



The Role of Liquid Alternative Investments in Institutional Portfolios

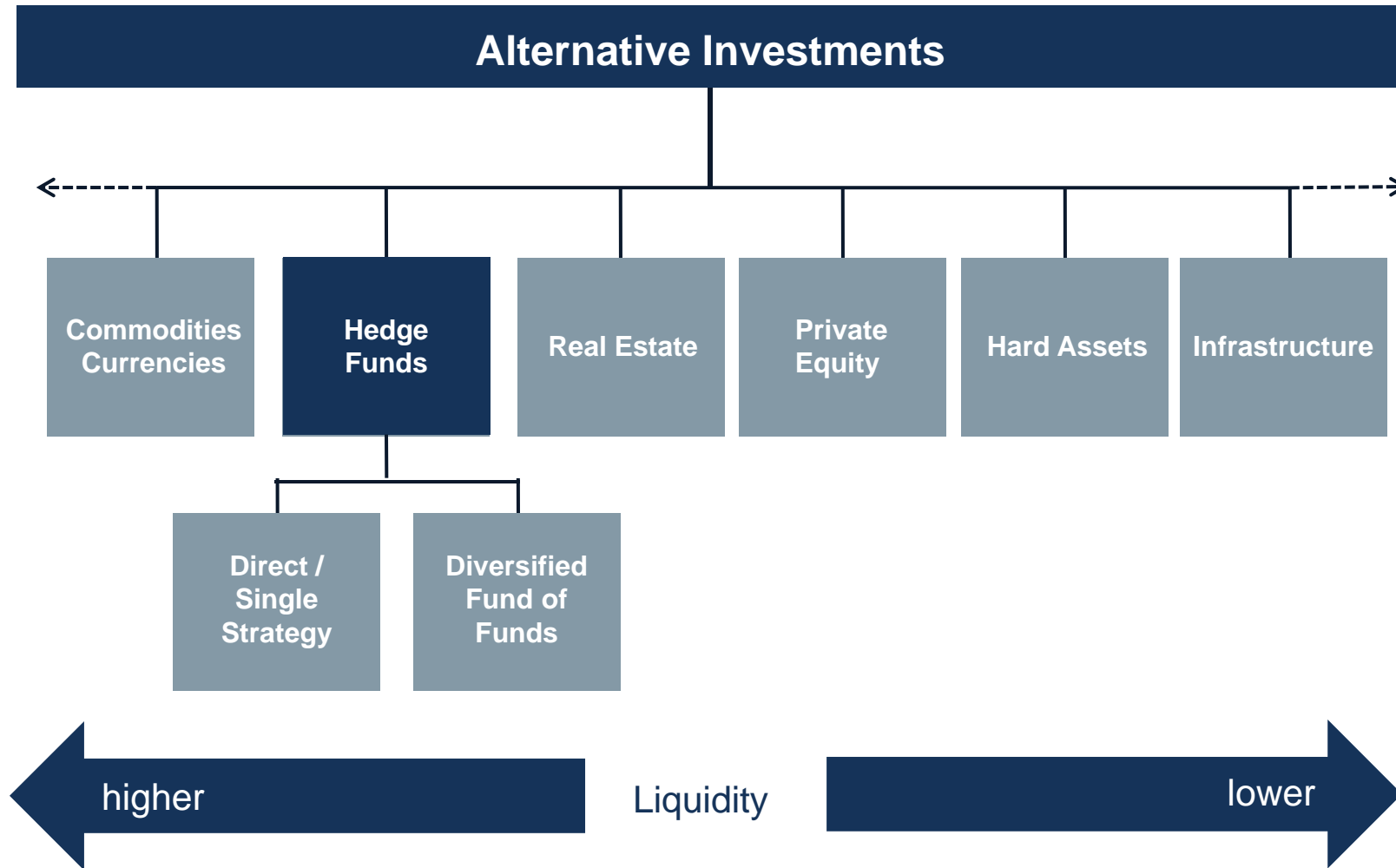
February 2013



Agenda

- What are they and why are we talking about alternatives?
- Adding value and de-risking in a portfolio context
- Implementation considerations for trustees

Alternative Investments Are A Broad Category





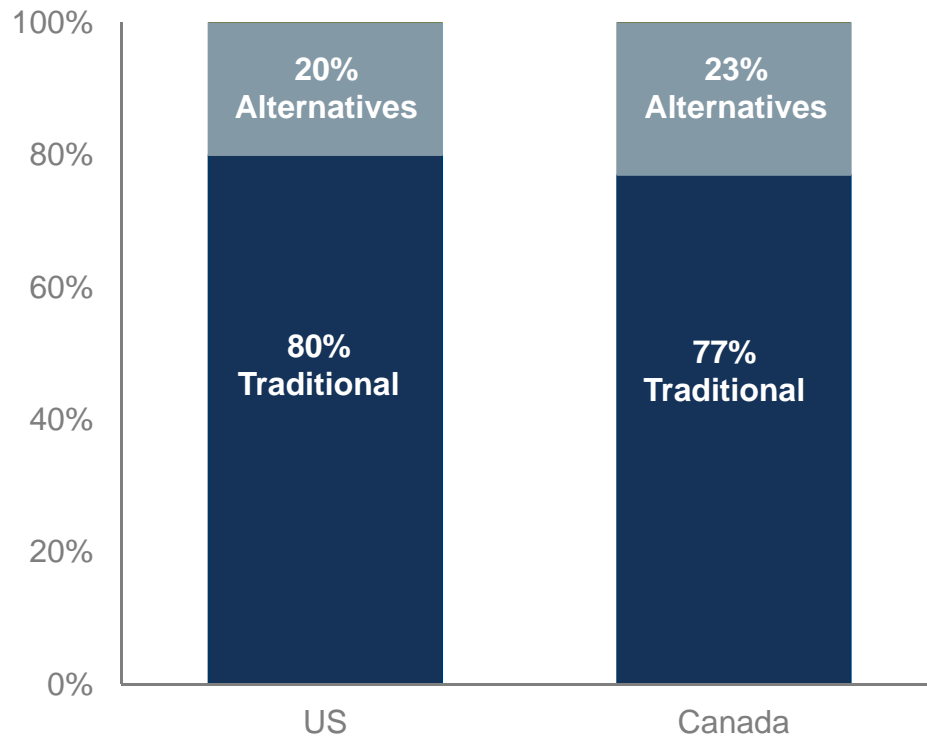
MANKOFF

"I'm looking for a hedge against my hedge funds."

