TO:	**INVESTMENT BOARD**
SUBJECT:	**2023 INVESTMENT MANAGEMENT ANNUAL REPORT**
PREPARED BY AND KEY CONTACT:	**T. RAYAISSE, PORTFOLIO MANAGER (X4724)** **J. BAYLEY, INVESTMENT ANALYST (X4423)**
SUBMITTED BY:	**C. MILLAR, CHIEF FINANCIAL OFFICER (X5130)**

RECOMMENDED MOTION

1. That the Report to the Investment Board concerning the 2023 Investment Management Annual Report, and approved by the Investment Board on February 21, 2024, be received for information.

PURPOSE & BACKGROUND

2. The purpose of this report is to discuss the performance of the investment portfolio in 2023, 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” 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 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 citizen members. Members are appointed for a maximum of two (2) four (4) year terms. A successor board can be appointed or 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 Council about the performance of the City's investment portfolio.

8. On March 30, 2022, the Investment Board adopted the CFA Institutes environmental, social and governance (ESG) Framework for incorporating ESG factors into the portfolio management process.

ANALYSIS

Market Commentary:

9. Against the macroeconomic backdrop of high inflation and high interest rates, and considering the portfolio's investment objectives of liquidity, capital preservation and income stability, the portfolio remained defensively invested in a well diversified basket of high yield, high quality securities. The portfolio invested in longer term bonds locking in higher yields for longer periods as interest rates appeared to peak in the summer. Canadian bonds gained 6.5%, meanwhile equities performed better than expected with the S&P/TSX Composite showing a strong comeback with an 11.7% total return and the S&P 500 posting an impressive 22.9% total return (in Canadian dollar terms). The S&P 500 return was not broad-based, but rather fueled by impressive gains from the so called "Magnificent Seven" stocks. For a more detailed market commentary, refer to Appendix B.

Portfolio Commentary

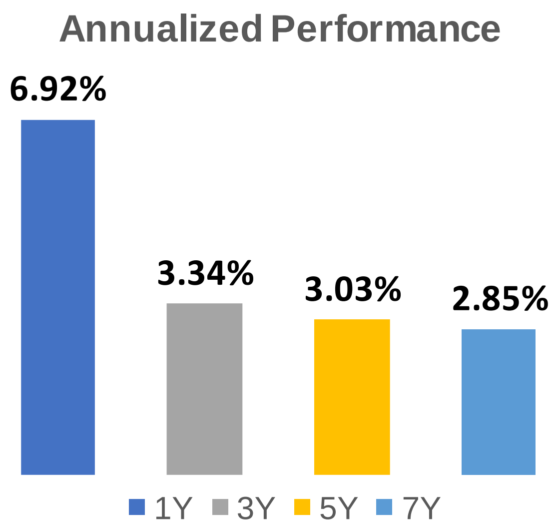
10. The City's portfolio, composed of operating cash and the Prudent Investor portfolio, achieved a total return of 6.92% versus a benchmark return of 6.59%, which represents an outperformance of 0.33%. The benchmark serves as a reference point for evaluating the portfolio's performance. It is a predetermined mix of different asset classes, representing various types of investments. The asset mix reflects the City's investment objectives, considering the City's need for liquidity, capital preservation, and income. Derived from historical data, the asset mix aims to incur the least amount of risk while achieving an acceptable rate of return. The Prudent Investor portfolio benchmark is composed of:

- 20% Equity (Growth Fund): 10% S&P/TSX Composite Index (representing Canadian stocks) and 10% S&P 500 Index CAD (representing US stocks). Equities have the potential for higher returns but come with more volatility.
- 65% Bonds (Capital Fund): Canada Aggregate 1-10 Year Bond Total Return Index. Bonds are generally considered less risky than stocks and provide income stability.
- 15% Cash (Operating Fund): Canada 3-month Treasury Bill Total Return Index. This portion represents liquid assets, providing stability to the portfolio.

The Investment Board reviews and monitors the asset mix for ongoing refinement of the asset allocation strategy, which fosters a dynamic and resilient investment approach tailored to meet the City's long-term financial goals.

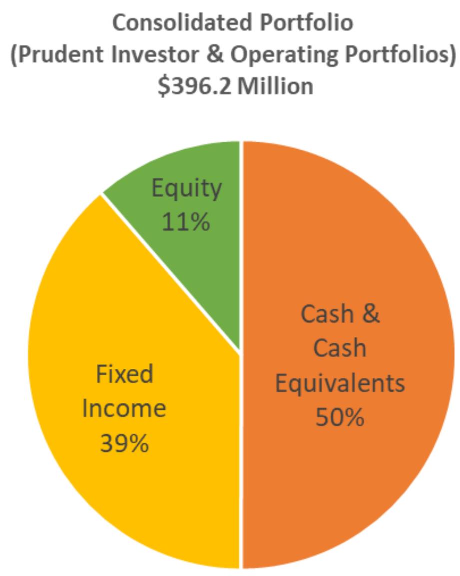
11. The portfolio earned a total return of $27.41 million on an average portfolio value of $396.2 million. Of the $27.41 million return, $20.13 million was realized and $7.28 million was unrealized. The returns will be allocated to reserves based on the reserve average weighting in 2023. A detailed analysis of the reserves and the return allocated to them will be provided in the year-end report which will go to General Committee in April 2024.

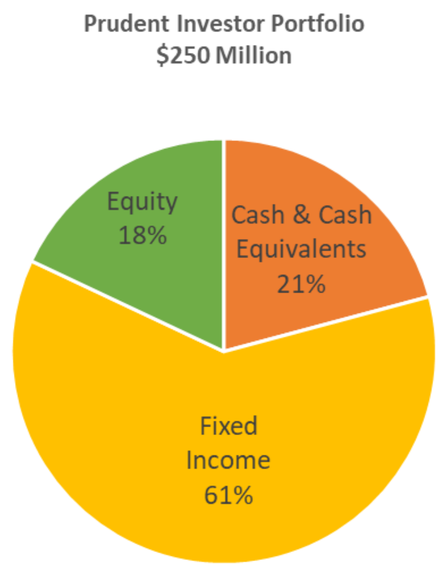
12. The adoption of the Prudent Investor Standard incorporated a broader fixed income selection across credits and durations as well as the introduction of domestic and foreign equities. Performance is appropriately gauged over a longer time horizon (a general market cycle of 5-10 years) rather than year over year. The chart below shows the historical annualized performance of the portfolio.



