

# 2015 INVESTMENT COMMITTEE ANNUAL REPORT

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 through affordable and responsible financial strategies for generations to come.

Over the last 10 years, these accomplishments have resulted in approximately \$750 million of investment earnings and dividends contributed to the City's budget. If this amount was related back to taxation, property taxes would have increased by an additional 7 per cent 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, as set in the City's strategic plan *The Way Ahead*, today and well into the future.

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# EDMONTON'S INVESTMENTS STRONG. UNCERTAINTY IN GROWTH GOING FORWARD

## UNINSPIRING RETURNS SEEN ON A GLOBAL SCALE

Capital market returns were uninspiring in 2015 as the existing economic and political themes continued to influence the markets throughout the year. Most major markets around the world stayed relatively unchanged in 2015, in contrast to the good performance seen during the two previous years.

Canadian equities lost 8.3 per cent in 2015, given the ongoing weakness in the price of oil and the Canadian dollar. In fact, the Canadian dollar and the price of oil declined by 16 per cent and 30 per cent respectively and ended the year at their lowest levels in over a decade.

US equities gained a mediocre 1.4 per cent, while other foreign equity markets posted slightly better returns. The significant decline of the Canadian dollar improved these returns considerably, once converted back into Canadian dollars.

Canadian fixed-income securities (bonds) increased by a modest 3.5 per cent in 2015. However, this gain was weaker than the strength seen during the previous year.

## EDMONTON'S INVESTMENTS EXCEED EXPECTATIONS

All of the City's seven investment funds outperformed their benchmarks in 2015. Performance ranged from 0.9 per cent (Money Market Fund) to 7.8 per cent (Ed Tel Endowment and Pension Funds), depending on each fund's asset mix.

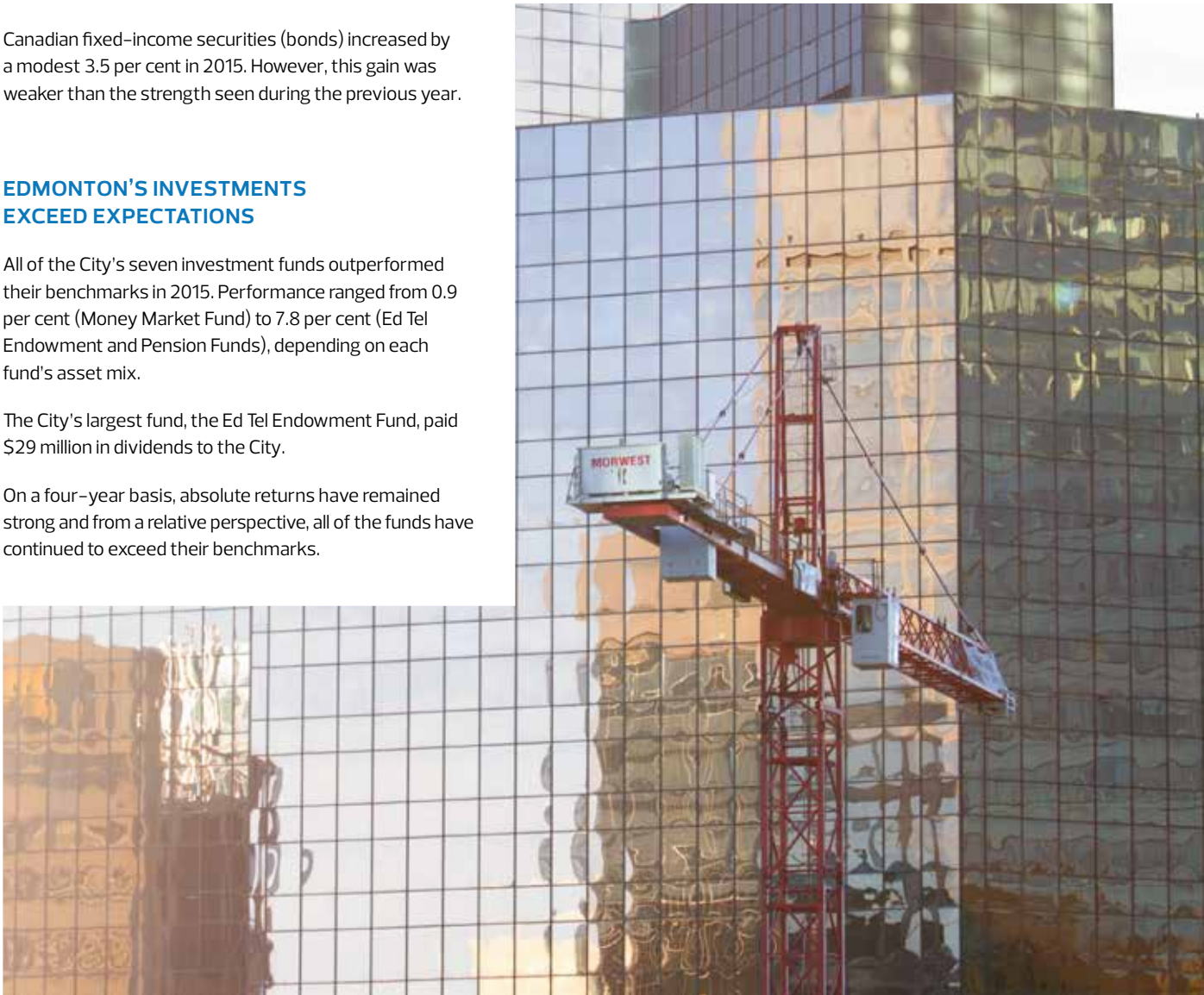
The City's largest fund, the Ed Tel Endowment Fund, paid \$29 million in dividends to the City.

