Pension News

UBC Faculty Pension Plan
Fourth Quarter 2007 Edition

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"Financial theory states that the higher the rate of return that an investor wants to earn, the greater the risk the investor must be prepared to take."

In this issue

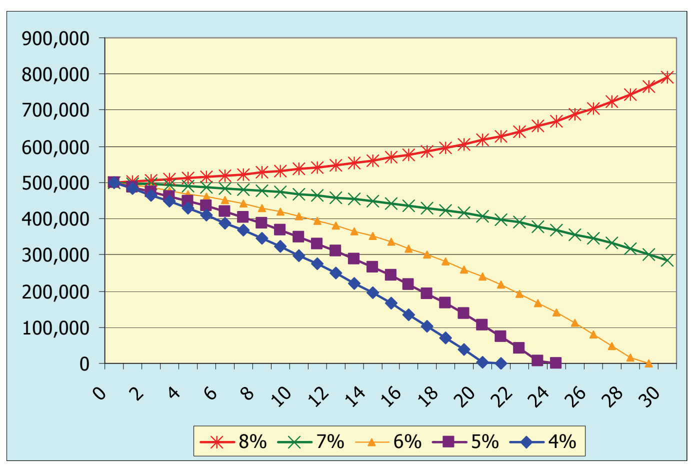
Choosing an asset allocation in retirement

"Asset allocation" is defined as the percentage mix invested in each asset category within a fund. The asset allocation decision is the most important decision an investor makes in managing a fund. This article examines the asset allocation choice for a fund providing LIF-type or RRIF-type payments in retirement.

The importance of investment earnings

Because a typical retiree may live 30 years or more after retirement, a substantial portion of the retiree's income needs to be generated from investment earnings. Graph 1 illustrates the importance of investment earnings in retirement. A retiree starts with a lump sum of $500,000, and withdraws $3,000 per month; the graph shows the account balance after each withdrawal at five different rates of return. (The rules that specify the amount that may be withdrawn are complex, and are described in "LIF-type and RRIF-type Payments" in the First Quarter 2007 edition of *Pension News*. The $3,000 monthly withdrawal assumption simplifies the analysis to focus on the impact of market performance and asset allocation.)

Graph 1



Graph 1 shows that if the fund earned only 4%, it would be sufficient to pay the $3,000 of monthly payments for only 20 years. If the fund earned 6%, it would be sufficient for 28 years; and if the fund earned

7% or more, the retiree would still have a substantial account balance after 30 years. The more the fund can earn, the longer the retirement savings will last and/or the higher the monthly payment can be.

Risk and reward

Financial theory states that the higher the rate of return that an investor wants to earn, the greater the risk the investor must be prepared to take. Graph 2 shows the results of the S&P/TSX index over the past 50 years. The stock market was strong, with an average rate of return of 11.7%, but there were 13 negative years, with some very poor years.

Graph 2

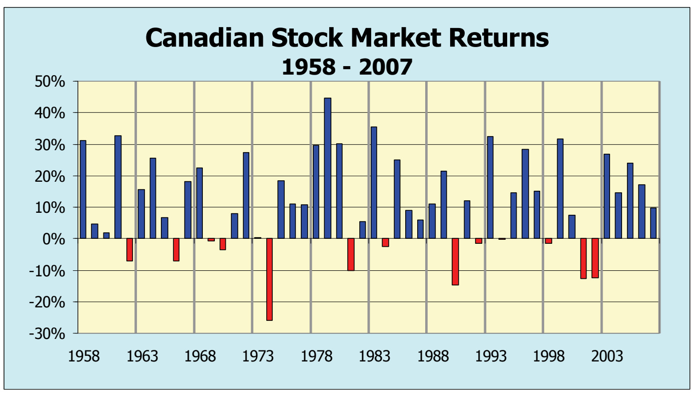


Table 1 shows some historical statistics over the past 50 years of three asset classes that are commonly used by investors: stocks, bonds and money market securities.

