INVESTMENT COMMITTEE ANNUAL REPORT
TO
THE BOARD OF GOVERNORS

For the Year Ended March 31, 2015

U N I V E R S I T Y   O F   A L B E R T A

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Executive Summary

The Board of Governors has delegated responsibility and authority for most investment related matters to the Investment Committee. Annually, the Committee presents the Board with this report.

The investment assets of the University of Alberta that are under the governance of the Investment Committee had a total market value of $1,982 million as of March 31, 2015 (2014 - $1,883 million) and consist of Endowment Funds and Non-Endowed Funds, as summarized in Exhibit 1.

Exhibit 1

	2015	2014
Non-Endowed Funds	Millions	
Short-term	$ 527	$ 567
Mid-term	47	17
Long-term	220	190
ABCP*	7	115
	801	889
Endowment Funds	1,181	994
	$ 1,982	$ 1,883

* Asset Backed Commercial Paper

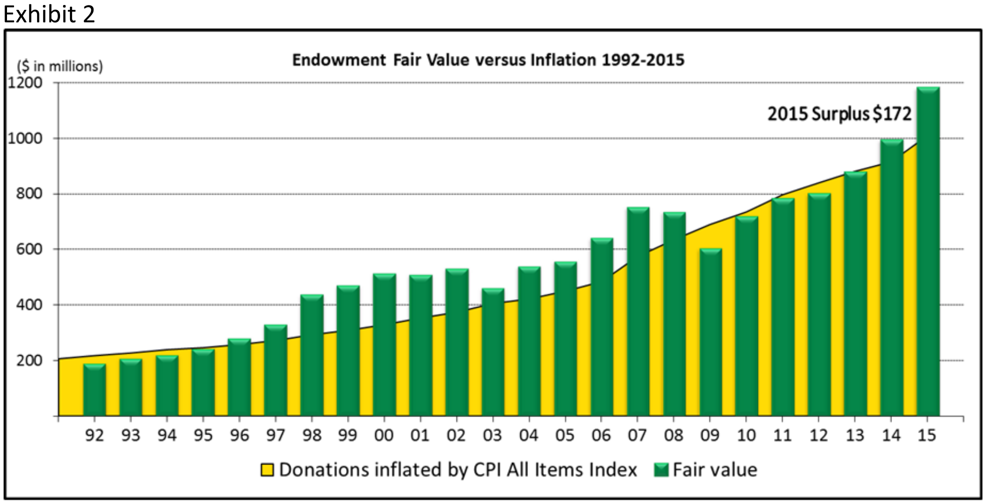
With very few exceptions, the Endowment Funds are pooled together and invested collectively in the Unitized Endowment Pool (UEP). The investment objective of the UEP is to achieve a long-term rate of return that in real dollars (i.e. adjusted for inflation) shall equal or exceed the rate of spending established in the UEP Spending Policy. This is done in order to provide the same level of support to future generations that current beneficiaries receive and it also implies that the real, long-term rate of return must equal or exceed the rate of spending.

Non-Endowed Funds are predominately short-term in nature. Consequently the primary investment focus is on money market securities and deposits to provide liquidity and preservation of capital.

Endowment Funds - Highlights

- The UEP returned 15.3% during the year. Global equities generated strong returns, while returns for the Canadian equity market were more modest.

Exhibit 2



- The market value of the Endowment Funds increased to $1,181 million, up $187 million from the end of fiscal 2014. This increase is comprised of $151 million in earnings, $82 million in new contributions, less $33 million spending allocation, $7 million administrative assessment and $6 million for investment management costs.