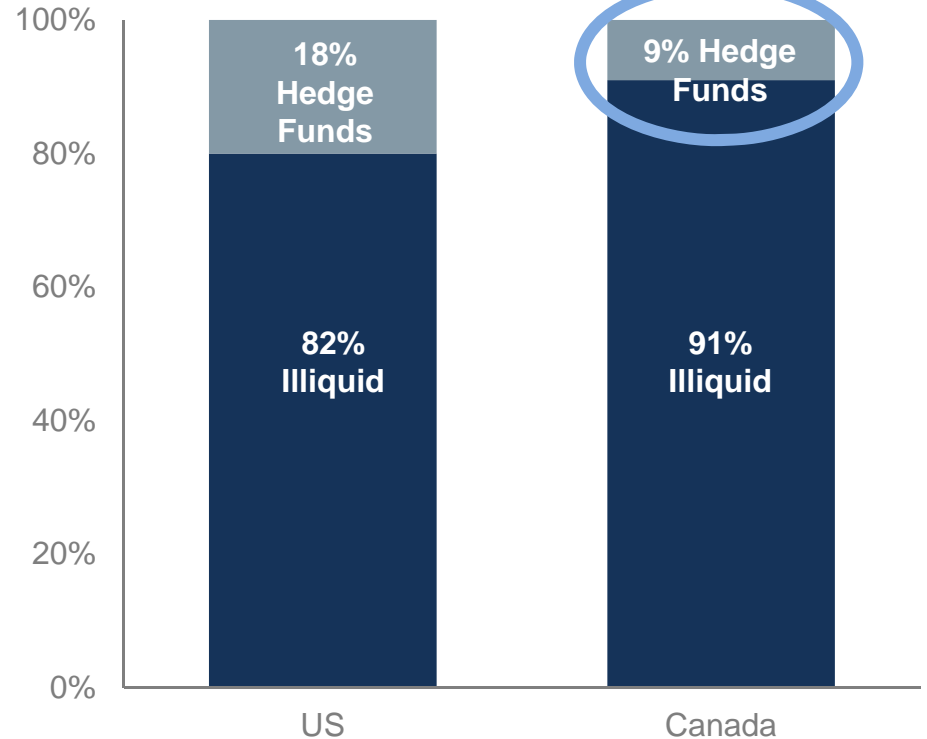
New Yorker Magazine, October 12, 1998

Meaningful Component Of Alternatives Allocations

Allocation To Alternatives
(Total Portfolio)

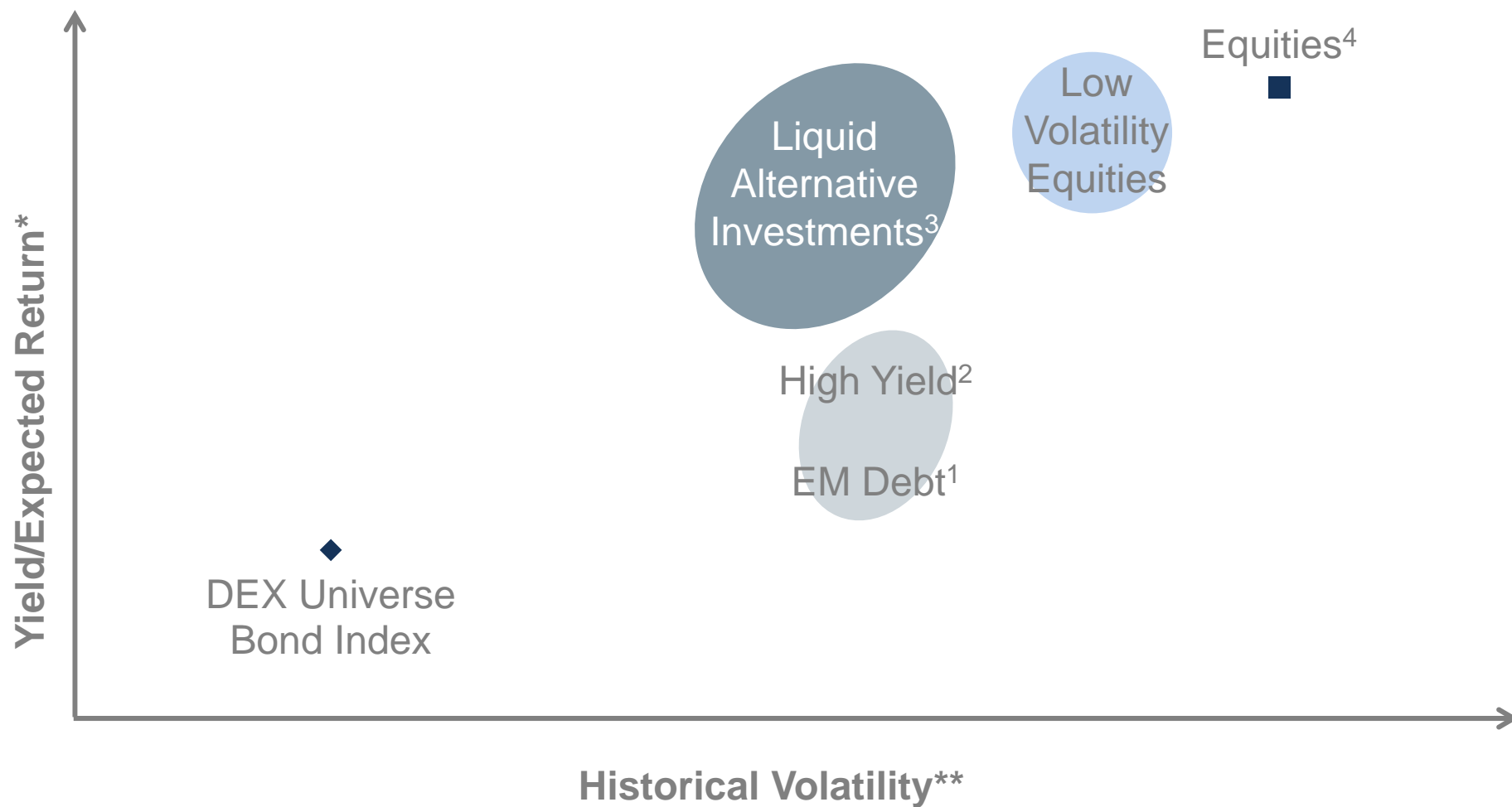


Hedge Funds vs. Illiquid Alternatives
Allocation
(% of Alternatives Sleeve)



Source: Cliffwater (2011), PIAC (2011)

Risk/Return Profile Complements Traditional Allocations



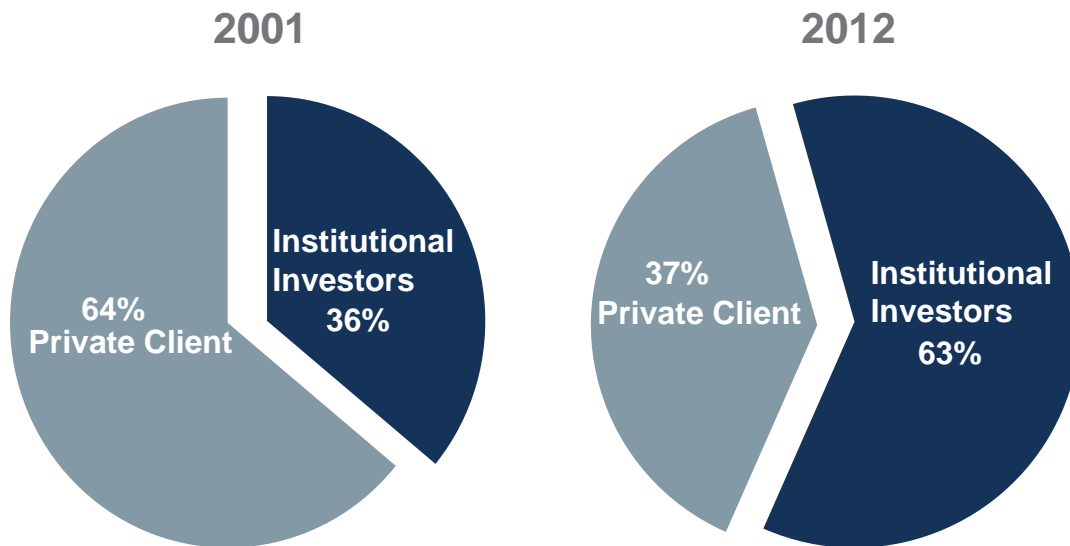
*Full disclosures are available on slide 27

** Annualized standard deviation of monthly returns, Jan 2003 – Dec 2012.

^{1,2,3,4} Full disclosures are available on slide 27

Institutional Investors Now Dominate The Market

Global Hedge Fund Investor Base



*Institutions includes Endowments,
Pension Funds and Foundations
(excluding fund of funds)*

Institutional demand driving:

- Greater Transparency
- Lower Fees
- Institutional Infrastructure

Source: Prequin 2011, KPMG 2012

Traditional Investments Differ From Hedge Funds

Traditional Investing

vs.

