TO:	**INVESTMENT BOARD**
SUBJECT:	**2022 INVESTMENT MANAGEMENT ANNUAL REPORT**
PREPARED BY AND KEY CONTACT:	**T. RAYAISSE, PORTFOLIO MANAGER, EXT. 4724** **J. BAYLEY, INVESTMENT ANALYST, EXT. 4423**
SUBMITTED BY:	**C. MILLAR, CHIEF FINANCIAL OFFICER, EXT. 5130**

RECOMMENDED MOTION

1. That the Report to the Investment Board dated February 27, 2023 concerning the 2022 Investment Management Annual Report, and approved by the Investment Board on February 27, 2023, be received for information.

PURPOSE & BACKGROUND

2. The purpose of this Report is to discuss the 2022 performance of the investment portfolio, as required by Ontario Regulation 43/18 (as amended) of the *Municipal Act*, *2001.*

3. Ontario Regulation 43/18 (Eligible Investments and Related Financial Agreements) of the *Municipal Act, 2001* requires certain disclosures to Council as outlined in Appendix “A” to this Report including a statement from the Treasurer indicating if all investments are consistent with the City’s Investment Policy and Investment Plan.

4. On June 3, 2019, City Council passed By-law 2019-047, adopting the Prudent Investor Standard in accordance with Section 418.1 of the *Municipal Act, 2001,* and approved the establishment of an Investment Board. The Investment Board is responsible for control and management of the City’s investments pursuant to the Prudent Investment Standard and the Investment Policy Statement adopted by City Council.

5. On January 13, 2020, City Council approved motion 20-G-001 appointing four (4) citizen representatives to the Investment Board in accordance with the terms of reference as authorized. Membership is comprised of the City’s Treasurer and the four (4) citizen members. Members are appointed for a term to expire on November 14, 2022, or until a successor board is appointed or unless otherwise provided by a resolution of City Council.

6. Following Council’s adoption of motion 20-G-091 regarding the Investment Policy Statement on June 15, 2020, the Investment Board met on November 18, 2020 and adopted an Investment Plan to achieve the objectives set out in the Investment Policy. The Investment Plan deals with how money is to be invested and sets out the asset allocation ranges.

7. As per Ontario Regulation 43/18, the Investment Board should submit an annual report to the Finance and Responsible Governance Committee about the performance of the City's investment portfolio.

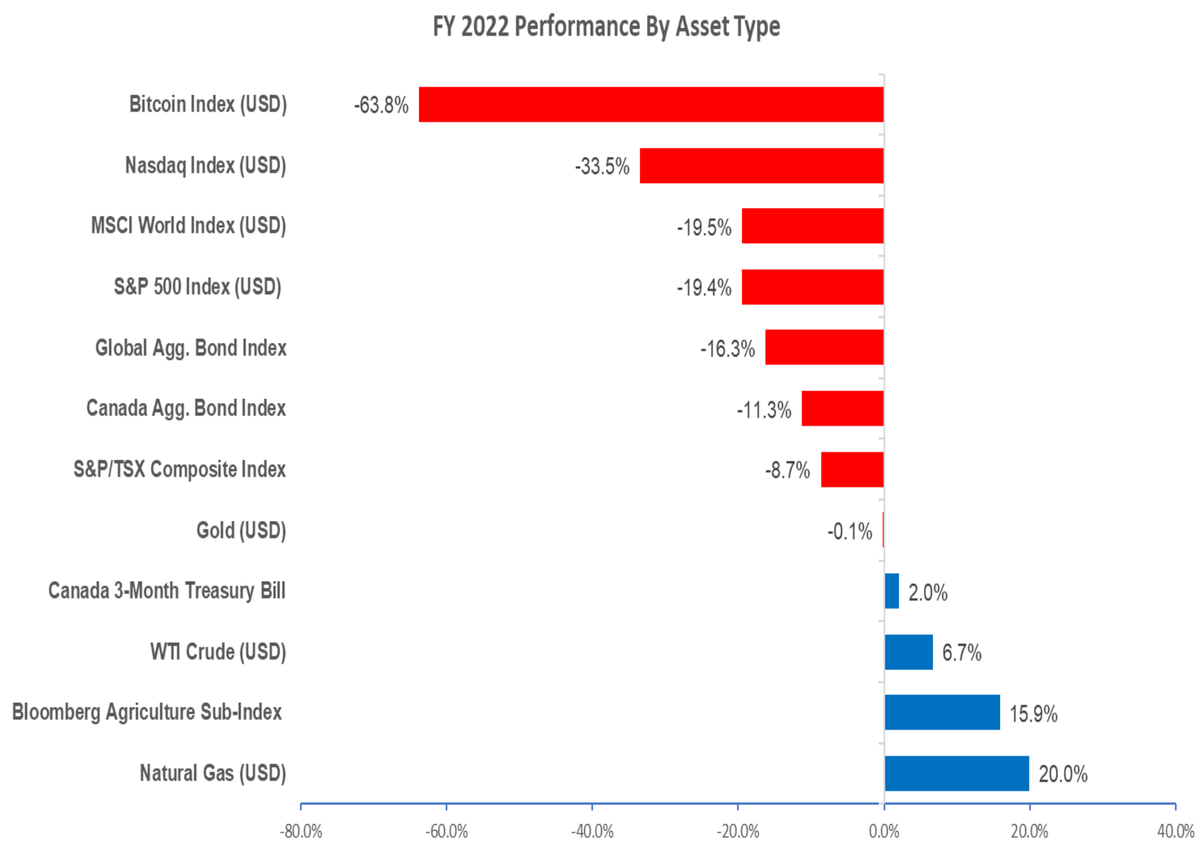
8. On March 30, 2022, the Investment Board adopted the Chartered Financial Analyst (CFA) Institute’s environmental, social and governance (ESG) Framework for incorporating ESG factors into the portfolio management process.

