

**INVESTMENT  
COMMITTEE**

**ANNUAL  
REPORT  
2017**

**Edmonton**

# BALANCED. RESPONSIBLE. DIVERSE.

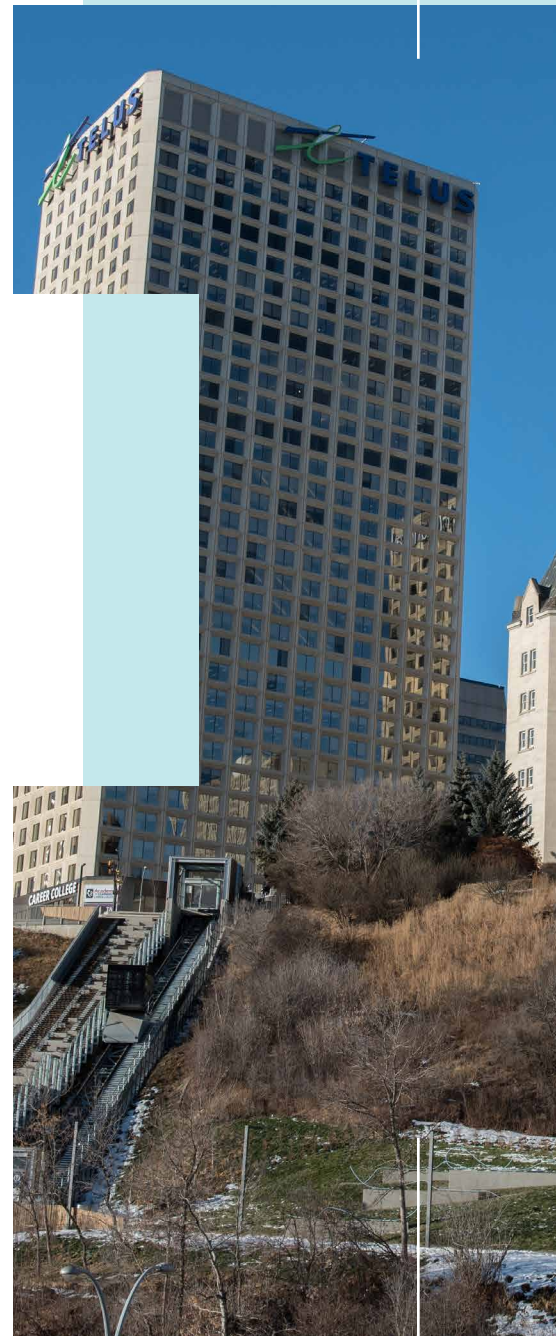
The City of Edmonton has rigorous policies and procedures in place to maximize investment returns at a prudent level of overall risk.

These policies and procedures guide the City's Investment Committee in managing and building upon the City's financial assets to help sustain Edmontonians' quality of life.

Over the past 10 years, these accomplishments have contributed approximately \$740 million of investment earnings and dividends to the City's budget. If this amount was related to taxation, property taxes would have increased by more than 6.5% over that time to make up the difference.

Successful management of the City's investment portfolio—which comprises seven funds—is one of the key factors in maintaining Edmonton's financial sustainability.

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# 2017 OVERVIEW

## Edmonton's Investments Remain Strong.

### FOREIGN EQUITIES LED THE WAY

In a somewhat surprising fashion, equity markets surged in 2017. Supported by the global synchronized economic recovery witnessed throughout the year, foreign equities led the way, returning anywhere from 15.2% to 30.6%, depending upon the market.

U.S. equities continued their strong performance returning 21.8%. This was the best one-year return since 2013, despite the Federal Reserve raising interest rates three times during the year.

Closer to home, the Canadian dollar and the price of oil both increased in 2017. The Canadian dollar increased 7% against the U.S. dollar, while the price of oil rose 12% to close the year at its highest level in over two years. Not to be outdone, Canadian equities returned 9.1% and ended 2017 at an all-time high.

Similar to the U.S., the Bank of Canada also raised interest rates, given the country's strong economic growth in 2017. Canada's central bank increased its key interest rate two times, tempering the return from Canadian fixed-income securities (bonds), which gained a modest 2.5% for the year.

### EDMONTON'S INVESTMENTS CONTINUE TO OUTPERFORM

All of the City's investment funds outperformed their benchmarks in 2017.

Performance ranged from 0.2% (Short-Term Bond Fund) to 10.8% (Ed Tel Endowment Fund), depending on each fund's asset mix.

