Hamilton

INFORMATION REPORT

TO:	Chair and Members HMRF / HWRF Pension Administration Sub-Committee
COMMITTEE DATE:	December 18, 2018
SUBJECT/REPORT NO:	Master Trust Pension Investment Performance Report as at December 31, 2017 (FCS17088(a)) (City Wide)
WARD(S) AFFECTED:	City Wide
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Council Direction:

Not Applicable.

Information:

Attached, as Appendix "A" to Report FCS17088(a), is Aon Hewitt's investment performance report for the Hamilton Municipal Retirement Fund (HMRF), the Hamilton-Wentworth Retirement Fund (HWRF) and the Hamilton Street Railway (HSR), as of December 31, 2017. Together, the three pension funds make up the Master Trust, which is referred to as the "Plan" throughout Report FCS17088(a).

As of December 31, 2017, the market value of the assets of the Plan was $341.9 M, an increase of $11.6 M compared with $330.3 M as at December 31, 2016.

The funded ratio increased to 75.2% which required a change in asset mix. The "Dynamic Investment Policy" set a long-term target of 80% fixed income assets with adjustment being upwards in fixed income holdings as interest rates rise and reduce the present value of liabilities as total returns exceed the prescribed discount rate and increase total asset present values.

For the one-year period ending December 31, 2017, the Plan's return was 9.5%, outperforming its benchmark return of 8.3% by 1.2%. The benchmark return is based on the benchmark asset mix for the Plan. The Plan return overall of 9.5% underperformed the OMERS (Gross) plan return of 11.5% by 2.0%.

Table 1 shows the Plan's one-year (ending December 31 in each year) return for the last five years.

Table 1
Plan's 1 year (ended Dec. 31) Returns

	12 Months Ended Dec. 31/17	12 Months Ended Dec. 31/16	12 Months Ended Dec. 31/15	12 Months Ended Dec. 31/14	12 Months Ended Dec. 31/13
Plan Return	9.5%	9.3%	2.6%	12.0%	13.0%
Benchmark	8.3%	8.0%	4.2%	13.7%	9.7%
Value Added	1.2%	1.3%	-1.6%	-1.7%	3.3%
Market Value	$341.9M	$330.3M	$320.6M	$330.5M	$316.3M
Funded Status	75.2%	68.6%	64.8%	68.4%	71.2%

The Plan's performance may be compared to the return earned in the broader pension market in Canada. Attached as Appendix "B" to Report FCS17088(a), RBC Investor & Treasury Service reports its universe of pension funds, which totals C$650 B and had an average annual return of 9.7% in the year ended December 31, 2017. The Plan's return of 9.5% underperformed the annual return by 0.2%. Fixed income and global equity returns were major contributors to the Plan's overall return.

Table 2 compares the Plan's returns to OMERS fund's gross returns over one, five and ten-year periods, all ending December 31, 2017. The Plan's gross returns are less than OMERS for two periods and higher for the five-year return.

Table 2
Annualized Returns

	Dec.31/17 One-Year Annualized Return	5-Year Annualized Return	10-Year Annualized Return
Plan (HSR, HMRF, HWRF)	9.5%	9.2%	6.0%
Plan Benchmark	8.3%	8.7%	5.9%
OMERS (Gross)	11.5%	8.9%	7.0%
OMERS Benchmark (Gross)	7.3%	N/A	N/A
OMERS Capital Markets	9.5%	N/A	N/A
OMERS Capital Markets Benchmark	N/A	N/A	N/A

The Plan's ten-year gross annualized return for the period ending December 31, 2017 is 6.0%, outperforming the benchmark return of 5.9% by 0.1% and underperforming OMERS return of 7.0% by 1.0%.

The Plan's five-year gross annualized return for the period ending December 31, 2017 is 9.2%, exceeding the benchmark return of 8.7% by 0.5% and outperforming OMERS return of 8.9% by 0.3%.

OMERS return in public market securities (OMERS Capital Markets in Table 2 above) is estimated at 9.5% for the one-year ending December 31, 2017. The Plan's gross return for the period ending December 31, 2017 is 9.5% and equaled OMERS 9.5% estimate. OMERS financial reports no longer separate this return, which was estimated by averaging the fixed income returns of 4.3%for fixed income and 14.7% for equities.

OMERS invests in public market securities (such as public equities and bonds) and in private market investments (such as private equity, real estate, infrastructure and strategic investments). The Plan invests only in public market securities. Private market investments require expertise developed over many years, have limited liquidity, require significant administrative costs and current valuations may or may not be realized.

Asset Mix:
Table 3 shows the percentage of Plan assets in each asset class of December 31, 2017 compared to December 31, 2016.

Table 3
Percentage of Plan Assets in Each Asset Class

Asset Class	Dec.31, 2017	Dec.31, 2016	Change
Canadian Equity	34.4%	32.6%	1.8%
Global Equity	25.8%	23.8%	2.0%
Total Equity	60.2%	56.4%	3.8%
Canadian Fixed Income	39.4%	43.2%	-3.8%
Cash	0.4%	0.5%	

Note: Anomalies due to rounding.