ANALYSIS

Market commentary:

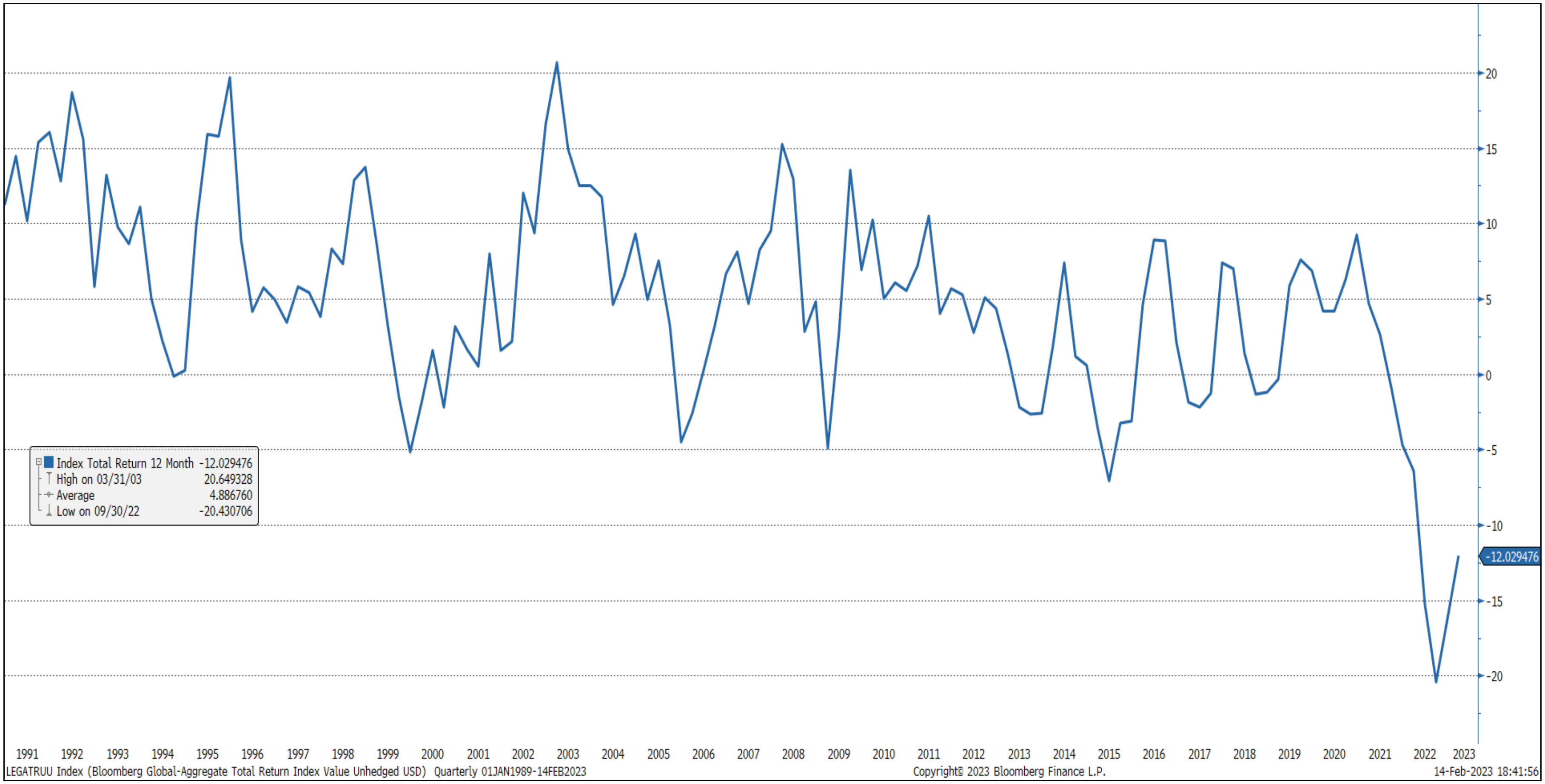
9. **Another year for the history books!** In 2022, global markets experienced multi-decade high inflation due to lingering supply chain bottlenecks, pent-up demand from the COVID-19 pandemic, record low interest rates, and the Russian invasion of Ukraine. In contrast, in 2021, inflation was rising due to increased demand, leading Central Banks to believe it was only temporary and kept interest rates low to support economic recovery.

10. **From "transitory" to "entrenched":** Then in Q1 2022, Central Banks swiftly changed this view and began sounding the alarm bells on the risks of inflation becoming entrenched. The Bank of Canada (BoC) and the US Federal Reserve (Fed) embarked on what would be the largest, and swiftest interest rate hiking cycle in modern history. The BoC ratcheted up interest rates from 0.25% on March 3rd, 2022, to 4.50% by January 25th 2023, an increase of 425 basis points in 10 months. The Fed followed suit with an increase of 425 basis points over the same period. This caused most asset classes with some exceptions to record heavy losses leaving few areas for investors to hide. Cash, energy, and agricultural commodities were the best performers and ended the year in positive territory. The Chart below shows the best and worst performers of 2022 by asset type.