On a four-year basis, absolute returns have remained strong and, from a relative perspective, all of the City's funds have continued to exceed their benchmarks.

The City's largest fund, the Ed Tel Endowment Fund, paid \$34 million in dividends to the City.



### KEY PROJECTS IN 2017

The City's investment custodian is a trust company responsible for the safekeeping of the City's financial assets. A **custody review** was previously initiated. The scope of the project included reviewing the custody agreement and associated fees, overall portfolio activity as well as cash management and foreign exchange services. The review confirmed that services are fairly well aligned; however, there was room for improvement in some areas. The findings were discussed with the City's custodian, which will result in an amended custody contract and updated fee schedule starting in 2018.

An upgrade of the **treasury system** for investments to enable the use of straight through processing (STP) and electronic settlement of the City's money market investment transactions began in 2017. Implementation of the new system for settlements will occur in 2018.

As part of an ongoing commitment to innovation and improvement, **internal fixed income management** processes are being refined. In particular, the strategies used to add value within the fixed income portfolios were reviewed and updated. In addition, work has begun with respect to enhancing the security selection process and will continue into 2018.

## WHAT'S AHEAD?

Financial markets entered 2018 with a positive tone. However, expanding global economic growth and improved earnings will be the main drivers of equity returns in the year ahead.

Nine years after the financial crisis, U.S. and Canadian equity markets ended 2017 at all-time highs. U.S. and Canadian equities have risen 295% and 114%, respectively, since the lows reached in March 2009. Given this extraordinary performance, equity market returns are expected to be much more moderate with increased volatility in the periods ahead.

Although monetary policy around the world remains accommodative, central banks have begun the path towards renormalizing interest rates and withdrawing monetary stimulus. Not surprisingly, the price of oil and the Canadian dollar will be significant factors in determining capital market performance in Canada.

As different regions are in varying stages of their economic and market cycles, diversification and adhering to investment principles will be important in terms of navigating an increasingly volatile investment environment in the years ahead.

In the upcoming year, the Investment Committee will monitor the following key projects:

**Asset allocation studies.** The purpose of this project is to review the asset allocation policies for the Ed Tel Endowment Fund, the Pension Fund and the Long-Term Disability Fund. The analysis will determine whether each fund continues to have an appropriate asset mix in relation to its objectives, time horizon and risk tolerance.

**Appointment of new Investment Committee members.** As per the Terms of Reference, external members can only serve two consecutive three-year terms on the Investment Committee. This ensures continued good governance of the City's financial assets.

**Implementation of the unlisted infrastructure strategy.** The City continues to transition assets to the unlisted infrastructure strategy as suitable investment opportunities arise.



# CAPITAL MARKET PERFORMANCE

The rate of return for each City asset class is compared with the published total return of its corresponding broad-market index. These indices, weighted by the Policy Asset Mix, are used to calculate the performance benchmark for each fund.

The City uses the following indices as points of reference by which the investment performance of each fund is evaluated:

**Cash:** FTSE TMX Canada 91 Day Treasury Bill Index (91 Day T-Bills)

**Short-Term Bonds:** FTSE TMX Canada Short Term Bond Index (FTSE TMX Short-Term)

**Bonds:** FTSE TMX Canada Universe Bond Index (FTSE TMX Universe)

**Canadian Equity:** S&P/TSX Capped 10% Index (TSX)

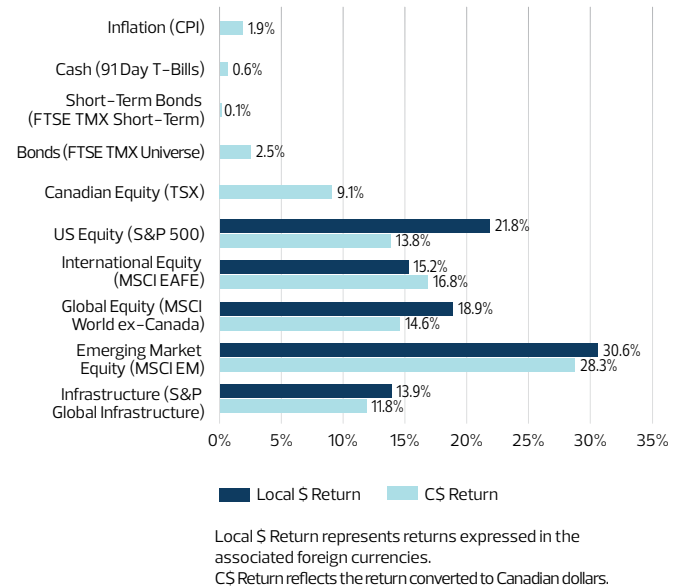
**Global Equity:** Morgan Stanley Capital International Inc. World Index excluding Canada (MSCI World ex-Canada)

