INFORMATION REPORT

TO: Chair and Members Audit, Finance and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: March 19, 2011	
SUBJECT/REPORT NO: Reserve/Revenue Fund Investment Performance Report - December 31, 2011 (FCS11075(a)) (City Wide)	
SUBMITTED BY: Roberto Rossini General Manager Finance & Corporate Services Department **SIGNATURE:**	**PREPARED BY:** Gerald T. Boychuk 905-546-4321

Council Direction:

Not Applicable.

Information:

The investment portfolio for the City of Hamilton's (City's) Reserve/Revenue Fund (comprised of reserve/revenue funds, capital account balances and unused operating funds) had an earnings rate of **3.33%** for the 12 months ending December 31, 2011, and an average earnings rate of **3.61%** over the past five years. Bond lending revenues of **$64,847** are included in the earnings rate of **3.33**%.

The City's portfolio generated approximately **$35.5** million in bond interest, net realized capital gains, lending revenue and bank interest over the 12 months ending December 31, 2011. The average dollar amount generated over the last five years is approximately **$33.90** million. Earnings in 2011 were buoyed by **$10.3** million in net realized capital gains, the same as in 2010. The total return of **$35.5** million was realized on an investment at an average cost of **$824,206,197** ($657,821,574 for the investment portfolio, plus $166,384,623 for the City's bank account balance). The percentage return on asset cost over this period was **4.31%**. Net unrealized capital gains totalled **$29.4** million as at December 31, 2011.

For the 12 months ending December 31, 2011, the overall return (which includes bond interest, bond lending revenues, realized and unrealized capital gains/losses) was **6.83%;** whereas the benchmark return was **5.76%,** resulting in an out-performance of **107** basis points. Over the past five years, the overall return has averaged **5.29%** per annum, outperforming the average benchmark return over the same five-year period of **5.01%** by **28** basis points.

By comparison, the overall returns for the ONE Funds portfolios (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers' Association), over the 12 month period ending December 31, 2011 were **4.19%** for bonds and **1.19%** for money market. If the City's Policy had been used in these funds (i.e. 90% bonds and 10% money market), the overall return would have been **3.89%** or **294** basis points less than the actual return of **6.83%.** On an average portfolio market value of **$676.7** million, an increase of **2.94%** return translates into a revenue increase of approximately **$19.9** million.

Table 1 below summarizes the investment return indicators:

Table 1

Investment Return Indicators (for information purposes only)

	12 Months ended 12/31/2011	**12 Months ended 12/31/2010**	**12 Months ended 12/31/2009**	**12 Months ended 12/31/2008**	**12 Months ended 12/31/2007**
Policy Target	5.76%	3.89%	1.72%	9.17%	4.50%
City's Portfolio	**6.83%**	**4.29%**	**4.92%**	**6.73%**	**3.67%(1)**
The One Fund – Bonds	4.19%	3.00%	3.35%	8.08%	3.84%
The One Fund – Money Market	1.19%	0.65%	0.75%	4.00%	4.39%
Dex - Short Government	4.62%	3.29%	1.94%	10.16%	4.53%
Dex – Mid Governments	10.20%	6.51%	1.57%	11.66%	4.52%
Bond Lending Revenue	$64,847	$69,350	$97,365	$84,071	$61,220
Earnings Rate (Excludes Capital Gains/Losses)	**3.33%**	**3.57%**	**4.26%**	**3.61%**	**3.30%(1)**
City's Return ONE Fund Investment (Equity)	**-7.71%**	**11.91%**	**31.18%**	**-19.04%**	**-0.15%**

(1) The earnings rate in 2007 was adjusted for an allowance of $14.4 million due to ABCP holdings. This allowance is an estimate only and actual results may differ due to realization from these holdings.

The investments in the portfolio consist of 100% bonds and 0% money market. During 2011, the rate earned in the City's bank account was higher than the rate earned on Treasury Bills and Banker's Acceptances (with terms less than 6 months) and therefore, as in 2010, cash earmarked for short term expenses was invested in the City's bank account. The City also continued to invest in a modest amount of floating rate notes as an attractive alternative to money market instruments.