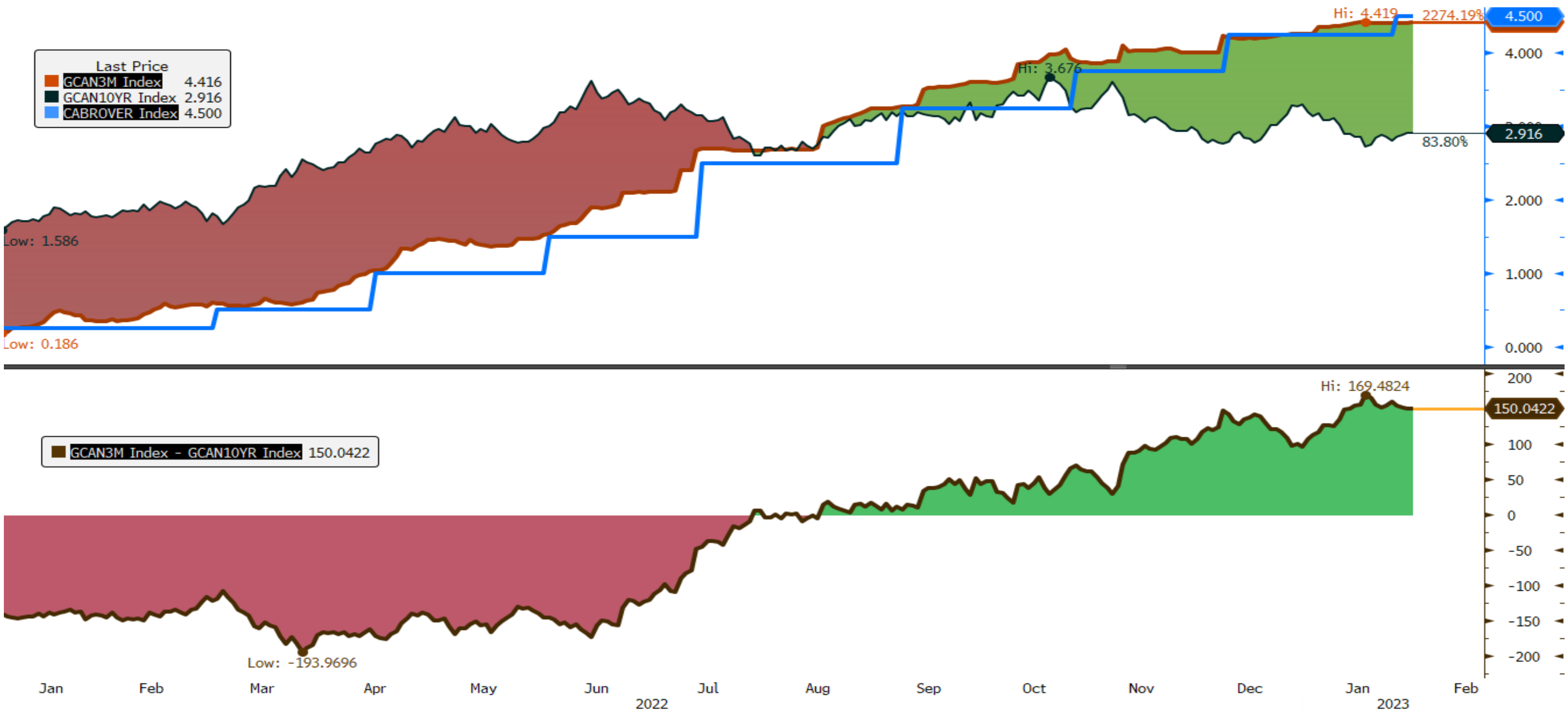


Source: Bloomberg. Returns are in CAD unless indicated otherwise.