Hedge Funds

- Relative return objectives
 - Benchmark driven
 - Asset based fee
 - Long only investments
 - No leverage
 - Highly liquid
 - Highly transparent
- Absolute or risk adjusted return objectives
 - No benchmark constraints
 - Incentive based fee
 - Long or short and/or derivatives positions
 - May use leverage
 - Liquidity restrictions and lock-up periods
 - Varying degrees of transparency

Attractive Historical Correlations And Volatility

Comparative Statistics 1990-2012

	Correlation to Diversified Hedge Funds*	Annualized Return	Annualized Volatility	Sharpe Ratio**
Diversified Hedge Funds (Net of Fees)*	1.00	7.7%	5.8%	0.97
Domestic Equities	0.67	7.9%	15.0%	0.40
Universe Bonds	0.14	8.5%	4.8%	1.37

Source: HFRI – 1990-2012, PH&N IM, Bloomberg

This example is for illustrative purposes only and is not intended to be representative of the performance of any actual or future investment. Past performance is not an indicator of future results

* HFRI Fund of Funds Composite Index, ** Assumes Risk Free Rate of 2% and fully currency hedged returns

Domestic Equities = S&P/TSX Composite Index, Universe Bonds = DEX Universe Bond Index

But The Last 5 Years Have Been Challenging

Comparative Statistics 2007-2012

	Correlation to Diversified Hedge Funds*	Annualized Return	Annualized Volatility	Sharpe Ratio**
Diversified Hedge Funds (Net of Fees)*	1.00	-1.7%	6.4%	-0.58
Domestic Equities	0.84	0.8%	17.0%	-0.07
Universe Bonds	-0.08	6.3%	3.4%	1.2

Source: HFRI – 2007-2012, PH&N IM, Bloomberg

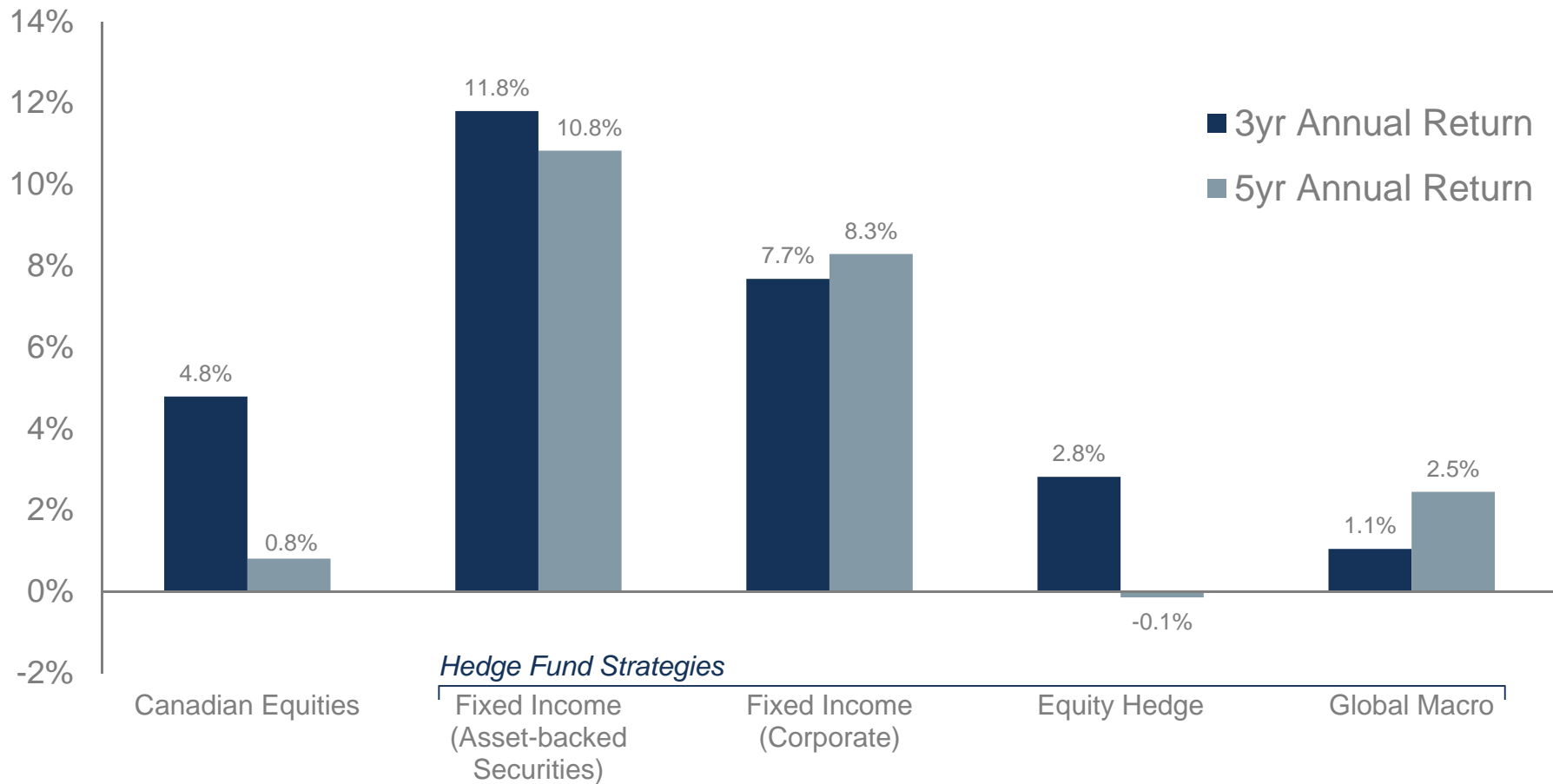
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Domestic Equities = S&P/TSX Composite Index, Universe Bonds = DEX Universe Bond Index

Though There Were Winners And Losers

3 and 5 Year Annualized Returns by Strategy



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Diversifying Portfolios To Reduce Risk

Diversified
Fund of
Funds



Lower expected volatility of return seeking portfolio



Lower expected volatility relative to liabilities in de-risking process

Would Hedge Funds Have Made A Difference?

Historical return of a Balanced Portfolio (1990-2012)

