



2014

INVESTMENT  
COMMITTEE  
ANNUAL REPORT

Edmonton







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, the committee ensures that the funds are well-positioned and appropriately invested to meet their objectives.



## 2014 OVERVIEW

The world's major markets produced mixed results in 2014, varying substantially across sectors and regions.

All of the City of Edmonton investment funds outperformed their benchmarks in 2014. Performance of the funds ranged from a low of 1.2% (Money Market Fund) to a high of 12.2% (Ed Tel Endowment & Pension Funds), as a result of each fund's asset mix.

On a four-year basis, absolute returns have been strong. From a relative perspective, all of the investment funds continued to exceed their policy benchmarks.

Dividends of approximately \$25 million were paid to the City from the Ed Tel Endowment Fund in 2014.

Since 1995, the Ed Tel Endowment Fund has

- earned a compound annual rate of return of 8.4% versus the benchmark return of 7.4%,
- grown its principal from \$465 million to \$768 million and
- paid \$636 million in dividends to the City.

Key projects in 2014 included the introduction of a new fixed income structure and a review of the City's equity strategies.

# CAPITAL MARKETS OVERVIEW AND OUTLOOK

**Capital market returns varied substantially in 2014, reflecting the high level of dispersion that continues to exist with respect to political and economic conditions around the world.**

Bolstered by an improving economy, US equities were the best performer in 2014, returning 13.7%. This return, when converted to Canadian dollars, was enhanced further due to the relative strength of the US dollar throughout the year. Canadian equities returned a respectable 10.6% while foreign equity returns were somewhat mixed.

One of the defining stories of the year was the dramatic decline in oil prices. The plunge of more than 40% was the largest one-year decline since 2008.

Finally, as a result of falling interest rates, Canadian fixed income (bonds) increased by a surprising 8.8% in 2014. (Refer to the next page for a summary of returns across various capital markets.)

As countries remain in different stages of economic recovery and monetary policy, fundamentals should continue to be the main driver of investment returns in 2015, albeit with ongoing volatility. Closer to home, the price of oil and the Canadian dollar are two key factors that will greatly influence the overall investment climate throughout 2015.





## Performance Benchmarks

- The rate of return for each City asset class is compared with the published total return of its corresponding broad-market index.

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

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

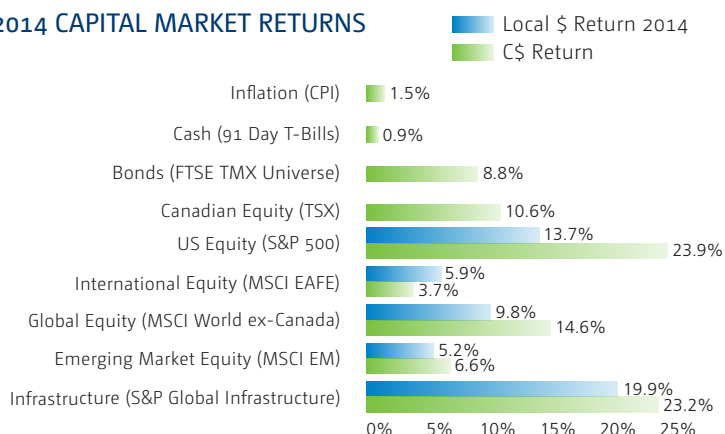
**Global Equity:** Morgan Stanley Capital International Inc. World Index excluding Canada (MSCI World ex-Canada)

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

### Infrastructure:

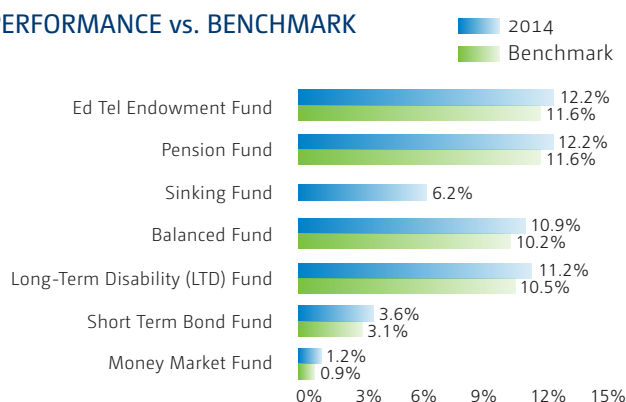
- Unlisted* – Consumer Price Index (CPI) + 5%
- Listed* – Standard & Poor's Global Infrastructure Index (S&P Global Infrastructure)
- These indices, weighted by the Policy Asset Mix, are used to calculate the performance benchmark for the total fund.
- The benchmark is used as a point of reference by which the investment performance of the total fund is evaluated.
- Industry standard is to present investment performance returns before deducting management fees.