- During the year, the real value of the endowments increased by 9.9%. This increase was due to the aforementioned gain in market value of 15.3% on the investment assets less total expenditures of 4.2% and inflation of 1.2%. The value of the Endowment Funds over their cumulative inflation adjusted objective increased to $172 million as at March 31, 2015 (2014 - $78 million) or 17.0% (2014 – 8.5%).
- Revisions to the UEP Spending Policy to allow the first fiscal year's earnings associated with new contributions to be fully recapitalized for growth and inflation protection and to change calculation dates to enable the spending allocation to be set one full year in advance were approved by the Board of Governors.
- For the fiscal year, $33 million was made available for program spending on academic programs, chairs and professorships, research and scholarships, an increase of $0.5 million from the previous year. The spending allocation is linked to inflation, provided the real value of the endowment portfolio is able to meet certain conditions. One of those conditions is that the market value of the UEP must exceed its inflation tracking target by at least 10%. The spending allocation was not indexed for inflation this past year as this condition was not met as of March 31, 2013.
- Significant progress was made in restructuring the investment portfolio as contemplated by the Investment Policy. In the growth strategy a specialist manager was retained to focus on smaller publicly traded Canadian companies and commitments to two private equity investments were finalized. In the deflation hedging strategy, three fixed income mandates were transitioned to an internally managed mandate focused exclusively on Government of Canada bonds. Allocations to natural resource and oil and gas equities were brought towards their targets in the inflation sensitive strategy, while due diligence reviews related to two oil and gas private equity funds were completed. In the diversifiers strategy, the active currency overlay mandate was terminated.
- The fund's benchmark returned 16.9%, indicating UEP underperformance of 1.6% on a one year basis. On a ten year basis the fund has outperformed its benchmark by an annualized rate of 0.1%.

Non-Endowed Funds - Highlights

- The Non-Endowed Investment Pool (NEIP) recorded an overall return of 4.7% for the year (2014: 6.0%).
- The majority of the NEIP continues to be invested in one year short term money market products, which again outperformed their 91-day Treasury-bill benchmark.
- During the year the majority of the asset-backed commercial paper (ABCP) portfolio was redeemed through a voluntary unwind auction process. Redemption proceeds were re-invested in the short-term and long-term strategies. As at March 31, 2015 the remaining exposure to restructured ABCP was $7 million.

Investment Policy & Risk

Endowment Funds

The primary investment objective for the UEP is to achieve a long-term real rate of return that equals or exceeds total expenditures. The Investment Committee has implemented a number of strategies both to meet the UEP return objectives and also to control risk through the establishment of a target allocation that classifies the assets in the portfolio into their respective strategic roles: Growth, Inflation Sensitive, Deflation Hedging and Diversifiers:

- To meet spending targets and grow the value of the assets over time, a large allocation to public and private equities, hedge funds and other assets with exposure to equity market returns is necessary.
- Inflation sensitive assets are those that adjust to unexpected and/or rising inflation. The assets in this category include real estate, natural resource equities, commodities as well as exposure to oil and gas private equity.
- Deflation sensitive assets are those that increase in value during times of extreme economic and capital market turmoil. This asset class consists of high-quality sovereign bonds.
- Diversifiers are any asset classes that have low or no correlation with the capital markets and inflation.

Non-Endowed Funds

Non-Endowed funds are pooled together for investment purposes until required for expenditure. Long-term cash flow projections indicate that a substantial portion of these funds will likely not be required on an urgent or unplanned basis for at least five years. Accordingly, Non-Endowed funds are invested across three distinct strategies with varying maturity profiles.

- To meet the University's liquidity requirements, the short-term strategy is focused primarily on the preservation of capital and invests predominantly in government and high quality bank issued money market securities maturing within one year.
- In order to enhance the yield of the Non-Endowed funds, while remaining focused on the preservation of capital, the mid-term strategy invests in government and high quality bank issued bonds maturing within five years.
- For return enhancement purposes, the long-term strategy invests in the UEP.

Major Initiatives during the Year

Continued Implementation of Target Asset Allocation

The Investment Policy's asset mix and target portfolio are designed to:

- Increase the expected real rate of return while maintaining the present level of risk and volatility
- Maintain an appropriate allocation to illiquid investment strategies
- Improve the level of diversification in the investment program
- Increase the inflation sensitivity of the UEP
- Optimize the number of investment mandates

