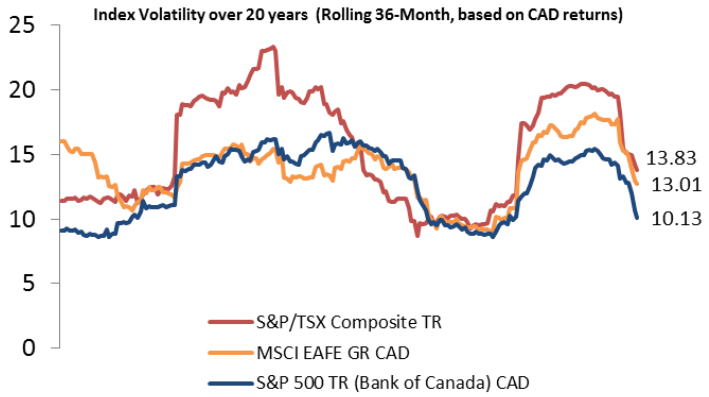
Lakehead UNIVERSITY

Spring/Summer 2014

RETIREMENT PLAN REVIEW

Looking Beyond Canada

Canadian investors continue to flock to domestic markets at the expense of their foreign counterparts. This stems from the sentiment that we are more comfortable with what we know. The lack of proper global diversification is also driven by the common misperception that the rising correlation between foreign and Canadian markets eliminates the necessity for international diversification. The fallacy here can be attributed to two myths: that risk reduction is the only benefit of holding international assets, and that Canadian assets are less risky than their international counterparts.



Correlation measures whether two assets move in the same direction in a given market environment – low correlation means one will move up when the other moves down, offsetting one another. This is why you would never want a portfolio comprised entirely of highly correlated assets. But high correlation does not imply similar returns. The lesson here is that while low correlation is always key to a well-diversified portfolio, including some assets that are highly correlated is not necessarily a bad thing. If both assets move up in a given market environment, they will be highly correlated, even though one may move up to a much greater degree than the other. A perfect example is how the U.S. market, in spite of its very strong correlation, outperformed the Canadian market by more than 10% annualized over 4 years and by almost 30% in 2013!

The key driver for foreign investing should be the diversification of opportunities rather than the lower correlation of returns. If geography no longer mattered and all equities were the same – i.e. highly correlated – the appropriate response would be to look at all developed markets as a single opportunity set from which to draw the very best investments.

This approach would not only expand the opportunity set, it would have the additional benefit of reducing volatility over the long run, since the MSCI EAFE Index, a broad market index including all developed countries (excluding the U.S.), is more diversified than the S&P/TSX Composite Index on virtually every measure, namely currencies, countries, industries and companies.

The long-standing presumption that foreign equities are more volatile than Canadian equities appears to be outdated. The hedged EAFE Index – without the impact of currency – was considerably more volatile than the S&P/TSX Composite Index during the first half of the 1990s. That was primarily a result of the 1990 bursting of Japan's economic bubble, a market that accounted for more than 60% of the EAFE Index at its peak. Since then, the broader geographic and industry diversification has made the EAFE Index less volatile.

Diversification goes beyond the traditional mix of bonds and equity. You must consider the proper global diversification of your equity exposure.

NEWSLETTERS ON-LINE!

Lakehead University Plan Members have access to the Proteus website where you can view current and past newsletters, Proteus' performance updates, investment manager presentations and other pension plan related documents.

The website is secure.proteusperformance.com/member User ID: **Lakehead** Password: **learning**

PROTEUS

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Ready to Retire?

We often interact with plan members nearing retirement and invariably the conversation turns to their most pressing issue: what to do with their retirement nest egg? Many retirees like the idea of annuities, which provide guaranteed income for life in exchange for a lump-sum payment. In the past, people often purchased annuities as soon as they retired in order to replace their employment income, especially if they had no pension. That may not be such a good idea any longer.

Annuity payout rates are affected by interest rates, and current payouts are dismally low. That doesn't mean you should shun these investments altogether—it just means it pays to wait. There's always a trade-off when you delay buying an annuity. You'll receive payments for a shorter period, and you'll need another income source to bridge the gap. But those payments will be larger, so you'll also have a higher stream of reliable cash flow to protect you if you live well into your 90s.

Many experts say the current sweet spot for annuities these days is past the age of 70 and they suggest easing in over three to five years. This gradual approach makes you less dependent on payout rates at any particular moment. If your finances are tight and you feel the need for assured income, starting to convert at 65 might make sense, but you must be willing to put up with the low payouts.

Annuities suit many middle-class seniors but they are not for everyone. Annuities can be complex and come in multiple forms, so you will need to do your homework carefully before buying. How much savings you ultimately convert to annuities is up to you. Some retirees like to have a combination of annuities and government benefits to cover basic spending. That way, if your investment portfolio suffers a big setback, your basic lifestyle is still assured.

Annuities cannot be undone, so make sure this is the right option for you. As always, it is highly recommend to consult with a qualified financial advisor to discuss all of your options and make the decision that is right for you.

Do you have a retirement topic for a future edition? If so, please send to: retirement@proteusperformance.com

Market Review

Canadian stocks were up 6.1% over the quarter, leading most developed markets. Returns were positive across all sectors. The health care sector continued to lead the way with a 12.6% gain. The materials sector rebounded from its poor performance in 2013 and posted the next highest return at 9.7%. The energy, utilities, and consumer staples sectors also outperformed the market. Small-cap stocks outperformed their large-cap counterparts over the quarter.

