

2022 INVESTMENT COMMITTEE ANNUAL REPORT

Edmonton



May 3, 2023 - Executive Committee | FCS01734

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 the quality of life of Edmontonians.

Over the past 10 years, these accomplishments have contributed over \$860 million of investment earnings and dividends to the City's budget, offsetting what would otherwise have required a six per cent increase in property taxes during this time.

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

- 1 Investment Philosophy
- 2 2022 Overview
- 3 Capital Market Performance
- 5 Portfolio Performance
- 12 Governance
- 13 Management Strategies

INVESTMENT PHILOSOPHY

A prudent approach to investing municipal assets

The investment program plays an essential 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 risks is asset mix. As a result, the City establishes an asset allocation policy for each of its investment funds that is consistent with each fund's specific objectives, risk profile and investment time horizon.

Diversification is further enhanced within the various asset classes through the split between internal and external investment managers, resulting in a multi-asset, multi-manager investment framework.

Over time, diversification has been a key driver of the program's successful evolution, particularly in terms of expanding the depth of employed strategies and broadening the scope of investment opportunities. 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 worldwide.

Investment beliefs are the guiding principles used to determine the overall investment structure and strategy for the City's various funds. One of the main beliefs is that equities will outperform fixed income (bonds) to compensate for their higher risk over the long term. This concept is known as the Equity Risk Premium. 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 50 per cent 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 equity markets' higher volatility.

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.



2022 OVERVIEW

Edmonton's investments outperform in a difficult year

MARKETS DELIVERED NEGATIVE RETURNS IN 2022

In contrast to the strong performance seen over the last number of years, financial markets declined on a global scale in 2022. Inflation rates hitting multi-decade highs accompanied by aggressive interest rate tightening by central banks around the world created an extremely volatile and uncertain market environment for financial assets.

Canadian equities were the best performing market, on a relative basis, as they fell 5.8 per cent for the year, significantly outperforming other markets. Given the comparably higher sector weight in energy, Canada's main benchmark outperformed other equity indices, as the price of oil rose over 4 per cent to end the year at \$80 per barrel.

U.S. equities were the worst performer, down 18.1 per cent for 2022. However, with the Canadian dollar falling 7 per cent versus the U.S. dollar, this return improved once it was converted back into Canadian dollars.

Global equities and international equities returned -16.4 per cent and -7 per cent, respectively. This was the first negative year for these markets since 2018.

Given the rise in interest rates by monetary policymakers to levels not seen since 2008, Canadian bonds had a return of -11.7 per cent during 2022, which was the worst year since 1980.

THE CITY'S INVESTMENTS CONTINUED THEIR OUTPERFORMANCE

All of the City's investment funds outperformed their benchmarks in 2022.

Performance ranged from 2 per cent (Money Market Fund) to -7.4 per cent (Balanced Fund), reflecting each fund's asset mix.

On a four-year basis, investment returns remain positive and all of the City's funds are exceeding their policy benchmarks. Over a longer term 10-year basis, returns have been even stronger, with all of the funds continuing their outperformance against their benchmarks.

The City's largest fund, the Ed Tel Endowment Fund, paid \$54 million in dividends to the City – the largest contribution in the fund's history.

KEY PROJECTS

Major Cities Investment Regulation

The Major Cities Investment Regulation, which outlines the permitted investments for the cities of Edmonton, Calgary and Medicine Hat, was up for renewal in June 2022. Following a review by the Government of Alberta, this regulation was replaced by a new Municipal Investment Regulation for a 10-year term, while still allowing the major cities much broader investment opportunities.

Fixed Income Investment Structure Review

A review of the City's fixed income investment structure was undertaken to identify areas where potential enhancements could be made. The analysis supported the addition of a new private debt investment mandate, which is expected to provide additional yield and diversification improvements. Following this decision, a manager search was initiated and an investment firm was selected to manage the new strategy. This work will continue in 2023 (see **What's Ahead**).

Update to Money Market Fund Mandate

The Investment Management Mandate of the internally managed Money Market Fund was revised to reflect the fund's growth since the last revision, including incorporating some additional market updates.

New Committee Appointment

A new member was appointed to the City's Investment Committee as an opening for another external member was available. As per the committee's Terms of Reference, external members can serve only two consecutive three-year terms on the Investment Committee; this ensures continued good governance of the City's financial assets.