Exhibit 3

Investment Strategies	UEP Portfolio (Mar 31 2014)	UEP Portfolio (Mar 31 2015)	Target UEP Portfolio
U.S. Equity	14.2%	0.0%	0.0%
Canada Equity	19.7%	17.4%	13.0%
Global Equity	31.6%	43.4%	30.0%
Emerging Markets Equity	4.5%	4.2%	10.0%
Private Equity	0.0%	0.4%	6.0%
Canada (Government) Bonds	13.4%	12.2%	16.0%
Natural Resource Equity	0.0%	4.2%	5.0%
Commodities	0.0%	0.0%	5.0%
Real Estate	5.9%	5.4%	5.0%
(Private) Oil & Gas Equity	0.0%	4.4%	5.0%
Absolute Return (Low Beta)	5.6%	5.4%	5.0%
Cash	5.1%	3.0%	0.0%
	100.0%	**100.0%**	**100.0%**
Expected Real Return	6.1%	6.2%	6.5%
Expected Standard Deviation	12.3%	12.3%	11.7%
Expected Sharpe Ratio	0.41	0.43	0.47
Actual Real Return*	7.9%	9.9%	
Actual Standard Deviation*	7.7%	7.0%	
Actual Sharpe Ratio*	0.58	0.73	
Growth Engine	70%	65%	59%
Deflation Hedging	13%	12%	16%
Inflation Sensitive	6%	14%	20%
Diversifiers	11%	8%	5%

*** Four Year Annualized**

The Investment Committee receives quarterly updates from Management on the status of the transition to the target asset allocation (Exhibit 3). The transition is projected to be substantially completed by March 31, 2016.

During the year, a new equity investment manager was retained for a $30 million Canadian small cap equity mandate. This strategy was funded through a reduced allocation to Canadian large cap equities. The growth strategy also saw $15 million in commitments to two private equity funds.

Deflation Hedging activity saw the three external mandates focused on the broad Canadian bond universe replaced by an internally managed mandate focused exclusively on bonds issued by the Government of Canada. This transition involved the purchase and sale or redemption of $180 million of fixed income securities.

Periodically throughout the year additional exchange traded funds (ETFs) were purchased to build up exposure to the natural resource equity and oil and gas portions of the inflation sensitive strategy. These

ETFs provide market exposure while active management and private equity investment opportunities are investigated. During the year due diligence was completed on two Canadian oil and gas private equity funds. A $20 million commitment to one manager was finalized during the year and it is anticipated that a $10 million commitment to the other manager will be finalized early in the 2015/16 fiscal year.

Management and the Investment Committee undertook a major review of the strategic decision taken in 2005 to hedge 50% of the UEP's exposure to foreign currency. It was concluded that hedging currency exposure will not usually reduce the volatility of overall returns. The active currency overlay was terminated in the latter half of November 2014. The timing of this strategic long-term decision was accretive to returns for the current fiscal year.

Asset Backed Commercial Paper (ABCP)

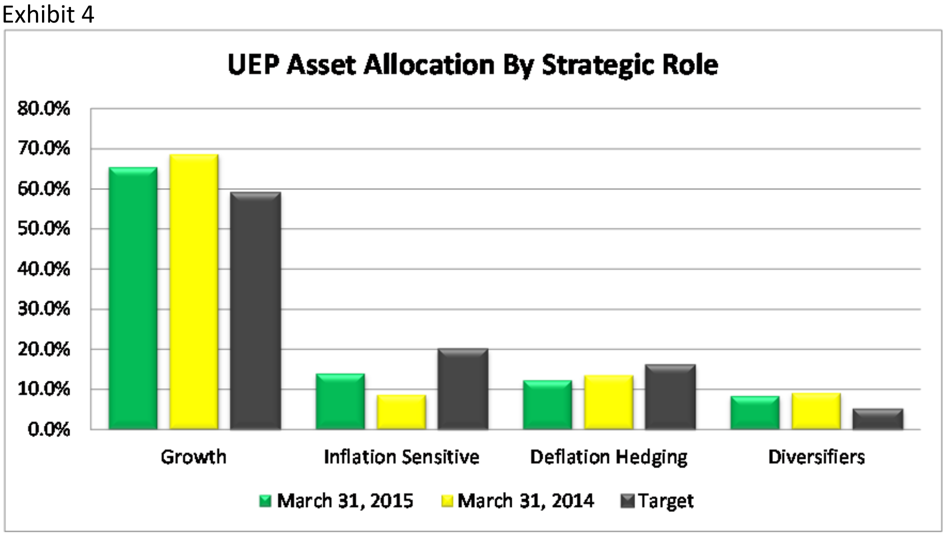
The University successfully redeemed the majority of its ABCP holdings through a voluntary unwind auction process in May 2014 at a clearing price of 95.3%. The majority of the redemption proceeds, totalling $106 million, were received during the quarter ending September 30, 2014. Additional proceeds of $4 million were received from the sale of selected remaining restructured ABCP notes. During the year, Barclays abandoned its litigation related to the Devonshire notes that had not been restructured, resulting in a full principal repayment of $3 million.

