may promise negative real returns, many investors judge them a better option than traditionally riskier asset classes, notably equities. Equities are indeed risky, as evidenced by a decade or more of negative cumulative returns across most developed country markets. Yet when interest rates rise - as eventually they must - bond-heavy portfolios will be hammered (interest rates and bond prices move in opposite directions).

Does it follow, then, that stocks are the wise choice for nervous investors? Economists have tended to believe that, over the long haul, equities should outperform bonds. Because stocks typically carry more risk than bonds, the returns for holding them should be higher; this is often referred to as the "equity risk premium." If one adopts a sufficiently long-term perspective, the data show that stocks have, in fact, done better.

But it's increasingly clear that the definition of "long term" can test the staying power of even patient investors. Indeed, in the U.S. long-term government bonds have produced higher cumulative returns than stocks over the past 25 to 30 years, despite being a much "safer" asset class. This result runs contrary to the expectations generated by finance theory.

The UBC Pension Administration Office is moving!

Read the details inside

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Today, the broad equity market indexes in many advanced countries are trading below their levels of 10, 12 or - in the case of Japan - 20 years ago. In Canada, the TSX index is about one-fifth below where it stood in the summer of 2008. How long before the benchmark Canadian index punches through the 15,000 level set a little more than four years ago? No one knows. In the meantime, stocks could easily fall another 10 to 15 per cent, amid a struggling global economy and faltering growth here in North America.

In part, the outperformance of bonds versus stocks can be explained by a long secular decline in interest rates (and inflation) over the 1980s and 1990s, which served to boost fixed income returns. With interest rates currently plumbing the depths, it's hard to conjure up a scenario of rising bond prices going forward. The end of the long bond bull market may cause investors to look more fondly on equities.

Yet consider what the "smart money" is doing. Many of Canada's largest public pension funds - the Canada Pension Plan Investment Board, the B.C. Investment Management Corp. and the Ontario Teachers' Pension Plan, to name just three - are shifting capital away from publicly traded securities (stocks as well as bonds) and toward "alternative" assets like real estate, infrastructure and private equity. To some extent this reflects prudent portfolio diversification. But it also speaks to a belief by these sophisticated money managers that the returns on public securities are apt to disappoint in the years to come.

In a slow-growth world where many advanced economies are burdened with both excessive debts and unfavourable demographics, it makes sense to scale back expectations for financial market returns.

Instead of the eight-per-cent annual returns targeted by many fund managers before the 2008-09 financial crisis, something closer to five to six per cent seems reasonable.

This assumes a portfolio mix of 30 to 40 per cent fixed income, 50 to 60 per cent equities, and 10 per cent cash, gold and other alternative assets.

Some market-watchers judge even five to six per cent to be optimistic. Legendary U.S. money manager Bill Gross, for one, recently speculated that nominal returns of three to four per cent may become the new normal. Gross also has helpfully announced the "death" of what he calls "the cult of equities."

Of interest, the Canadian Pension Plan Investment Board has set a real return objective of four per cent per year, which including inflation amounts to roughly a six per cent nominal return. Given its extensive resources, unrivalled access to investment opportunities and ability to minimize costs and fees, the board is likely to outperform most other institutional money managers.

If the board is correct in its assessment of economic and financial market prospects, even returns of five to six per cent may be out of reach for the rest of us. ■

Jock Finlayson is the Executive Vice President & Chief Policy Officer for the Business Council of British Columbia. The views expressed are those of the author and not necessarily those of the Business Council of B.C. or the UBC Faculty Pension Plan trustees, management and staff, which make no representations as to their completeness or accuracy.

BNY Mellon June 2012 Report

BNY Mellon, the Faculty Pension Plan's (FPP) performance measurement firm, reports that the Plan's Balanced Fund has returned 6.4% per annum (5.9% net of fees/costs) over the 10-year period up to June 30, 2012.

The FPP Balanced Fund's performance ranks in the top quartile (24th) when measured against a survey of similar balanced funds. The Fund has also ranked in the least risky quartile over this timeframe. Over the last 31 years, the FPP Balanced Fund has returned over 9% per annum.

Holiday Closure

The Pension Administration Office will be closed from noon on December 24, 2012 to January 1, 2013 inclusive. Please submit all member request forms to the Pension Administration Office by 4 p.m. on December 20, 2012 to ensure they are processed effective month end.

If you have an urgent pension inquiry during the holiday closure, please leave a message at 604.827.3286. These messages will be monitored daily over the holiday period.

The FPP trustees, management and staff wish you and your family a safe and happy holiday season.

MARKET COMMENTARY

The markets had a strong third quarter resulting from several pieces of good news that improved investor sentiment. This led to a nice rebound from the previous weak second quarter. The troubled European markets were buoyed by the European Central Bank's announcement that they would do everything possible to preserve the Euro. This was followed by a stated unlimited bond buying program aimed at lowering government borrowing costs. The U.S. also helped the markets by their Federal Reserve announcing a third round of quantitative easing ("QE3") based on buying large amounts of mortgage bonds with the hope that this would stimulate job growth. The U.S. Federal Reserve also indicated that interest rates will likely be held very low until at least mid-2015.

The Canadian stock market returned a strong 7.0% in the third quarter and is now at 5.4% on a year-to-date basis. The Canadian market's high exposure to commodity stocks (i.e. the Materials and Energy sector) helped returns this quarter. Government announcements of injecting more liquidity into global markets were positive news, increasing the prices of most commodities.