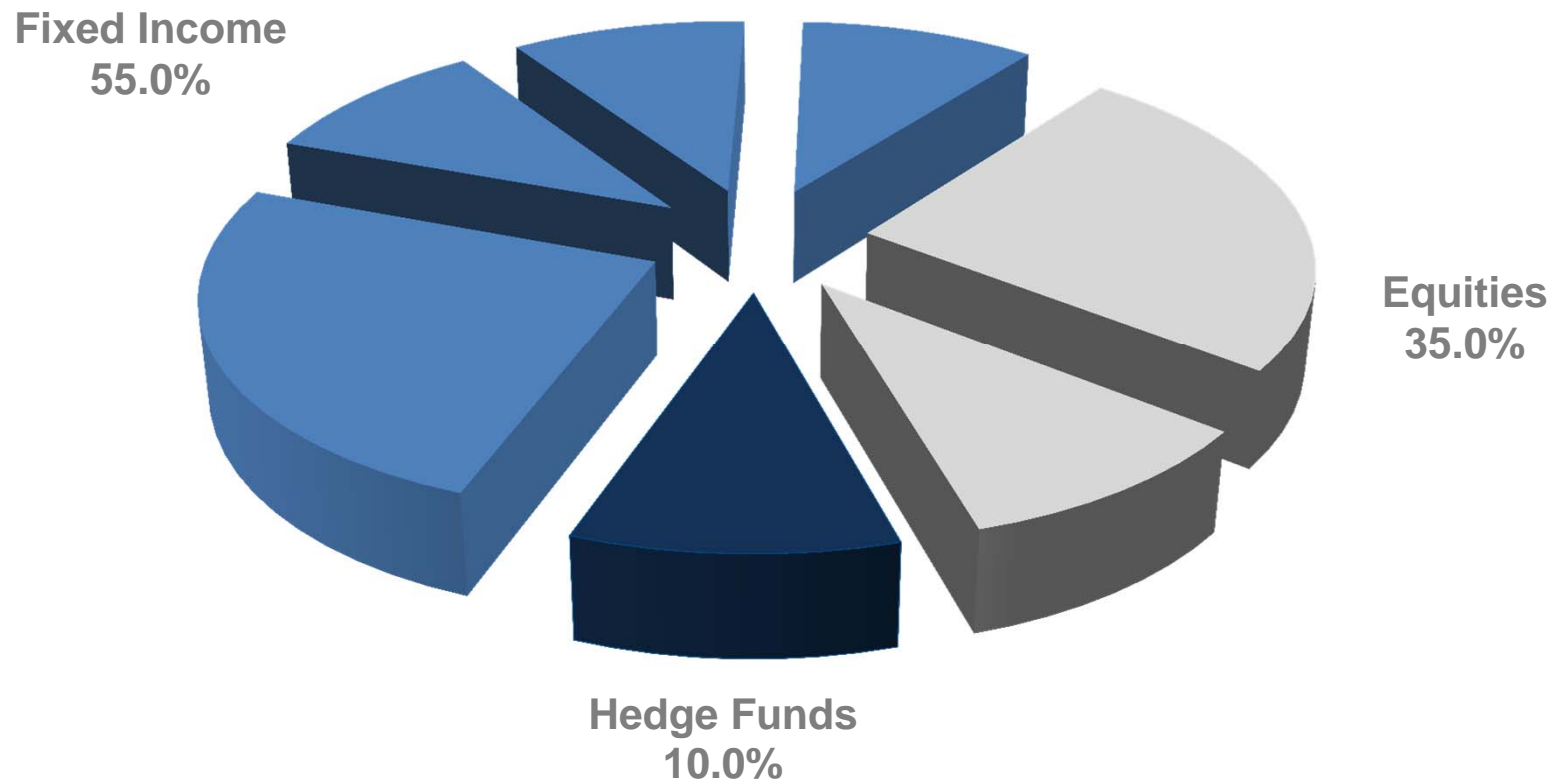
	Universe Bonds	Domestic Equity	Global Equity	Diversified Hedge Funds	Historical Return	Standard Deviation	Sharpe Ratio*
Portfolio A - Balanced	40%	30%	30%	0%	7.6%	9.2%	0.60
Portfolio B - Alternatives (Reduce Equity)	40%	20%	20%	20%	7.7%	7.2%	0.79

Source: Hedge Fund Research Inc – 1990-2012, PH&N IM, Bloomberg, *Assumes Risk Free Rate of 2% and fully currency hedged returns
 Universe Bonds = DEX Universe Bond Index, Domestic Equity = S&P/TSX Composite Index, Global Equity = MSCI World Index, Diversified Hedge Funds = HFRI Fund of Funds Composite Index

This example is for illustrative purposes only and is not intended to be representative of the performance of any actual or future investment. Hedge fund returns net of fees.

Diversifying Sources Of Risk And Return

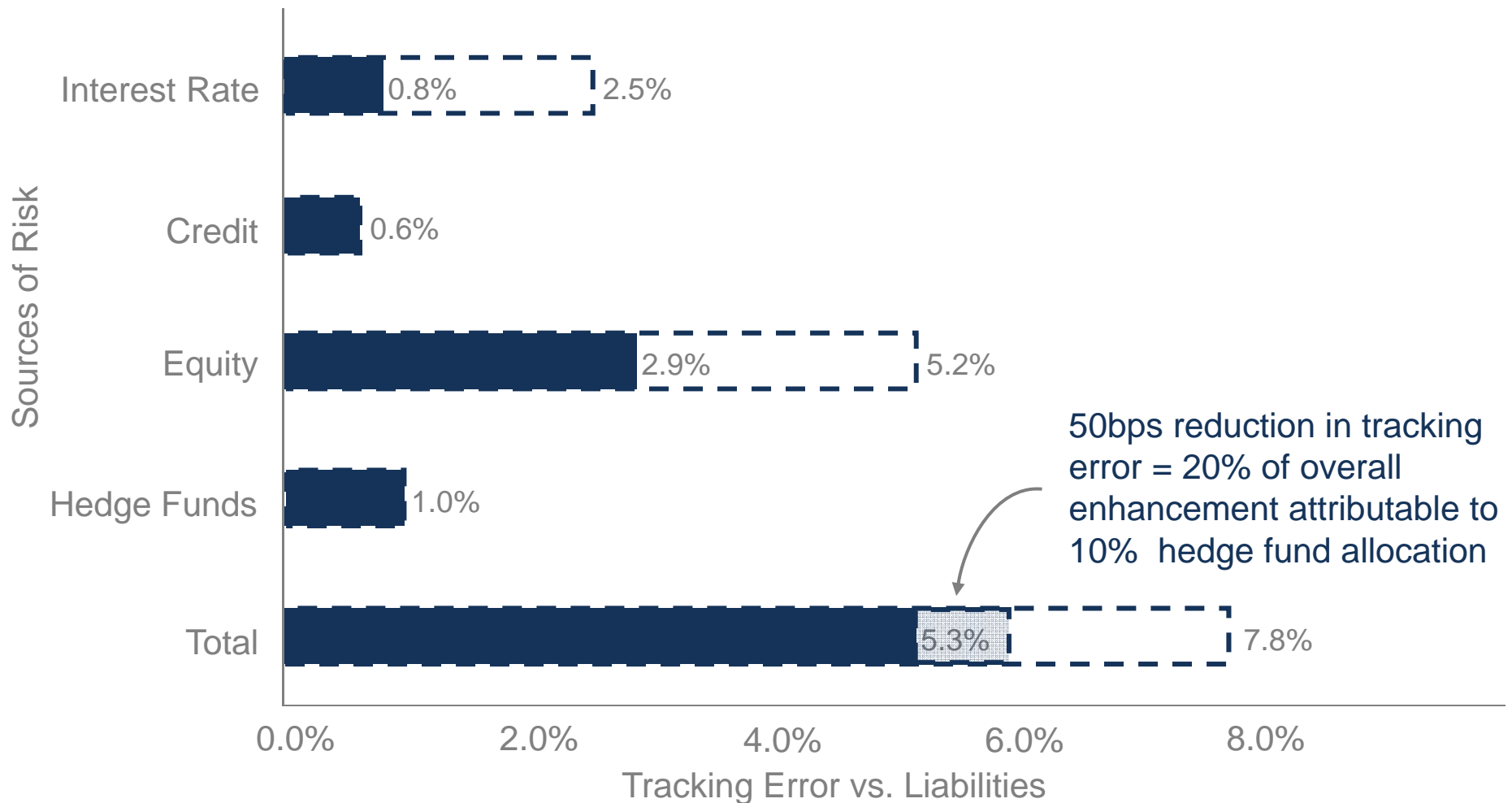
Diversified Portfolio With Alternatives



This example is for illustrative purposes only.