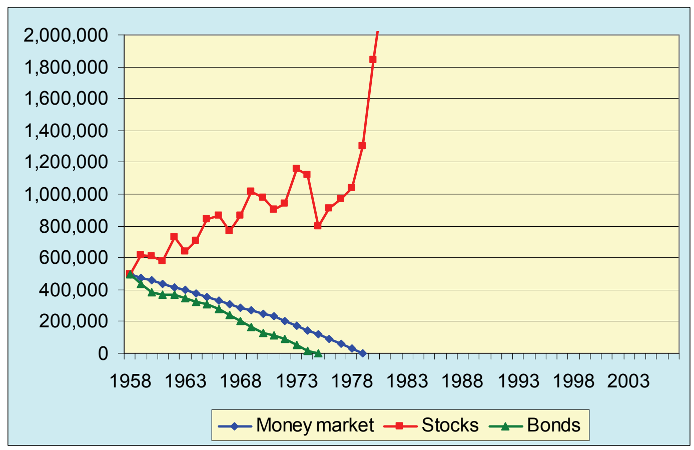
Table 1

	Average rate of return	# of years with a negative return	# of years with a return below -10%
Stocks	11.7%	13	5
Bonds	8.0%	10	1
Money market	6.8%	0	0

Table 1 shows that stocks delivered the highest rate of return of the three asset classes, on average, but also the greatest number of years of negative returns and very poor years losing more than 10%. Money market securities, on the other hand, were the safest, with no negative years, but also with the lowest rate of return.

Graph 3 is intended to show the progression of account balances, starting with $500,000, with $3,000 per month withdrawals, invested 100% in each of stocks, bonds and money market in the 50-year period from 1958-2007. Although money market securities are considered to be safe, the fund would have run out after 21 years. Bonds actually ran out even earlier, after 17 years, because of poor results early in that period. Investing in stocks produced the best results, although the results were very volatile – the fund would have lost more than $300,000 in 1974 – but after its rebound went above the chart in 1979, and continued its upward climb.

Graph 3

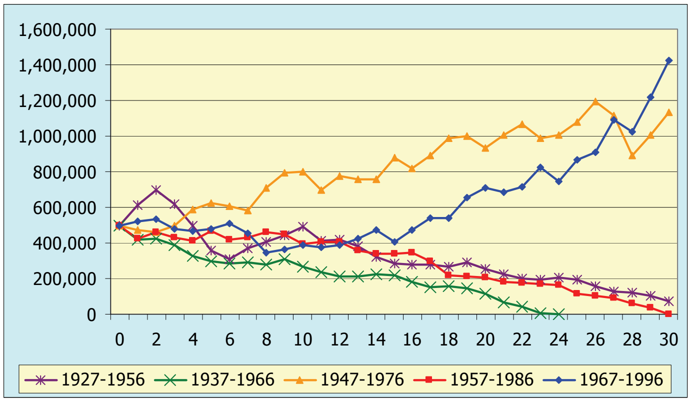


Balanced Funds

A "balanced fund" is a fund that is composed of several asset classes, combining higher-growth higher-risk asset classes such as stocks, with lower-growth lower-risk asset classes such as bonds and money market securities. Balanced funds also include other diversifying asset classes which, on their own, may not necessarily have attractive risk/return characteristics, but when combined with riskier assets help produce more stable rates of return.

The advantage of a balanced fund is that, because of the diversifying characteristics of the asset classes, they tend to perform well on average over most economic periods. Graph 4 shows the performance of a fund with 60% stocks and 40% bonds over five different periods, again each starting with $500,000, with $3,000 of monthly withdrawals.

Graph 4

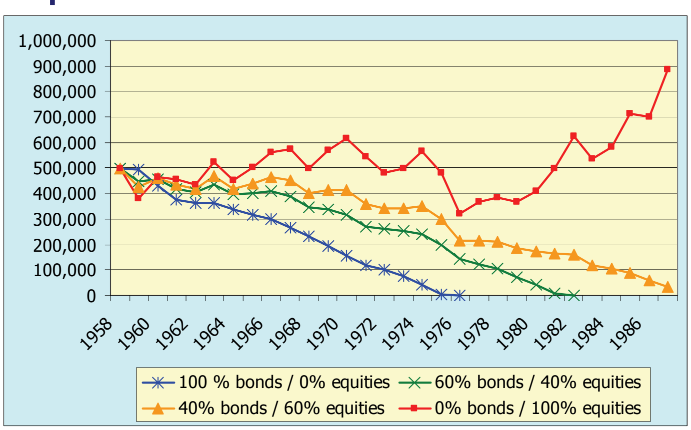


In four out of the five periods, the balanced fund was able to sustain monthly payments of $3,000 per month for virtually the entire 30-year period. In one of the periods, the fund would have run out after 26 years; in two periods the fund balance was actually higher at the end than at the beginning.