WHAT'S AHEAD?

Following the disappointing results of the prior year, financial markets began 2023 with a positive tone. Given their forward looking nature, markets typically begin to rise before financial conditions have fully recovered. However, a number of factors will continue to drive capital market returns in 2023. For example, geopolitical concerns, risks of an economic recession, and the direction of inflation and interest rates. While volatility is expected to remain relatively high, markets should stabilize once investors have more confidence that a number of these uncertainties have been addressed.

Diversification and maintaining prudent levels of risk are key elements in navigating the investment climate ahead.

In the upcoming year, the Investment Committee will oversee the following projects:

Asset Allocation Studies

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

Fixed Income Investment Structure Implementation

As a result of the work undertaken in 2022, a new fixed income investment structure is being introduced. This includes finalizing the investment management agreement with the selected investment manager and allocating assets to the new strategy. The new structure should provide added value by increasing expected returns and improving diversification.

Implementation of Unlisted Infrastructure and Real Estate Strategies

As part of a multi-year project, the City continues to transition assets to unlisted infrastructure and real estate strategies 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 evaluates the investment performance of each fund using the following indices as points of reference:

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

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

Bonds: FTSE Canada Universe Bond Index (FTSE Universe)

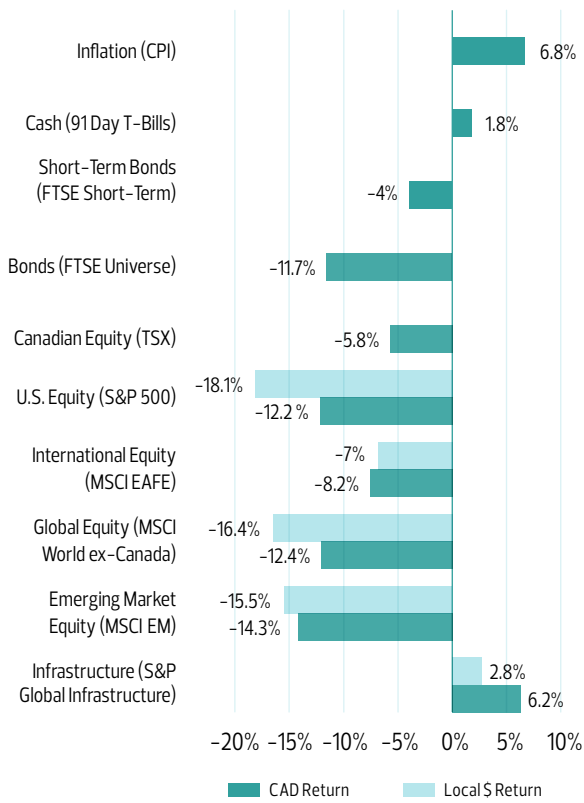
Canadian Equity: S&P/TSX Capped 10% Index (TSX)

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 (MSCI EM)

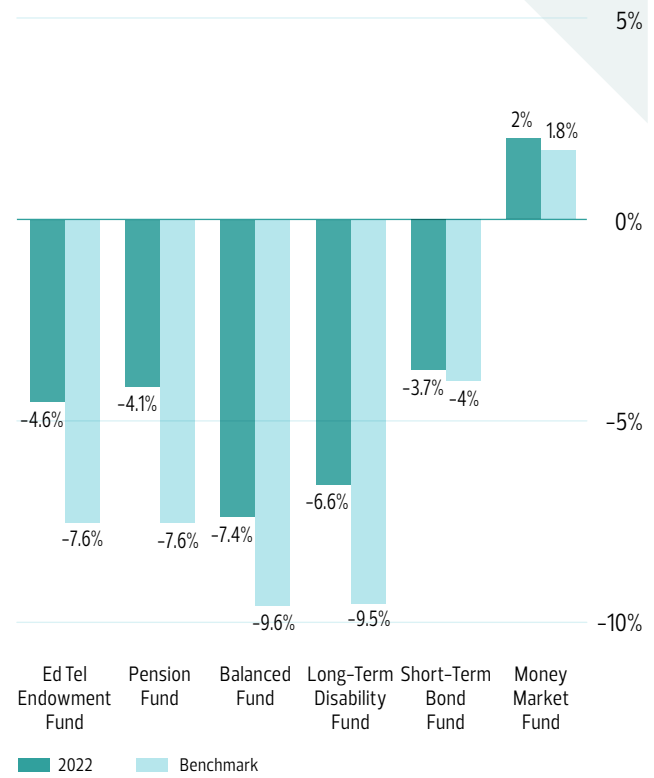
Infrastructure & Real Estate: Consumer Price Index (CPI) +4.5%