**Emerging Market Equity:** Morgan Stanley Capital International Inc. Emerging Markets Index (MSCIEM)

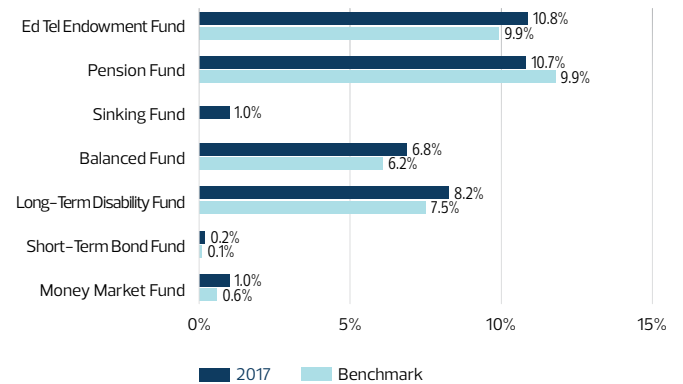
**Infrastructure:**  
 Unlisted – Consumer Price Index (CPI) + 5%  
 Listed – Standard & Poor’s Global Infrastructure Index (S&P Global Infrastructure)

Investment performance returns are presented before management fees are deducted – according to industry standards.

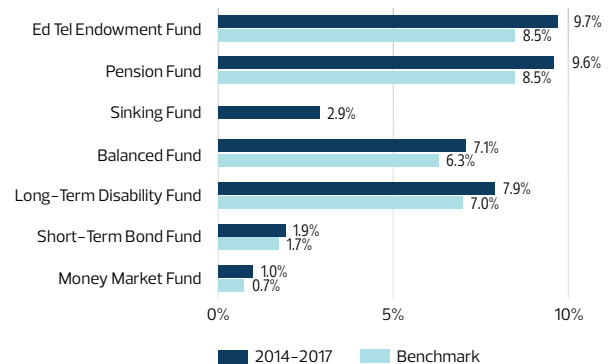
## 2017 Capital Market Returns



## 2017 Performance vs. Benchmark



## Four-Year Performance vs. Benchmark (2014-17)





# PORTFOLIO PERFORMANCE

## INVESTMENT FUNDS

ED TEL ENDOWMENT FUND | PENSION FUND | LONG-TERM DISABILITY FUND | SINKING FUND

## RESERVES AND WORKING CAPITAL FUNDS

MONEY MARKET FUND | SHORT-TERM BOND FUND | BALANCED FUND

### ED TEL ENDOWMENT FUND

#### Fund Management

Multiple Investment Managers

#### Market Value

\$864 million (Dec. 31, 2017)

#### Performance (rate of return)

Over one year (2017)	+10.8%
Over four years (2014–2017, per annum)	+9.7%

#### Performance against Policy Benchmark

Over one year (2017)	+0.9%
Over four years (2014–2017, per annum)	+1.2%

#### Description

The Ed Tel Endowment Fund was created in 1995 to hold the financial assets generated by the sale of Edmonton Telephones to Telus Corporation. The objective of an endowment fund is to provide a source of income in perpetuity while ensuring the real purchasing power of the fund is maintained. The Ed Tel Endowment Fund is considered a financial legacy for future generations that delivers a stable, sustainable and growing dividend for the City.

The Ed Tel Endowment Fund paid a dividend of \$34 million in 2017. The total dividend to be paid in 2018 is set at \$46 million, which comprises a regular dividend of \$37 million and a special dividend of \$9 million, as a result of the strong performance achieved by the fund over the preceding several years.

Since 1995, the Ed Tel Endowment Fund has earned a compound annual rate of return of 8.4% versus the benchmark return of 7.5%, grown its principal from \$465 million to \$864 million and paid \$739 million in dividends to the City.