Choosing an Asset Allocation

As noted above, financial theory states that the higher the rate of return that an investor wants to earn, the greater the risk the investor must be prepared to take. Graph 5 shows the progression of an account balance for the 30-year period 1957-1986 – a period that started with low interest rates, similar to now – with four different asset allocations.

Graph 5



Graph 5 shows that with an allocation entirely to bonds, the initial $500,000 would be sufficient to pay monthly payments of $3,000 for only 18 years. Such an individual, if unwilling to take risk to earn a higher rate of return, would have to reduce their monthly payments at some point in their retirement.

A retiree who chose to invest entirely in equities would have performed well in this period, but there would have been some dramatic changes in the value of the fund, both up and down – between the end of 1972 and 1974, for instance, the account would have declined by more than $240,000. Such volatility might not be acceptable.

The two "balanced" funds, one with 40% equities and the other with 60% equities, produced reliable income without dramatic swings in value. The fund with 40% equities was able to sustain the monthly payments for 24 years, while the 60% equity fund produced income for the whole 30-year period.

The FPP Balanced Fund holds 60% equities (including real estate). Such a fund is not without risk – with 60% equities, it could lose value. In 2002, it lost 2.6%. Nonetheless, like most balanced funds, it has done well over the long term, earning 7.2% on average each year over the past 10 years.

A retiree who is more risk averse, can "tilt" the portfolio to include a portion in the Balanced Fund (for instance, 70% or 80%), with 20% or 30% in the Bond or Short Term Investment Funds.

A retiree who can tolerate above-average risk, for instance one who has other sources of retirement income or a spouse with retirement income, can "tilt" the portfolio more aggressively, with perhaps 20% or 30% in one of the equity funds.

In all cases, retirees should seek the advice of a financial planner in making their asset allocation decision.

This article was prepared by Satanove & Flood Consulting Ltd. Comments should be sent to: fpp@hr.ubc.ca

Faculty Pension Plan Open House

The Faculty Pension Plan is having an Open House on Thursday, May 15, 2008, from 2:00 to 4:00 pm at St. John's College Social Lounge. Please join us and meet the trustees and staff of the FPP. At 2:30 pm, Joost Blom, Chair of the Faculty Pension Plan, will comment on the Plan's performance and accomplishments in 2007 and outline the Plan's initiatives for 2008. Please confirm your attendance with Shirley Lim at 604-822-8100 or e-mail shirley.lim @ubc.ca

Election Results

On January 23, 2008, the FPP Board of Trustees elected Mr. Joost Blom as Chair and Dr. Rob Heinkel as Vice-Chair for the 2008 calendar year. Mr. Blom was appointed to the Board on July 17, 2003 and Dr. Heinkel was first elected to the Board in January, 1990.

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Workshops Offered by the Pension Administration Office

1. You & Your Pension Plan

If you are a new member or wish to learn more about the Plan, we host seminars to cover all aspects of the UBC Faculty Pension Plan.

2. Understanding Your Retirement Income Options

For members approaching retirement, this seminar explains the various options available.

If you are interested in either of these sessions, please call Jim Loughlean at 604-822-8987 or e-mail him at jim.loughlean@ubc.ca to find out the next available dates.

Contribution Limits For 2008

The contribution limit for pension plans in 2008 is 18% of income, to a maximum of $21,000; contributions over the maximum will be deposited to the Supplemental Plan. Further information on the Supplemental Plan can be found on the FPP website at www.pensions.ubc.ca/faculty/. Please contact Jim Loughlean at 604-822-8987 or e-mail him at jim.loughlean@ubc.ca if you would like additional information about your contribution limits or the Supplemental Plan.

Financial Planning Lecture Series

The following lectures are sponsored by the UBC Faculty Association in conjunction with UBC Continuing Studies:

February 6	Investment Strategies within the UBC Faculty Pension Plan and Tax Strategies for Retirement Income
February 13	Representation Agreements vs Enduring Powers of Attorney – what you need to know now to plan for ageing parents and your own retirement
February 27	Real Estate Strategies for the Lower Mainland Market
March 5	Estate Planning and Wills
March 12	What does Retirement Mean for You?

All lectures are from 12:10 to 12:55 pm in Lecture Hall 3, Woodward IRC, 2194 Health Services Mall.