2022 Capital Market Returns

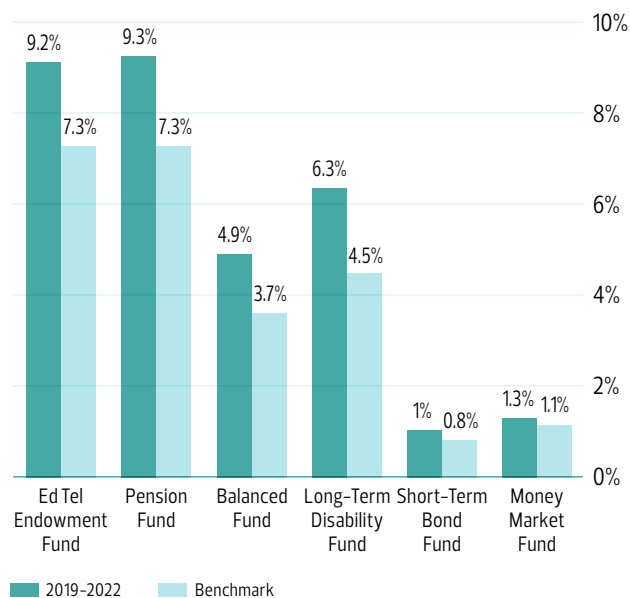


Local \$ Return represents returns expressed in the associated foreign currencies. CAD Return reflects the return converted to Canadian dollars.

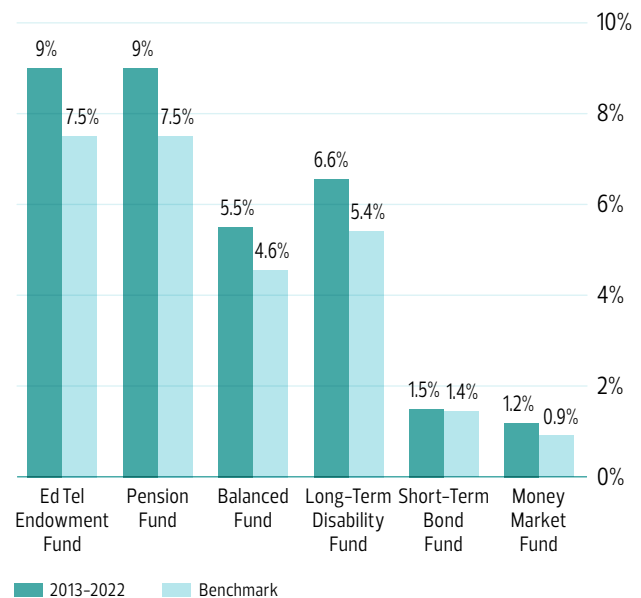
2022 Performance vs. Benchmark



Four-Year Performance vs. Benchmark (2019-2022)



Ten-Year Performance vs. Benchmark (2013-2022)



According to industry standards, investment performance returns are presented before deducting management fees.

PORTFOLIO PERFORMANCE

INVESTMENT FUNDS

Ed Tel Endowment Fund | Pension Fund | Long-Term Disability Fund

RESERVES AND WORKING CAPITAL FUNDS

Money Market Fund | Short-Term Bond Fund | Balanced Fund

Investments within the reserves and working capital funds represent financial holdings of the corporation held for a specific purpose within the City's budget. The investment earnings from these funds are transferred to the City's capital budget annually.