Global stocks were positive again, with the MSCI World Index returning 5.3% in Canadian dollars. Europe and the U.S. both outperformed the market. In contrast, Japanese equities detracted value. The Canadian dollar continued to depreciate which helped boost the Canadian dollar returns of foreign assets.

Emerging markets once again trailed developed markets thanks in part to declines in Russia and China. The recent events taking place in Ukraine have contributed to the volatility in the Russian market.

The FTSE TMX Canada (formerly DEX) Universe Bond Index posted a 2.8% return for the quarter. The provincials, municipals and corporate sectors each outperformed the broader market while federal bonds lagged the market. Yields decreased across the Canadian curve during the quarter, especially in the long-end. Investors maintained their appetite for risk as high yield bonds outperformed investment grade issues. The Bank of Canada maintained its overnight rate at 1.0%, while the U.S. Federal Reserve left the Fed Funds Rate target unchanged at 0-0.25%.

Lakehead's Investment Structure and Managers

Investment Structure

Lakehead University Main Pension Plan

Lakehead Pension Total Portfolio — The pension plan investment structure is comprised of a number of underlying investment funds managed by various investment management firms (see below). The goal of the investment mix is to provide long term capital growth and capital preservation. The Portfolio is currently invested in Canadian large-cap and mid-cap equities, Canadian bonds, American large-cap and small cap equities and International large-cap and small-cap equities.

Lakehead University Short Term Account

Short Term Account — The Short Term Account is comprised of one underlying investment fund managed by Jarislowsky Fraser (JF). The underlying fund is a money market fund. Money market funds invest in short term interest bearing (or discount) securities of governments, corporation and other short term borrowers with a time horizon generally under one-year. The rate of return for the fund should be consistent with short term Canadian interest rates.

Underlying Investment Managers

Main Pension Plan

Balanced Funds

Jarislowsky Fraser Total Portfolio — Invests in the pooled JF Canadian equity and bond funds. The target allocation is a 50-50 split between the two funds. The JF Canadian equity fund emphasizes buying long-term growth at a reasonable price. The JF Bond fund is managed based on safety of principal, conservative duration management, and optimization of yield.

Letko Brosseau Total Portfolio — Invests in the Letko Brosseau RSP Balanced and RSP Equity funds. Equity portfolios typically consist of 80 to 120 companies diversified by sector, geography, and individual security. The process is driven by security selection. In fixed income the emphasis is on high quality bonds that meet the objectives of stability and income. Turnover on fixed income is approximately 10% per year.

Canadian Equity Fund

CGOV Canadian Equity — Attempts to buy companies at a sufficient discount to their intrinsic values. The companies are diversified across a minimum of globally recognized industry sectors with the mandate limited to 25 companies. The fund is not expected to exhibit index-like characteristics.

American Equity Fund

Advisory Research American Small Cap Value — Focuses on value-oriented companies with market capitalizations within the range of the Russell 2000 Value Index at time of purchase. Bottom up stock selection is utilized.

Global Equity Fund

State Street Global Advisors (SSgA) — A portfolio of primarily large capitalization global equity stocks that is intended to match the return on the MSCI World Index.

International Equity Fund

Dimensional International Small Cap Value — Invests primarily in securities of small-cap international (non-U.S.) companies.

Fixed Income Fund

Addenda Bond Fund — Invests in a diversified portfolio of bonds and provides investors with interest income and safety of principal along with opportunities for moderate capital growth.

Investment Strategy

Long Term Investing

Capital Markets are unpredictable over short time periods, making attempts to shift between asset classes and 'time the market' difficult for even professional investors. Because of short-term volatility, a well diversified portfolio and a long time horizon generally offer the best protection from fluctuating markets.

A long term investor typically does not focus on poor performance in any given year. Instead, they review their strategy and consider whether the investment still fits with their long term objectives. If you are a long way from retirement, a mix of stocks and bonds may be prudent. If you are close to retirement, a more conservative investment approach may be appropriate as there is less time to recover investment losses. If you are unsure of the best strategy for you, you should seek independent professional advice before making your investment decisions.

Performance Summary

Period Ending March 31, 2014				
	1 year	3 year	4 year	10 year
Lakehead Pension Total Portfolio	17.8	9.8	10.1	7.4
Benchmark	*13.6*	*7.7*	*8.5*	*6.4*
Lakehead Short Term Account*	1.2	1.2	n/a	n/a
Benchmark	*1.0*	*1.0*	*n/a*	*n/a*

Returns are shown before fees unless indicated. Past performance of a fund is not necessarily indicative of future performance.

**Performance shown is for the underlying pooled fund.*

Plan Governance

Plan Governance is handled by the Pension Board and Pension Advisory Committee.

The Professional Plan is administered by the Pension Board which is advisory to the Board of Governors. The Pension Board consists of the following members:

- Two Members of the Faculty (Bargaining Units #1 and #2);
- One Pensioner;
- One Member of Non-Faculty Staff; and
- Two persons chosen by the Board of Governors.

The Employee Plans is administered by the Pension Advisory Committee, which is advisory to the Board of Governors of the University. The Committee consists of:

- Two members appointed by the Board of Governors;
- One member of each bargaining unit;
- One member of non-union staff; and
- One member of non-union Technical staff.