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

## KEY PROJECTS IN 2015

A new **equity structure** was introduced in 2015 as an outcome of a previously conducted review. 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 **Major Cities Investment Regulation**, which outlines the permitted investments for the cities of Edmonton and Calgary, came up for renewal in 2015. The review with the Government of Alberta determined that the regulation continues to meet the City of Edmonton's ongoing investment requirements. As a result, it was extended for another five years.



## WHAT'S AHEAD?

In 2016, the policy actions by central banks, economic growth within developed and emerging markets and the price of oil are expected to be some of the key dynamics that will guide market direction and drive investment returns during the year.

Financial markets entered 2016 with a negative tone and heightened volatility as uncertainty surrounding global growth continues to impact sentiment. Further to this, the International Monetary Fund recently reduced its world growth outlook; however, given their forward-looking nature, markets should begin to rise before the economic softness ends.

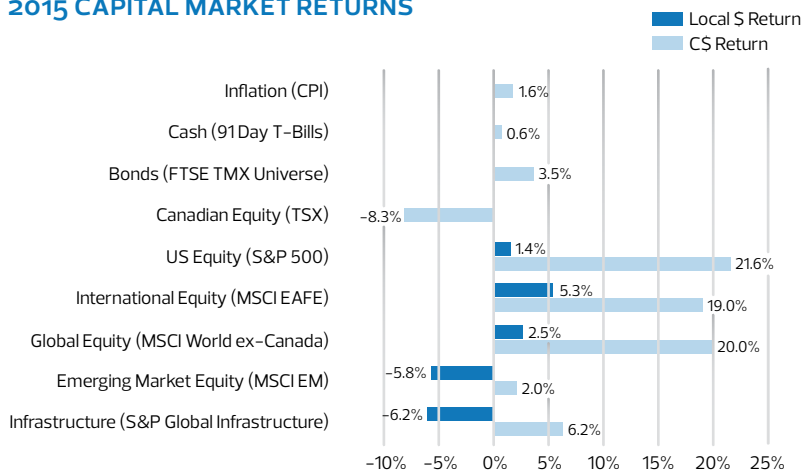
In the upcoming year, the Investment Committee will monitor the following three key projects:

- **Investment Tracking System upgrade.** The current internal Investment Tracking System records, tracks and controls investment activity for the City's fixed income securities, excluding money market. The upgrade will allow the system to also support money market activity, thereby enabling the use of straight-through processing and electronic settlement of money market investment transactions.
- **Custody review.** The City's custodian is responsible for the safekeeping of the City's financial assets. The project includes reviewing the custody agreement and associated fees, overall portfolio activity, cash management and foreign exchange services.
- **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

## 2015 CAPITAL MARKET RETURNS



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 the total fund.