ED TEL ENDOWMENT FUND

Fund Management

Multiple Investment Managers

Market Value

\$893 million (December 31, 2022)

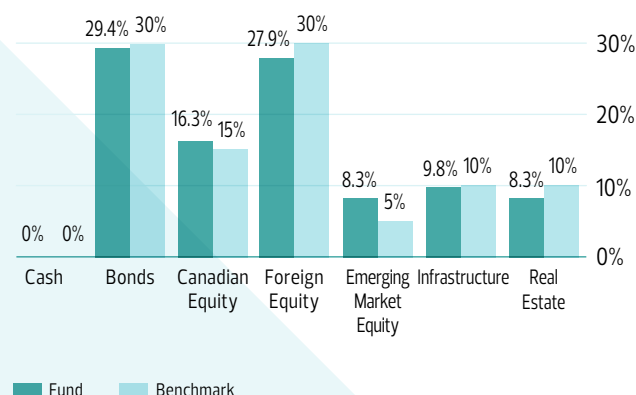
Performance (rate of return)

Over one year (2022)	-4.6%
Over four years (2019–2022, per annum)	+9.2%
Over ten years (2013–2022, per annum)	+9.0%

Performance against Policy Benchmark

Over one year (2022)	+3.0%
Over four years (2019–2022, per annum)	+1.9%
Over ten years (2013–2022, per annum)	+1.5%

Ed Tel Endowment Fund Asset Mix vs. Policy Mix

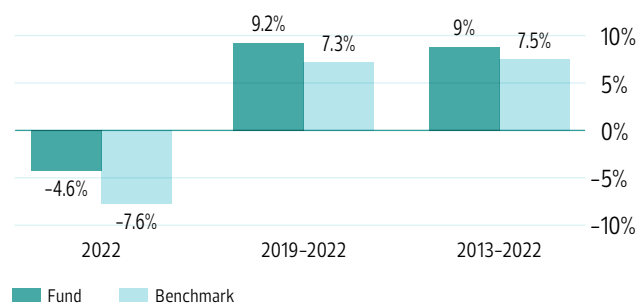


DESCRIPTION

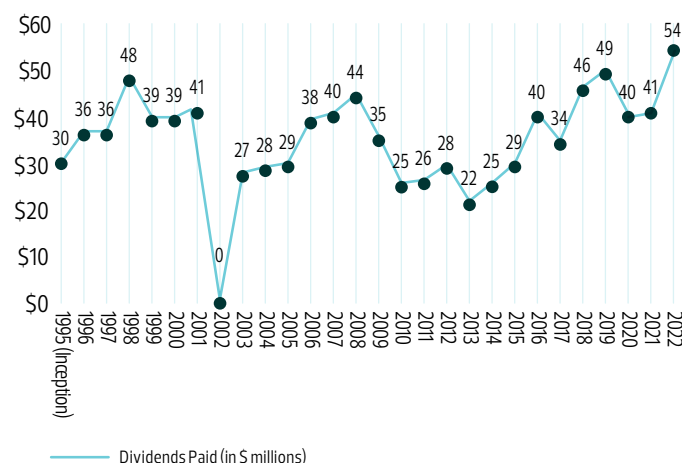
The objective of an endowment fund is to provide a source of income in perpetuity while ensuring the real purchasing power of the fund is maintained. The Ed Tel Endowment Fund was created in 1995 to hold the financial assets generated by the sale of Edmonton Telephones to TELUS Corporation. It is considered 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 \$54 million in 2022, which comprised a regular dividend of \$43 million and a special dividend of \$11 million, as a result of the strong performance over the preceding number of years. This was the largest total dividend paid since the fund was established. The dividend to be paid in 2023 is set at \$45 million.

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 8.1 PER CENT VERSUS THE BENCHMARK RETURN OF 7.1 PER CENT, GROWN ITS PRINCIPAL FROM \$465 MILLION TO \$893 MILLION AND PAID \$969 MILLION IN DIVIDENDS TO THE CITY.

ED TEL ENDOWMENT FUND BYLAW – KEY SUCCESS FEATURES

Inflation Indexing: To avoid erosion of real purchasing power, 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

\$318 million (December 31, 2022)

Performance (rate of return)

Over one year (2022)	-4.1%
Over four years (2019-2022, per annum)	+9.3%
Over ten years (2013-2022, per annum)	+9.0%