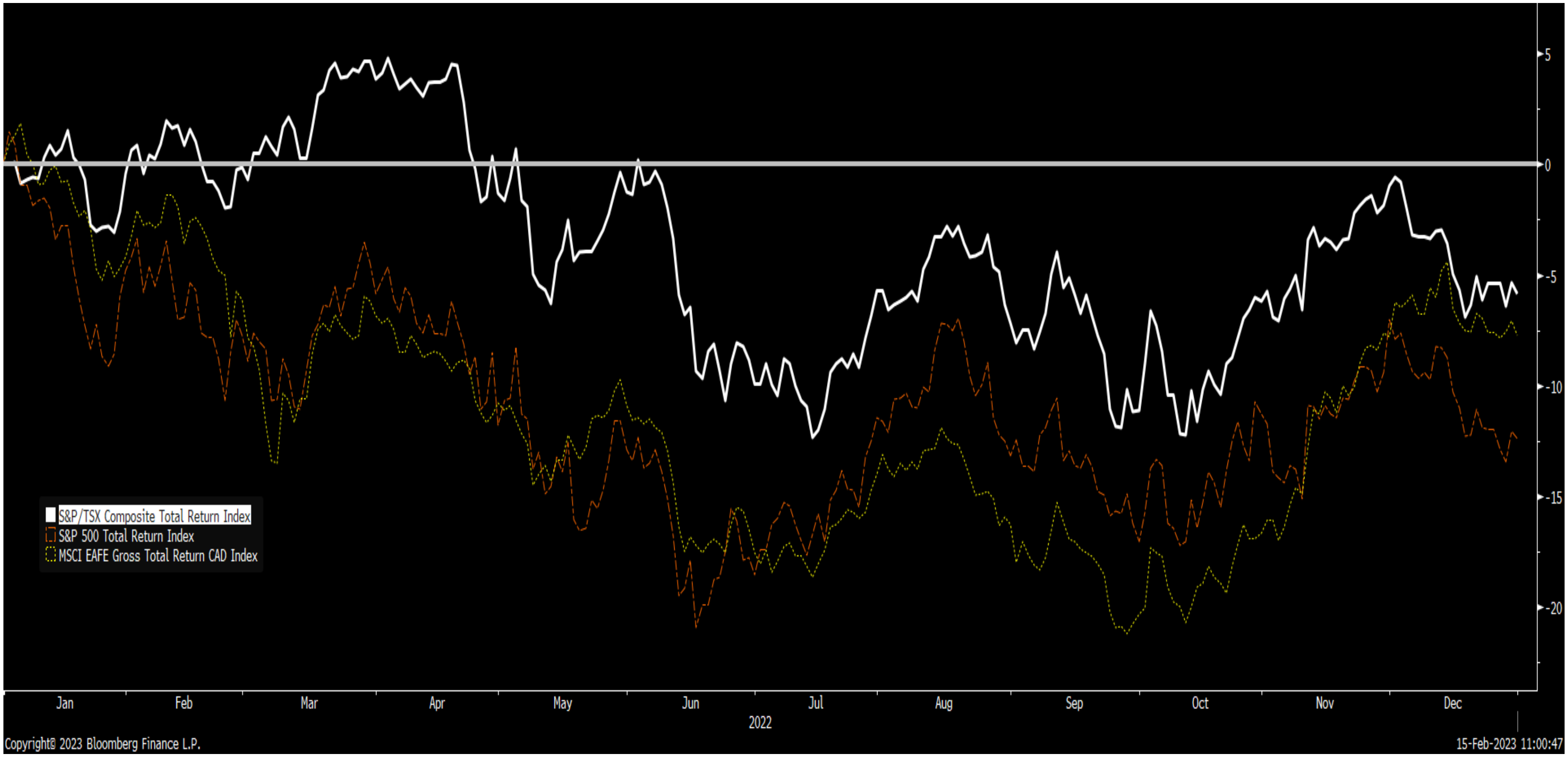
11. **Worst year on record for Bonds.** With the unprecedented rise in interest rates, bonds had their worst record in recent history. Returns were mostly in the negative double digits, and bonds failed to act as an effective diversifier for balanced portfolios. The Bloomberg Global Aggregate Bond Index lost 16.3%, the worst performance in more than 30 years as shown on the chart below, and the Bloomberg Canada Aggregate Bond Index fell 11.27%. Bonds with longer maturities were among the worst performers, with the Bloomberg Canada Aggregate 10Y+ Bond Index falling -21.37%.



12. **Cash and short duration strategies outperformed**. The charts below show the magnitude of the yield curve inversion driven by the increases to the BoC policy rate (blue line on the top chart below). The chart shows the spread between the 10Yr Canada Bond and the 3-month T-Bill reaching a record high of 147 basis point in 2022 (and 169 in January 2023), meanwhile the 10Yr/2Yr spread peaked at 101 basis point in December. In the bottom part of the chart the areas shaded in green show the extent of the yield curve inversion. These charts also show the very difficult starting point for yields with very few options to be invested with a 2% yield or higher leading into 2022 and ending the year with yields north of 4%. This afforded cash and short duration strategies to outperform.



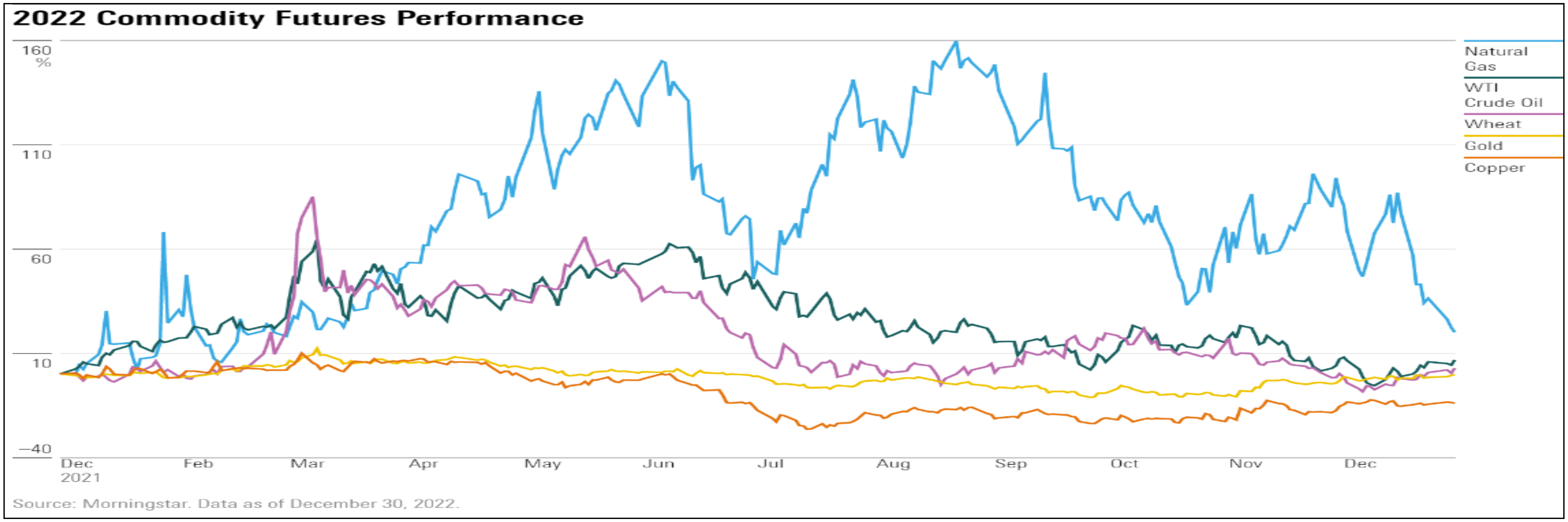
13. **Volatile year for stocks:** Equity markets generally perform well in moderately inflationary environments where companies can reasonably pass-through higher costs to consumers, however this was not the case for 2022 as higher uncertainty, record high inflation, and worries of a recession were generally bad for market sentiment – resulting in investors being net sellers of stocks. The relatively heavier energy and materials exposure of the S&P/TSX Composite Index resulted in it outperforming many of its global peers, with a total return of -5.75%; compared to the S&P 500 Index (CAD) and MSCI EAFE Index (CAD) which were -12.42% and -7.92% respectively.



