Hamilton

INFORMATION REPORT

TO: Chair and Members Audit, Finance and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: October 8, 2013	
SUBJECT/REPORT NO: Hamilton Future Fund Investment Performance Report - June 30, 2013 (FCS13064) (City Wide)	
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SIGNATURE:	

Council Direction:

Not Applicable.

Information:

The City of Hamilton Future Fund portfolio of investments had an earnings rate of **3.47%** for the 12 months ending June 30, 2013 and an average earnings rate of **4.38%** over the past five years. Bond lending revenues of **$4,992** are included in the earnings rate of **3.47%**. The earnings rate includes interest and lending revenues, but excludes realized and unrealized capital gains/losses.

The City of Hamilton Future Fund's portfolio generated approximately **$2.40** million in bond interest, net realized capital gains and lending revenue over the last 12 months ending June 30, 2013. The total return of **$2.40** million was realized on an investment at an average cost of **$70,703,048**. The percentage return on investment cost over this period was **3.39**%. Interest, net realized capital gains/losses and lending income over the last five years have averaged approximately **$3.3** million annually. The duration of the portfolio of investments was **5.05** years as of June 30, 2013 compared to **6.55** years as of December 31, 2012. As at June 30, 2013, the market value of the portfolio was

$70,974,421; net unrealized capital gains totalled **$287,128;** and a net capital loss of **$120,000** was realized over the past 12 months.

For the 12 months ending June 30, 2013, the overall return (which includes interest, bond lending revenue, realized and unrealized capital gains/losses) was **0.51%,** outperforming the benchmark return of **0.25%** by **26** basis points. Over the past five years, the overall return has averaged **3.12%** per annum, outperforming the average benchmark return over the same five-year period of **2.64%** by **48** basis points. The outperformance of the Hydro fund relative to the benchmark is attributed mostly to its longer duration and its holdings in Schedule I Canadian Bank Deposit Note and Provincial bonds, primarily in the five and ten year terms.

The overall returns for the One Fund (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers Association) for the year ended June 30, 2013 were **0.80%** for bonds and **0.98%** 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 **0.82%** or **31** basis points more than the actual return of **0.51%**. Using an average portfolio market value of **$72,779,026** for the past 12 months, a decrease of **0.31%** in overall return translates into a revenue decrease of approximately **$225,615**. The One Funds outperformance was due to its criteria of investing only in short-term bonds, which were less affected when rates increased substantially in May and June of 2013.

The following Table 1 summarizes the investment return indicators.

Table 1

Investment Return Indicators (for information purposes only)

	12 Months ended 06/30/2013	**12 Months ended 12/31/2012**	**12 Months ended 12/31/2011**	**12 Months ended 12/31/2010**	**12 Months ended 12/31/2009**
Policy Target	0.25%	1.56%	5.76%	3.89%	1.72%
Hamilton Future Fund Portfolio	**0.51%**	**2.16%**	**4.33%**	**3.91%**	**4.69%**
The One Fund – Bonds	0.80%	1.55%	4.19%	3.00%	3.35%
The One Fund – Money Mkt.	0.98%	1.04%	1.19%	0.65%	0.75%
DEX - Short Government	0.75%	1.17%	4.62%	3.29%	1.94%
DEX – Mid Governments	-0.71%	3.45%	10.20%	6.51%	1.57%
Lending Revenue	$4,992	$2,318	$6,697	$4,046	$8,524
Earnings Rate (Excludes Capital Gains/Losses)	**3.47%**	**4.16%**	**4.72%**	**4.57%**	**5.00%**

A portion of the Hamilton Future Fund has been purposely invested in some shorter-term maturities due to the upcoming need to finance Pan Am and West Harbour lands spending requirements.

Table 2 below summarizes the changes in Canadian interest rates over the past 18 months.

Table 2

CANADIAN INTEREST RATES			
Canada Benchmark Bond	**Interest Rate June 30, 2013**	**Interest Rate January 2, 2013**	**Interest Rate January 3, 2012**
One Month (T-Bill)	1.01%	0.91%	0.90%
2 year	1.22%	1.17%	0.98%
5 year	1.80%	1.43%	1.31%
10 year	2.44%	1.87%	1.99%

Over the six month period ending June 28, 2013, Canadian bond yields generally declined until May 2 after which they reversed course and climbed sharply, ending the first half with the benchmark 10-year Government of Canada bond yield up 0.6% compared with the beginning of the year. As at June 28, 2013, credit spreads for Provincial bonds, Canadian Schedule I Bank Deposit Notes and Canada Housing Agency bonds, relative to Government of Canada bonds, were generally wider compared with the beginning of the year. Commodities declined by 7% and gold by 27% whereas crude oil rose by 2%. The Canadian dollar relative to the U.S. Dollar depreciated by about 6 cents closing at 95.06 versus 1.0154 at the beginning of the year, mostly a result of slower global growth in the first half of 2013 - primarily the U.S. and with China tracking GDP growth below 8% - which dampened demand for commodities.

During the second quarter, the outlook for U.S. economic growth for the second half of 2013 and for 2014 improved as labour markets showed stability and as private demand strengthened. With this backdrop, the Federal Reserve on May 22 opened the door to the possibility of tapering its bond purchase program (known as quantitative easing) over the next few policy meetings but still maintained its stance for a zero-interest-rate policy. This caused U.S. bond yields, and concurrently Canadian bond yields, to rise. The Bank of Canada kept the policy interest rate at 1% throughout the first half of 2013 and at its most recent policy meeting on July 17, 2013.

The Bank of Canada’s latest forecast for Canadian economic growth is 1.8% for 2013 and 2.7% for 2014. In its July World Economic Outlook, the International Monetary Fund (IMF) revised downward by 0.2% its global growth forecast for 2013 to 3.1% and for 2014 to 3.8%, noting risks to growth from the emerging markets which are underperforming relative to expectations. However, the IMF forecasts growth in the U.S. to rise from 1.7% in 2013 to 2.7% in 2014.

A key downside risk in the bond market for the second half of 2013 is whether the Federal Reserve reduces its bond purchase program and, if so, the rate of the reduction. This risk is linked to the risk of stronger than expected growth in the U.S. in 2013 to 2014 with uncontained inflation expectations. However, slower than expected growth accompanied by deflation would likely cause bond yields to decline.