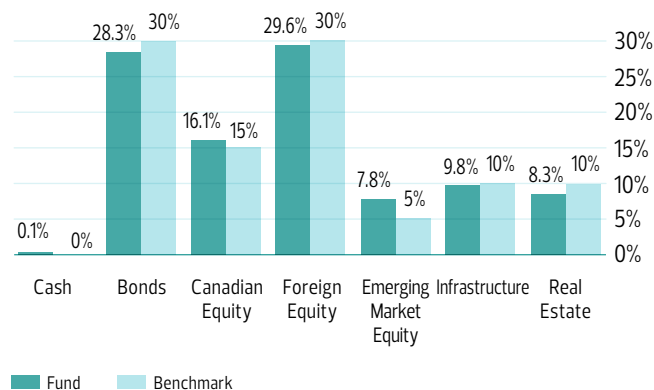
Performance against Policy Benchmark

Over one year (2022)	+3.5%
Over four years (2019-2022, per annum)	+2.0%
Over ten years (2013-2022, per annum)	+1.5%

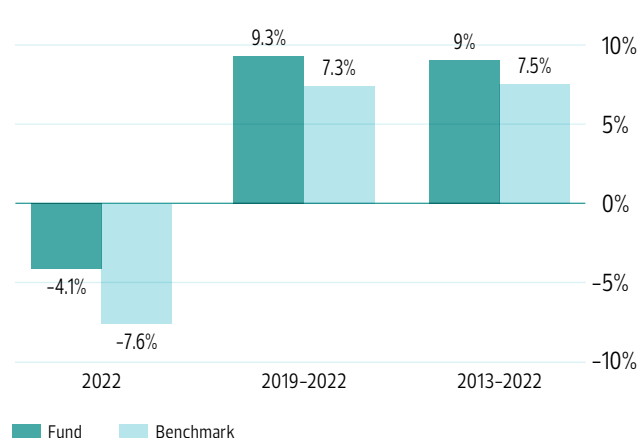
Description

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 a small number of beneficiaries.

Pension Fund Asset Mix vs. Policy Mix



Pension Fund Performance vs. Benchmark



LONG-TERM DISABILITY FUND

Fund Management

Multiple Investment Managers

Market Value

\$152 million (December 31, 2022)

Performance (rate of return)

Over one year (2022)	-6.6%
Over four years (2019–2022, per annum)	+6.3%
Over ten years (2013–2022, per annum)	+6.6%

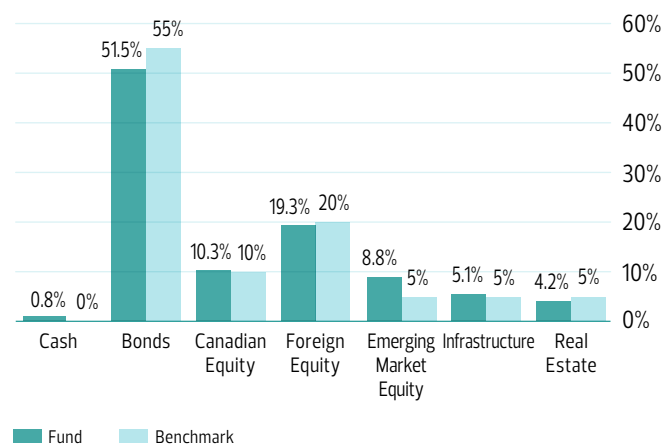
Performance against Policy Benchmark

Over one year (2022)	+2.9%
Over four years (2019–2022, per annum)	+1.8%
Over ten years (2013–2022, per annum)	+1.2%

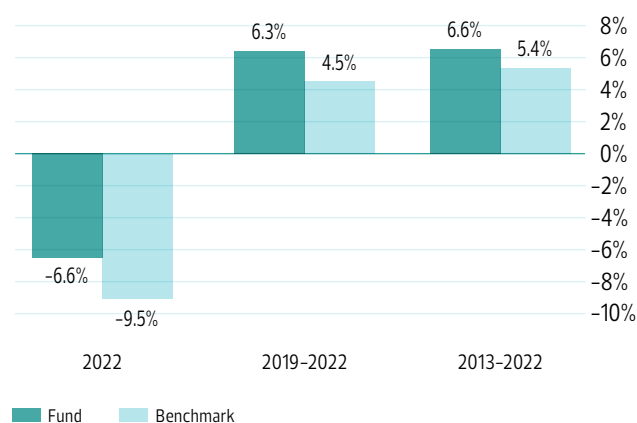
Description

The Long-Term Disability (LTD) Fund holds investments for six City of Edmonton long-term disability plans.