## 2014 CAPITAL MARKET RETURNS

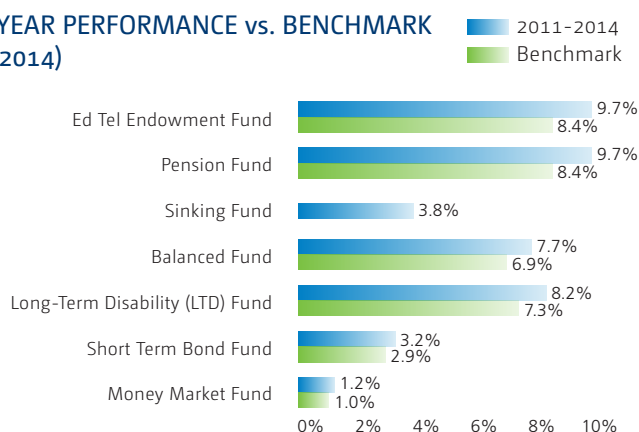


Local \$ Return represents returns expressed in the associated foreign currencies.  
C\$ Return reflects the return converted to Canadian dollars.

## 2014 PERFORMANCE vs. BENCHMARK



## FOUR-YEAR PERFORMANCE vs. BENCHMARK (2011-2014)



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

The investment program plays an important role in *The Way We Finance*, Edmonton's financial sustainability plan.

*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 have allowed the program to provide 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 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. Expanding the depth of strategies employed 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 and reduce the possibility of investment losses, while also ensuring 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 high 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. 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 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 the various risk mitigation strategies and controls in place are appropriate and consistent with industry standards.

Additional information on how the investment program has evolved and the success it has achieved is provided at [edmonton.ca/investments](http://edmonton.ca/investments).



## 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 and Procedures. 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.

# 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 exceed the return of 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 over time.

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 (passive)  
Toron AMI  
Triasima Portfolio Management

### Canadian Fixed Income

City of Edmonton Investment Management Section (internal)

### Global Fixed Income

Investec Asset Management

### Global Equity and Emerging Market Equity

Arrowstreet Capital

### U.S. Equity

TD Asset Management (passive)

### 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 investing in a subset of securities expected to outperform the broader 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:

\$768 million (Dec. 31, 2014)

### Performance (Rate of Return):

Over one year (2014): +12.2%

Over four years (2011-2014, per annum): +9.7%

### Performance against Policy Benchmark:

Over one year (2014): +0.6%

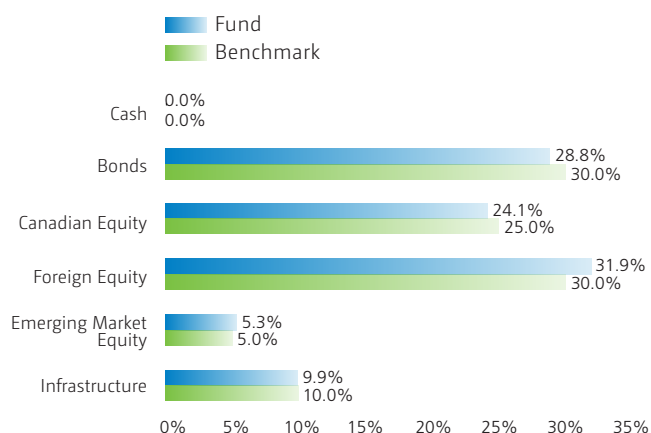
Over four years (2011-2014, per annum): +1.3%

### Description/Purpose:

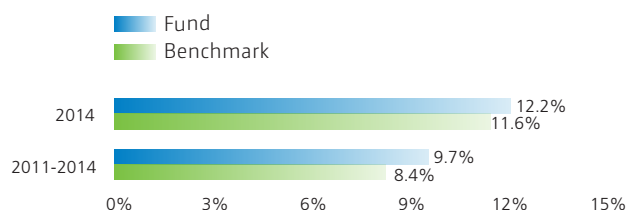
The Ed Tel Endowment Fund was created in 1995 to hold the financial assets generated by the sale of Edmonton Telephones to Telus Corporation. The objective of an endowment fund is to provide a source of income in perpetuity while ensuring the real purchasing power of the fund is maintained. The Ed Tel 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 \$25 million in 2014. The dividend to be paid in 2015 is set at \$29 million, as a result of the fund's strong recent performance.