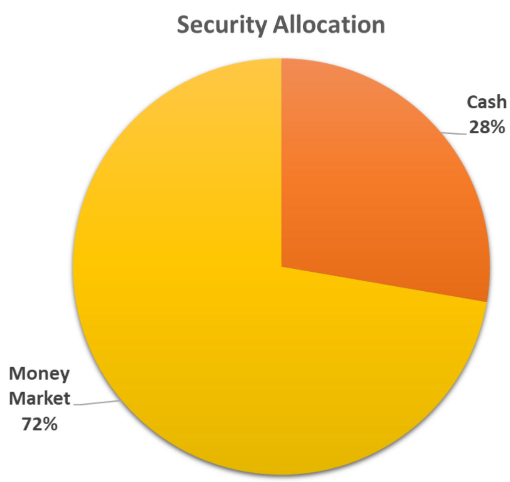
Please note that past performance is not indicative of future return expectations.

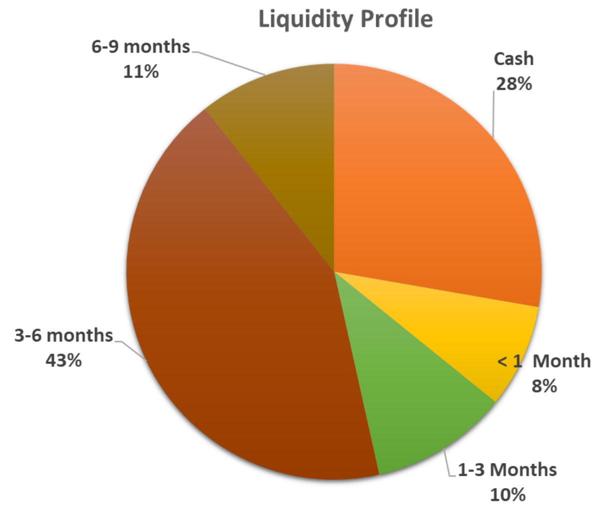
13. **Asset Allocation:** In 2023, the Prudent Investor portfolio outperformed its benchmark by 8 basis points (0.08%), with a 4% underweight to fixed income and 2% underweight to equities relative to its benchmark. This deviation is attributed to tactical asset allocation in light of market expectations.





14. The **Operating Fund:** The purpose of this fund is to meet the liquidity requirements of the City and consists of cash and high-quality short-term securities. The fund returned 5.46% on a weighted average balance of $245.9 million, 57 basis points (0.57%) higher than the Canada 3-month Treasury Bill Index's return of 4.89%. The outperformance was attributable to active management with robust cash flow forecasting which allowed for the inclusion of higher yielding short-term opportunities beyond cash, resulting in positive security selection effects. The weighted average yield on the money market securities portion was 5.68%, as compared to the weighted average yield on cash of 4.60%.

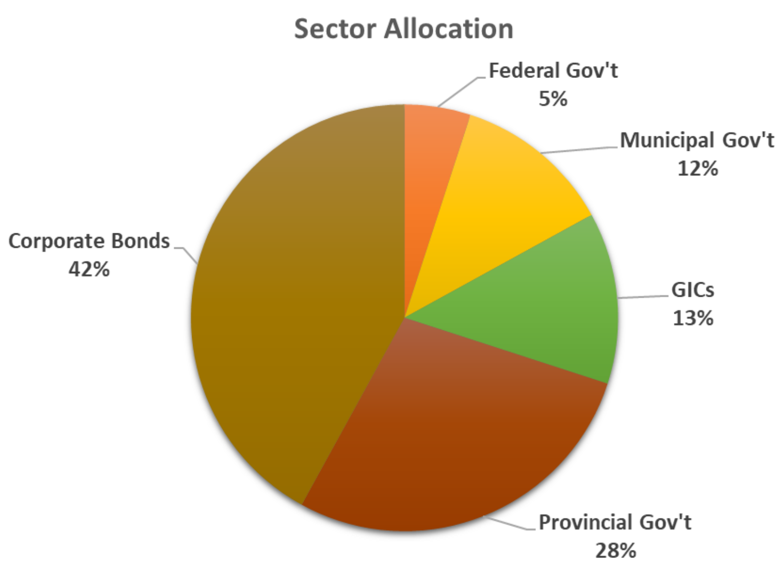




15. The **Capital Fund**: The purpose of this fund is to match the City's cash requirements for capital projects underway or slated to be completed within the ensuing five years. The fund consists of fixed-income instruments such as Government and Investment-Grade Corporate bonds and Guaranteed Investment Certificates (GICs).

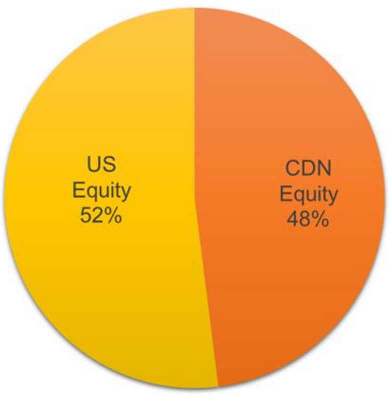
The fund returned 7.02% on a weighted average balance of $116.0 million. Compared to the Canada Aggregate 1–10 Year Bond Index benchmark return of 5.35%, the fund outperformed by +167 basis points (1.67%). The significant outperformance was driven by active management decisions, mainly a combination of tactical duration tilts (degree of interest rate sensitivity), security selection (issuer, sector, and credit quality), and market timing factors. For the first two quarters of the year, the shorter duration (3.7 vs. 4.2) relative to the benchmark led to an outperformance of 95 basis points (0.95%).

As bond yields peaked in third quarter, the duration of the fund was extended (4.9 vs. 4.1) beyond the benchmark to take advantage of the potential decline in yields, resulting in a further outperformance of 72 basis points (0.72%). The fund held $20 million in GICs with an average maturity of 1.5 years and an average yield of 5.31%.

