PENSION NEWS

UBC FACULTY PENSION PLAN | First Quarter 2010 Edition

The Financial Crisis – An Update

2009 was a remarkable year: the world's stock markets started the year by continuing the steep decline that began in 2008, and then bounced back in early March, rising steadily the rest of the year, leading to strong results for the full year.

The Canadian market fell 15% at the beginning of the year to its bottom, turned around, and finished up by more than 35% for the entire year. Economic activity, which appeared to be in collapse at the beginning of the year, gradually turned around with positive growth in the fourth quarter.

Various stages in the Financial Crisis were described in three editions of the *Pension News* – the 3rd and 4th quarters of 2008 and the 2nd quarter of 2009. This article looks at the past year, one year after the market bottom, and also provides an outlook for the current year.

THE BANKS

Although the causes of the financial crisis are open to debate, any discussion of the crisis must mention the large U.S. banks. These multi-dimensional institutions were involved in the globe's financial and economic activity in ways that most people did not imagine, not only as lenders and as holders of deposits, but also as active traders in the financial markets and as creators of exotic financial instruments. It was the banks' trading and financial engineering activities that got them into trouble, but it was their abandonment of their traditional lending role that caused wider problems. The problem wasn't limited to the U.S., as a number of European banks also faced insolvency. The government bailouts were intended to re-ignite the banks' traditional lending activity, which now, one year later, has been largely successful.

Being central to the financial crisis and often blamed for it, banks have been subjected to considerable scrutiny. Politicians and regulators worldwide have been contemplating a number of measures to prevent a recurrence of the 2008 collapse. Suggested measures to prevent future failure include requiring banks to increase their levels of capitalization, splitting the banks' economically important functions of lending and deposit-taking from their risk-taking functions such as proprietary trading, and changing the financial industry's compensation systems to remove the financial incentives to take excessive risk. Now, one year later, there is agreement that change is required, but no agreement as yet, on what the changes should be.

INDIVIDUALS AND BUSINESSES

Although the most visible sign of economic distress was the collapse of financial institutions in mid 2008, the seeds of the collapse were sown much

In This Issue

continued from page 1

earlier with the proliferation of the so-called ninja mortgages (no income, no job, no assets), which were repackaged as investments. When business slowed, the unemployment rate rose, homeowners defaulted on their mortgages, homes were foreclosed and abandoned and new homebuilding stopped. Now, one year out, the U.S. unemployment rate remains high at 9.7%, with jobless rates as high as 15% in some areas. Also, although the housing market in the U.S. is showing some signs of recovery, some areas, such as Las Vegas, Phoenix, and parts of Florida and California continue to be challenged. Some researchers estimate that more than 20% of U.S. homes are "underwater" – the homes are worth less than the mortgages on them – and more than 50% are underwater in some of the distressed areas. The Canadian experience has been better, but some European countries have the same problem as the U.S.

Individuals have responded appropriately: reducing spending, reducing debt, increasing savings and moving to more affordable accommodation. Paradoxically, while this behaviour is prudent for the individual, it is not good for the economy as the reduction in consumption lowers production and jobs. Although credit is available at very low rates, prognosticators expect that consumer demand, economic growth and employment will continue to be weak for some time.

Businesses responded quickly to the crisis, cutting costs (including employees) and reducing inventory. Credit-worthy businesses have had easy access to low-cost financing; 2009 annual reports showed that many companies were profitable. Investors who anticipated increased business profits pushed stock prices up more than 50% from the March 2009 bottom. But the improved company performance has also been described as a "jobless recovery," because although profitability returned, economic growth is low and employment is stagnant.

AROUND THE GLOBE

Before the crash, countries around the world, especially in Europe and in particular the countries referred to as the PIIGS (Portugal, Ireland, Italy, Greece, and Spain), also experienced construction overbuilding and under financing, leading to a large segment of the population that is unemployed and who cannot afford their newly built homes. With the erosion of the tax base and the escalation of the cost of social support systems, government deficits have risen sharply. Some countries allegedly masked their true financial position with the aid of the big banks and creative financial engineering. Greece's debt funding problem is perhaps the most visible. The country itself faces insolvency and will likely require external funding from their European counterparts or the International Monetary Fund. The economic crisis initially affected consumers, but one year out, individual and business debt has been passed on to governments, creating troublesome government debt problems.