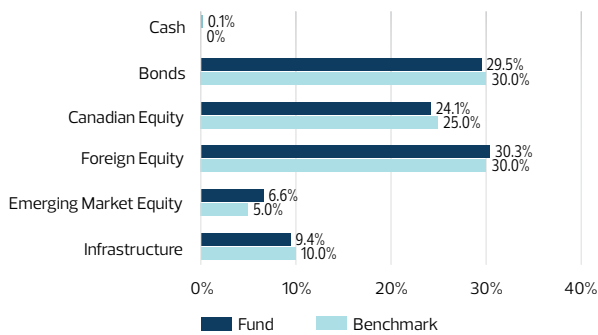
**ED TEL ENDOWMENT FUND BYLAW – KEY SUCCESS FEATURES**

**Inflation Indexing:** To ensure real purchasing power is not eroded, the City maintains the "Inflation Adjusted Principal" of the fund.

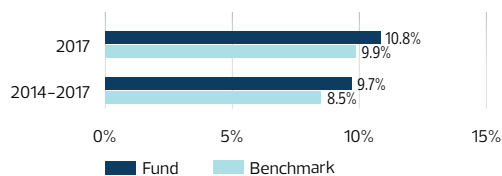
**Spending Rate:** The fund's investment policy sets the portion of the fund paid out annually as dividends.

**Smoothing Mechanism:** The dividend calculation formula minimizes the effects of volatile investment returns and provides for a more stable and predictable annual dividend from the fund.

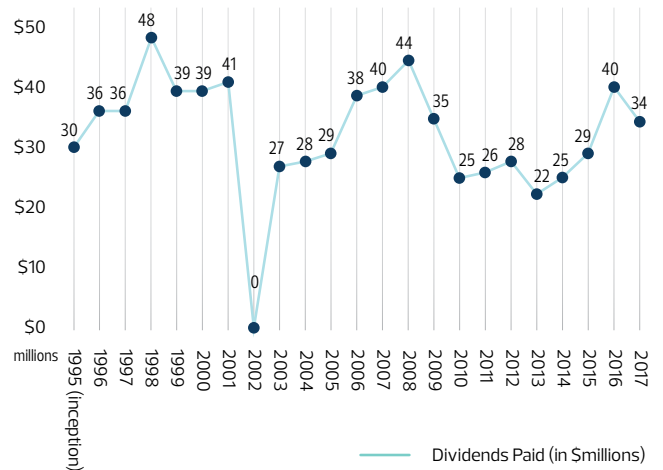
Ed Tel Endowment Fund Asset Mix vs. Policy Mix



Ed Tel Endowment Fund Performance vs. Benchmark



Ed Tel Endowment Fund Annual Dividend Payments



## PENSION FUND

### Fund Management

Multiple Investment Managers

### Market Value

\$248 million (Dec. 31, 2017)

### Performance (rate of return)

Over one year (2017)	+10.7%
Over four years (2014–2017, per annum)	+9.6%

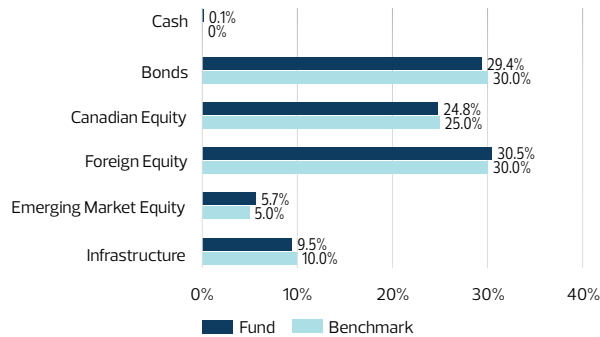
### Performance against Policy Benchmark

Over one year (2017)	+0.8%
Over four years (2014–2017, per annum)	+1.1%

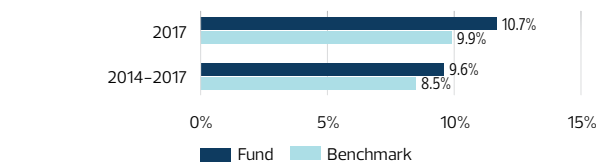
### Description

The Pension Fund consists of the Firefighters' Supplementary Pension Plan, the Fire Chief and Deputy Fire Chiefs' Supplementary Pension Plan and one closed pension plan with only a few beneficiaries. Over time, the smaller plan will be wound up.