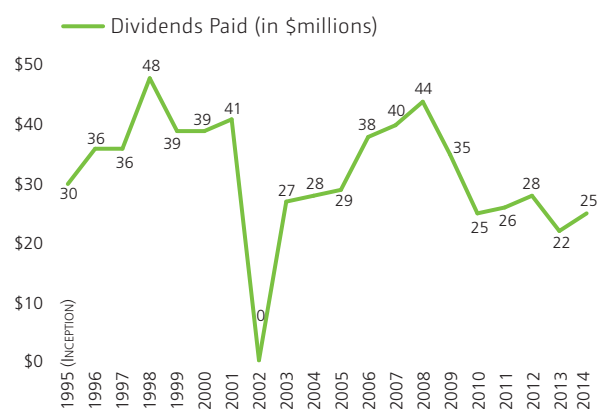
### ED TEL ENDOWMENT FUND ASSET MIX vs. POLICY MIX



### ED TEL ENDOWMENT FUND PERFORMANCE vs. BENCHMARK



### ED TEL ENDOWMENT FUND ANNUAL DIVIDEND PAYMENTS





## 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 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 Fund

### Fund Management:

Multiple Investment Managers (see page 5)

### Market Value:

\$213 million (Dec. 31, 2014)

### Performance (Rate of Return):

Over one year (2014): +12.2%

Over four years (2011-2014, per annum): +9.7%

### Performance against Policy Benchmark:

Over one year (2014): +0.6%

Over four years (2011-2014, per annum): +1.3%

### Description/Purpose:

The Pension Fund consists 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.

## Long-Term Disability (LTD) Fund

### Fund Management:

Multiple Investment Managers (see page 5)

### Market Value:

\$127 million (Dec. 31, 2014)

### Performance (Rate of Return):

Over one year (2014): +11.2%

Over four years (2011-2014, per annum): +8.2%

### Performance against Policy Benchmark:

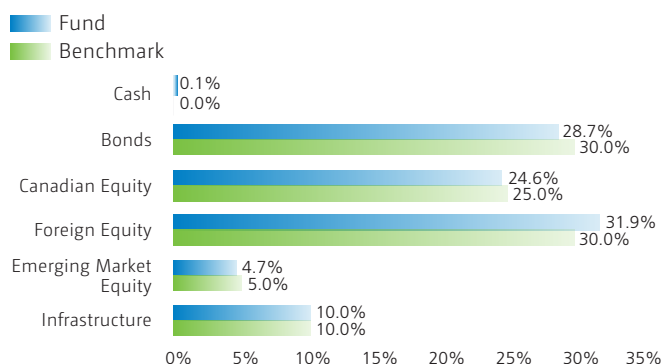
Over one year (2014): +0.7%

Over four years (2011-2014, per annum): +0.9%

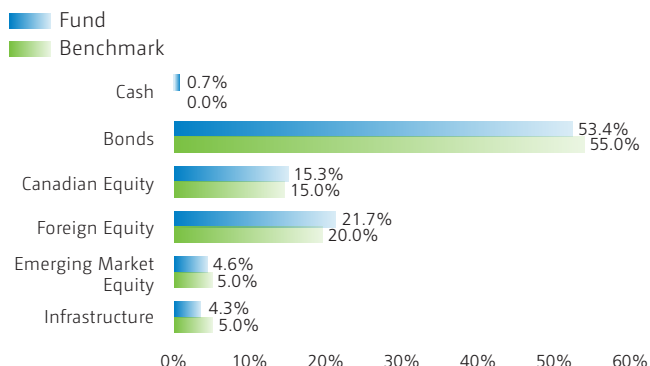
### Description/Purpose:

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

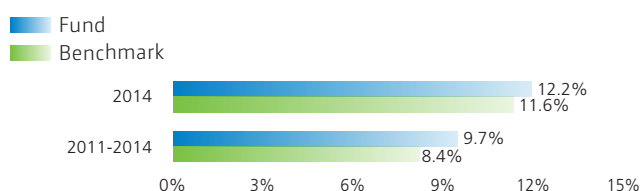
### PENSION FUND ASSET MIX vs. POLICY MIX



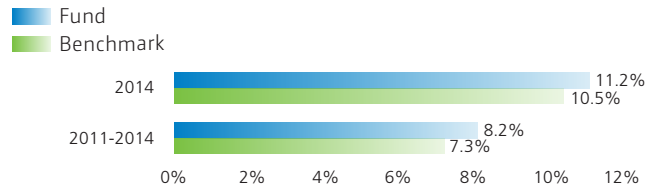
### LTD FUND ASSET MIX vs. POLICY MIX



### PENSION FUND PERFORMANCE vs. BENCHMARK



### LTD FUND PERFORMANCE vs. BENCHMARK





# Sinking Fund

## Fund Management:

City of Edmonton Investment Management  
Section (internal)

## Market Value:

\$77 million (Dec. 31, 2014)

## Performance (Rate of Return):

Over one year (2014): +6.2%  
Over four years (2011-2014, per annum): +3.8%

## Performance against Policy Benchmark:

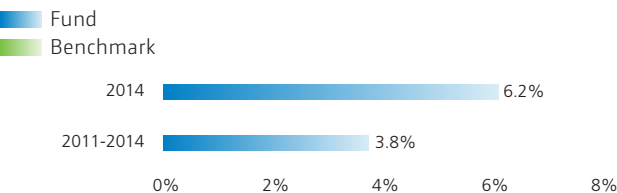
Over one year (2014): n/a  
Over four years (2011-2014, per annum): n/a

**Note:** Starting in Q2 2013, the fund management strategy changed 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 so that monies could be set aside regularly for the eventual redemption of various public debenture issues (borrowings). 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 together represent the City's working capital.