LTD Fund Asset Mix vs. Policy Mix



LTD Fund Performance vs. Benchmark



MONEY MARKET FUND

Fund Management

City of Edmonton Investment Management (internal)

Market Value

\$525 million (December 31, 2022)

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

Performance (rate of return)

Over one year (2022)	+2.0%
Over four years (2019–2022, per annum)	+1.3%
Over ten years (2013–2022, per annum)	+1.2%

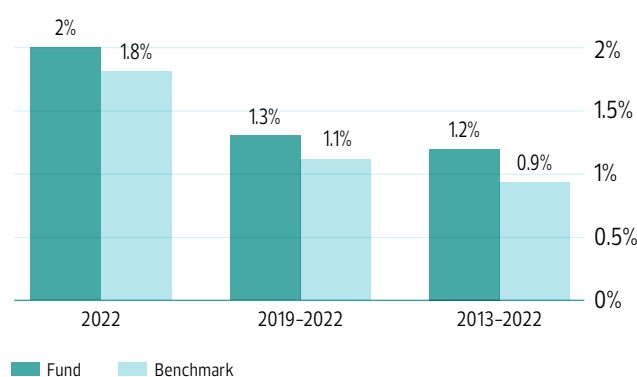
Performance against Policy Benchmark

Over one year (2022)	+0.2%
Over four years (2019–2022, per annum)	+0.2%
Over ten years (2013–2022, 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

\$329 million (December 31, 2022)

Performance (rate of return)

Over one year (2022)	-3.7%
Over four years (2019–2022, per annum)	+1.0%
Over ten years (2013–2022, per annum)	+1.5%

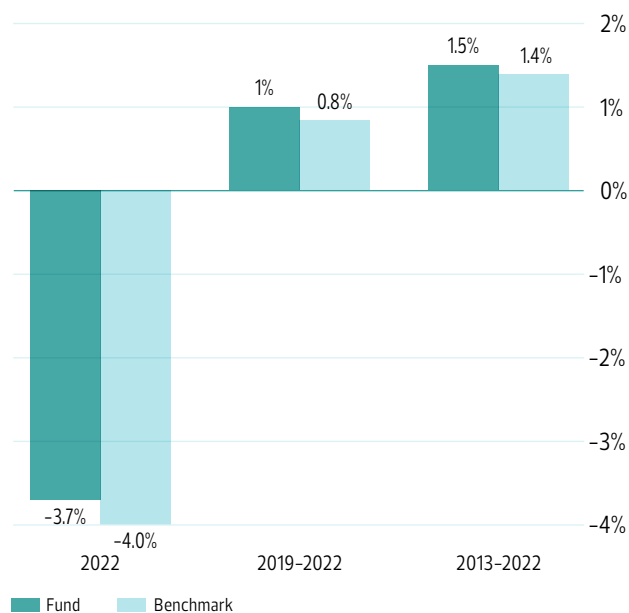
Performance against Policy Benchmark

Over one year (2022)	+0.3%
Over four years (2019–2022, per annum)	+0.2%
Over ten years (2013–2022, per annum)	+0.1%

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 fewer than five years of an investment horizon.

Short-Term Bond Fund Performance vs. Benchmark



BALANCED FUND

Fund Management

Multiple Investment Managers

Market Value

\$820 million (December 31, 2022)

Performance (rate of return)

Over one year (2022) -7.4%

Over four years (2019–2022, per annum) +4.9%

Over ten years (2013–2022, per annum) +5.5%

Performance against Policy Benchmark

Over one year (2022) +2.2%

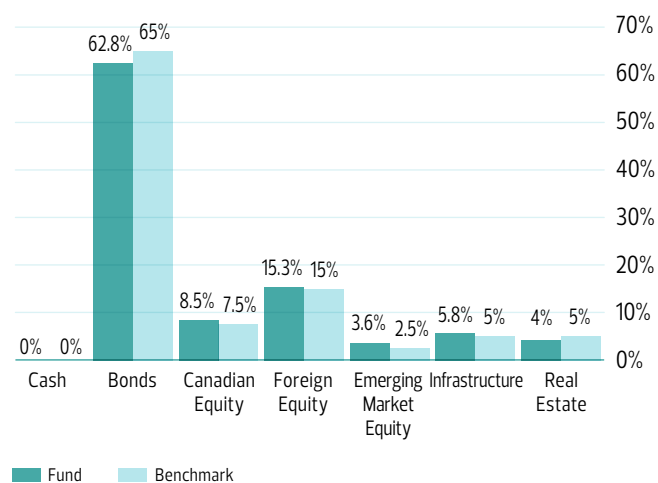
Over four years (2019–2022, per annum) +1.2%