Pension Fund Asset Mix vs. Policy Mix



Pension Fund Performance vs. Benchmark



## LONG-TERM DISABILITY FUND

### Fund Management

Multiple Investment Managers

### Market Value

\$137 million (Dec. 31, 2017)

### Performance (rate of return)

Over one year (2017)	+8.2%
Over four years (2014–2017, per annum)	+7.9%

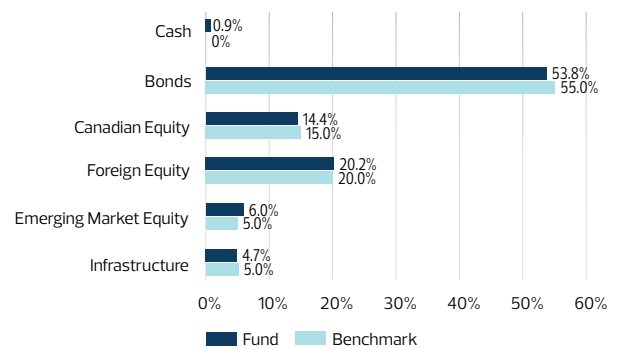
### Performance against Policy Benchmark

Over one year (2017)	+0.7%
Over four years (2014–2017, per annum)	+0.9%

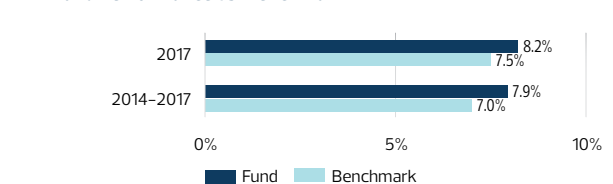
### Description

The LTD Fund holds investments for five City of Edmonton long-term disability plans.

LTD Fund Asset Mix vs. Policy Mix



LTD Fund Performance vs. Benchmark







## SINKING FUND

### Fund Management

City of Edmonton Investment Management (internal)

### Market Value

\$90 million (Dec. 31, 2017)

### Performance (rate of return)

Over one year (2017)	+1.0%
Over four years (2014–2017, per annum)	+2.9%

### Performance against Policy Benchmark

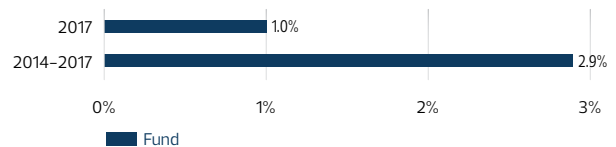
Over one year (2017)	n/a
Over four years (2014–2017, per annum)	n/a