As at March 31, 2015 the remaining exposure to ABCP was $7 million. Of this amount, $3.4 million represents indemnification holdback notes related to the aforementioned voluntary unwind auction process. A further $3.3 million relates to the Superior notes sponsored by Bank of America/Merrill Lynch. Both remaining holdings will mature during the 2016/17 fiscal year.

Endowment Funds

Endowment investments are categorized by Strategic Role in Exhibit 4.

Exhibit 4



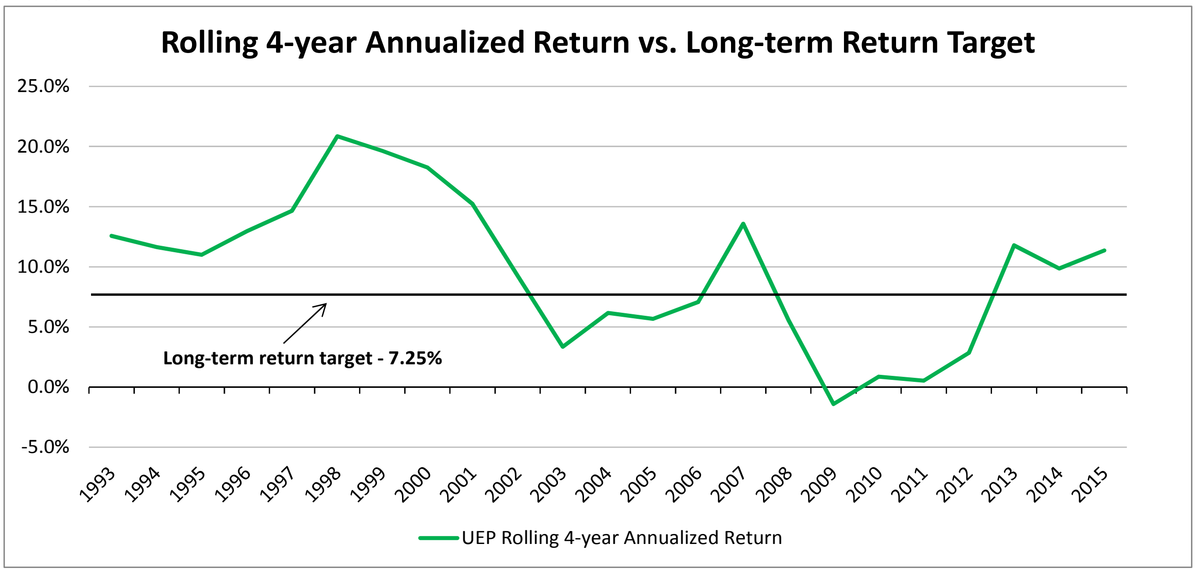
Investment Performance Relative to Objectives

The UEP returned 15.3% for the year ending March 31, 2015, surpassing total spending plus CPI of 5.4% by a healthy margin. The return of 15.3% reflects:

- strong global equity and managed futures performance,
- a depreciating Canadian dollar and,
- a high allocation to equities.