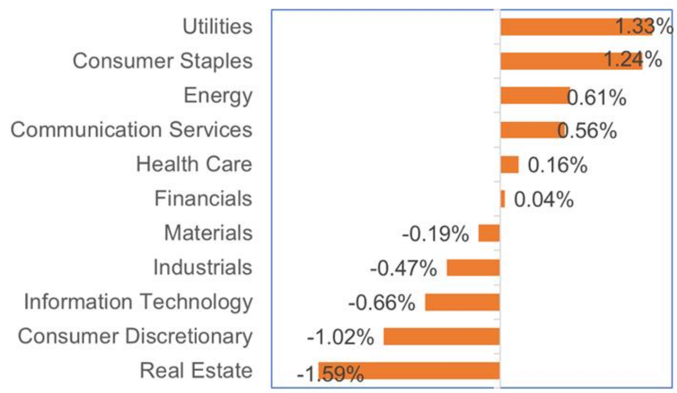


16. The **Growth Fund**: The purpose of this fund is to meet longer-term growth requirements of the City with the objectives for long-term capital appreciation. The fund is invested in Canadian and US equities. The fund achieved a total return of 15.26% on a weighted average balance of $34.3 million. The fund lagged its benchmark by 206 basis points (2.06%) mainly due to a defensive sector bias. This strategic tilt, made in response to increased uncertainty and the prospect of weaker macroeconomic conditions, proved to be a performance drag, particularly as higher-yielding defensive sectors underperformed. The Canadian portion of the equity portfolio outpaced its benchmark but in the US market the broadly diversified portfolio with a yield bias did not fully participate in a more narrowly defined market, dominated by a few large cap technology names (see Appendix B – Magnificent 7 Chart, paragraph 28). Strategically, the portfolio maintained its US bias on expectations of superior economic and stock market performance relative to Canada. The charts below show the equity portfolio's average geographic and sector tilts relative to the benchmark.

Geographic Allocation



Portfolio Average Exposure Relative to Benchmark

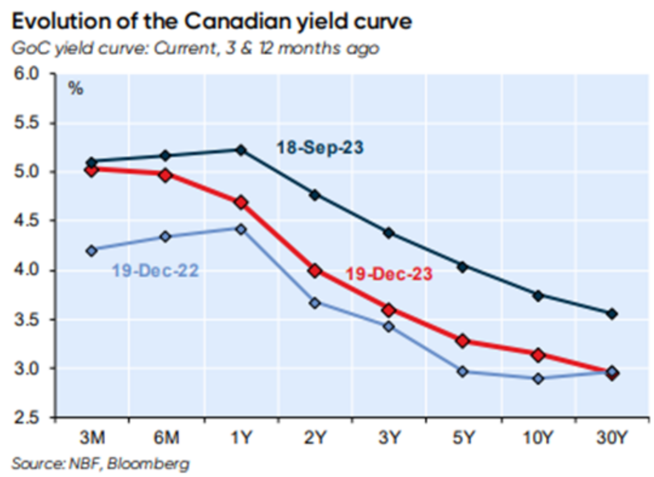


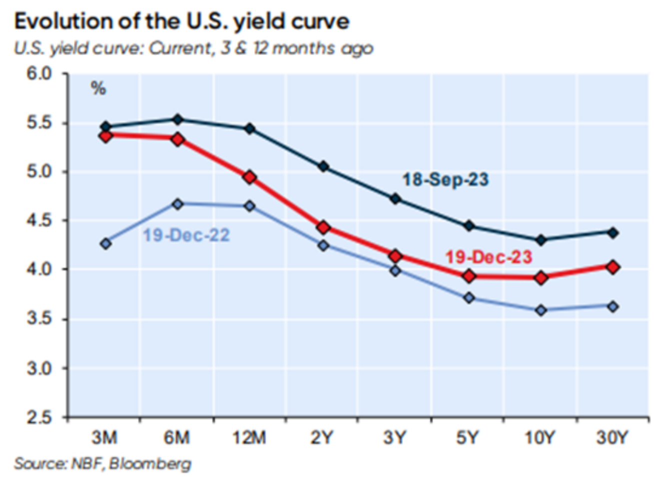
17. The Information Technology (+48%), Consumer Discretionary (+36%) and Communication Services (+40%) sectors contributed the most to the portfolio performance, meanwhile the utilities (-10%) and energy (-2.8%) sectors underperformed.

18. The weaker US dollar against the Canadian dollar negatively impacted equity returns, detracting 173 basis points (1.73%) from the total equity return, effectively giving back most of the unrealized currency gains from 2022. Geographically, the growth fund maintained a higher overweight position in US equities compared to Canadian equities. This decision was supported by the view that any potential economic deterioration would likely be more pronounced in Canada due to structural factors, including the housing market, excessive household debt, etc.

Market Outlook

19. Interest rate volatility characterized 2023, with government yield curves remaining inverted. The impact of interest rate hikes resulted in shifts in both Canada and the US yield curves. Yields peaked in the third quarter, as the Federal Reserve (Fed) signaled the end of rate hikes.





20. The story is likely to continue somewhat in 2024 as overall market sentiment improved marginally in the last two months of 2023, driven by optimism about the Federal Reserve's ability to engineer a soft landing. Tighter credit conditions are anticipated in 2024. The 2024 US election, with a likely Biden-Trump rematch, may introduce more volatility. The Canadian dollar is expected to remain volatile against the US dollar, with the market favouring the US dollar due to economic conditions and potential interest rate differentials.

21. The yield curve inversion suggests a probability of a mild recession within the coming months; however, market expectations are for an engineered soft landing by central banks. As at the time of the writing of this report, the market is expecting the Bank of Canada and the US Federal Reserve to begin easing policy in the summer, with the Fed cutting 1.5% and the BoC 1.0% by December 2024. However, both central banks signalled that they would remain data dependent.

APPENDIX “A”

Regulatory Disclosures

i) Performance

The Corporation of the City of Barrie earned a total return of 6.92% in 2023, 33 basis points (0.33%) higher than the benchmark return of 6.59%. Despite the difficult year for the markets, the City’s portfolio performed well.