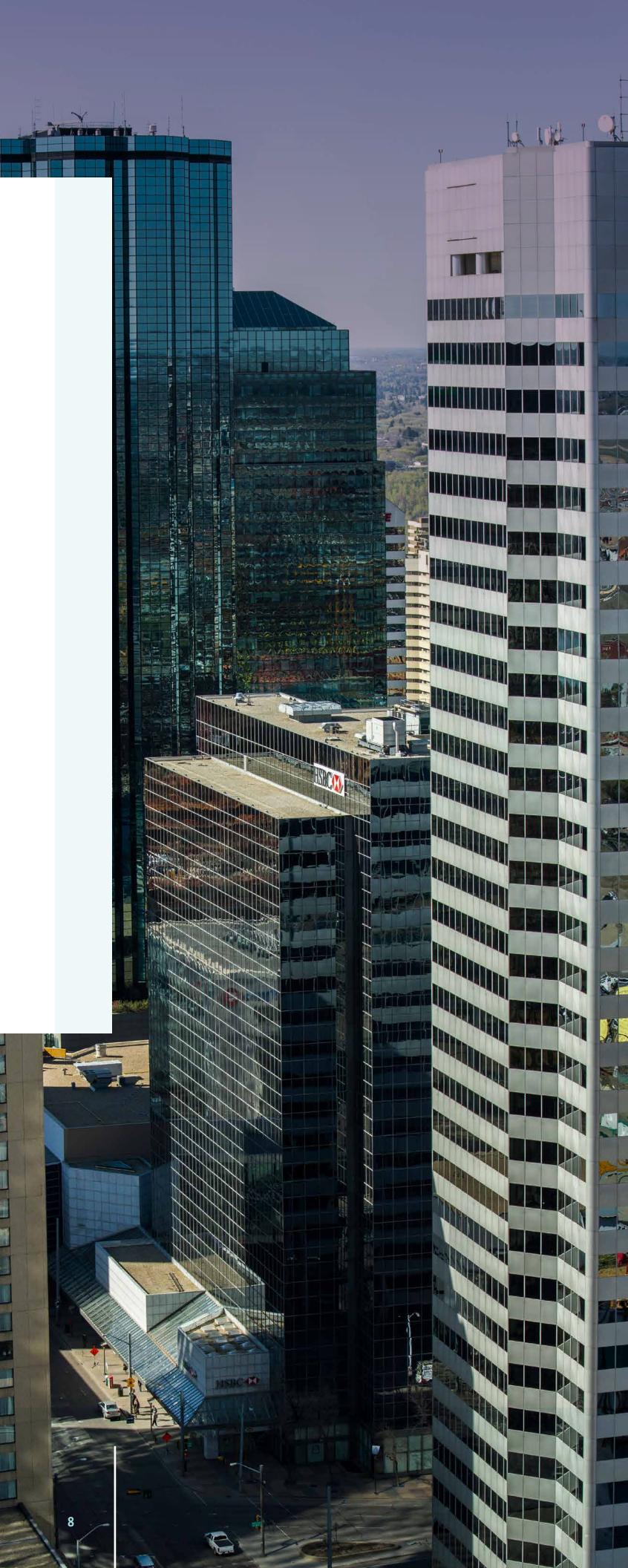
### Description

The Sinking Fund was established to meet the needs of various public debenture issues (borrowings) that require monies be set aside regularly for the eventual redemption of these debenture issues. One outstanding debenture issue will mature in 2018, and the Sinking Fund is accumulating assets for that redemption.

The fund utilizes a cash-matched strategy investing in fixed income securities, making a traditional benchmark comparison ineffective.

Sinking Fund Performance





## MONEY MARKET FUND

### Fund Management

City of Edmonton Investment Management (internal)

### Market Value

\$455 million (Dec. 31, 2017)

The City's revenue streams are cyclical; the fund value peaks each July at approximately \$1 billion.

### Performance (rate of return)

Over one year (2017)	+1.0%
Over four years (2014–2017, per annum)	+1.0%

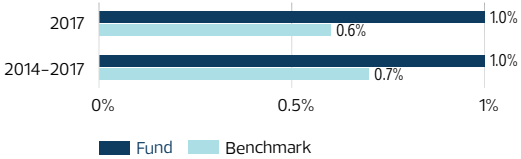
### Performance against Policy Benchmark

Over one year (2017)	+0.4%
Over four years (2014–2017, per annum)	+0.3%

### Description

The Money Market Fund absorbs the excess or shortfall in the daily operating requirements of the City. The fund ensures that sufficient cash and liquid assets are available to cover the City's short-term obligations. As such, the fund is solely invested in money market securities with a time horizon of one year or less, depending on the City's forecast of commitments.

Money Market Fund Performance vs. Benchmark



## SHORT-TERM BOND FUND

### Fund Management

City of Edmonton Investment Management (internal)

### Market Value

\$264 million (Dec. 31, 2017)

### Performance (rate of return)

Over one year (2017)	+0.2%
Over four years (2014–2017, per annum)	+1.9%

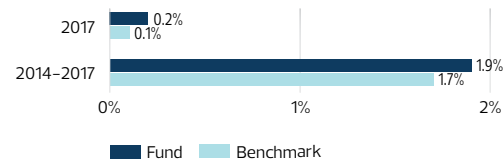
### Performance against Policy Benchmark

Over one year (2017)	+0.1%
Over four years (2014–2017, per annum)	+0.2%

### Description

The Short-Term Bond Fund provides an investment vehicle for working capital that is not currently needed to fund City operations but will be needed in less than five years. Therefore, the fund holds fixed income securities with an investment horizon of less than five years.

Short-Term Bond Fund Performance vs. Benchmark



## BALANCED FUND

### Fund Management

Multiple Investment Managers

### Market Value

\$697 million (Dec. 31, 2017)

### Performance (rate of return)

Over one year (2017)	+6.8%
Over four years (2014–2017, per annum)	+7.1%

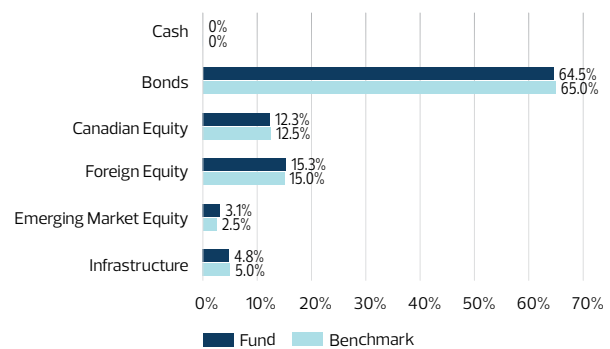
### Performance against Policy Benchmark

Over one year (2017)	+0.6%
Over four years (2014–2017, per annum)	+0.8%

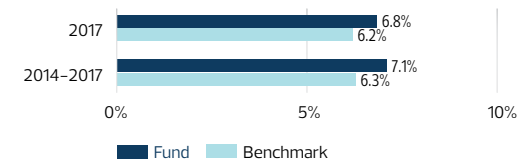
### Description

The Balanced Fund has a time horizon of greater than five years and is a long-term investment vehicle for operating and capital reserve funds, deferred revenue accounts and other similar funds. Because it has a longer-term investment horizon, it has a risk tolerance that permits owning some equities. The fund is reported and performance is benchmarked against the mid-points of its policy asset mix ranges.

