

# 2013 INVESTMENT COMMITTEE ANNUAL REPORT







# INVESTMENT COMMITTEE ANNUAL REPORT 2013

The Investment Committee oversees the City of Edmonton's investments, balancing the desire for maximum return with a prudent level of overall risk. By continually monitoring the City's investment program and implementing changes as necessary, (see Key Projects in 2013 on page 12), the committee ensures that the funds are well-positioned and appropriately invested to meet their objectives.

More information on the Investment Committee and the role of City Council is available on pages 11-13. The City's Investment Policy and Procedures, including asset allocation policies, investment principles and guidelines can be found at [www.edmonton.ca/investmentpolicy](http://www.edmonton.ca/investmentpolicy).



## OVERVIEW

- The world's major equity markets provided impressive returns in 2013, exceeding the solid performance of the prior year.
- Performance of the City of Edmonton funds ranged from a low of 0.4% (Sinking Fund) to a high of 18.9% (Pension Funds), depending on each fund's asset mix (see Fig. 3-2, page 3).
- The Ed Tel Endowment Fund's 18.8% return for 2013 was the best one-year return since the fund was established.
- On a four-year basis, absolute returns have remained strong and from a relative perspective, all of the investment funds have exceeded their policy benchmarks (see Fig. 3-3, page 3).
- Dividends of approximately \$22 million were paid to the City from the Ed Tel Endowment Fund in 2013.
- Since 1995, the Ed Tel Endowment Fund has:
  - earned a compound annual rate of return of 8.2% versus the benchmark return of 7.2%,
  - grown its principal from \$465 million to \$710 million, and
  - paid \$610 million in dividends to the City.

# CAPITAL MARKETS OVERVIEW AND OUTLOOK

Although a great deal of uncertainty continued to weigh on the markets in 2013, equity indices around the globe surged higher throughout the year. Canadian equities returned a very respectable 13.0% in 2013. Foreign equity returns were even better as, for example, U.S. equities were up 32.4%—the best one-year return since 1997—and ended the year at an all-time high. The weakness of the Canadian dollar meant that foreign gains improved further once translated back into Canadian dollars. Canadian fixed income securities (bonds) declined 1.2% in 2013 due to interest rates rising during the year. This was the first negative annual return for bonds

since 1999 (see Fig. 3-1, page 3 to compare the rates of return for various capital markets.)

Looking ahead to 2014, monetary policies are likely to remain supportive for global growth. However, given the many risks that still exist with respect to a sustainable economic recovery, volatility is expected to remain relatively high. In addition, the strong recent performance should not be used as a basis for future returns as equity market gains are expected to be more moderate in the periods ahead.



## PERFORMANCE BENCHMARKS

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

**Bonds:** DEX Universe Bond Index (DEX Universe)

**Canadian Equity:** S&P/TSX Composite 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 (MSCI EM)

### Infrastructure:

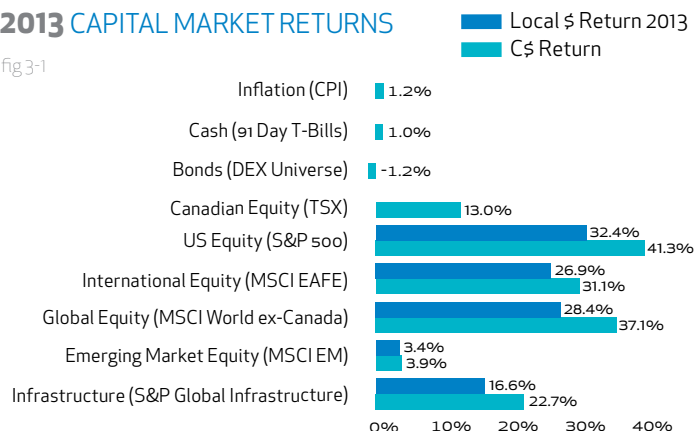
*Unlisted* – Consumer Price Index (CPI) + 5%

*Listed* – Standard & Poor's Global Infrastructure Index (S&P Global Infrastructure)

- Industry standard is to present investment performance returns before deducting management fees.