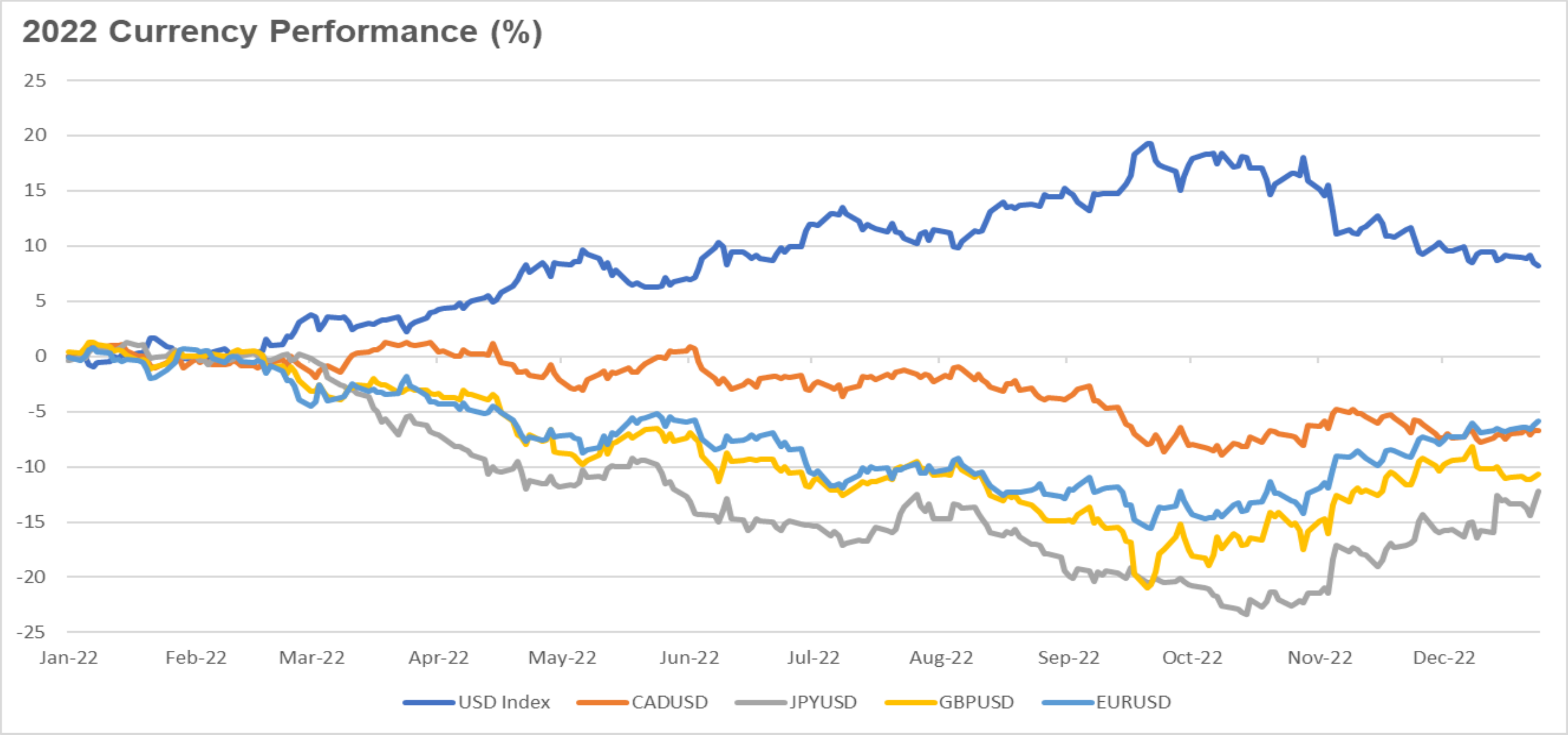
Source: Bloomberg. Returns are Total Return in Canadian dollars.

14. Energy stocks were the best performing sector (+56% YoY) as OPEC production cuts and Russia's attack on Ukraine sent oil prices over $120 per barrel early into 2022. Technology stocks which had been the best performers for the past decade ended the year 30% lower with all the "Big Tech" names lower year over yeaer - Tesla (-65%), Apple (-29%), Microsoft (-28%), Alphabet (-39%), Amazon (-51%). Growth stocks (-30.6%) significantly underperformed Value stocks (-7.8%) as recession fears weighed and caused investors to rotate out of cyclically sensitive sectors and to overweight more defensive, higher dividend paying sectors like Energy, Utilities, Consumer Staples, Materials, and Healthcare. Despite some impressive rallies off the 2022 lows (June 16th and October 12th), stocks failed to break-out of the downtrend – a classic feature of bear markets where rallies off the lows are typically met with selling as investors reposition their exposures. The CBOE Volatility Index (VIX) or fear gauge as it is more commonly known averaged a level of 26, peaking several times in the mid-30's throughout the year. Traditionally, a level above 20 is broadly considered as indication of negative market sentiment.