Significant Contribution As A Complement To Equity Risk

Same Expected Return with Less Risk



Source: PH&N IM
Sample 14-year duration liability profile
For illustrative purposes only.

Single Strategies In A Stand Alone Setting

Direct/
Single
Strategies



Can be effective in times of stress

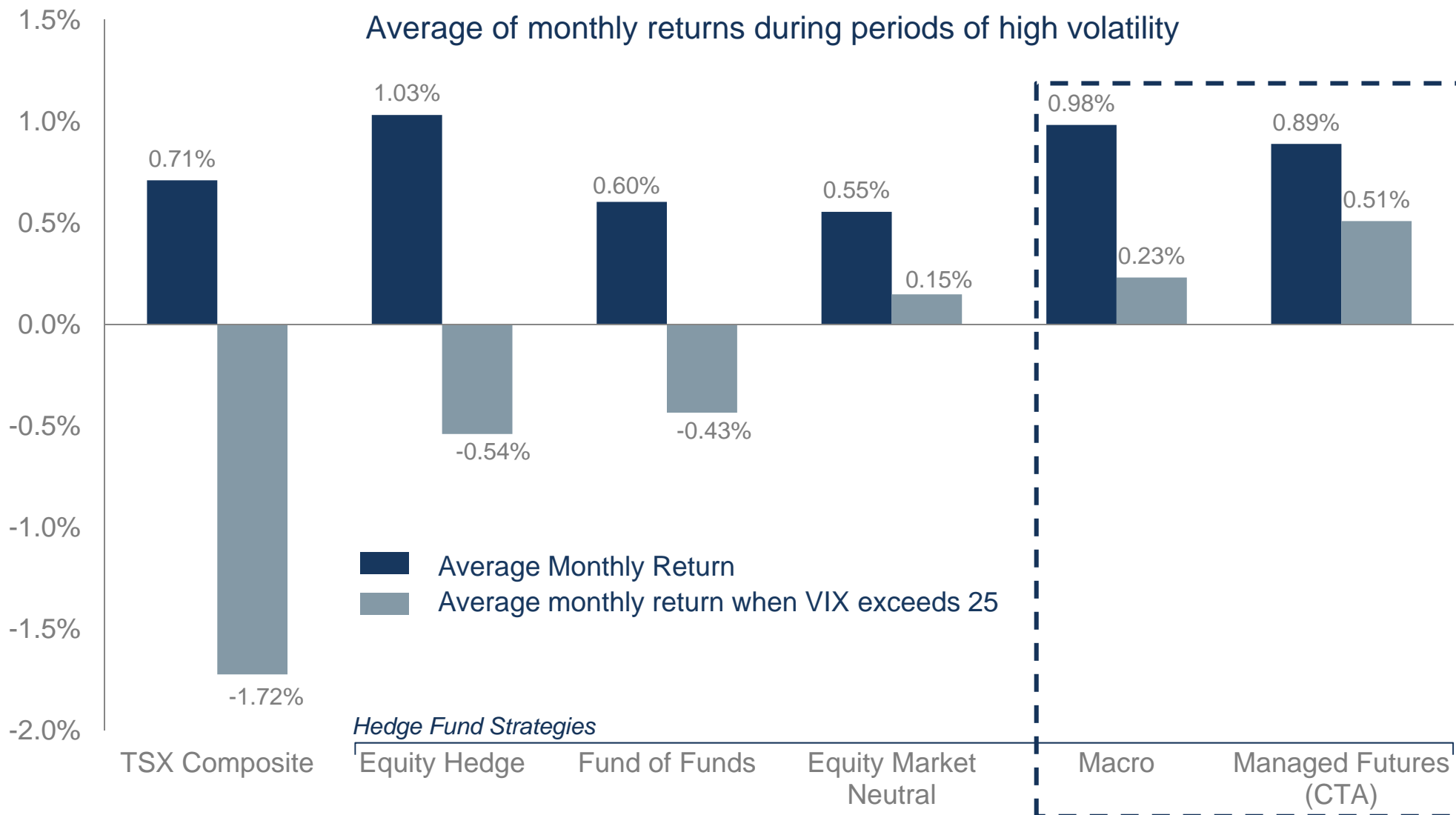


Can reduce exposure to tail risks



Have potential to enhance yields and returns

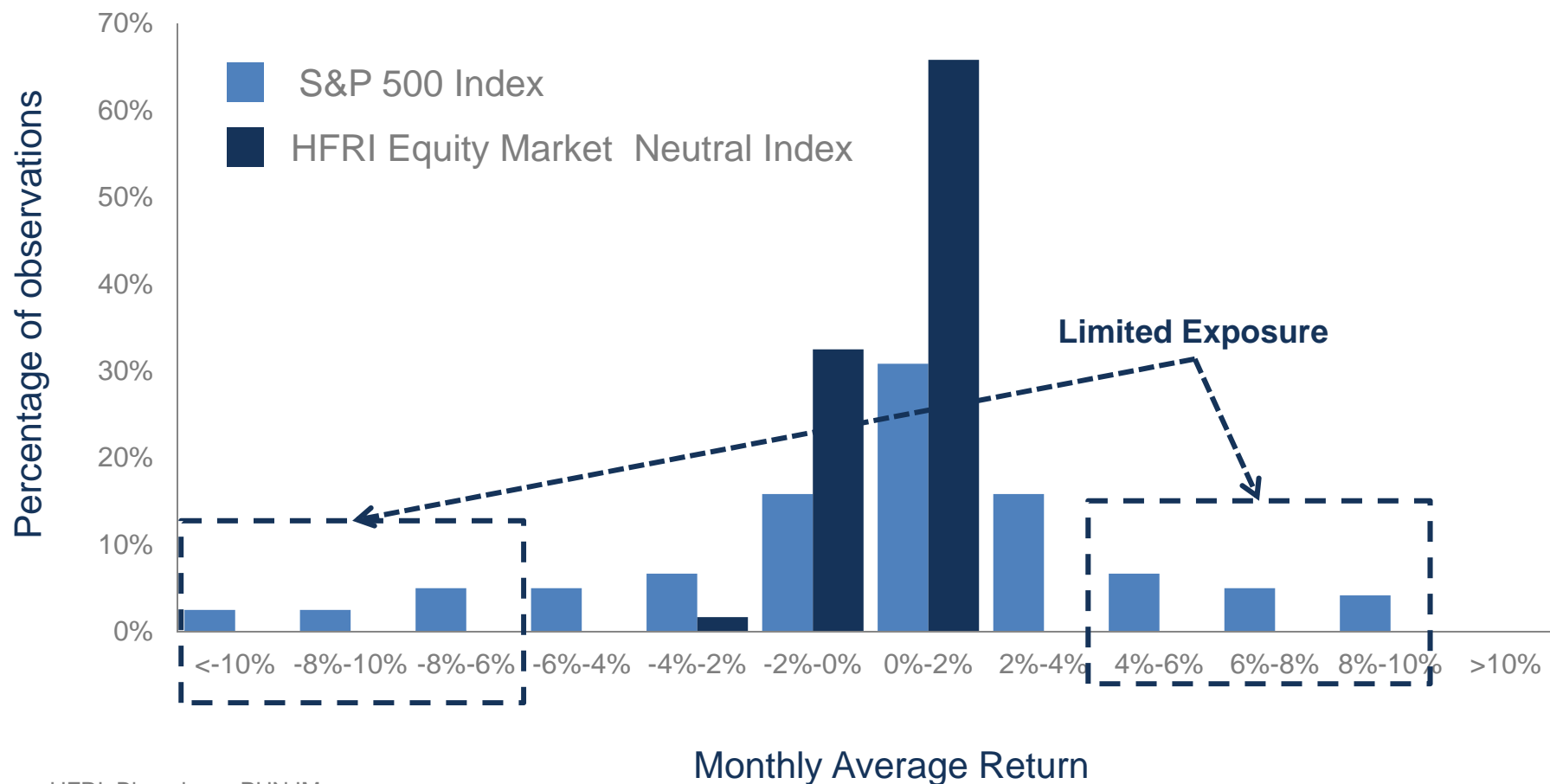
Single Strategies Can Be Effective In Times Of Stress



Source: HFRI, Bloomberg, PH&N IM, Jan. 1990 – Dec. 2012. VIX is represented by the CBOE Volatility Index. This example is for illustrative purposes only and is not intended to be representative of the performance of any actual or future investment. See slide 29 for full disclosures.

