When Canadian Investment Review held its inaugural Global Investment Conference 20 years ago, foreign investments were something of a niche for Canadian pension plans. With the foreign property rule, investors couldn’t hold more than 20 per cent of their assets in non-Canadian investments. But jump ahead to today, and many pension funds have already made a huge shift outside Canada, embracing global investments across every asset class. To find out how Canadian plan sponsors are feeling about Canada, Canadian Investment Review and the Canadian Institutional Investment Network surveyed their views on the domestic economy and their intentions with regard to both global and Canadian assets.

The survey covered 52 of Canada’s biggest defined benefit and defined contribution plans, as well as foundations and endowments. With an even split between public and private plans, the survey took place in February and March as U.S. President Donald Trump talked about major changes to the North American Free Trade Agreement and policy-makers like the Organisation for Economic Co-operation and Development tempered a generally positive forecast for Canadian growth with plenty of warnings about risks to the economy, such as high debt loads and residential real estate.

After a year in which Canada’s equity markets had a strong performance, the idea was to see whether Canadian plan sponsors see Canada — to borrow a phrase from Trump — becoming great again, at least in terms of its economy and investment outlook. Despite the generally positive economic numbers for Canada in recent months, the survey uncovered a sense that this country needs to reinvent itself to become more appealing to investors as plans continue to pull out of domestic assets and look globally.

Survey results at a glance

The survey started out by gauging attitudes and concerns about the broader Canadian economy. When asked what the outlook will be for the Canadian economy over the next two years, the majority (76.9 per cent) of respondents agree with the OECD that the country’s gross domestic product will grow by about two per cent.

When asked about their views on U.S. economic policy and the potential implications for Canada, a very clear majority (94 per cent) expressed a concern about the negative impact of border taxes on imports. Another 60 per cent see the prospect of renegotiating NAFTA as having a negative impact on Canada.

Of course, there could be an upside to changing U.S. policy. U.S. trade protectionism against Mexico and China could have a positive effect on Canada, according to the survey (48 per cent felt actions against Mexico could be positive, with 38 per cent believing that to be true in the case of China).

Plan sponsors were also lukewarm on the positive impacts of infrastructure and related deficit spending on the Canadian economy. Seventy-seven per cent see a minor benefit but not much else. Clearly, even the fanfare around the Canada infrastructure bank has failed to excite plan sponsors about Canadian assets right now.

So where will growth in the Canadian economy come from? Respondents ranked their top three sources of growth as finance, insurance, real estate and leasing, followed by forestry, mining, oil and gas and professional, scientific and technical services.

Respondents were split on the fate of the Canadian dollar relative to the U.S. currency over the next two years. Half think it will remain at the same level for the most part, while 37 per cent think it will weaken. But the majority (71 per cent) believe Canadian interest rates are heading upwards along with inflation, albeit not in any significant way. Three-quarters of respondents are calling for minor inflation.

Decisions on asset allocation

Given the range of views about the Canadian economy, the survey also asked plan sponsors about how they’re shifting their asset allocations. On the upside, respondents are planning to make the biggest move towards foreign infrastructure and foreign real estate, with roughly half planning to boost allocations in each of those areas. Foreign private debt, emerging market equities and foreign fixed income were next.

And what about Canadian assets? The enthusiasm wanes. A third (29 per cent) are planning to boost their exposure
Plan sponsors and Canada

Cutting out Canada is a clear trend among plan sponsors, but it’s not just political and economic uncertainty that’s driving the decision.

Terri Troy, chief executive and chief investment officer at the Halifax Regional Municipality pension plan, explains that while trade lost to protectionism and rising border taxes could have a significant negative impact on this country, the decision to diversify out of Canada dates back quite a while. “With or without these new developments, our plan is to decrease Canadian equities to reduce our home-country bias to seek out better risk-adjusted returns net of fees,” says Troy.

“Our public equity exposure was approximately 38 per cent of our total plan assets at the end of 2016. Nineteen per cent of public equities was in Canadian equities, with the balance in foreign.” That number isn’t going up any time soon. However, Troy says the plan will likely maintain its 14 per cent exposure to Canadian public and private debt. But with that, it’s also looking at short-term emerging market debt, as well as global multi-asset strategies, to supplement existing global credit.

“Equity markets have been strong, so reducing our beta exposure makes sense,” she says.

“We’re at the stage where the Canadian economy needs to reinvent itself and create some diversification away from the single bet on extraction,” says Adam Bomers, portfolio manager and director at Scotia Institutional Asset Management in Toronto, adding that the loss of manufacturing jobs to automation and cheap labour abroad have made it a tough environment for Canadian exporters.

Bomers suggests Canada would do well to invest in technology, an area where he says “more stringent immigration policies in...
the U.S. could potentially help Canada.”
And while he says the current political risks are hard to navigate, protectionism isn’t good for capitalism. “It’s going to throw sand in the gears and slow things down,” he says, raising the possibility of both slow growth along with high inflation. Bomers adds that his portfolios are already at very low levels for Canadian equities and are heading towards zero.

Not everyone is as pessimistic.
Blair Richards, chief executive officer of the Halifax Port International Longshoremen’s Association/Halifax Employers Association pension plan, sees a lot of positives for Canada, especially from the perspective of someone located on the East Coast. “From where I am, the free-trade agreement with Europe is more impactful than NAFTA or the Trans-Pacific Partnership. We are seeing a huge pickup on trade with Europe. With Brexit, we are hoping to see even more.”

While allocations to Canadian equities and fixed income are on the wane, investments in real assets in Canada look more promising, according to the survey. But even then, plan sponsors are moving cautiously. As many plan sponsors pull back from Canadian assets, some areas of Canadian infrastructure and private equity are still attractive. Nevertheless, not all deals are created equal and the costs can be very high, says Zev Frishman, chief investment officer at Morneau Shepell Asset & Risk Management Ltd. in Toronto.

“Everybody is chasing infrastructure,” he says. “Prices are being bid up, and there are doubts whether the premiums over public markets justify them.”

Will the new Canada infrastructure bank help? Frishman says plan sponsors aren’t exactly flocking to it. “When the government first announced the bank, they expected pension plans to jump on it. But plans aren’t over the moon: they’re taking their time. They want to look at the deals to make sure they work for their members. We’re not going to jump in just because we’re Canadian and it’s good for Canada. We want to see more.”

Canadian assets, of course, will always play a role in Canadian portfolios. “They always provide a match for plan liabilities, which are in Canadian dollars,” says Ian Struthers, partner and investment consulting practice director at Aon Hewitt in Toronto.

“In most cases, there will be an overweight in Canadian assets in both the return-seeking and fixed-income parts of a pension portfolio.”

While plans should only have about six per cent allocated to Canadian investments based on the scale of Canadian assets globally, most small plans still have up to 40 per cent of their return-seeking portfolio invested in Canada. That number is heading down, something Calum Mackenzie, associate partner and head of central Canada investment consulting at Aon Hewitt, says is in order. “Canadian pension funds can’t rely on Canadian assets in an all-weather portfolio. They have to be global.”

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