The City uses the following performance benchmarks as a point of reference by which the investment performance of the total fund is evaluated:

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

**Canadian Equity:** 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)

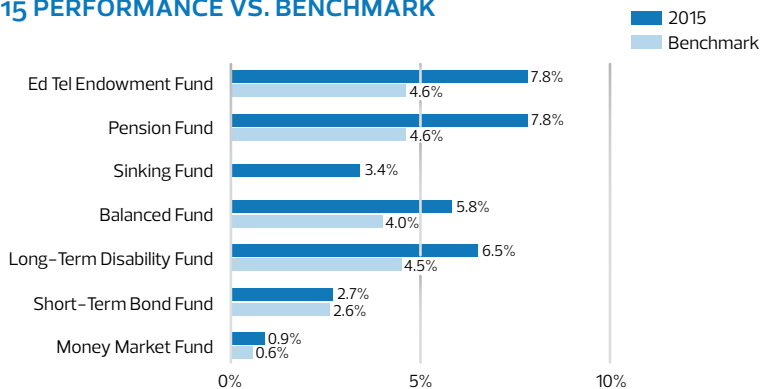
**Infrastructure:**

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

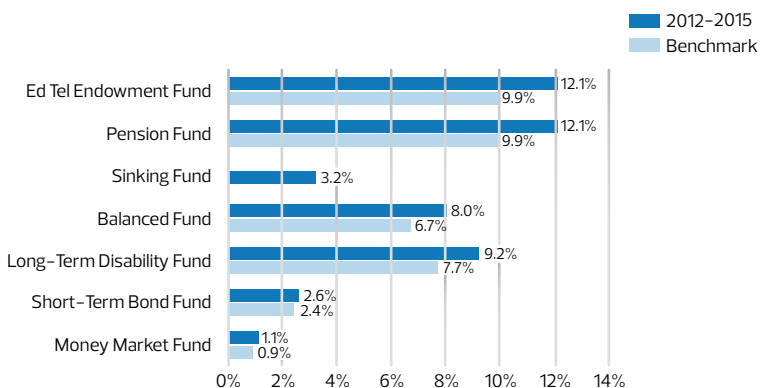
*Listed* – Standard & Poor's Global Infrastructure Index (S&P Global Infrastructure)

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

## 2015 PERFORMANCE VS. BENCHMARK



## FOUR-YEAR PERFORMANCE VS. BENCHMARK (2012-15)



# 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

\$795 million (Dec. 31, 2015)

#### Performance (rate of return)

Over one year (2015) +7.8%

Over four years (2012–2015, per annum) +12.1%

#### Performance against Policy Benchmark

Over one year (2015) +3.2%

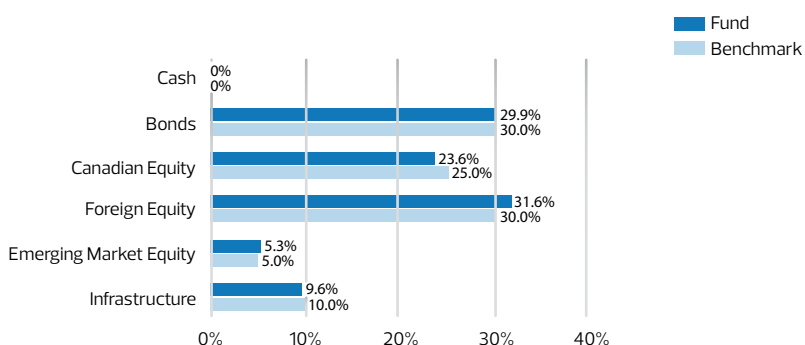
Over four years (2012–2015, per annum) +2.2%

#### Description

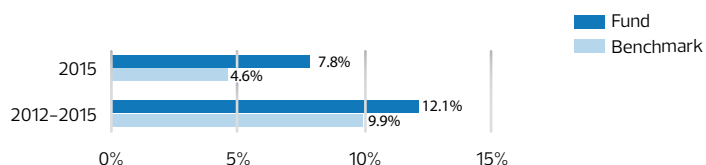
The Ed Tel Endowment Fund was created in 1995 to hold the financial assets generated by the sale of Edmonton Telephones to Telus Corporation. The objective of an endowment fund is to provide a source of income in perpetuity while ensuring the real purchasing power of the fund is maintained. The Ed Tel 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 \$29 million in 2015. The total dividend to be paid in 2016 is set at \$40 million, which comprises a regular dividend of \$32 million and a special dividend of \$8 million, as a result of the strong performance achieved by the fund over the preceding several years.