And Limit Exposure To “Tail Risk”

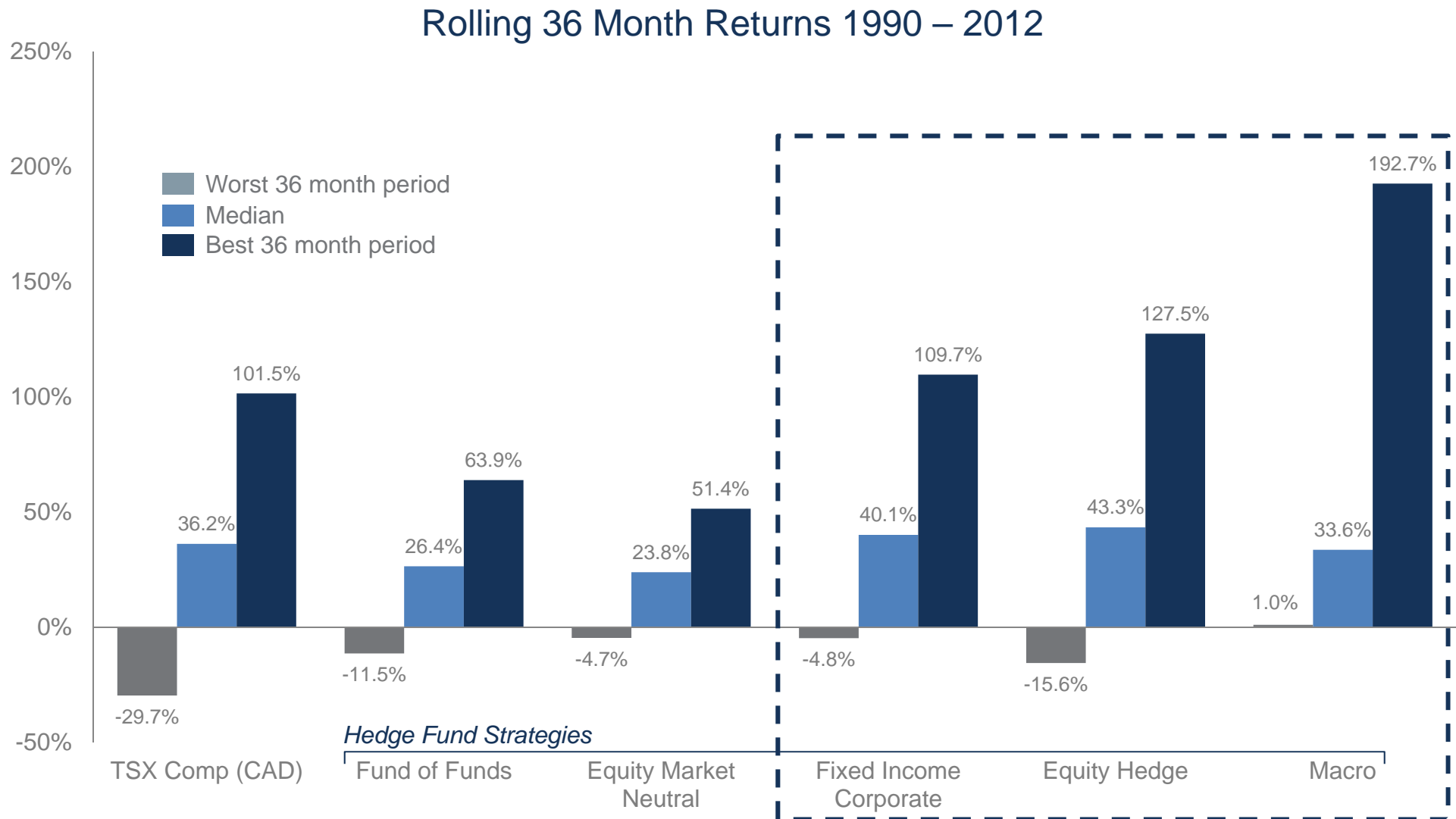
Equity Market Neutral Return Distribution



Source: HFRI, Bloomberg, PHN IM
 Base on historical data from 2002 – 2012

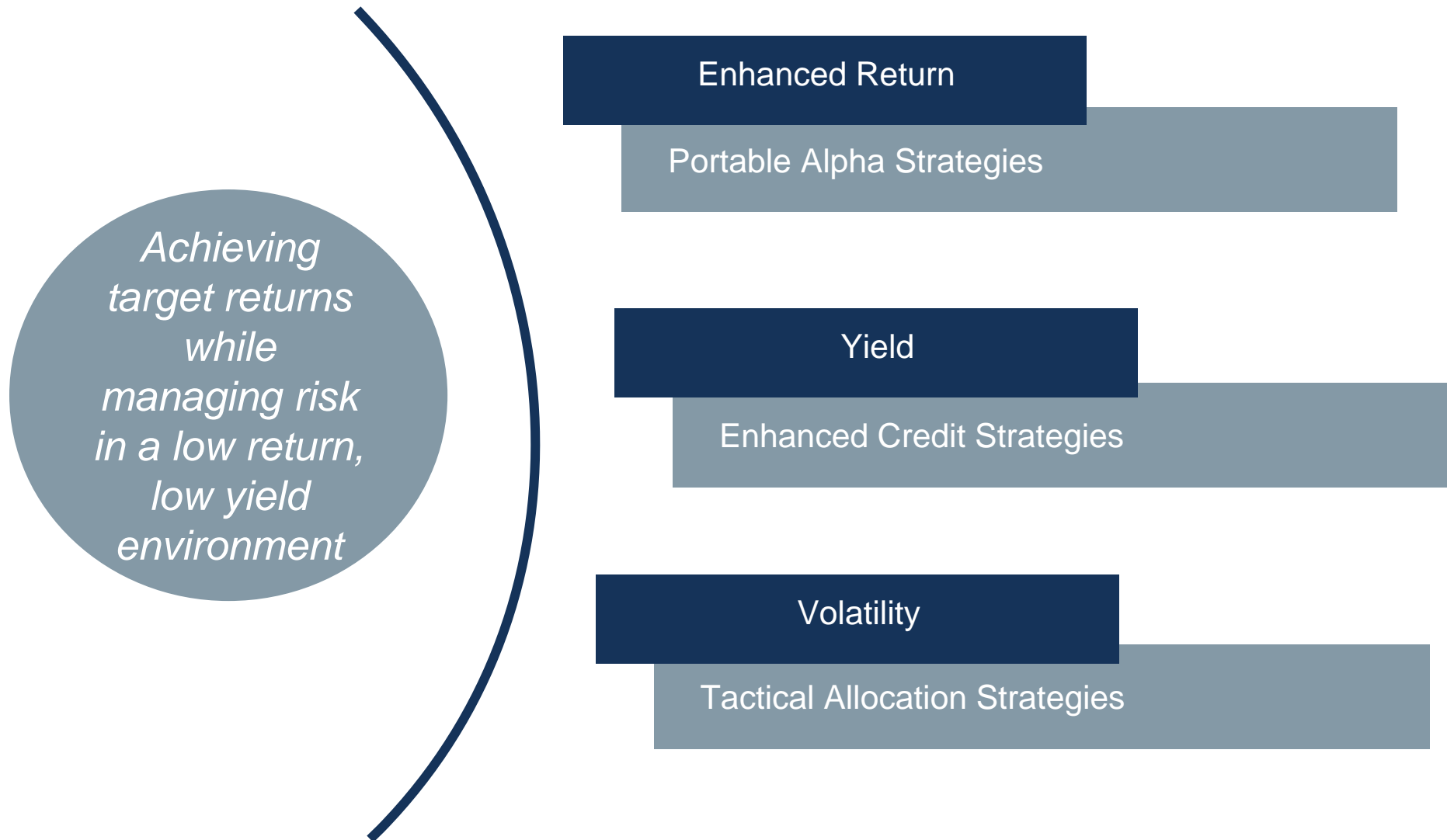
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While Providing Potential For Enhanced Returns