## Money Market Fund

## Fund Management:

City of Edmonton Investment Management  
Section (internal)

## Market Value:

\$452 million (Dec. 31, 2014)

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 (2014): +1.2%  
Over four years (2011-2014, per annum): +1.2%

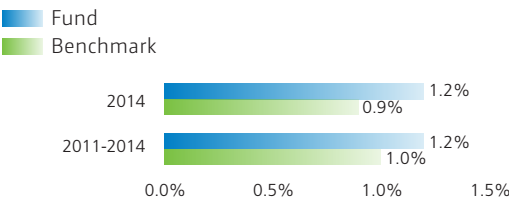
## Performance against Policy Benchmark:

Over one year (2014): +0.3%  
Over four years (2011-2014, per annum): +0.2%

## Description/Purpose:

The Money Market Fund absorbs 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:**  
\$254 million (Dec. 31, 2014)

**Performance (Rate of Return):**  
Over one year (2014): +3.6%  
Over four years (2011-2014, per annum): +3.2%

**Performance against Policy Benchmark:**  
Over one year (2014): +0.5%  
Over four years (2011-2014, per annum): +0.3%

**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)

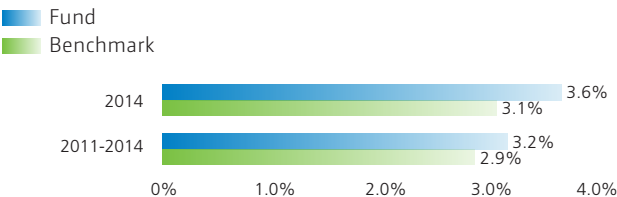
**Market Value:**  
\$593 million (Dec. 31, 2014)

**Performance (Rate of Return):**  
Over one year (2014): +10.9%  
Over four years (2011-2014, per annum): +7.7%

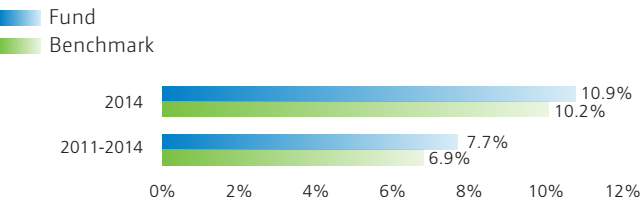
**Performance against Policy Benchmark:**  
Over one year (2014): +0.7%  
Over four years (2011-2014, per annum): +0.8%

**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. It also assures taxpayers that existing policies, procedures and controls maximize investment returns at a prudent level of overall risk.

The key roles and responsibilities of the Investment Committee, as outlined in the Investment Committee Terms of Reference, are to

- review the Investment Policy and Procedures and Terms of Reference and recommend changes as necessary;
- review investment strategies, capital market assumptions, investment 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 presentation 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, 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 2014

**Fixed Income Structure Implementation.** As a result of a previous review, a new fixed income structure was introduced in early 2014. The new structure, which includes a global bond mandate, increases the amount of active management and enhances diversification. These improvements are expected to generate added value within the overall fixed income allocation.

**Equity Structure Review.** A recent review identified areas of the City's equity allocation that would benefit from certain style and structural changes. The City will begin moving to a new structure in early 2015.



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

## Future Work

The Investment Committee will monitor the following key projects in 2015:

**Major Cities Investment Regulation.** The Major Cities Investment Regulation, which outlines the permitted investments for the cities of Edmonton and Calgary, is up for renewal in 2015. As a result, work will be undertaken with the Province of Alberta to review the regulation and ensure it continues to meet the City's ongoing investment requirements.

**Equity Structure Implementation.** The new structure is expected to provide additional value to the City's investment program by

- introducing new investment strategies to improve diversification,
- focusing active management in markets where potential value is highest and
- employing internal and passive management, where suitable, to provide cost efficiencies.

The move to the new structure includes the following work:

- Manager searches for three new investment strategies: a) passive US equity, b) Canadian all capitalization equity and c) global small capitalization equity;
- Finalizing the investment management agreements with the selected managers; and
- Transitioning the assets to the new structure. In addition to the three new strategies, a portion of Canadian equity will be managed internally.

### **Implementation of the unlisted infrastructure strategy.**

Assets continue to be transitioned to the unlisted infrastructure strategy as suitable investment opportunities arise.



# 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 2014, 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 a senior governing fiduciary, 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.



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**[edmonton.ca/investments](http://edmonton.ca/investments)**