15. **Soaring Commodity prices:** Commodity prices were mostly higher as would be expected with higher headline and core inflation. Natural gas traded 20% higher to levels not seen since 2008, as Russia threatened to cut off Europe's supply in winter months in retaliation to sanctions. Crude oil initially rallied 65% to its peak on March 8th before retreating to $80 per barrel or 7% on the year. Gold's performance was largely disappointing with weak performance of -0.1%, providing some safety versus financial assets but failing to act as an inflationary hedge as the return fell short of the 6.3% annualized inflation rate. Copper (typically a bell-weather for the global economy) declined nearly 15%. With persistently high inflation it was also not a surprise that most agricultural commodities rallied with both Wheat and Corn futures gaining +3% and +14% respectively. Agricultural commodities were buoyed by fears of a significant drop in output from Ukraine (which is known as the breadbasket of Europe).



16. **US Dollar flight-to-safety**: The USD which is generally a counter-cyclical currency, meaning it generally outperforms during periods of significant market stress and/or uncertainty as investors prefer to hold the relative safety of dollars versus other currencies. As a result, the USD outperformed its major peers such seen in the chart below with the CAD, Euro, Yen, and Sterling. The USD traded above CAD $1.30 in Q2 and continued its run to CAD$1.39 in mid-October where it peaked. With sentiment improving somewhat in Q4 and with risk assets rallying off their 2022 lows, the BoC was widely seen as closer to the end of their hiking cycle and close to a “policy pivot” given inflation was decelerating, the USD safety trade began to unwind, closing the year higher but off the peak at CAD$1.35 (USD 74 cents). The stronger USD provided a currency tailwind of approximately 8% to Canadian investors in USD denominated assets.

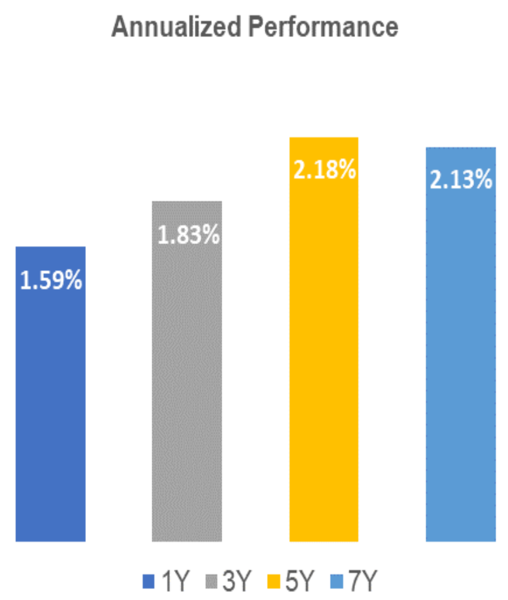


Portfolio Commentary:

17. The City's portfolio is comprised of three funds – the Operating Fund, the Capital Fund and the Growth Fund. Collectively the portfolio achieved a FY 2022 total return of +1.59% or $6.17 million on an average portfolio value of $389 million.

18. The portfolio's benchmark return was -6.11% and compared to the investment portfolio this represented an outperformance of +769 basis points despite the macro-economic environment. The benchmark is comprised of 15% S&P Canada 3-month Treasury Bill Total Return Index; 65% Canada Aggregate 1-10 Year Bond Total Return Index; 10% S&P/TSX Composite Total Return Index; and 10% S&P 500 Index (CAD) Unhedged Total Return.

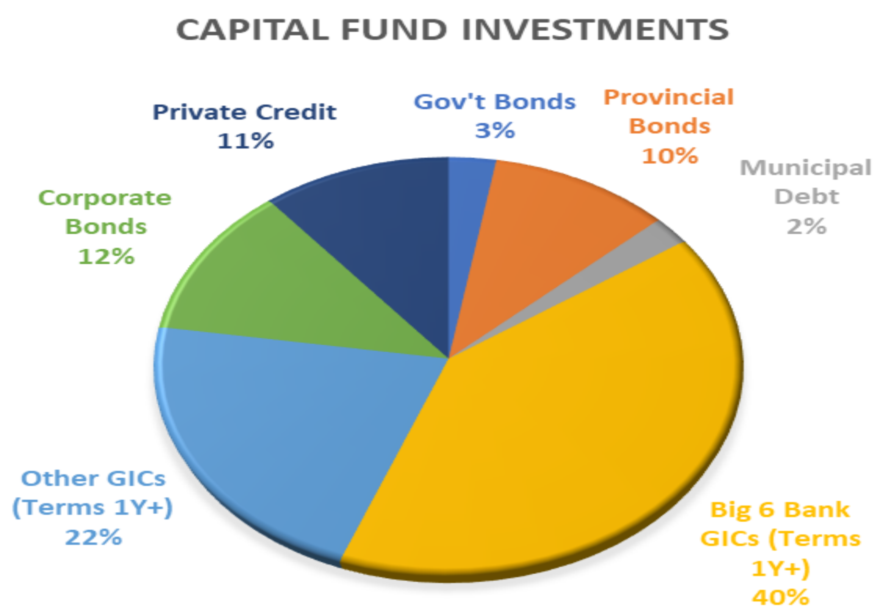
19. The adoption of the Prudent Investor Standard incorporated a broader fixed income selection across credits and durations as well as the introduction of equities. Performance is appropriately gauged over a longer time periods (a market cycle of 5-10 years) rather than year over year. The charts below show periodic and cumulative returns since 2016.