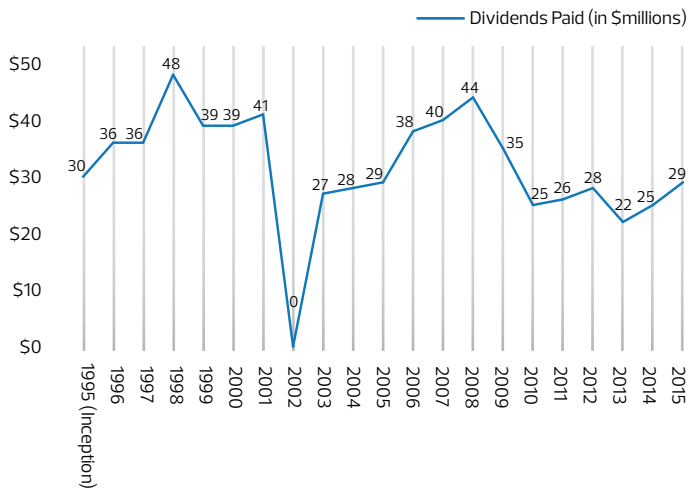
### ED TEL ENDOWMENT FUND ASSET MIX VS. POLICY MIX



### ED TEL ENDOWMENT FUND PERFORMANCE VS. BENCHMARK



## ED TEL ENDOWMENT FUND ANNUAL DIVIDEND PAYMENTS



Since 1995, the Ed Tel Endowment Fund has earned a compound annual rate of return of 8.3 per cent versus the benchmark return of 7.3 per cent, grown its principal from \$465 million to \$795 million and paid \$665 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:** This dividend calculation formula minimizes the effects of volatile investment returns and provides for a more stable and predictable annual dividend from the fund.



## PENSION FUND

### Fund Management

Multiple Investment Managers

### Market Value

\$213 million (Dec. 31, 2015)

### Performance (rate of return)

Over one year (2015)	+7.8%
Over four years (2012–2015, per annum)	+12.1%

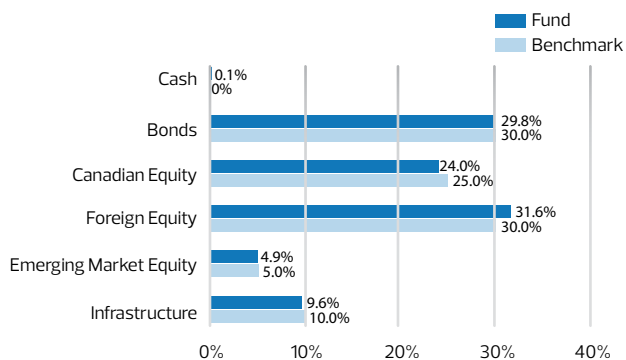
### Performance against Policy Benchmark

Over one year (2015)	+3.2%
Over four years (2012–2015, per annum)	+2.2%

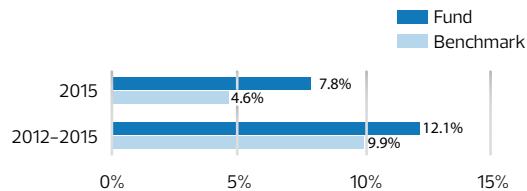
### Description

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



## PENSION FUND PERFORMANCE VS. BENCHMARK



## LONG-TERM DISABILITY (LTD) FUND

### Fund Management

Multiple Investment Managers

### Market Value

\$132 million (Dec. 31, 2015)

### Performance (rate of return)

Over one year (2015)	+6.5%
Over four years (2012–2015, per annum)	+9.2%

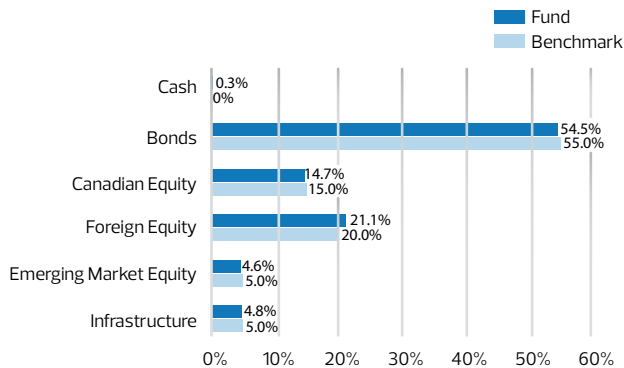
### Performance against Policy Benchmark