Total equity increased by 3.8% to 60.2% and total fixed income decreased by a corresponding 3.8% to 39.4%. Global equity increased by 2.0% to 25.8%. Canadian equity holdings increased by 1.8% to 34.4%. Canadian fixed income decreased to 39.4%. The year saw equity returns domestically and internationally ranging from 9.3% to 18.1%. The fixed income portfolios incurred marginal returns for the year ranging from 4.2% to 5.3%.

The Master Trust at year-end was not within its prescribed boundaries set by the Plan's investment policy given the funded ratio at 75.2% (60.2% equity and 39.4% fixed income). The fund was rebalanced and the fixed income bond percentage was increased to 42.5% by June 30, 2018.

The Canadian equities held between Guardian and Letko totaled 34.4%, while the global equities totaled 25.8%. Canadian equities were reduced to balance out holdings in equities and fixed income by December 31, 2017.

Managers' Performance:
Managers' investment performance relative to their benchmark and peer group is summarized in Table 4. One-year rates of return, percentages of plan assets and rankings in terms of quartile performance are as of December 31, 2017.

Table 4
Managers' Performance

	Manager Return	Benchmark Return	Value Added (Manager Return less Benchmark Return)	Percentage Total Assets
Period Ending Dec.31/17				
Canadian Equity:				
Guardian	9.9%	9.1%	0.8%	12.9%
Letko	13.8%	9.1%	4.7%	21.5%
Global Equity				
Aberdeen[1]	17.1%	14.4%	2.7%	6.9%
Brandes	9.3%	14.4%	-5.1%	5.2%
GMO[2]	18.1%	14.4%	3.7%	13.7%
Fixed Income:				
TDAM Long Bonds[3]	7.0%	7.0%	0.0%	22.1%
TDAM Real Return Bonds[3]	0.6%	0.7%	-0.1%	17.4%

Notes: *[1] Engaged in April 2010*
[2] Engaged in July 2010
[3] Toronto Dominion Asset Management (TDAM) engaged in March 2012

Guardian, one of the two Canadian active equity managers, had a return of 9.9% and outperformed its benchmark return of 9.1% by 0.8%. Its performance is second quartile (31%) over the one-year and first quartile (23%) over the four-year period, with a benchmark return of 10.6% and an actual return of 13.0%. Guardian manages 12.9% of Plan assets and added value of 0.8%.

Letko, the second Canadian active equity manager, had a return of 13.8% and outperformed its benchmark return of 9.1% by 4.7%. Its performance is first quartile over the one-year period and first quartile over the four-year period (13.8% and 11.2%, respectively). Letko manages 21.5% of Plan assets and added value of 4.7%.

Aberdeen is the first active global equity manager. Its return was 17.1% outperforming the benchmark return of 14.4% by 2.7%. Aberdeen's performance is second quartile (42%) over the one-year period and added value of 2.7%. Aberdeen manages 6.9% of Plan assets. The firm's performance is fourth quartile (93%) over four years.

Brandes, second of the three active global equity managers, had a return of 9.3% and underperformed the benchmark return of 14.4% by 5.1%. Brandes manages 5.2% of Plan assets. It is a deep-value manager with historically volatile returns, typically beating the benchmark by a significant margin in some years which off-sets some significant underperformance in other years. Brandes one-year return was fourth quartile (92%) and the four-year return was fourth quartile (83%) and underperformed by 5.1% for the year and returned 9.3% vs 14.4% (benchmark).

GMO is the third active global equity manager. Its return was 18.1%, outperforming the benchmark return of 14.4% by 3.7%. GMO's performance is second quartile (38%) over the one-year period and added value of 3.7%. GMO manages 13.7% of Plan assets and is fourth quartile (87%) over four years yet returned 10.7% vs 12.7% (benchmark).

TDAM Long Bonds - The active long bond fund manager has 22.1% of the portfolio holdings under management. Performance over one year is a return of 7.0% compared to the benchmark return of 7.0%. This is a third quartile (56%) ranking with no added value. The four-year ranking is third quartile (68%).

TDAM Real Return Bonds – The passively managed fund has 17.4% of the portfolio under management and returned 0.6% over the one-year period compared to the benchmark return of 0.7%. Value added was -0.1%.

In summary, the Plan's gross return of 9.5% underperformed OMERS' gross return of 11.5% by 2.0% and its funding ratio increased to 75.2%. However, OMERS Capital Markets return was 9.5% while the Plan's 9.5% return equaled OMERS comparable return. Through the upcoming year (2018), bonds are expected to be emphasized over equities if interest rates increase and / or the trigger point of 75% remains. Global Equity returns were positive and much higher than their benchmarks, with a range of 9.3% to 18.1% contributing significantly to overall returns. Potential alternatives to one global manager are being reviewed.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" – The City of Hamilton Master Trust Period Ending December 31, 2017

Appendix "B" – Canadian Defined Benefit Pension Plans Gain Further Ground in 2017: RBC Investor & Treasury Services

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