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.

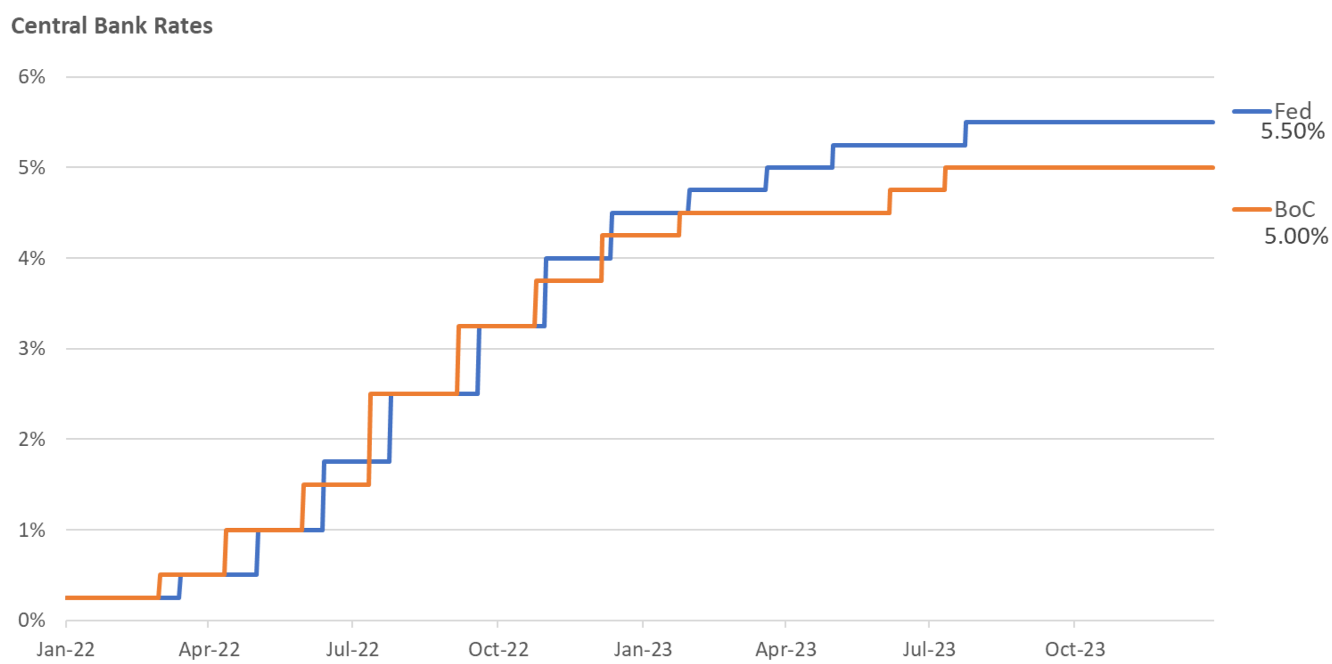
C. Millar, MBA, CPA, CGA
Chief Financial Officer and Treasurer

APPENDIX "B"

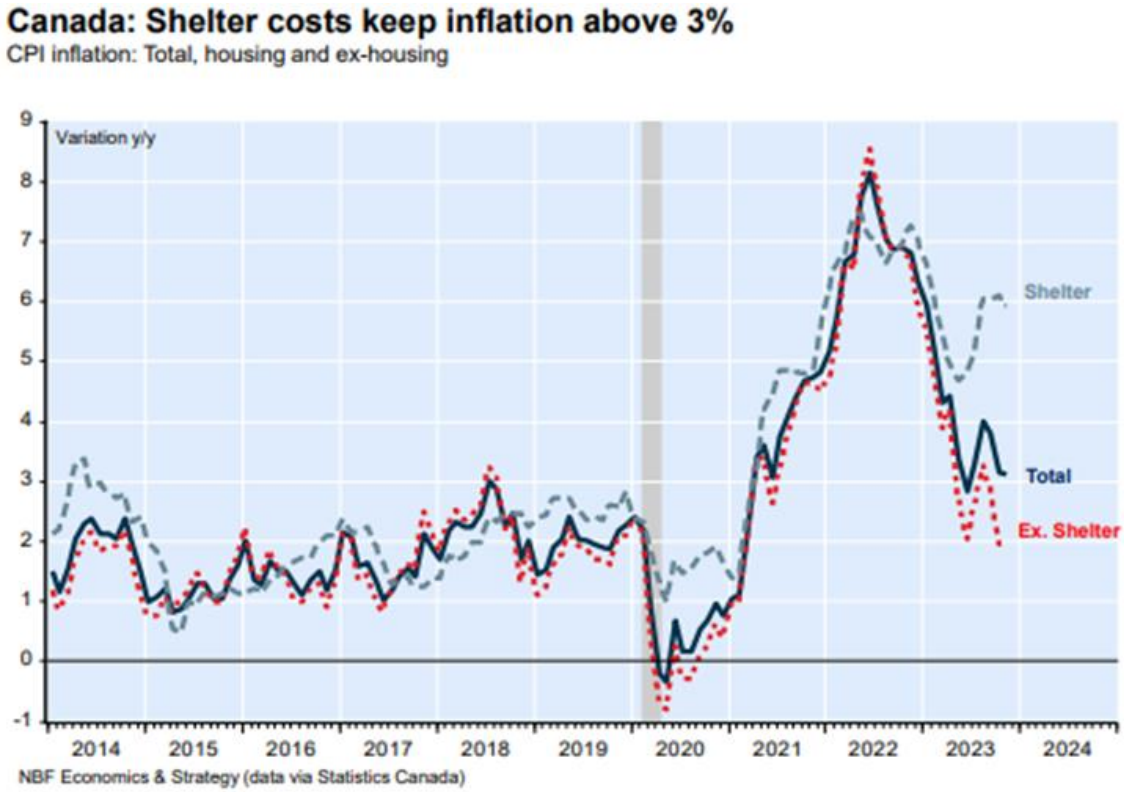
Market Commentary

22. **Markets entered 2023 climbing a wall of worry, a continuation of 2022.** Coming off 2022, the S&P 500 and S&P/TSX were down 20% and 9% respectively, along with bonds having their worst performance in over a century. Elevated interest rates, persistently high inflation, and various external factors such as weather impacting food prices, geopolitical tensions affecting energy, and rising shelter costs due to increased interest rates continued to exert pressure on market conditions. Despite this, unemployment rates remained historically low, although GDP growth slowed.