At one point, the Western world hoped for support from some of the newer, emerging economies. But some of those countries, too, have had problems. Dubai World, the investment company that manages a wide range of businesses for the Dubai government, is currently trying to rearrange more than $20 billion of debt.

Perhaps the biggest unknown in the whole global economic puzzle is China. Before the decline, China had exhibited economic growth of epic proportions; but while they also suffered through the decline, their growth remained positive, just at a lower rate. The Chinese government directly finances infrastructure projects, investing massively throughout the country, and maintaining a high level of employment.

ONE YEAR OUTLOOK

A year ago, as the government stimulus packages took hold, many commentators thought that the equity markets would recover, at least over the short term. Going forward, there is a wide range of views about the economy and the markets. The economic crisis started with the U.S. consumer/homeowner and will likely end there. The stimulus packages have successfully re-energized the economy, but the longer term impact is far from clear. The big question mark is still the so-called "exit strategy" from the government stimulus programs. Removing easy lending too soon could stop the momentum of economic growth, but continuing the programs could increase public sector debt to unmanageable levels.

Some analysts point out that massive government debt incurred to revive the economy will require interest payments that will crowd out regular government activity; generating government revenue through higher taxes will sap crucial financial resources necessary for private sector economic growth. These analysts also point to future demographic challenges: as the boomer population ages, the cost of government pension programs and health care will continue to rise. The consensus view is for future economic growth, but the level of growth will be slower than in the past. Therefore, stock market performance is not expected to be as robust as in 2009.

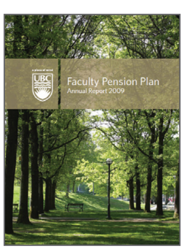
As the Chinese economy grows to rival that of the U.S., economic conditions in China will have an increasingly

continued from page 2

important impact on the global economy. To maintain employment levels, Chinese must export a large part of their production. But for Chinese export industries – already with narrow margins – to remain viable, their currency (the yuan) cannot be allowed to appreciate substantially. If the yuan is kept artificially low, as some claim it is, Chinese exports will crowd out exports from other nations, causing conflict with their exporting competitors. The U.S. in particular is perturbed by the Chinese position on currency, leading some U.S. politicians to demand that China be labelled a currency manipulator, which will allow the U.S. to apply sanctions to Chinese goods. Of course, the U.S. also relies on the Chinese to purchase U.S. debt so that the U.S. government and consumers can continue to spend. The challenge worldwide is for countries to be able to balance their imports with exports, but weak, uncompetitive industries may have sufficient domestic political influence to lead governments to implement protectionist measures.

A year from now, *Pension News* may have yet another article about the financial crisis. Given the wide range of current forecasts on the future, what that article might say is just a guess. ■

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



2009 Annual Report
is available online at
www.pensions.ubc.ca/faculty/publications/reports/2009AnnualReport.pdf

MARKET COMMENTARY

IN THE FIRST QUARTER OF 2010, stock markets continued to climb from the lows reached in March 2009. Much of the economic results reported either positive or "less negative" news, providing investors with some level of comfort that things were generally improving in the economy.

The Canadian stock market had another positive quarter returning 3.1% for a strong total one-year return of 42.1%. However, despite this result, the index returns are still negative over the last three years at -0.9%. All industry sectors had positive returns in the first quarter of 2010, with the exception of the Energy sector, which was down -2.0% for the quarter. The Financial sector, which makes up almost 32% of the stock index, had another strong quarter, up 8.1%, resulting in an impressive 67.7% return over the one-year period.

The U.S. stock market also performed well in the first quarter at 5.4%, with a one-year return of 49.8%, in U.S. dollar terms. However, due to the weakening U.S. dollar, this translated into returns of 2.0% for the first quarter and 20.8% for the one-year period in Canadian dollar terms. Non-North American equities (as measured by the EAFE index) returned 4.3% and 44.7% over the first quarter and one-year periods respectively, in local currency terms. Due to a strengthening Canadian dollar, these returns were -2.4% and 24.5% respectively when translated into Canadian dollars. Emerging markets were weak at -0.9% for the first quarter but had strong one-year results at 46.0%.