Over one year (2015)	+2.0%
Over four years (2012–2015, per annum)	+1.5%

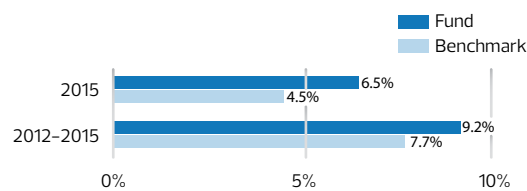
### Description

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

\$82 million (Dec. 31, 2015)

### Performance (rate of return)

Over one year (2015)	+3.4%
Over four years (2012–2015, per annum)	+3.2%

### Performance against Policy Benchmark

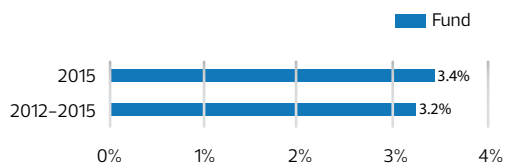
Over one year (2015)	n/a
Over four years (2012–2015, per annum)	n/a

### 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.

In the second quarter of 2013, the fund management strategy transitioned to meet the cash flow requirements of the final debenture maturity in 2018, making a traditional benchmark comparison ineffective.

## SINKING FUND PERFORMANCE



## MONEY MARKET FUND

### Fund Management

City of Edmonton Investment Management (Internal)

### Market Value

\$318 million (Dec. 31, 2015)

The City's revenue streams are cyclical; the fund value peaks each July at approximately \$700 million.

### Performance (rate of return)

Over one year (2015)	+0.9%
Over four years (2012–2015, per annum)	+1.1%

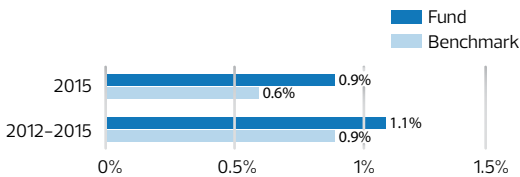
### Performance against Policy Benchmark

Over one year (2015)	+0.3%
Over four years (2012–2015, per annum)	+0.2%

### 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. 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 (internal)

### Market Value

\$261 million (Dec. 31, 2015)

### Performance (rate of return)

Over one year (2015)	+2.7%
Over four years (2012–2015, per annum)	+2.6%

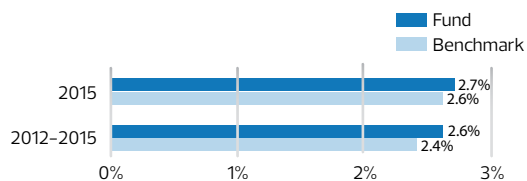
### Performance against Policy Benchmark

Over one year (2015)	+0.1%
Over four years (2012–2015, 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. The investment horizon, accordingly, is less than five years.

## SHORT-TERM BOND FUND PERFORMANCE VS. BENCHMARK



## BALANCED FUND

### Fund Management

Multiple Investment Managers

### Market Value

\$626 million (Dec. 31, 2015)

### Performance (rate of return)

Over one year (2015)	+5.8%
Over four years (2012–2015, per annum)	+8.0%

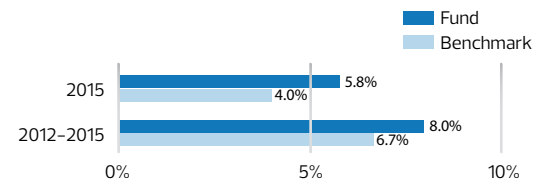
### Performance against Policy Benchmark

Over one year (2015)	+1.8%
Over four years (2012–2015, per annum)	+1.3%

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

## BALANCED FUND PERFORMANCE VS. BENCHMARK



# INVESTMENT PHILOSOPHY

## 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 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.

### 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.

### 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.

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 standards.





## 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*  
Chief Financial Officer and Treasurer  
City of Edmonton

**Stacey Padbury** *Secretary*  
Deputy City Treasurer and Branch Manager, Financial Services  
City of Edmonton

**Aaron Brown**  
Director, Portfolio Management  
Alberta Treasury Board and 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 RESPONSIBILITIES OF THE INVESTMENT COMMITTEE

- Review and recommend changes to the Investment Policy and Procedures 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 and Treasurer 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.