As at December 31, 2011, the duration of the portfolio was **4.2** years compared to **4.0** years as at December 31, 2010. The total market value of the investment portfolio was **$706,160,751**, an increase of **$38.99** million compared to December 31, 2010.

The total market value of the portfolio includes **$76.3** million (attributed cost) of restructured MAV Notes, and **$9.9** million of Devonshire Trust Asset Backed Commercial Paper which was not restructured. The MAV Notes were received in exchange for the previously held Asset Backed Commercial Paper (ABCP). In 2007 and 2008, the City took a reserve loss position of **$12.9** million against all the restructured MAV Notes. Currently, the Devonshire Trust ABCP is the subject of litigation between the Investment Industry Regulatory Organization of Canada and the Ontario Securities Commission, and between the City and Deutsche Bank in an independent litigation. The Devonshire Trust ABCP has an allowance for loss of **$5.5** million.

In June 2007, the City began subscribing to the ONE Funds Equity Account. Over a period of 55 months ending December 31, 2011, the City has deposited a total of **$6.0** million with the ONE Funds Equity Account. As at December 31, 2011, the market value of the City's investment in the ONE Funds Equity Account is **$6.11** million, which corresponds to **0.9%** of the total market value of the City's investment portfolio. Over the past twelve months ending December 31, 2011, the City's one-year return on its investment in the ONE Funds Equity Account was **-7.71%.**

The out-performance of the Reserve/Revenue investment portfolio relative to its benchmark is mostly attributed to its slightly longer duration and its holdings in Schedule I Canadian Bank Deposit Note and Provincial bonds, primarily in the five and ten year terms.

Table 2 below shows the changes in Canadian interest rates over the past 24 months:

Table 2

CANADIAN INTEREST RATES			
Maturity Term: Canada Benchmark	**Interest Rate January 2, 2012**	**Interest Rate January 3, 2011**	**Interest Rate January 2, 2010**
One Month (T-Bill)	0.73%	0.90%	0.14%
2 yr	0.96%	1.67%	1.45%
5 yr	1.28%	2.42%	2.76%
10 yr	1.94%	3.12%	3.61%

As at December 31, 2011, compared to December 31, 2010, the yields on Government of Canada bonds were sharply lower across the entire yield curve – the yield on the 10-year bond reached an all-time low of 1.84% in mid-December – and credit spreads were moderately wider on Provincial, Canadian Schedule I Bank Deposit Note and Canada Housing Trust Agency bonds. Commodities were down by 8.3%; crude oil was up 8.2%; gold was up 10.1%; and the Canadian dollar relative to the U.S. dollar weakened from about parity at the end of 2010 to USD97.89 on December 31, 2011. In the second half of 2011, flight to quality and higher risk aversion were the key themes driving the bond market rally as the European sovereign debt crisis intensified and as U.S. and global economic growth prospects were revised downward. Throughout 2011, the Bank of Canada kept the policy interest rate at 1%, unchanged, citing external downside risks.

Recently, on January 25, 2012, the Federal Reserve said it will extend the period over which it plans to keep the policy rate near zero until late 2014, signalling that a full recovery in the U.S. economy is still years away. On January 17, 2012, as expected, the Bank of Canada continued to stand pat and said in its Monetary Policy Report, that "the outlook for the global economy has deteriorated and uncertainty had increased". Still, market expectations are that the Bank of Canada will raise policy rates ahead of the Federal Reserve and possibly in 2013.

The Bank of Canada projects that the Canadian economy will grow by 2 per cent in 2012. The International Monetary Fund (IMF) recently reduced its estimate for 2012 global growth to 3.3 per cent from 4 per cent just three months ago mostly because of ongoing European debt crisis.

Some downside risks to the global economic outlook in 2012 include a hard economic landing in China as the momentum slows in its economy; a deeper than expected recession in Europe including a recession in the U.S.; and deflation.