23. **Central Banks stayed the course**. Central Banks maintained a sense of urgency in response to stubborn inflation. Both the Bank of Canada (BoC) and the US Federal Reserve (Fed) continued to tighten monetary policy. The BoC implemented a series of rate hikes, 25 basis points (0.25%) in January and 50 basis points (0.50%) of "insurance hikes" in the summer to prevent a resurgence of inflation. Meanwhile, the Fed raised its overnight rate four times from 4.50% to 5.50% signaling that rates could stay "higher for longer".

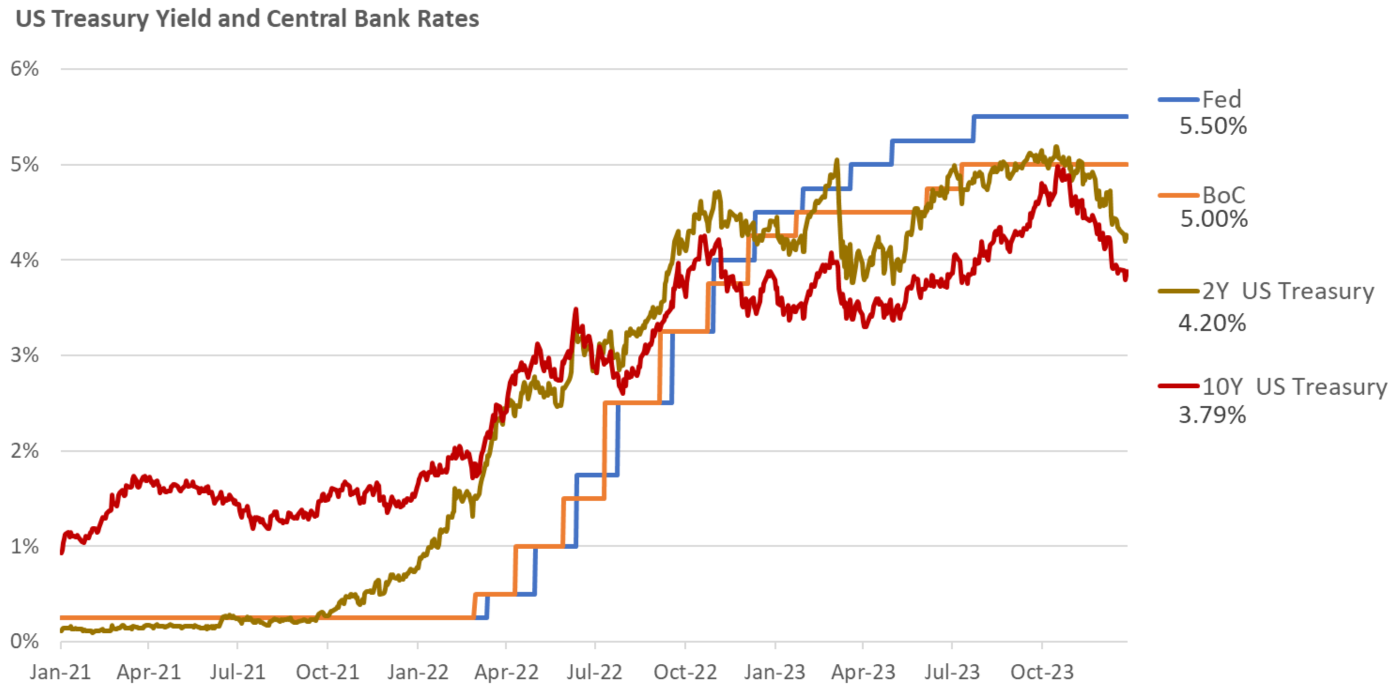


24. **Inflation continued to decelerate in 2023.** In Canada inflation exhibited an uneven but decelerating trend, closing the year at 3.4%. Despite declines in energy and agricultural commodity prices, transportation and shelter costs contributed to persistent core inflation. As the chart below shows, excluding the impact of interest costs and shelter inflation, annual inflation would align more closely with the Bank of Canada's 2% target.