## 2013 CAPITAL MARKET RETURNS

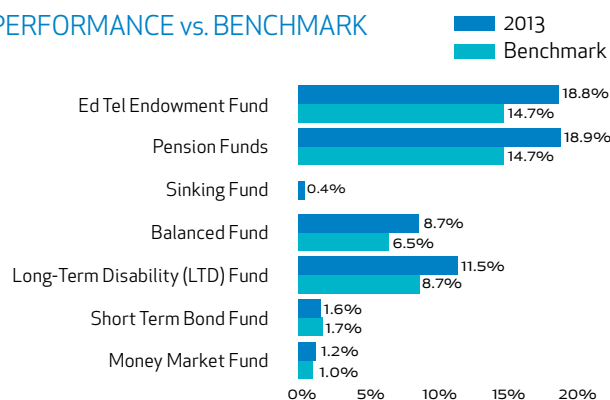
fig 3-1



Local \$ Return represents returns expressed in the associated foreign currencies.  
C\$ Return reflects the return converted to Canadian dollars.

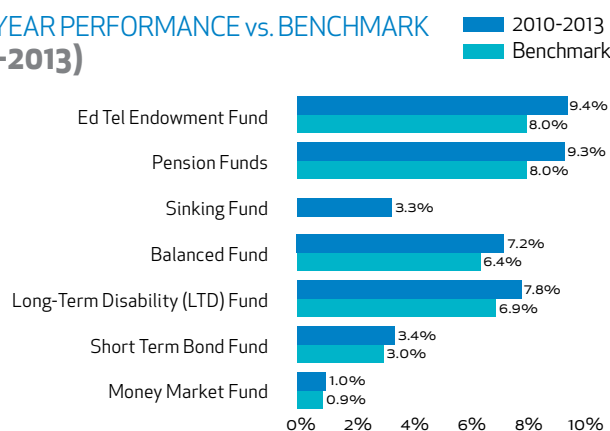
## 2013 PERFORMANCE vs. BENCHMARK

fig 3-2



## FOUR-YEAR PERFORMANCE vs. BENCHMARK (2010-2013)

fig 3-3



# THE CITY OF EDMONTON INVESTMENT PROGRAM AND THE IMPORTANCE OF ASSET MIX

The investment program plays an important role in *The Way We Finance* and the City Vision. *The Way We Finance* addresses Edmonton's financial sustainability and the development of a long range financial plan. Strong accountability and oversight matched with diversified expertise has allowed the program to offer considerable added value to the City of Edmonton over time.

Empirical evidence suggests that 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 in order to meet the specific objectives for each one, while remaining consistent with the fund's risk profile and investment time horizon.

Within the various asset classes, diversification is enhanced even further by using multiple external investment managers who are then paired with internal management. Expanding the depth and breadth of strategies employed and opening up investment opportunities has been a key driver of the program's evolution over time. Different investment styles offer additional risk control and greatly reduce the possibility of investment losses, while also ensuring that fund objectives are met. Furthermore, the City of Edmonton has certain comparative advantages, such as liquidity, the ability to invest long term, and a cost-effective investment program, which allow the opportunity to earn a significant incremental return over time. As an example, the City typically falls within the high value-added and low-cost category in an annual survey of institutional investment managers around the world.

The guiding principles used in determining the broad investment structure and strategy for the City's various funds are called *Investment Beliefs* (see page 13). One of the main beliefs is that over the long term, equities will outperform bonds to compensate for their higher risk. While 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 Funds 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 consequently are sheltered from the higher volatility of the equity markets.

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



## ASSET MIX/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 mix, over a long period of time, should allow the fund to meet its stated investment objectives. Over shorter time periods, the returns may fall short or exceed the investment objectives.



# INVESTMENT MANAGEMENT

## EXTERNAL FUND MANAGEMENT

The City's investment structure combines active and passive investment strategies. Active strategies are used where there is higher potential to surpass the established benchmark by actively selecting securities. Passive strategies, which cost less, are used in markets where active management has generally not outperformed the benchmark.

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

### **Canadian Equity**

Greystone Managed Investments  
State Street Global Advisors  
Toron AMI  
Triasima Portfolio Management

### **Canadian Fixed Income**

City of Edmonton Investment Management Section (Internal)  
TD Asset Management

### **Global Equity and Emerging Market Equity**

Arrowstreet Capital

### **U.S. Equity**

Rainier Investment Management

### **International (EAFE) Equity**

Pyramis Global Advisors

### **Infrastructure**

Northleaf Capital Partners (Unlisted)

RARE Infrastructure (Listed)

## INTERNAL FUND MANAGEMENT

The Sinking Fund, Money Market Fund and the Short Term Bond Fund are all managed internally by the City of Edmonton Investment Management Section. Annual fee savings from managing a portion of the City's financial assets in-house are approximately \$1.5 million. Compared to having these assets managed externally, this has resulted in upwards of \$15 million in total savings to the City over the last 10 years.