The Bond market overall had a positive return in the first quarter of 1.3% and 5.1% for the one-year period. Long Term Bonds were strongest in the first quarter at 2.6% versus 1.7% for Mid Term Bonds, and 0.4% for Short Term Bonds. The Corporate bond sector at 2.2% also continued to outperform Federal Bonds (0.7%) and Provincial Bonds (1.2%) for the quarter. Real Returns Bonds had a strong year with a 10.5% return. ■

PERFORMANCE OF THE FUNDS
FOR PERIODS ENDING MARCH 31, 2010*

	3 months	1 year	3 years*	5 years*	10 years*
Balanced Fund - gross	1.31%	17.89%	0.13%	5.24%	4.84%
Balanced Fund - net	1.19%	17.33%	-0.38%	4.74%	4.38%
Composite Index 1	1.06%	16.69%	-0.02%	4.60%	4.04%
Bond Fund - gross	1.59%	10.09%	5.79%	5.51%	6.41%
Bond Fund - net	1.50%	9.74%	5.48%	5.24%	6.14%
Composite Index 2	1.22%	5.84%	5.33%	5.10%	6.41%
Canadian Equity Fund - gross	3.24%	40.11%	0.19%	8.01%	8.43%
Canadian Equity Fund - net	3.13%	39.53%	-0.23%	N/A	N/A
Composite Index 3	3.00%	40.96%	0.12%	7.39%	5.07%
Foreign Equity Fund - gross	-0.52%	22.09%	-10.24%	-1.02%	-2.86%
Foreign Equity Fund - net	-0.65%	21.53%	-10.64%	N/A	N/A
Composite Index 4	-0.16%	21.86%	-9.02%	-0.52%	-2.35%
Short Term Investment Fund - gross	0.05%	0.26%	2.33%	2.83%	3.25%
Short Term Investment Fund - net	0.01%	0.10%	2.18%	2.66%	3.03%
Composite Index 5	0.04%	0.21%	2.10%	2.66%	3.06%

*Annualized returns

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

Composite Index 2: 86.8% DEX Universe, 13.2% 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: 48% MSCI-EAFE, 48% S&P 500, 4% DEX 91-Day TB

Composite Index 5: DEX 91-Day TB Index until August 2007, DEX 30-Day TB Index commencing September 2007

The Average Rate of Return for the FPP funds are updated on a monthly basis and posted on the FPP website at **www.pensions.ubc.ca/faculty/ror_summary.php.**

COMPOSITION OF THE FUNDS
AS AT MARCH 31, 2010

	Market Value ($ Millions)	% of Funds
BALANCED FUND		
Equities - Canada	224.8	21.7%
Equities - U.S.	156.7	15.1%
Equities - EAFE	141.9	13.7%
Absolute Return Hedge Fund	23.5	2.3%
Real Estate - Canada	87.9	8.5%
Fixed Income	332.4	32.1%
Real Return Bonds - Canada	61.9	6.0%
Cash	5.9	0.6%
Total Balanced Fund	1,035.0	100.0%
BOND FUND		
Fixed Income	45.4	83.9%
Real Return Bonds - Canada	8.5	15.7%
Cash	0.2	0.4%
Total Bond Fund	54.1	100.0%

	Market Value ($ Millions)	% of Funds
CANADIAN EQUITY FUND		
Equities - Canada	91.7	98.4%
Cash	1.5	1.6%
Total Canadian Equity Fund	93.2	100.0%
FOREIGN EQUITY FUND		
Equities - U.S.	15.9	47.5%
Equities - EAFE	14.4	43.0%
Absolute Return Hedge Fund	1.5	4.5%
Cash	1.7	5.0%
Total Foreign Equity Fund	33.5	100.0%
SHORT TERM INVESTMENT FUND		
Total Short Term Invest. Fund	52.3	100.0%

Investment Changes *in* Managing the Funds' Foreign Equities

IN A RECENT LETTER TO MEMBERS, investment changes effective April 1, 2010 were outlined, which affected the Balanced, Bond, and Foreign Equity fund options. One change was in regards to how the foreign equities were to be managed going forward. The previous structure in the Balanced Fund and Foreign Equity Fund equally weighted both a U.S. equity mandate and a Non-North American equity mandate (i.e. 15% each in the Balanced Fund). Specialty investment managers were used to invest in each of these two geographic regions.