Balanced Fund Asset Mix vs. Policy Mix



Balanced Fund Performance vs. Benchmark



# INVESTMENT PHILOSOPHY

## A prudent approach to investing municipal assets

The investment program plays an important role in Edmonton's Financial Sustainability Plan, which addresses Edmonton's financial sustainability and the development of a long-range financial plan. Strong accountability and oversight matched with diversified expertise have allowed the program to provide considerable added value to the City of Edmonton over time.

Empirical evidence suggests the most important determinant of investment returns and risk is asset mix. As a result, the City establishes an asset allocation policy for each of its investment funds that is consistent with the specific objectives, risk profile and investment time horizon of each fund.

Within the various asset classes, diversification is further enhanced through the split between internal and external investment managers, which results in a multi-asset, multi-manager investment framework.

Expanding the depth of employed strategies and broadening the scope of investment opportunities have been key drivers of the program's successful evolution over time. Different investment styles offer additional risk control, reduce the possibility of investment losses and ensure that fund objectives are met. Comparative advantages, such as liquidity, the ability to invest long term and a cost-effective investment

program, allow the City the opportunity to generate a significant incremental return over time. As an example, the City typically falls within the positive value-added and low-cost category in an annual survey of institutional investment managers around the world.

The guiding principles used to determine the broad investment structure and strategy for the City's various funds are called investment beliefs. One of the main beliefs is that over the long term, equities will outperform bonds to compensate for their higher risk. Although equity returns are expected to be greater than bonds over the long run, they are also more volatile. For this reason, equity investments are only suited for investment portfolios with longer-term (for example, more than five years) investment horizons. Accordingly, only the Ed Tel Endowment Fund and the Pension Fund have significant equity allocations (each has 60% equity). Conversely, the investment funds with a lower tolerance for risk and shorter time horizons (for example, working capital funds) are not invested in equities and therefore are sheltered from the higher volatility of equity markets.

Finally, as part of an annual review process, a formal risk assessment of the City's investment program ensures risk mitigation strategies and controls are in place and consistent with industry best practices.

### ASSET ALLOCATION

The mix of asset classes in a fund is called the asset mix. For example, a fund could have an asset mix of 30% bonds, 25% Canadian equity, 30% global equity, 5% emerging market equity and 10% infrastructure.

The asset mix reflects the investor's underlying goals and objectives for the fund in terms of risk and reward.

The Policy Asset Mix is the long-term target asset mix of the fund, as stated in the Investment Policy. This allocation is structured to allow the fund to meet its stated investment objectives over time. Over shorter time periods, the returns may fall short or exceed the investment objectives.

### INFRASTRUCTURE INVESTMENTS

Infrastructure is defined as large-scale projects that provide essential services to society. Examples include toll roads, airports and utilities and may involve developing, operating and/or maintaining the asset.

The infrastructure asset class is a global market. Investments can be made either through unlisted (private) or listed (publicly-traded) strategies. Possible opportunities for investors are expected to continue expanding significantly in the coming years.



## INVESTMENT BELIEFS

1. The investment return on the funds is a function of capital market returns, asset allocation, manager structure and individual managers.
2. There is a relationship between risk and return – higher returns generally require taking higher risk.
3. In the long term, equities will outperform bonds to compensate for their higher risk.
4. The long-term asset mix is the most important component of a portfolio's risk and return.
5. Active management can add value but comes with added costs and effort, which must be assessed along with the passive alternative, whenever changes are made.
6. Alternative strategies/asset classes may be appropriate and will be evaluated based on their liquidity, the management time needed to monitor the investment and the level of transparency.
7. Market timing at the policy level is an inefficient strategy for consistently increasing returns.
8. Diversification of asset classes, implementation strategies and security selection can improve the risk and return characteristics of the funds.
9. Asset mix rebalancing generally adds value relative to buy and hold strategies.
10. Effective manager structure can improve the net returns and lower the risk of the funds.