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Market commentary

Global equity markets were heavily concerned with the credit market crisis and global growth in the fourth quarter. The Canadian equity market was very volatile during the quarter, rallying at the end of the year to result in a fourth quarter loss of -1.25%, but a gain for the total year of 9.8%. During the fourth quarter, health care, industrials and consumer staples were the worst performing sectors. The almost 18% gain in the Canadian dollar relative to the U.S. dollar during 2007 resulted in negative Canadian dollar foreign equity returns for the year. The U.S. S&P 500 index returned -4.0% for the fourth quarter and -10.5% for the year, while the MSCI-EAFE index returned -2.4% for the quarter and -5.7% for the year (all in Canadian dollars).

During the fourth quarter, the Bank of Canada cut its overnight rate by 25 basis points to 4.25% on December 4. The DEX Universe Bond Index (formerly the Scotia Capital Universe index) returned 2.7% for the last quarter, (3.7% for 2007) with risk aversion remaining the dominant theme. During the fourth quarter, government bonds outperformed corporates and long term bonds outperformed shorter maturities. Real return bonds returned 2.7% for the quarter (1.6% for the year).

The Canadian dollar reached a high of $1.10 U.S. in November and ended the year at $1.0073 U. S., approximately the same level as the start of the quarter.

Performance of Funds for periods ending December 31, 2007

	3 Months	1 year	3 years	5 years	10 years
Balanced Fund - gross	0.21%	3.19%	9.72%	10.09%	7.15%
Balanced Fund - net	0.01%	2.66%	9.24%	9.62%	6.72%
Composite Index 1	0.23%	2.16%	8.56%	9.68%	6.95%
Canadian Equity Fund - gross	-0.81%	11.52%	17.98%	19.39%	10.48%
Canadian Equity Fund - net	-0.92%	11.07%	N/A	N/A	N/A
Composite Index 2	-1.07%	10.16%	16.87%	18.38%	9.70%
Foreign Equity Fund - gross	-4.09%	-9.74%	5.67%	6.69%	3.38%
Foreign Equity Fund - net	-4.14%	-10.06%	N/A	N/A	N/A
Composite Index 3	-3.03%	-7.62%	5.56%	7.42%	3.61%
Bond Fund - gross	2.77%	3.78%	4.46%	5.24%	6.07%
Bond Fund - net	2.72%	3.57%	4.24%	5.00%	5.82%
Composite Index 4	2.74%	3.40%	4.36%	5.37%	6.16%
Short Term Investment Fund - gross	1.12%	4.49%	3.74%	3.30%	4.35%
Short Term Investment Fund - net	1.09%	4.34%	3.56%	3.10%	4.06%
DEX 30-day T-Bill Index	1.01%	4.41%	3.66%	3.24%	3.83%

Composite Index 1: *33% SCU, 10% S&P/TSX Capped, 5% S&P/TSX, 5% S&P/TSX 60, 15% S&P 500, 15% MSCI-EAFE, 2% DEX 91-Day TB, 10% IPDCPI, 5% DEX Real Return Bonds*

Composite Index 2: *50% S&P/TSX Capped, 25% S&P/TSX, 25% S&P/TSX 60*

Composite Index 3: *48% S&P 500, 48% MSCI-EAFE, 4% DEX 91-Day TB*

Composite Index 4: *86.8% SCU, 13.2% DEX Real Return Bonds*

Composition of Funds as at December 31, 2007

Balanced Fund	**Market Value ($ Millions)**	**% of Fund**
Equities - Canada	225.9	20.7%
Equities - U.S.	140.1	12.8%
Equities - EAFE	151.1	13.8%
Absolute Return Hedge Fund	21.6	2.0%
Real Estate - Canada	128.2	11.7%
Fixed Income	372.9	34.2%
Real Return Bonds - Canada	48.0	4.4%
Cash & Short term	4.3	0.4%
Total Balanced Fund	1,092.1	100.0%
Canadian Equity Fund	86.1	100.0%
Foreign Equity Fund		
Equities - U.S.	16.3	46.2%
Equities - EAFE	17.6	49.9%
Absolute Return Hedge Fund	1.4	4.0%
Total Foreign Equity Fund	35.3	100.0%
Bond Fund		
Fixed Income	23.2	88.5%
Real Return Bonds - Canada	3.0	11.5%
Total Bond Fund	26.2	100.0%
Short Term Investment Fund	40.9	100.0%