INFORMATION REPORT

TO:	Chair and Members HMRF / HWRF Pension Administration Sub-Committee
COMMITTEE DATE:	December 10, 2019
SUBJECT/REPORT NO:	Master Trust Pension Investment Performance Report as at December 31, 2018 (FCS18091(a)) (City Wide)
WARD(S) AFFECTED:	City Wide
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COUNCIL DIRECTION

Not applicable.

INFORMATION

Attached, as Appendix “A” to Report FCS18091(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 at December 31, 2018. Together, the three pension funds make up the Master Trust, which is referred to as the “Plan” throughout Report FCS18091(a).

As of December 31, 2018, the market value of the assets of the Plan was $311.5 M, a decrease of $30.4 M compared with $341.9 M as at December 31, 2017.

The funded ratio decreased to 73.4% which required no 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. Interest rates rose towards year end and values declined putting the plan’s fixed income holdings back in balance, requiring no re-balance by June 2019.

For the one-year period ending December 31, 2018, the Plan's return was -4.2%, underperforming its benchmark return of -2.6% by 1.6%. The benchmark return is based on the benchmark asset mix for the Plan. The Plan return overall of -4.2% underperformed the OMERS (Gross) plan return of 2.3% by 6.5%.

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. 31/18	12 Months Ended Dec. 31/17	12 Months Ended Dec. 31/16	12 Months Ended Dec. 31/15	12 Months Ended Dec. 31/14
Plan Return	-4.2%	9.5%	9.3%	2.6%	12.0%
Benchmark	-2.6%	8.3%	8.0%	4.2%	13.7%
Value Added	-1.6%	1.2%	1.3%	-1.6%	-1.7%
Market Value	$311.5 M	$341.9 M	$330.3 M	$320.6 M	$330.5 M
Funded Status	73.4%	75.2%	68.6%	64.8%	68.4%

The Plan's performance may be compared to the return earned in the broader pension market in Canada. Attached as Appendix "B" to Report FCS18091(a), RBC Investor & Treasury Service reports its universe of pension funds, which totals C$650 B and had an average annual return of -0.7% in the year ended December 31, 2018. The Plan's return of -4.2% underperformed the annual return by 3.5%. 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, 2018. The Plan's gross returns are less than OMERS for all three periods. This is to be expected due to OMERS strategy of emphasizing private investments and minimizing public securities, which remained stable with generally better returns.

Table 2
Annualized Returns

	Dec.31/18 One-Year Annualized Return	5-Year Annualized Return	10-Year Annualized Return
Plan (HSR, HMRF, HWRF)	-4.2%	5.7%	7.5%
Plan Benchmark	-2.6%	6.4%	7.6%
OMERS (Gross)	2.3%	8.1%	8.0%
OMERS Benchmark (Gross)	7.3%	N/A	N/A
OMERS Capital Markets	-4.6%	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, 2018 is 7.5% underperforming the benchmark return of 7.6% by 0.1% and underperforming OMERS return of 8.0% by 0.5%.

The Plan's five-year gross annualized return for the period ending December 31, 2018 is 5.7% underperforming the benchmark return of 6.4% by 0.7% and underperforming OMERS return of 8.1% by 2.4%.

OMERS return in public market securities (OMERS Capital Markets in Table 2) is -4.6% for the one-year ending December 31, 2018. The Plan's gross return for the period ending December 31, 2018 is -4.2% and bettered OMERS -4.6% estimate. OMERS financial reports no longer separate this return, which was estimated by averaging the fixed income returns of 1.8% for fixed income and -8.3% 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. OMERS gross return included private investments which returned 10.7% and gave OMERS a positive return overall of 2.3%

Asset Mix:

Table 3 shows the percentage of Plan assets in each asset class of December 31, 2018 compared to December 31, 2017.

Table 3
Percentage of Plan Assets in Each Asset Class

Asset Class	Dec.31, 2018	Dec.31, 2017	Change
Canadian Equity	28.3%	34.4%	-6.1%
Global Equity	24.4%	25.8%	-1.4%
Total Equity	52.7%	60.2%	-7.5%
Canadian Fixed Income	46.7%	39.4%	+7.5%
Cash	0.6%	0.4%	

Note: Anomalies due to rounding.

Total equity decreased by 7.5% to 52.7% and total fixed income increased by a corresponding 7.5% to 46.7%. Global equity decreased by 1.4% to 24.4%. Canadian equity holdings decreased by 6.1% to 28.3%. Canadian fixed income increased to 46.7%. The year saw equity returns domestically and internationally ranging from -1.4% to -12.7%. The fixed income portfolios incurred marginal losses for the year ranging from -0.2% to -0.3%.