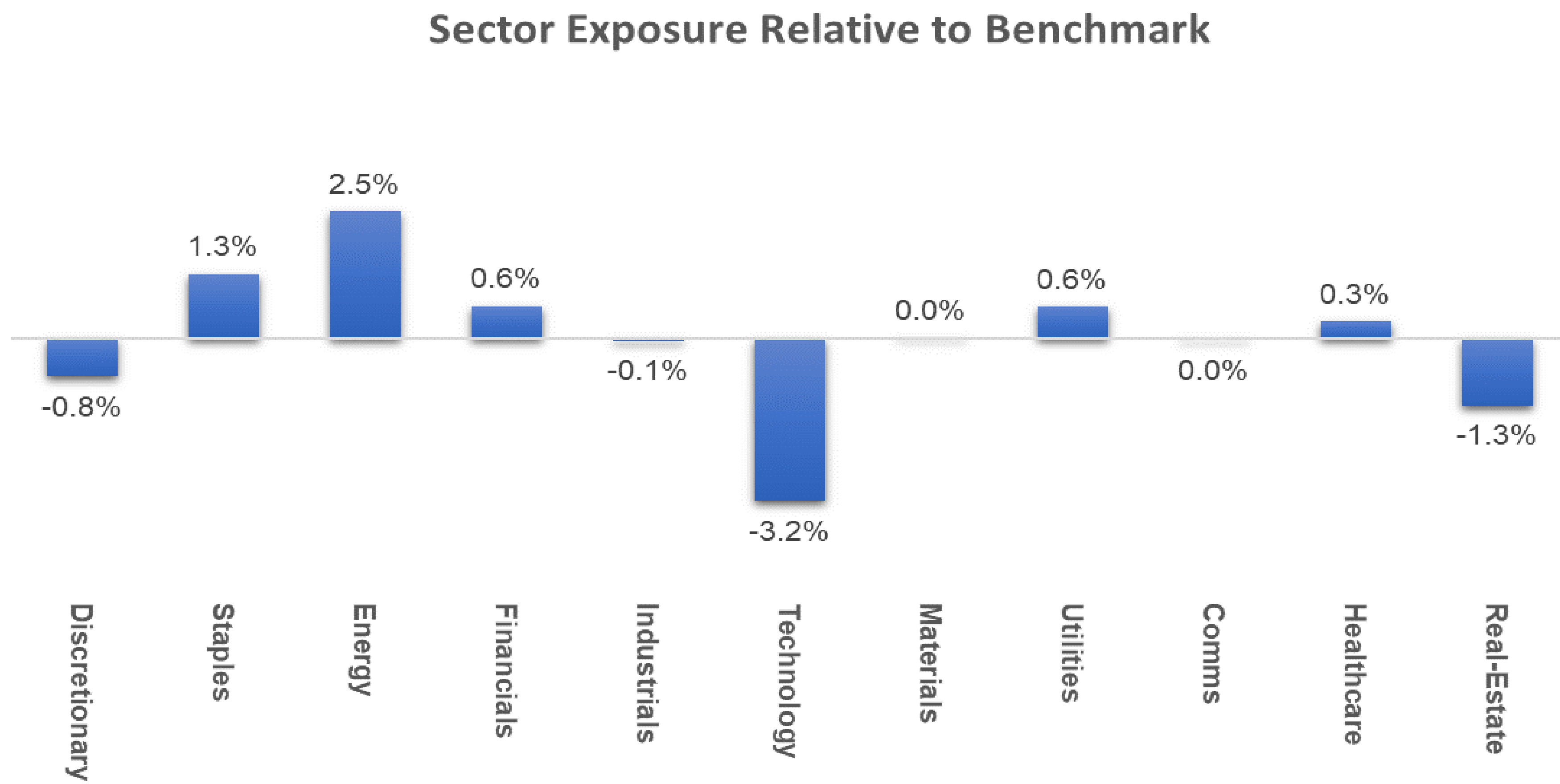
Disclaimer: Past performance is not reflective of future return expectations.

20. The **Operating Fund:** The purpose of this portfolio is to meet the liquidity requirements of the City and consists of cash and high quality short-term securities. The Operating fund returned 2.32% on a weighted average balance of $251 million, 28 basis points higher than the Canada 3-month Treasury Bill Index's return of 2.04%. This outperformance was due to an increase in short-term rates. Rising interest rates and the inversion of the yield curve caused the portfolio to take a more tactical and defensive positioning, leading to higher than forecasted assets in the operating fund. With rates now above pre-financial crisis levels and equity markets near pre-Covid levels, the portfolio is well positioned to deploy funds to both fixed income and equity markets.

21. The **Capital Fund**: The purpose of this portfolio is to match the City's cash requirements for capital projects under way or slated to be completed within the ensuing five years. The fund consists of fixed income instruments such as Government and Investment-Grade Corporate bonds, Guaranteed Investment Certificates, and the Alectra Promissory Note (Private Credit). The fund returned 0.86% on a weighted average balance of $127 million. Compared to the Canada Aggregate 1–10 Year Bond Index benchmark return of -6.26%, the Capital fund outperformed by +712 basis points due to its higher average yield (4.7% vs. 3.8%), shorter duration (2.6 vs 4.1), and higher average coupon (4.7% vs. 2.4%). The GIC portion of the portfolio was laddered and diversified amongst the largest and highest quality Canadian banks and credit unions. This portion of the Capital fund had a weighted average yield of 4.90% and a term to maturity of 1.6 years. The Alectra promissory note contributed 23 basis points to total portfolio return.