## ACTIVE MANAGEMENT

- Active managers try to exceed performance benchmarks by selecting securities believed to be superior to those in the benchmark index.
- The selection of securities is usually based on a specific theory or investment style.

## PASSIVE MANAGEMENT

- Passive managers fully replicate (by buying securities in the same proportion) a broad market index such as the TSX or S&P 500.
- This ensures returns are virtually the same as the published index returns. It minimizes the risk of underperformance but also means there is little opportunity for outperformance.
- Fees and expenses are significantly lower than those for active management.



# INVESTMENT FUNDS

## ED TEL ENDOWMENT FUND

**Fund Management:** Multiple Investment Managers  
(see page 5)

**Market Value:** \$710 million (Dec. 31, 2013)

**Performance (Rate of Return):**

Over one year (2013): +18.8%  
Over four years (2010-2013, per annum): +9.4%

**Performance against Policy Benchmark:**

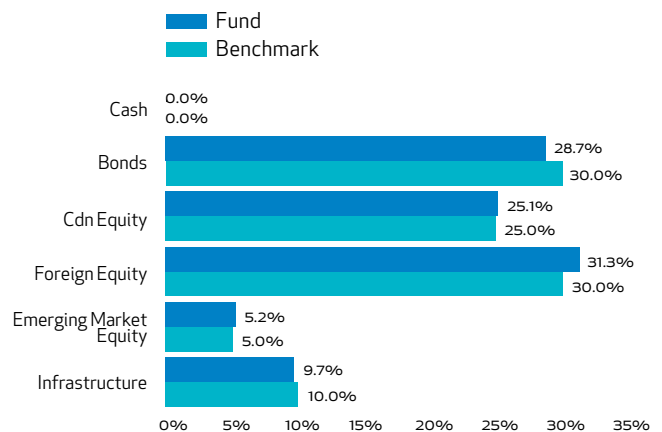
Over one year (2013): +4.1%  
Over four years (2010-2013, per annum): +1.4%

**Description/Purpose:**

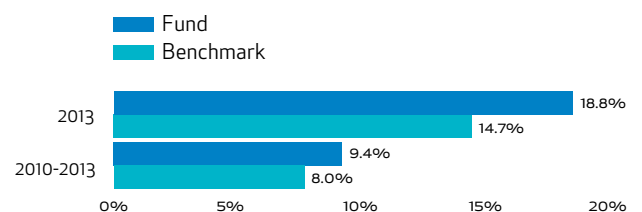
The Ed Tel Endowment Fund was created in 1995 to hold the financial assets generated by the sale of Edmonton Telephones to Telus Corporation. The objective of an endowment fund is to provide a source of income in perpetuity while ensuring the real purchasing power is maintained. The Ed Tel Endowment 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's dividend formula (see page 7) paid a dividend of \$22 million in 2013. The dividend declared in June 2012 to be paid from the fund in 2013 was reduced as a result of moderate returns experienced during the preceding 12 months. However, given the fund's strong results since that time, the dividend to be paid in 2014 has been raised to \$25 million. The annual dividends from the Ed Tel Endowment Fund since inception are illustrated in the accompanying chart.

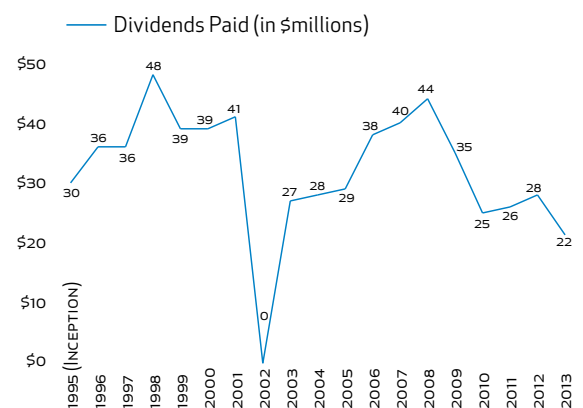
## ED TEL ENDOWMENT FUND ASSET MIX vs. POLICY MIX