## 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 — 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 2015, the City of Edmonton exercised its shareholder rights and voted its proxies in accordance with the Investment Policy and Procedures.



# 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 has generally 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

### External Fund Management

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

### Canadian Equity

QV Investors  
Triasima Portfolio Management  
City of Edmonton Investment Management (internal/passive)

### 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

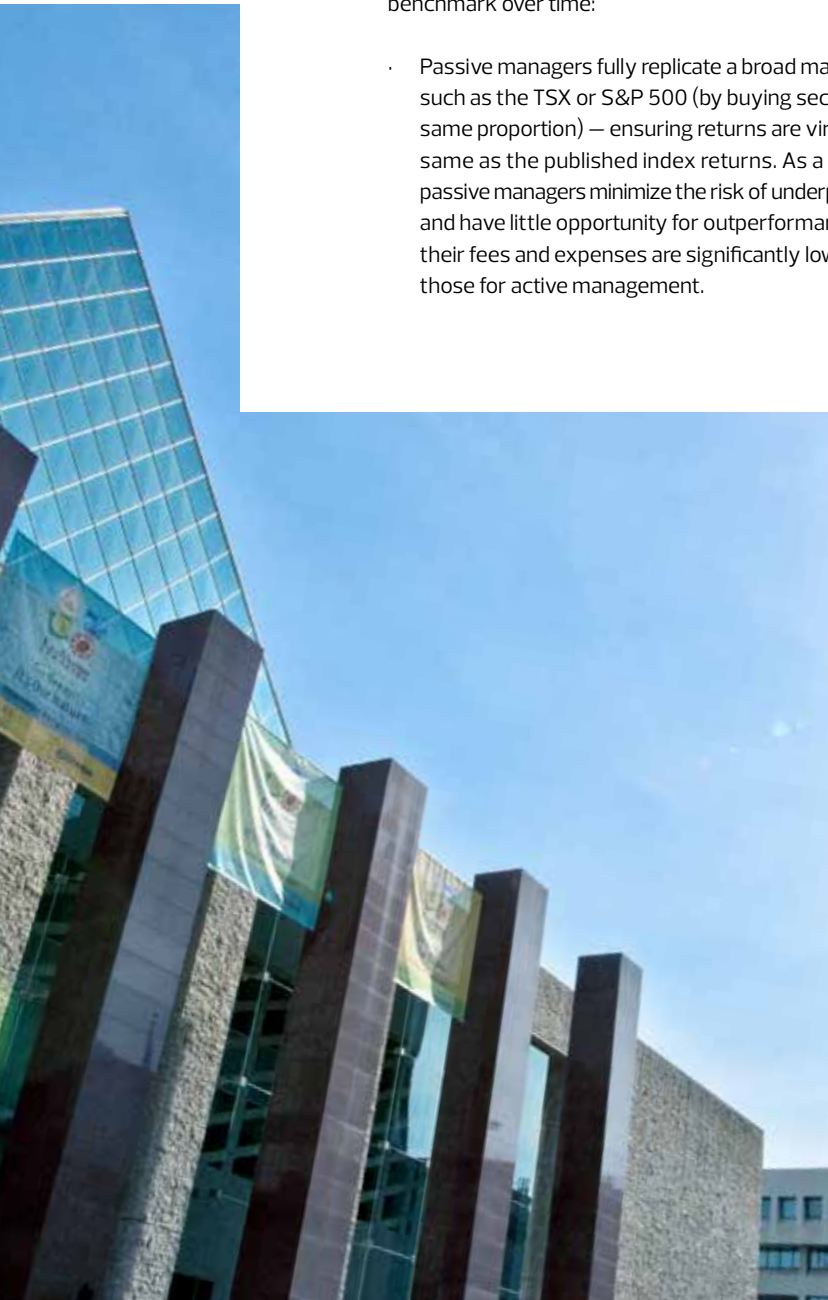
Fidelity Institutional Asset Management

### Infrastructure

Northleaf Capital Partners (unlisted)  
RARE Infrastructure (listed)

## INTERNAL FUND MANAGEMENT

The Sinking Fund, Money Market Fund and the 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.



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