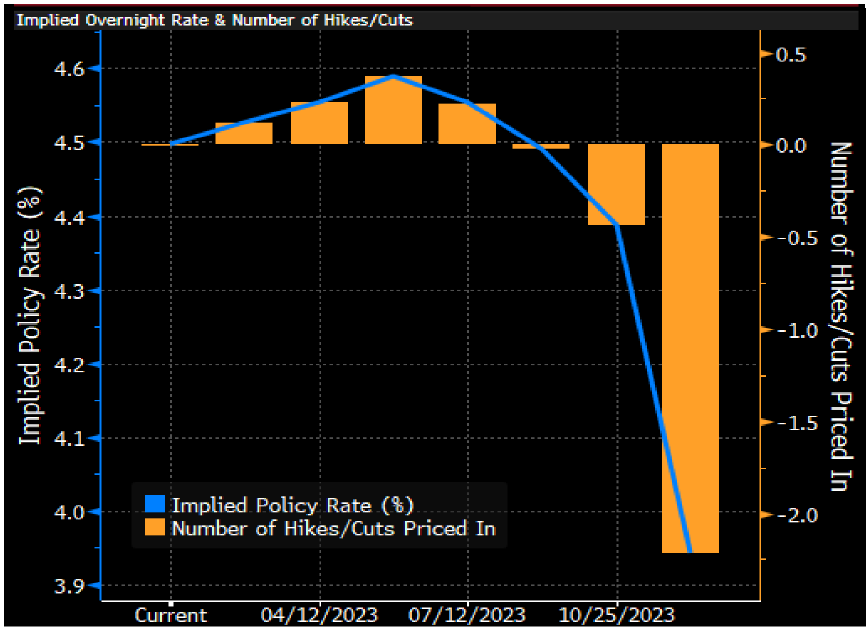
22. The **Growth Fund**: The purpose of this portfolio is to meet longer term growth requirements of the City with the objectives for long term capital appreciation. The fund is invested in Canadian and US equities. The fund achieved a total return of -7.57% on a weighted average balance of $10 million, outperforming its benchmark return of -11.71% by +414 basis points. This was driven by its overweighting of defensive sectors, dollar cost averaging, and the stronger US dollar. As shown in the chart below, the fund had a higher allocation to the consumer staples, utilities, and energy sectors, which did well last year. Meanwhile, the fund had a smaller allocation, compared to the benchmark, to the technology and real estate sectors, which underperformed.

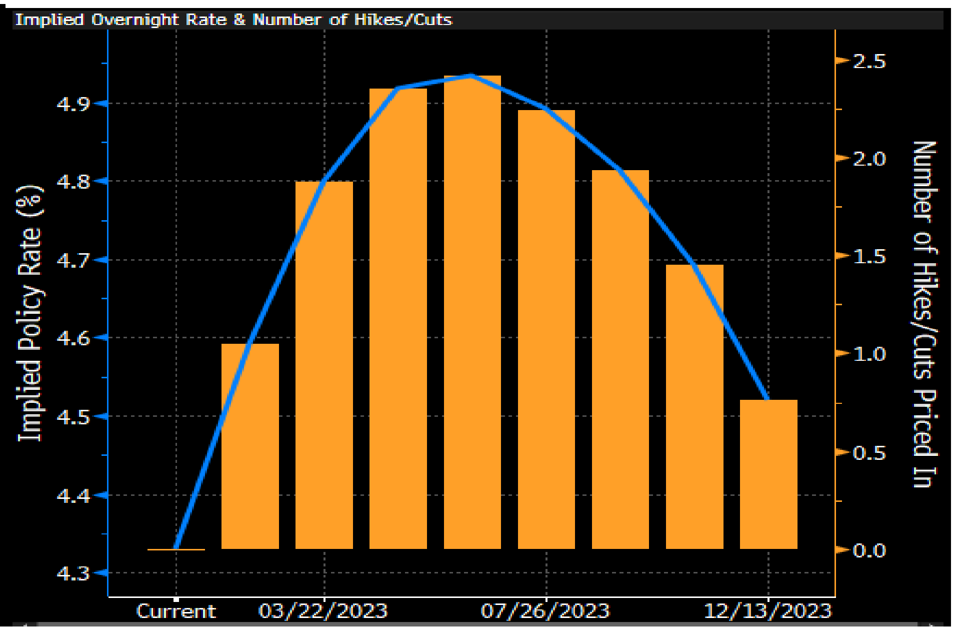


Market Outlook

23. The Canadian labour market has remained strong, with the unemployment rate hovering around 5.6% since the start of 2022. Even with the projected uptick in layoffs, expectations are for the unemployment rate to remain relatively low in the near-term. In addition, wage growth has been robust and is expected to continue to increase as employers remain in competition for talent and the job market remains tight. This wage growth has helped to offset some of the household budgetary pressures, however the overall outlook for the economy remains uncertain and the Bank of Canada is likely to remain data dependent as we move into 2023.

24. The yield curve inversion suggests a probability of a mild recession within the next 12 months; however, expectations are for a relatively swift recovery in equities and a more gradual recovery in bonds barring any exogenous shocks to the system. As at the time of the writing of this report, the Bank of Canada is expected to begin easing policy by December 2023 (as shown on the bottom left chart) and the US Federal Reserve is expected to hike an additional 50 basis points in 2023, followed by a pause at a rate of 5.0% (as shown on the bottom right chart).





Source: Bloomberg

APPENDIX “A”

Regulatory Disclosures

i) Performance

The Corporation of the City of Barrie earned a total return of 1.59% in 2022, 769 basis points higher than the benchmark return of -6.11%. Despite the difficult year for the markets, the City’s portfolio performed well and year over year was able to mitigate some of the downside risk. Returns were 2 basis points lower compared to last year.

ii) Statement of Treasurer regarding Compliance with Investment Policy

I, Craig Millar, Chief Financial Officer and Treasurer of the City of Barrie, hereby state that in my opinion, all investments are consistent with the City’s investment policy and investment plan.

C. Millar, MBA, CPA, CGA
Chief Financial Officer and Treasurer