The Master Trust at year-end was not within its prescribed boundaries set by the Plan's investment policy given the funded ratio at 73.4% (52.7% equity and 46.7% fixed income). The fund was rebalanced and the fixed income bond percentage was increased to 42.5% by June 30, 2018 and 46.7% by December 31, 2018 due to declining stability in world trade and markets.

The Canadian equities held between Guardian and Letko totalled 28.3%, while the global equities totaled 24.4%. Canadian equities were reduced to balance out holdings in equities and fixed income by December 31, 2018.

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, 2018.

Table 4
Managers' Performance

	Manager Return	Benchmark Return	Value Added (Manager Return less Benchmark Return)	Percentage Total Assets
Period Ending Dec.31/18				
Canadian Equity:				
Guardian	-6.3%	-8.9%	2.6%	12.1%
Letko	-12.7%	-8.9%	-3.8%	16.2%
Global Equity				
Aberdeen[1]	-2.8%	-0.6%	-2.2%	4.5%
Brandes	-1.4%	-0.6%	-0.8%	5.6%
GMO[2]	-5.3%	-0.6%	-4.7%	14.3%
Fixed Income:				
TDAM Long Bonds[3]	-0.2%	0.3%	-0.5%	24.2%
TDAM Real Return Bonds[3]	-0.3%	0.0%	-0.3%	22.5%

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 -6.3% and outperformed its benchmark return of -8.9% by 2.6%. Its performance is first quartile (13.0%) over the one-year and first quartile (22%) over the four-year period, with a benchmark return of 2.5% and an actual return of 4.0%. Guardian manages 12.1% of Plan assets and added value of 1.5% over four years.

Letko, the second Canadian active equity manager, had a return of -12.7% and underperformed its benchmark return of -8.9% by 3.8%. Its performance is fourth quartile (92%) over the one-year period and first quartile over the four-year period (4.6% and 2.5%, respectively). Letko manages 16.2% of Plan assets and added value of 2.1% over four years.

Aberdeen is the first active global equity manager. Its return was -2.8% underperforming the benchmark return of -0.6% by 2.2%. Aberdeen's performance is third quartile (63%) over the one-year period and added value of -2.2%. Aberdeen manages 4.5% of Plan assets. The firm's performance is fourth quartile (94%) over four years, underperforming the benchmark of 8.8% by -2.8%, with a return of 6.0%.

Brandes, second of the three active global equity managers, had a return of -1.4% and underperformed the benchmark return of -0.6% by 0.8%. Brandes manages 5.6% 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 third quartile (51%) and the four-year return was fourth quartile (84%) and underperformed by -1.8% for the 4 years and returned 7.0% vs 8.8% (benchmark).

GMO is the third active global equity manager. Its return was -5.3%, underperforming the benchmark return of -0.6% by -4.7%. GMO's performance is third quartile (80%) over the one-year period and added value of -4.7%. GMO manages 14.3% of Plan assets and is fourth quartile (82%) over four years yet returned 7.1% vs 8.8% (benchmark).

TDAM Long Bonds - The active long bond fund manager has 24.2% of the portfolio holdings under management. Performance over one year is a return of -0.2% compared to the benchmark return of 0.3%. This is a third quartile (91%) ranking with an added value of -0.5%.

TDAM Real Return Bonds – The passively managed fund has 22.5% of the portfolio under management and returned -0.3% over the one-year period compared to the benchmark return of 0%. Value added was -0.3%.

In summary, the Plan's gross return of -4.2% underperformed OMERS' gross return of 2.3% by 6.5% and its funding ratio decreased to 73.4% from last year's 75.2%. However, OMERS Capital Markets return was -4.6% while the Plan's -4.2% return outperformed OMERS comparable return. Through the upcoming year (2019), bonds are expected to be emphasized over equities if interest rates increase and / or the trigger point of 75% remains. Global Equity returns were negative and close to their benchmarks, with a range of -1.4% to -5.3% contributing to marginally to overall negative returns. Canadian equities contributed to significantly negative returns with returns ranging from -6.3% to -12.7%.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to Report FCS18091(a) – The City of Hamilton Master Trust Period Ending December 31, 2018 – AON Release

Appendix "B" to Report FCS18091(a) – Canadian Pension Returns Retreat in 2018: RBC Investor & Treasury Services Release

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