# GOVERNANCE

Established by the City Manager, the Investment Committee governs the investment of the City's financial assets and provides proper oversight of the City's investment efforts. Committee members bring investment and business expertise. Continual monitoring of the City's investment program and implementing changes as necessary ensures that the funds are well positioned and appropriately invested to meet their objectives. This approach also assures Edmontonians that the City's policies and procedures maximize investment returns at a prudent level of overall risk.

## INVESTMENT COMMITTEE MEMBERS

### **Todd Burge** *Chairperson*

Deputy City Manager and Chief Financial Officer  
City of Edmonton

### **Stacey Padbury** *Secretary*

Deputy City Treasurer and  
Branch Manager, Financial Services  
City of Edmonton

### **Greg Holubowich**

President  
Edmonton Fire Fighters' Union

### **Filip Ksiazkiewicz**

Senior Portfolio Manager  
TELUS Investment Management

### **Savvas Pallaris**

Vice-President, Life Investments  
Addenda Capital

### **Robert Seidel, QC**

Canada Managing Partner  
DLA Piper (Canada) LLP

### **Blake Walker**

Manager Treasury and Deputy City Treasurer  
City of Calgary

## KEY RESPONSIBILITIES OF THE INVESTMENT COMMITTEE

- Review and recommend changes to the Investment Policy and Terms of Reference.
- Review investment strategies, capital market assumptions and manager structure.
- Monitor all reported investment activities for compliance with City policy and statutory requirements.
- Meet with external investment managers, performance measurement advisors and external auditors.
- Monitor investment performance versus established performance benchmarks.
- Assist the Chief Financial Officer in preparing an annual report on investment performance for recommendation to the City Manager and City Council.

## KEY RESPONSIBILITIES OF CITY COUNCIL

City Council, as senior governing fiduciaries, receives reports and recommendations from the City Manager and approves the Investment Policy, which establishes the following:

- investment objectives and beliefs,
- permitted investment categories and asset allocation,
- performance benchmarks and implementation strategies,
- proxy voting guidelines, and
- monitoring, controls and reporting requirements.

## COMPLIANCE

As at December 31, 2017, the investment funds were in compliance with the City of Edmonton Investment Policy and all statutory requirements.

## PROXY VOTING

The City's Investment Policy contains a commitment for the City of Edmonton to support social and ethical business practices through proxy voting – the shareholder resolution process.

A proxy voting agent is retained to vote the City's ballots for the companies in which the City owns shares. The voting service adheres to the City's guidelines through careful analysis of each voting issue.

During 2017, the City of Edmonton exercised its shareholder rights and voted its proxies in accordance with the Investment Policy.

# MANAGEMENT STRATEGIES

The City's investment structure combines active and passive management strategies.

**Active strategies** are in place when the potential to exceed the return of the established benchmark by actively selecting securities is believed to be high:

- Active managers try to exceed performance benchmarks by investing in a subset of securities expected to outperform the broader benchmark index – basing the selection of securities on a specific theory or investment style.

**Passive strategies** are used in markets where active management generally has not outperformed the benchmark over time:

- Passive managers fully replicate a broad market index such as the TSX or S&P 500 (by buying securities in the same proportion) – ensuring returns are virtually the same as the published index returns. As a result, passive managers minimize the risk of underperformance and have little opportunity for outperformance, but their fees and expenses are significantly lower than those for active management.

## INVESTMENT MANAGERS

The Ed Tel Endowment Fund, Pension Fund, Long-Term Disability Fund and Balanced Fund all share the same investment managers.

### Canadian Equity

QV Investors  
TD Asset Management (passive)  
Triasima Portfolio Management

### Canadian Fixed Income

City of Edmonton Investment Management (internal)

### Global Fixed Income

Investec Asset Management

### Global Equity

Arrowstreet Capital  
Copper Rock Capital Partners

### Emerging Market Equity

Arrowstreet Capital

### US Equity

TD Asset Management (passive)

### International Equity

Fidelity Institutional Asset Management

### Infrastructure

Northleaf Capital Partners (unlisted)  
RARE Infrastructure (listed)

## INTERNAL FUND MANAGEMENT

The Sinking Fund, Money Market Fund and Short-Term Bond Fund are all managed internally by the City of Edmonton Investment Management Section. The fee savings from managing a portion of the City's financial assets in-house are approximately \$1.5 million a year. This approach has resulted in more than \$15 million in savings over the last 10 years.