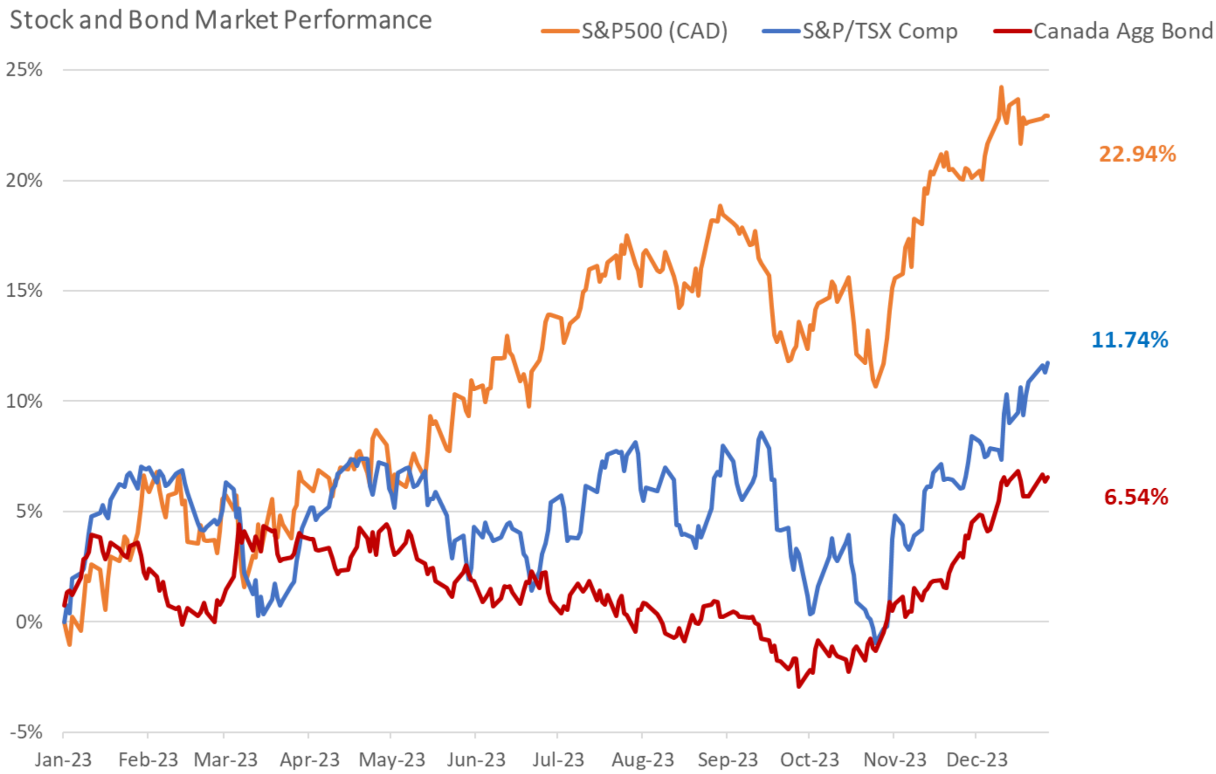


25. **US economy proved resilient.** Global economic growth surpassed expectations, driven by a robust US economy. US consumption remained strong, supported by resilient employment growth and households spending pandemic-accumulated savings. Despite initial concerns of a recession, the economy held solid ground, even in the face of the first-quarter regional banking crisis. The collapse of Silicon Valley Bank and the fear of the economy falling into recession led to a shift in expectations towards Federal Reserve easing.

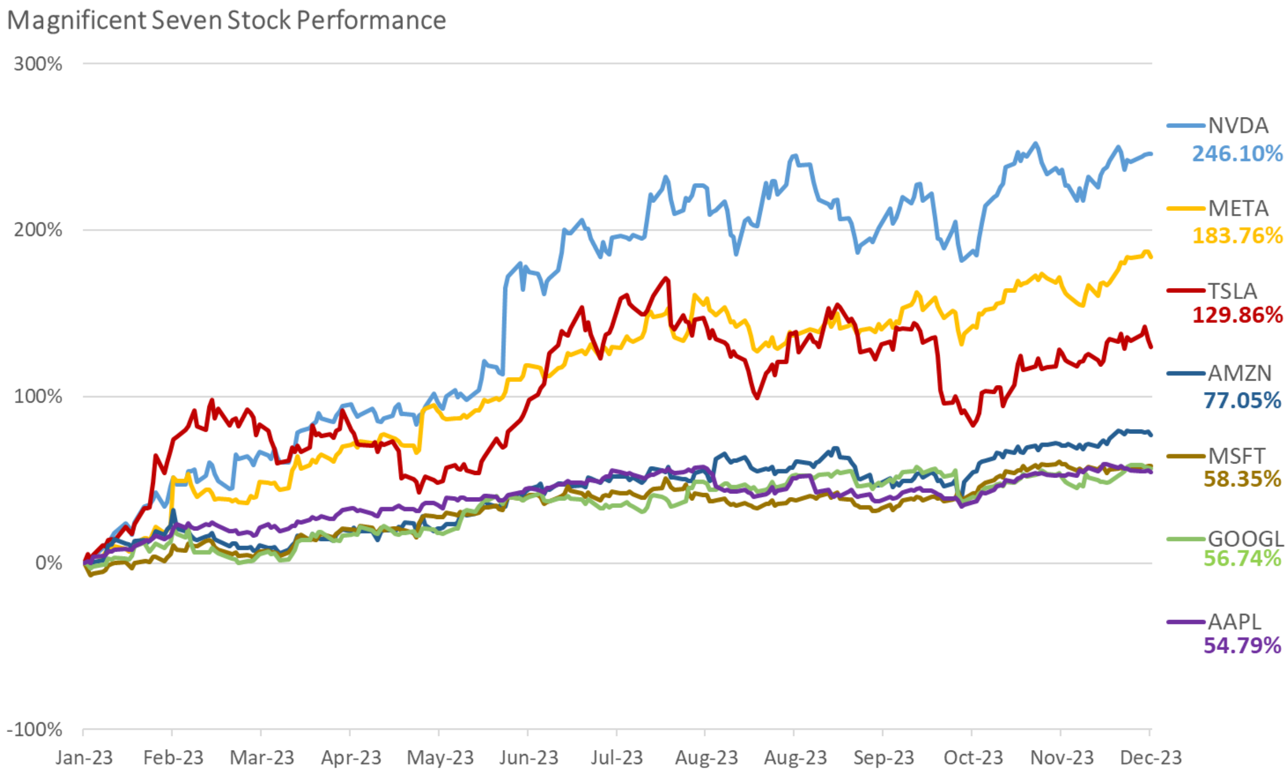
26. **Summer turbulence:** Treasury bond yields spiked in early August in response to news that the federal government had a larger-than-expected need to borrow money through bond sales in the third quarter and data showing a red-hot jobs market. This led to a summer selloff that saw bond yields spike to their highest level in 17 years, with the yield on the US 10-year treasury note reaching 5% as shown in chart below.



27. **Reprieve in the fourth quarter.** In the fourth quarter, evidence of continued moderation in inflation, coupled with cooling in the red-hot jobs market, swung expectations back to the Federal Reserve easing and bonds rallied strongly. This was confirmed in December when the Fed signaled that it expected to lower rates in 2024. Equity markets rebounded strongly, with the S&P/TSX Composite showing a strong comeback with an 11.7% total return and the S&P 500 posting an impressive 22.9% total return (CAD) fuelled by the so called “Magnificent Seven” stocks. US stocks outperformed Canadian stocks by a wide margin. Canada Aggregate Bond Index gained 6.5% as shown below.