The new structure for investing the foreign equities component primarily uses two newly hired managers (MFS and JP Morgan), with a "Global" mandate. This mandate allows these managers to choose the best stocks in the world's developed markets, regardless of country or geographic constraints. The main rationale for moving to a "Global" mandate is that it provides the managers with a larger opportunity set in which to select the best stocks. For example, a manager with only a U.S. mandate could only choose the best Bank stock in the U.S. market. Whereas a manager with a Global mandate can select the best Bank stock wherever it happens to reside in the world.

With the increasing globalization of the world's economies, most investment management firms have been moving their research and analyst teams from a "geographic" to a "sector" approach. In this approach, they are looking to select the best stocks in a specific sector (e.g. autos, energy, banks), regardless of where they happen to be geographically located. By allowing managers this broader approach to where they can invest, it should hopefully lead to stronger returns and/or lower risk. Performance surveys by various consulting firms have verified that the median active Global manager has outperformed an equally weighted (i.e. 50/50) combination of active U.S. and Non-North American managers over most time periods.

It is important to note that the distinction between U.S. versus Non-North American is based on where a stock is geographically listed (e.g. Ford on the NYSE). Whereas, what is normally more important to a stock's performance is how and where the firm generates their revenues and earnings. Recently stated, at least 50% of the revenues of firms listed on the U.S. S&P 500 index are actually generated outside of the U.S. Hence, a distinction based on where a stock is listed (i.e. U.S. versus Non-North American) is becoming less relevant with the increasing globalization of companies and markets.

A separate, specific allocation to U.S. equities of 6% in the Balanced Fund and 21% in the Foreign Equity Fund is still being maintained. This specific allocation is in addition to whatever proportion in U.S. equities is held by the two new Global equity managers. The 6% U.S. weighting in the Balanced Fund is a result of the asset mix review completed with an outside consulting firm in 2009, and reflects a bias to a greater weighting in U.S. versus Non-North American stocks. The asset mix review indicated this could be of some benefit by enhancing the expected risk and/or returns to the FPP funds. However, the actual total overall weighting to U.S. and Non-North American stocks in the Balanced and Foreign Equity fund options will ultimately be a result of how the two Global managers choose their portfolio, and the resulting country weightings that this produces. ■

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2010 Variable Payment Life Annuities (VPLA)

Aon Consulting has calculated the changes in the VPLA values for 2010. The increases were effective with the April 1, 2010 retirement payment.

Option	Increase in Value
4% VPLA	5.78%
7% VPLA	2.81%

Retirement Counselling Funding Available for Faculty Association Members

The University provides several resources to support members with their retirement, one of which includes funding for financial and retirement counselling.

UBC will reimburse Faculty Association members for counselling services from a UBC-approved financial consultant up to a maximum of 3 hours ($750 limit) per member. For more information and to request reimbursement, please refer to the 'Planning for Retirement' section at **www.hr.ubc.ca/faculty_relations/retirement/**.

Upcoming Workshops

You & Your Pension Plan - May 21, 2010
If you are a new member or wish to learn more about the Plan, this seminar will cover all aspects of the UBC Faculty Pension Plan.

Understanding Your Retirement Income Options - June 7, 2010
For members approaching retirement, this seminar is helpful as it explains the various options available.

If you are interested in either of these sessions or wish to register, please contact Jim Loughlean by e-mail at jim.loughlean@ubc.ca or by telephone at 604-822-8987. Please refer to **www.pensions.ubc.ca/faculty/workshops.html** for up-to-date workshop information and dates.