Over ten years (2013–2022, per annum) +0.9%

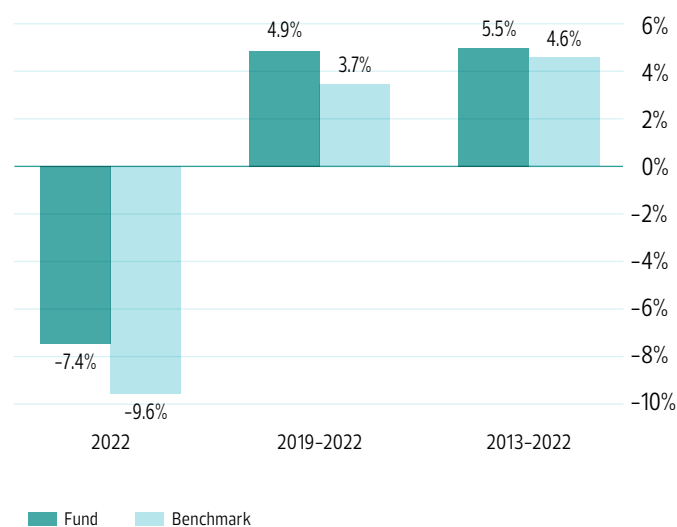
Description

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 midpoints of its policy asset mix ranges provide the performance benchmark when reporting the fund.

Balanced Fund Asset Mix vs. Policy Mix



Balanced Fund Performance vs. Benchmark



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 risks.
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.

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 per cent bonds, 50 per cent equities and 20 per cent private investments.

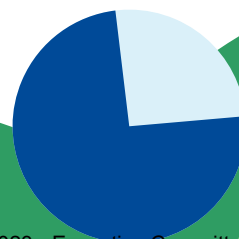
The asset mix reflects the investor's underlying goals and objectives for the fund in terms of risk and reward.

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 periods, the returns may fall short or exceed the investment objectives.

PRIVATE INVESTMENTS

Infrastructure and real estate are defined as large-scale projects that provide essential services to society. These investments may involve developing, operating and maintaining the asset.

Opportunities for investors are expected to continue expanding significantly in the coming years. These asset classes are available on a global scale and investments can be made either through unlisted (private) or listed (publicly traded) strategies.



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 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.

2022 INVESTMENT COMMITTEE MEMBERS

Stacey Padbury *Chairperson*

Deputy City Manager and Chief Financial Officer
City of Edmonton

Harmalkit Rai *Secretary*

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

Greg Rehman

President
Edmonton Fire Fighters' Union

Filip Ksiazkiewicz

Senior Portfolio Manager
TELUS Investment Management

Jai Parihar

Former President and CEO
UBC IMANT

M. Blake Walker

Former 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

Members of City Council, as senior governing fiduciaries, receive reports and recommendations from the City Manager and approve 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, 2022, the investment funds were in compliance with the City of Edmonton Investment Policy and all statutory requirements.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

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

The City retains a proxy voting agent to vote the City's ballots for the companies in which the City owns shares. The voting service adheres to the City's guidelines by carefully analyzing each voting issue.

In 2022, the City of Edmonton exercised its shareholder rights and voted its proxies in accordance with the Investment Policy. In addition, the City's investment managers incorporate ESG factors into their investment decision-making.

Furthermore, all of the managers are signatories of the UN Principles of Responsible Investment. The principles provide an industry-wide standard against which the manager can continue to assess itself and strive for best-in-class due diligence, investment monitoring and investor reporting.

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 that returns are virtually the same as those of the published index. 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.

INTERNAL FUND MANAGEMENT

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.

INVESTMENT MANAGERS

The Ed Tel Endowment Fund, Pension Fund, Long-Term Disability Fund and Balanced Fund 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

Ninety One PLC

Global Equity

Arrowstreet Capital
Spouting Rock Asset Management

Emerging Market Equity

Arrowstreet Capital

U.S. Equity

TD Asset Management (passive)

International Equity

Fidelity Institutional Asset Management

Infrastructure

Northleaf Capital Partners (unlisted)
ClearBridge Investments (listed)

Real Estate

WTW PLC