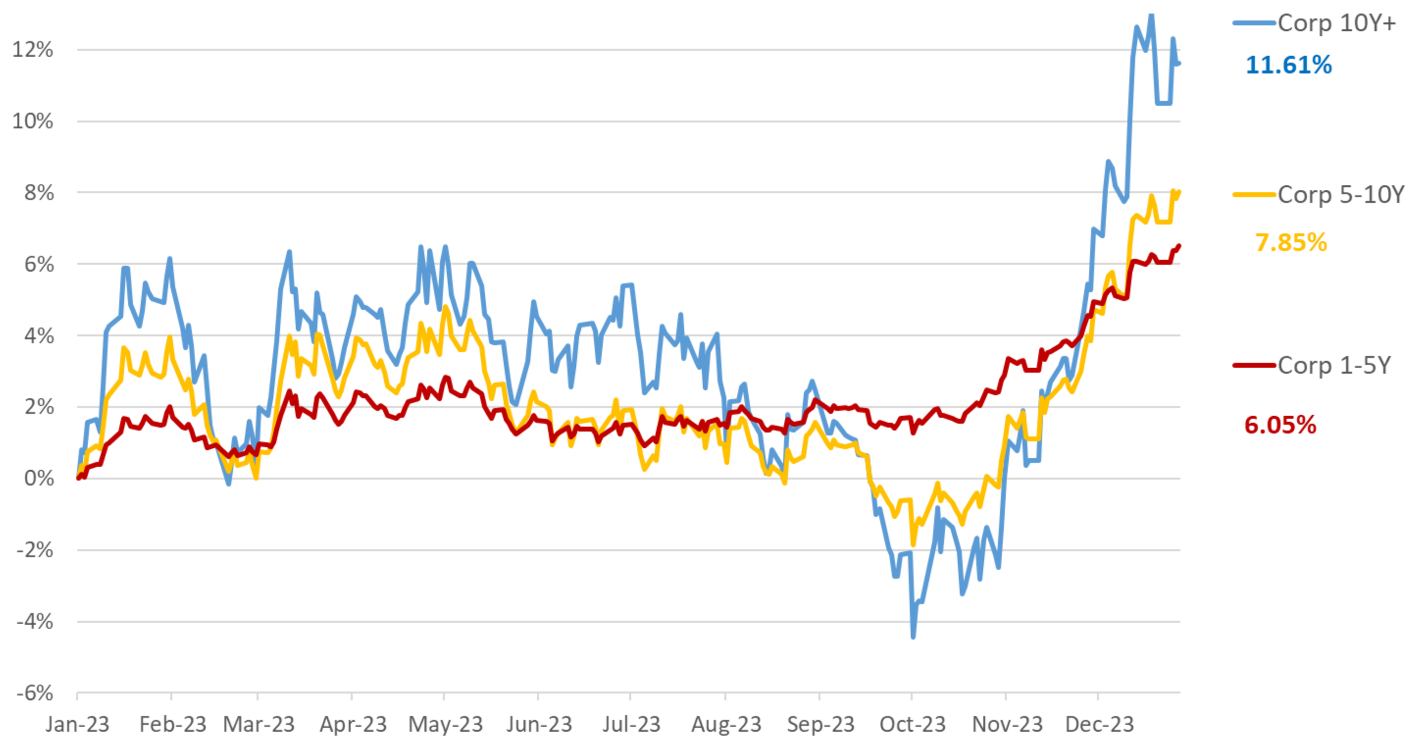


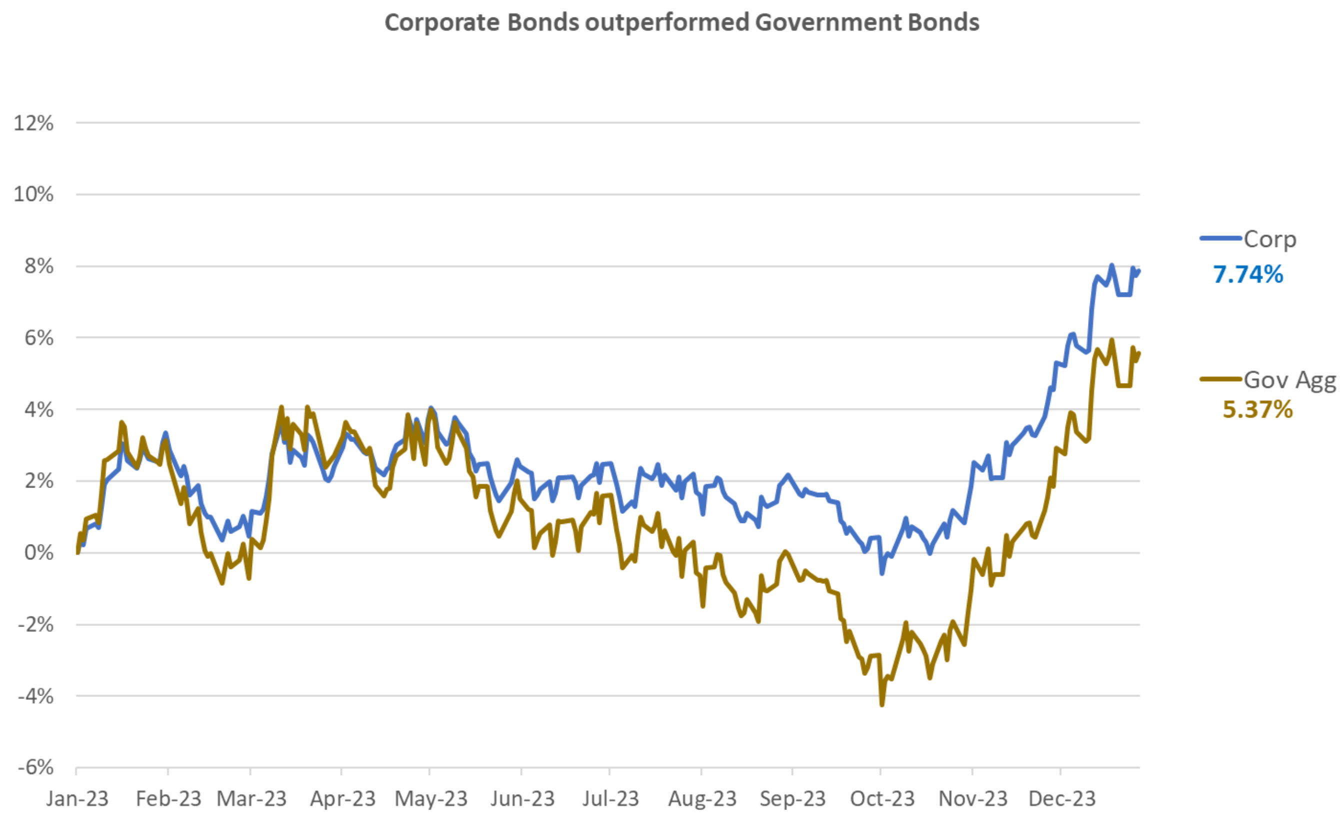
28. The performance of the "**Magnificent Seven"** stocks, including Apple, Alphabet, Microsoft, Amazon, Meta, Tesla, and Nvidia, was exceptional, contributing to 62.2% of the S&P500's total return.