## ED TEL ENDOWMENT FUND PERFORMANCE vs. BENCHMARK



## ED TEL ENDOWMENT FUND ANNUAL DIVIDEND PAYMENTS



# THE INVESTMENT COMMITTEE

## ED TEL ENDOWMENT FUND BYLAW

The Ed Tel Endowment Fund Bylaw incorporates the following key features:

- **Inflation Indexing:** Maintaining the “Inflation Adjusted Principal” of the fund is a primary objective to ensure that real purchasing power is not eroded.
- **Spending Rate:** The percentage of the fund paid out annually as dividends is currently set at 5% and is determined in accordance with the fund’s investment policy.
- **Smoothing Mechanism:** A formula is used in the calculation of the dividend in order to minimize the effects of volatile investment returns. It provides for a more stable and predictable annual dividend from the fund.



## PENSION FUNDS

**Fund Management:** Multiple Investment Managers  
(see page 5)

**Market Value:** \$191 million (Dec. 31, 2013)

### Performance (Rate of Return):

Over one year (2013): +18.9%  
Over four years (2010-2013, per annum): +9.3%

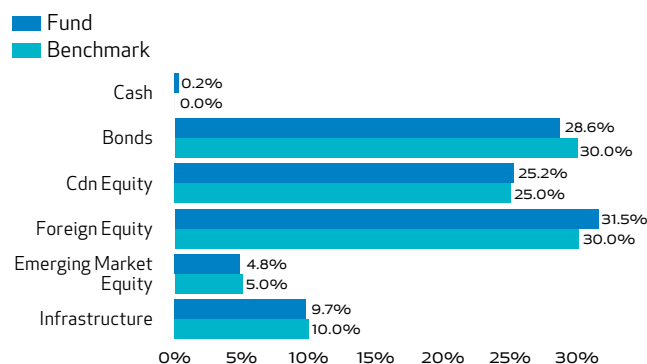
### Performance against Policy Benchmark:

Over one year (2013): +4.2%  
Over four years (2010-2013, per annum): +1.3%

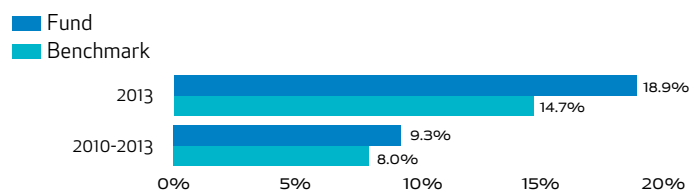
### Description/Purpose:

Pension Funds consist of the Firefighters' Supplementary Pension Plan, the Fire Chief and Deputy Fire Chiefs' Supplementary Pension Plan, and two closed pension plans with only a few beneficiaries each. Over time, the smaller plans will be wound up.

## PENSION FUNDS ASSET MIX vs. POLICY MIX



## PENSION FUNDS PERFORMANCE vs. BENCHMARK



## LONG-TERM DISABILITY (LTD) FUND

**Fund Management:** Multiple Investment Managers  
(see page 5)

**Market Value:** \$111 million (Dec. 31, 2013)

### Performance (Rate of Return):

Over one year (2013): +11.5%  
Over four years (2010-2013, per annum): +7.8%

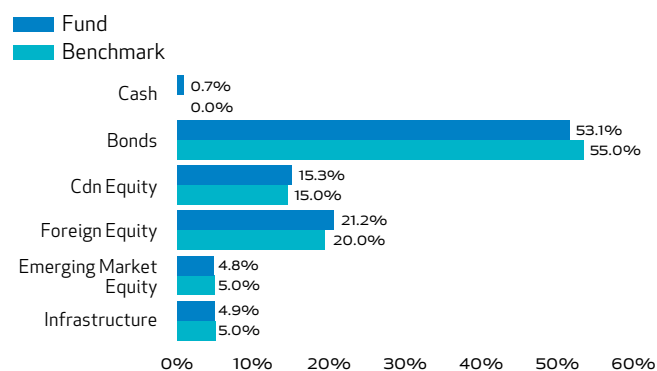
### Performance against Policy Benchmark:

Over one year (2013): +2.8%  
Over four years (2010-2013, per annum): +0.9%

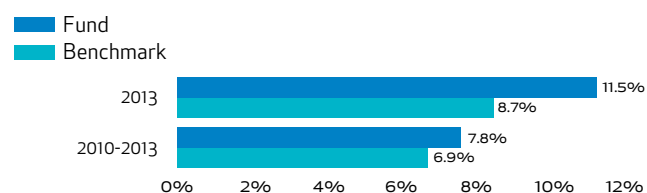
### Description/Purpose:

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 Section (Internal)

**Market Value:** \$69 million (Dec. 31, 2013)

### Performance (Rate of Return):

Over one year (2013): +0.4%  
Over four years (2010-2013, per annum): +3.3%

### Performance against Policy Benchmark:

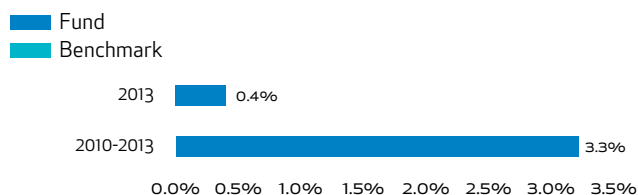
Over one year (2013): n/a  
Over four years (2010-2013, per annum): n/a

**Note:** Starting in Q2 2013, the fund management strategy transitioned to match the cash flow requirements of the final debenture maturity in 2018, making a traditional benchmark comparison ineffective.

### Description/Purpose:

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. There is one outstanding debenture issue, maturing in 2018, for which the Sinking Fund is accumulating assets.

## SINKING FUND PERFORMANCE vs. BENCHMARK



# RESERVES AND WORKING CAPITAL FUNDS

The Money Market Fund and Short Term Bond Fund (see page 10) together represent the City's working capital.

## MONEY MARKET FUND

**Fund Management:** City of Edmonton Investment Management Section (Internal)

**Market Value:** \$201 million (Dec. 31, 2013)

The City's significant revenue streams are cyclical; the fund value peaks each July at approximately \$600 million.

### Performance (Rate of Return):

Over one year (2013): +1.2%  
Over four years (2010-2013, per annum): +1.0%

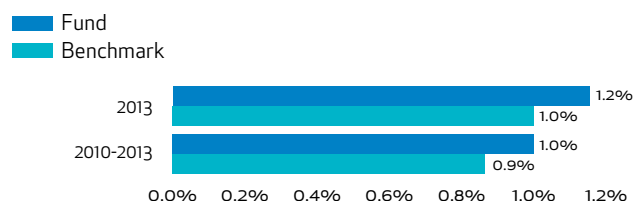
### Performance against Policy Benchmark:

Over one year (2013): +0.2%  
Over four years (2010-2013, per annum): +0.1%

### Description/Purpose:

The Money Market Fund represents the excess or shortfall in the daily operating requirements of the City. The purpose of the fund is to ensure that sufficient cash and liquid assets are available to cover the City's short-term obligations. The time horizon of the fund is 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 Section (Internal)

**Market Value:** \$124 million (Dec. 31, 2013)

### Performance (Rate of Return):

Over one year (2013): +1.6%  
Over four years (2010-2013, per annum): +3.4%

### Performance against Policy Benchmark:

Over one year (2013): -0.1%  
Over four years (2010-2013, per annum): +0.4%

### Description/Purpose:

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. The investment horizon, accordingly, is less than five years.

## BALANCED FUND

**Fund Management:** Multiple Investment Managers (see page 5)

**Market Value:** \$537 million (Dec. 31, 2013)

### Performance (Rate of Return):

Over one year (2013): +8.7%  
Over four years (2010-2013, per annum): +7.2%

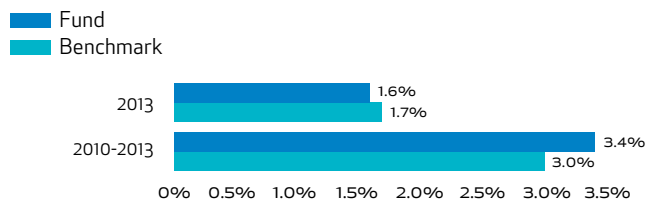
### Performance against Policy Benchmark:

Over one year (2013): +2.2%  
Over four years (2010-2013, per annum): +0.8%

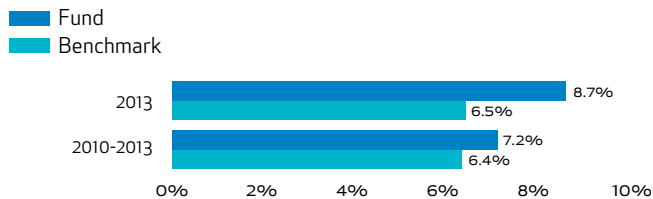
### Description/Purpose:

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 is a longer-term investment, it has a risk tolerance that permits owning some equities.