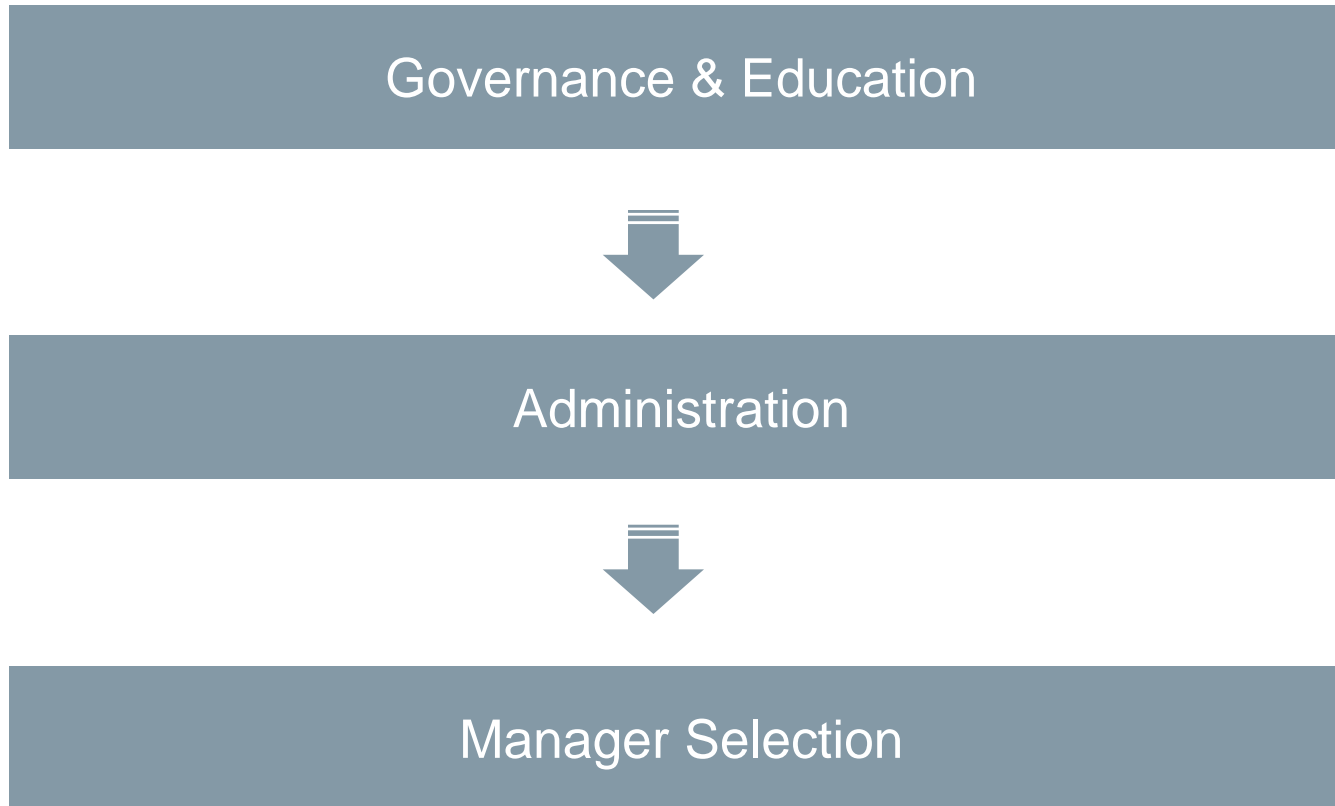


Source: Bloomberg, PHN IM, HFRI; data from January 1990 to December 2012. See slide 29 for full disclosure.