The U.S. stock market also had a good third quarter at 2.6%, and is up strongly, 12.5% year-to-date in Canadian dollar terms. Global equities were positive at 3.0% in the third quarter in Canadian dollar terms. These returns were largely a result of strong returns in both European and certain Far Eastern (excluding Japan) markets. Emerging markets also had a good third quarter (4.0%) as more positive global economic news moved investors to take on more risk with these more volatile markets.

The Canadian Bond market had a mediocre third quarter return of 1.2%, and has returned 3.3% on a year-to-date basis. Long-term bonds (1.9%) and Corporate bonds (2.1%) were the strongest performing bond sectors in the third quarter. The Bank of Canada left rates unchanged again but maintained their bias to increasing interest rates even with the continuing weak global economic news. Inflation remained low at only 1.3% for the first three quarters of the year. ■

We're Moving!

UBC Pension Administration Office

The UBC Pension Administration Office is moving to the second floor of the Donald Rix Building on **November 13, 2012**. Our office will be closed at noon on November 9, 2012 to prepare for the move.

The larger office space will allow both the Faculty and Staff Pension Plans to expand operations and services to meet the needs of our growing memberships. We thank you very much for your cooperation as we embark on this exciting time in the growth and expansion of the UBC Pension Administration Office.

Please note:

- E-mail addresses, telephone and fax numbers will remain the same.
- Mail sent to our old address will automatically be forwarded to our new address.
- Our fax line will not be in service and will be unavailable from approximately 10 a.m. to 2 p.m. on Friday, November 9. If you send a fax to us on this day, please call our office on Tuesday, November 13 to confirm receipt of your fax.

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For detailed maps, parking and accessibility information, please visit **http://www.maps.ubc.ca/?458**

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PERFORMANCE OF THE FUNDS
FOR PERIODS ENDING SEPTEMBER 30, 2012

*Annualized returns

	3 Months	YTD	1 year	5 years*	10 years*
Balanced Fund - gross	3.14%	7.42%	11.97%	3.63%	7.25%
Balanced Fund - net	3.02%	7.01%	11.41%	3.08%	6.74%
Composite Index 1	2.73%	5.81%	9.81%	3.29%	6.55%
Bond Fund - gross	1.43%	3.90%	7.55%	7.78%	6.46%
Bond Fund - net	1.36%	3.66%	7.22%	7.45%	6.17%
Composite Index 2	1.24%	3.21%	6.51%	7.46%	6.36%
Canadian Equity Fund - gross	6.01%	7.56%	12.52%	0.96%	10.63%
Canadian Equity Fund - net	5.90%	7.20%	12.04%	0.52%	N/A
Composite Index 3	6.95%	5.43%	9.02%	0.10%	9.76%
Foreign Equity Fund - gross	3.50%	11.17%	17.88%	-2.07%	3.37%
Foreign Equity Fund - net	3.34%	10.61%	17.10%	-2.66%	N/A
Composite Index 4	2.71%	9.95%	16.56%	-1.38%	3.97%
Short Term Investment Fund - gross	0.33%	0.92%	1.20%	1.49%	2.35%
Short Term Investment Fund - net	0.28%	0.79%	1.04%	1.33%	2.17%
Composite Index 5	0.24%	0.72%	0.94%	1.21%	2.19%

The Average Rate of Return for the FPP funds are updated on a monthly basis and are available under the QuickFind menu on the FPP website.

Composite Index 1: 32% DEX Universe, 10% S&P/TSX Capped, 5% S&P/TSX, 5% S&P/TSX 60 Capped, 6% S&P 500, 21% MSCI World Ex Canada, 3% Dex 91-Day TB, 10% CPI + 4% commencing November 2011 (retroactive), 8% DEX Real Return Bonds
Composite Index 2: 80% DEX Universe, 20% DEX Real Return Bonds
Composite Index 3: 25% S&P/TSX, 50% S&P/TSX Capped, 25% S&P/TSX 60 Capped
Composite Index 4: 73% MSCI World Ex Canada, 21% S&P 500, 6% DEX 91-Day TB
Composite Index 5: DEX 91-Day TB Index until August 2007, DEX 30-Day from September 2007 to January 2011, DEX 91-Day TB Index as of February 2011.

COMPOSITION OF THE FUNDS
AS AT SEPTEMBER 30, 2012

	Market Value ($ Millions)	% of Funds
BALANCED FUND		
Equities - Canada	242.3	19.9%
Equities - U.S.	194.7	16.0%
Equities - non-North American	127.6	10.5%
Absolute Return Hedge Fund	31.3	2.6%
Real Estate - Canada	132.1	10.9%
Fixed Income	378.4	31.1%
Real Return Bonds - Canada	106.3	8.7%
Cash	4.4	0.3%
Total Balanced Fund	1,217.1	100.0%
BOND FUND		
Fixed Income	61.5	77.5%
Real Return Bonds - Canada	17.3	21.8%
Cash	0.6	0.7%
Total Bond Fund	79.4	100.0%

	Market Value ($ Millions)	% of Funds
CANADIAN EQUITY FUND		
Equities - Canada	103.1	99.1%
Cash	0.9	0.9%
Total Canadian Equity Fund	104.0	100.0%
FOREIGN EQUITY FUND		
Equities - U.S.	24.2	55.6%
Equities - non-North American	15.9	36.6%
Absolute Return Hedge Fund	2.4	5.5%
Cash	1.0	2.3%
Total Foreign Equity Fund	43.5	100.0%
GUARANTEED INVESTMENT CERTIFICATES	11.6	100.0%
SHORT TERM INVESTMENT FUND	52.7	100.0%