### SHORT TERM BOND FUND PERFORMANCE vs. BENCHMARK



### BALANCED FUND PERFORMANCE vs. BENCHMARK



# THE INVESTMENT COMMITTEE

The Investment Committee was established by the City Manager to oversee the investment of the City's financial assets. Members are selected to bring both investment and business expertise to the Committee.

Governance is extremely important in ensuring proper oversight, as well as assuring citizens that their City government takes the management of investment funds very seriously. It also assures taxpayers that policies, procedures and controls are being developed to maximize investment returns at a prudent level of overall risk. The Investment Committee roles and responsibilities are clearly defined in the Investment Committee Terms of Reference. The key responsibilities are to:

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

## INVESTMENT COMMITTEE MEMBERS

**Lorna Rosen** *Chairperson*

Chief Financial Officer and Treasurer  
City of Edmonton

**Todd Burge** *Secretary*

Branch Manager, Client Financial Services  
City of Edmonton

**Aaron Brown**

Director, Portfolio Management  
Alberta Treasury Board & Finance

**Ron Helmhold**

Chief Financial Officer  
WCB – Alberta

**Greg Holubowich**

President  
Edmonton Fire Fighters' Union

**Savvas Pallaris**

Vice President, Life Investments  
Addenda Capital

**Robert Seidel**

Managing Partner  
Davis LLP



## KEY PROJECTS IN 2013

**Completing asset allocation studies for the Ed Tel Endowment Fund, the Pension Funds and the Long-Term Disability (LTD) Fund.** The results supported the changes that have occurred over the last number of years (for example, emerging market equities and infrastructure) and importantly, confirmed that each fund continues to have an appropriate asset mix in relation to its objectives, time horizon and risk tolerance.

**Fixed Income Structure Implementation.** As a result of a previous review that was completed, a new fixed income structure is being introduced. The structure should provide added value by increasing the amount of active management as well as improve diversification by introducing a global bond mandate to the overall fixed income allocation. During the year, a manager search for a global fixed income strategy was completed and the investment management agreement was finalized. The City transitioned to the new structure in early 2014.

## FUTURE WORK

The Investment Committee will monitor the following key projects in 2014:

**Implementation of the unlisted infrastructure strategy.** Assets continue to be transitioned to the unlisted infrastructure strategy as suitable investment opportunities arise (see text box below).

**Equity Structure Review.** A review of the City's current equity structure will be undertaken to identify any areas where potential enhancements could be made.



## INFRASTRUCTURE

- 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) securities. Possible opportunities for investors are expected to expand significantly over the next 10 years.



## RESPONSIBLE PROXY VOTING

Owning common stock confers certain rights. These include the right to propose and vote on corporate policies through the shareholder resolution process (proxy voting).

The City's Investment Policy and Procedures contain a commitment for the City of Edmonton to support social and ethical business practices through proxy voting. A proxy voting agent is retained to vote the City's ballots for the hundreds of companies in which the City owns shares. The voting service adheres to the City's guidelines through careful analysis of each voting issue.

During 2013, the City of Edmonton exercised its shareholder rights and voted its proxies in accordance with the Investment Policy and Procedures.



## RESPONSIBILITIES OF CITY COUNCIL

The role of City Council, as senior governing fiduciaries, is to periodically receive reports and recommendations from the City Manager and to approve the Investment Policy.

The Investment Policy and Procedures establish the following:

- investment objectives
- investment beliefs
- permitted investment categories
- asset allocation (policy mix and permitted ranges)
- performance benchmarks
- implementation strategies
- proxy voting guidelines
- monitoring and controls
- reporting requirements

## 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 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.



Financial Services and Utilities  
5th Floor, Chancery Hall  
3 Sir Winston Churchill Square  
Edmonton, Alberta T5J 2C3

780-496-4944

[www.edmonton.ca](http://www.edmonton.ca)