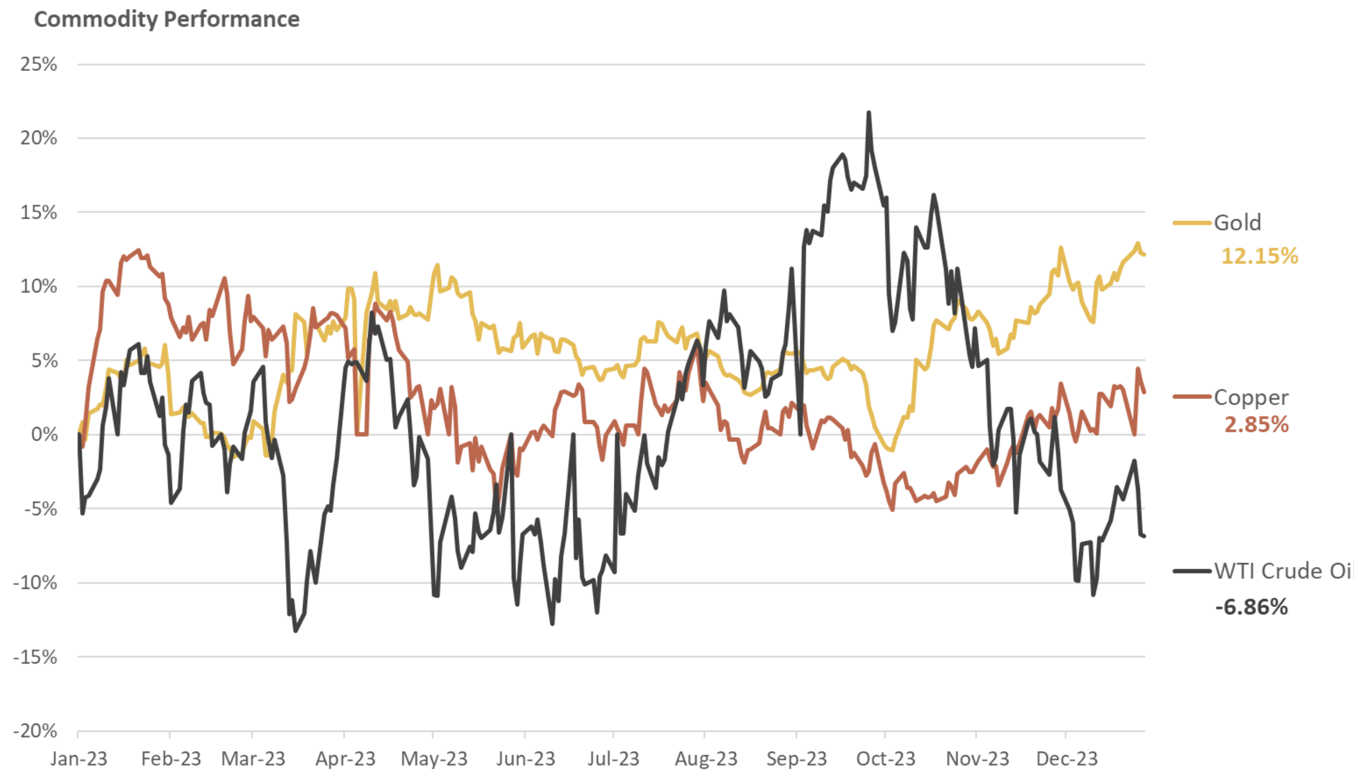
29. **Long duration strategy outperformed in 2nd half of 2023.** As shown in the charts below, bonds rallied on the back of a downward move in yields but more impressively, longer duration (higher interest rate sensitivity) bonds outperformed. Bond markets experienced a turnaround, initially weakened by concerns of rising interest rates. However, a rally occurred in November and December as optimism grew regarding cooling inflation and potential rate cuts. Long-duration strategies outperformed in the bond market, with the 10-Year+ corporate bond index returning 11.6%, 5.5% higher than the 1-5 Year corporate bond index. Corporate bonds also outperformed government bonds by 2.4%.

Longer-duration bonds outperformed





30. **Commodities had mixed returns in 2023**. Precious Metals, particularly gold, posted strong gains of 12% due to geopolitical tensions and inflation risk. Agriculture, Industrial Metals, and Energy faced losses, with oil experiencing volatility throughout the year. Despite OPEC's efforts to stabilize prices by cutting production, crude oil ended the year down by about 7%.



31. **The Stronger Loonie**. Late in the year, the Canadian dollar rallied on the back of the Fed signalling that interest rates had peaked, rebounding from its low of around 72 cents US per CAD (or $1.388 per US dollar) in late October. This marked the conclusion of a volatile 2023, during which the loonie experienced a series of ups and downs within the range of approximately 1.311 to 1.388 per US dollar. The Loonie closed 2023 at $1.324, 3% higher than at the start of the year when it was trading at 1.3671. For a Canadian investor in US-denominated assets this contributed to a performance drag as USD assets are translated at a lower CAD per USD exchange rate.