Single Strategies In Objectives Based Solutions

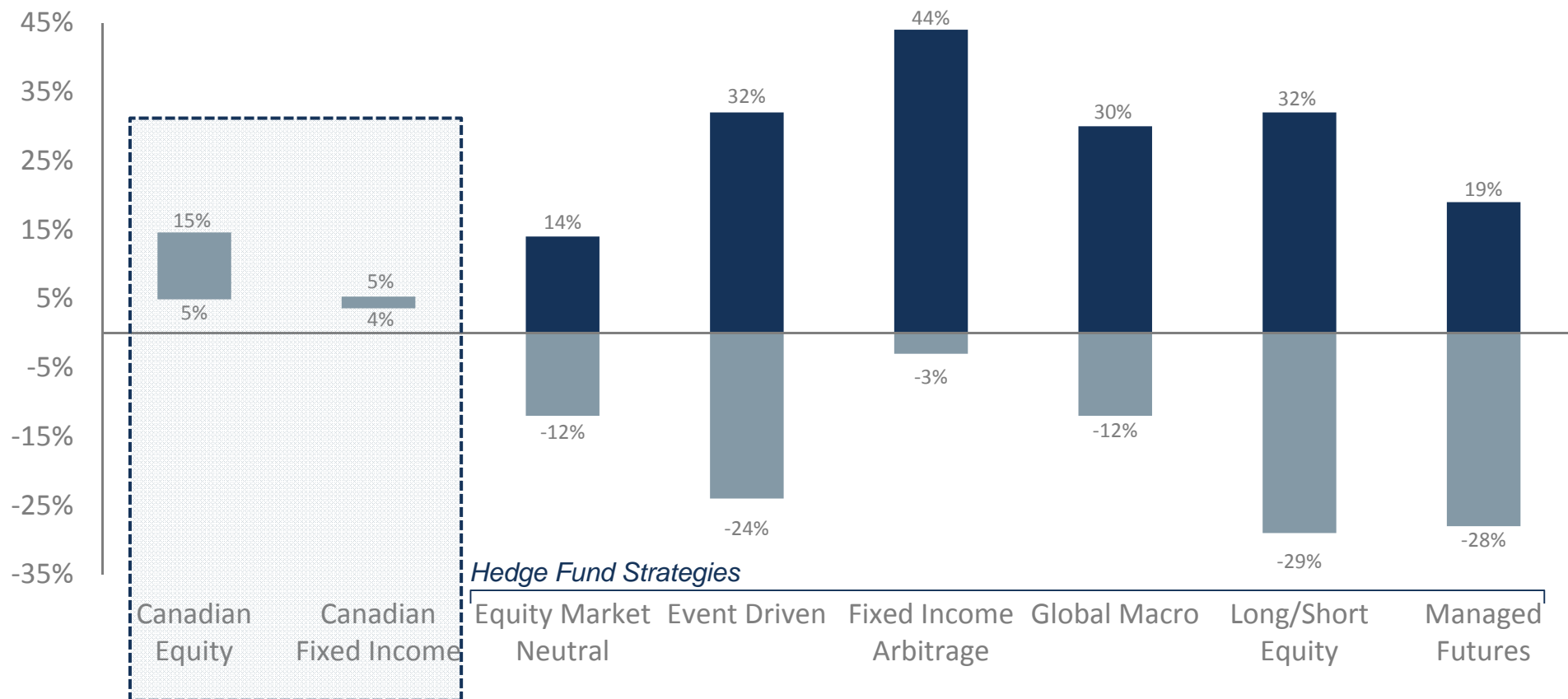


Key Implementation Considerations



Manager Selection Requires Resources And Expertise

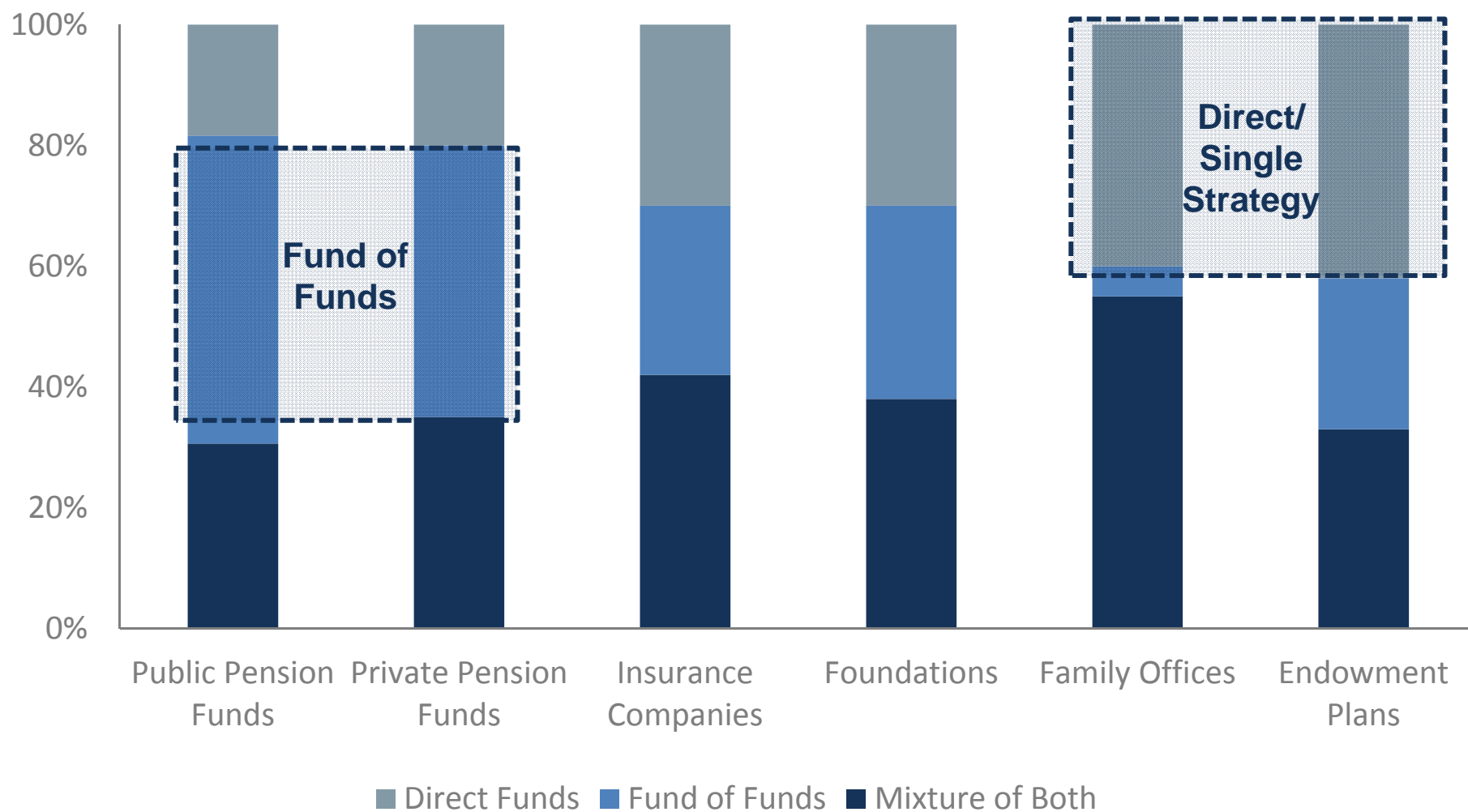
Hedge Fund Return Dispersion by Strategy in 2012



This example is for illustrative purposes only and is not intended to be representative of the performance of any actual or future investment
 Source: Credit Suisse 2012 Hedge Fund Market Review
 Mercer Investment Performance Survey of Canadian Institutional Pooled Funds, Q4 2012.
 Canadian Equity = S&P/TSX Composite, Canadian Fixed Income = DEX Universe Bond Index, Hedge Fund Strategies sourced from Credit Suisse.

Fund Of Funds Still Most Common Solution

Global Institutional Hedge Fund Allocation Strategy



Source: Preqin 2011 hedge fund Industry report

What Does This Mean For Institutional Investors?



A growing and important part of Institutional Investor asset mix



Manageable governance and administrative learning curve



Effective tool to improve risk adjusted returns and reduce volatility in both an absolute and liability driven setting



Hedge funds are worthy of institutional consideration

Questions?

Disclosures To Slide 6

Risk/Return Profile Complements Traditional Allocations

- * Fixed income expected returns are based on current yields less long term assumptions of net default costs. Equity expected returns are based current dividend yields+ nominal earnings growth expectations as estimated by PH&N IM and have assumed no change to current valuation levels.
 - ** Volatilities are based on historical monthly standard deviation measures from Jan 2003 – Dec 2012. Both returns and volatilities are annualized.
1. EM Debt C\$ represents benchmark composed of 40% JP Morgan Corporate Emerging Markets Bond Index Diversified C\$ (CEMBI, hard currency corporate), 40% JP Morgan Government Bond Index-Emerging Markets Broad Diversified C\$ (GBI-EM, local currency sovereign), 20% JP Morgan Emerging Markets Bond Index Global Diversified C\$(EMBI, hard currency sovereign)
 2. BoA/Merrill Lynch Global High Yield Index Unconstrained C\$
 3. S&P European Leveraged Loan Index C\$
 4. 50% S&P/TSX Composite Index C\$ + 50% MSCI Global Equity Index C\$

Disclosures To Slides 11, 18, 20

Data for the period from Jan 1990 to Dec 2012

Sources: Hedge Fund Research Inc., Bloomberg

Canadian Equities = S&P/TSX Composite Index (TR)

Canadian Fixed Income = DEX Universe Bond Index

Fund of Funds = HFRI Fund of Funds Composite Index

Equity Market Neutral = HFRI EH: Equity Market Neutral Index

Fixed Income (Asset-backed Securities) = HFRI RV: Fixed Income – Asset Backed

Fixed Income Arbitrage = HFRI RV: Fixed Income – Convertible Arbitrage Index

Fixed Income Corporate = HFRI RV: Fixed Income – Corporate Index

Equity Hedge = HFRI Equity Hedge (Total) Index

Event Driven = HFRI Event-Driven (Total) Index

Global Macro = HFRI Macro (Total) Index

Managed Futures (CTA) = HFRI Macro: Systematic Diversified Index

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