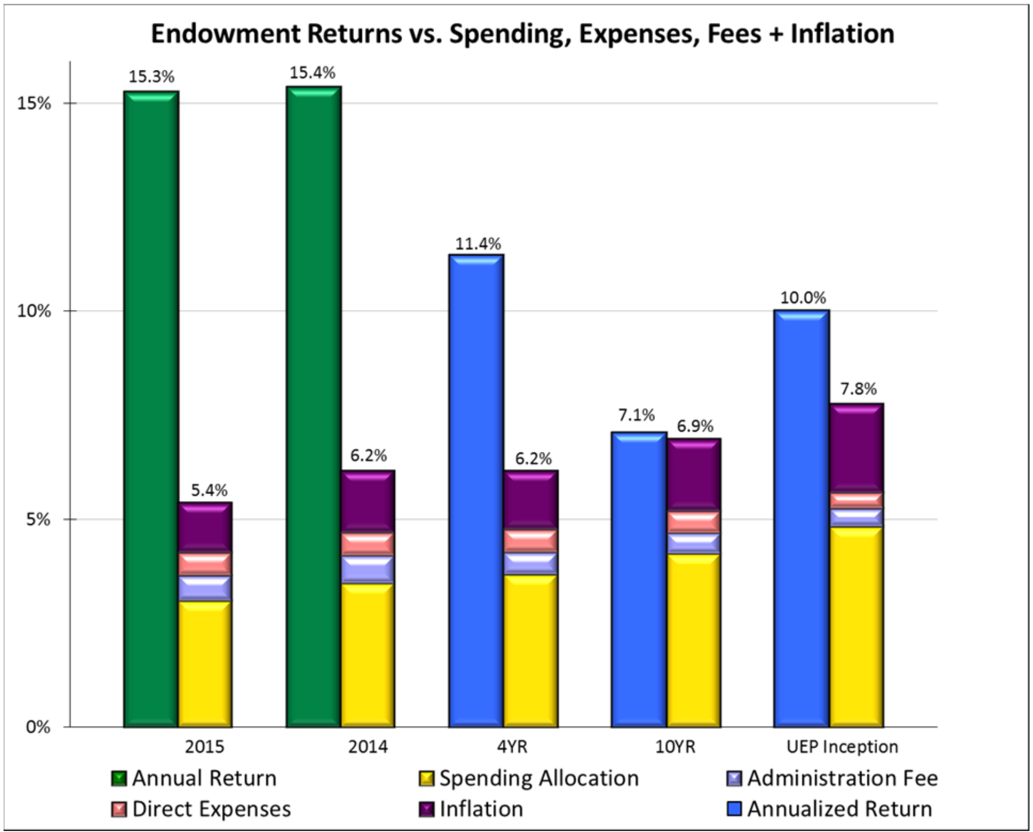
Not every year will see returns that are above the long-term return target. The Endowment Funds must be invested for the long-term and provide extra return in some years to make up for deficient returns in other years. Exhibit 5 illustrates the UEP's historical performance relative to that objective.

Exhibit 5



As shown in Exhibit 6, the UEP has, since its April 1989 inception, produced an annualized return of 10.0%. This return has exceeded annualized total spending plus inflation of 7.8% over that time period. This objective has also been achieved over all other time frames in the graph below. Although the excess return over total spending plus inflation for the 10 year annualized period is very small, it demonstrates that the UEP has recovered from the negative impacts of the global financial crisis.

Exhibit 6



Measuring Performance of Asset Classes Relative to Market Movements

The returns of individual asset classes in the UEP are measured against established market index benchmarks. The total fund return is measured against the weighted return of the current asset mix benchmark as shown in Exhibit 7. The difference between the endowment and the benchmark return reflects the impact of strategic allocation decisions together with active management decisions by our investment managers.

Exhibit 7

UEP Investment Policy Benchmark

S&P/TSX Composite Index	20%
MSCI ACWI Ex-Canada Index (CAD)	50%
IPD/Realpac Canada Property Index	6%
FTSE/TMX All Federal Bond Index	16%
HFRI Fund of Funds Composite Index	8%
	100%

With its 15.3% return, the fund underperformed its benchmark by 1.6% or 160 basis points. There were several reasons for this underperformance. First, off-benchmark allocations to the underperforming emerging markets equities and global natural resources strategies contributed 165 basis points to underperformance. Second, active global and emerging markets equity investment managers, in aggregate, underperformed the benchmark and contributed a further 45 basis points to total underperformance. Third, although the overall return from hedge fund strategies were strong, they trailed the benchmark and contributed a further 30 basis points to total underperformance. Underperformance was partially offset by a positive contribution of 40 basis points from real estate and 40 basis points from Canadian equity - despite the poorly performing off-benchmark allocation to oil and gas ETFs. Neither the active currency manager nor individual deviations from the benchmark contributed or detracted from relative performance by a meaningful amount.

Canadian equities gained 8.8% for the year, outperforming the S&P/TSX Composite Index benchmark by 1.9%. This was a second quartile ranking in the BNY Mellon Canadian Master Trust Universe of peer Canadian large cap investment managers. Despite no exposure to the very strong performing Health Care sector, the outperformance was largely driven by a sustained large underweight to the poorly performing Materials sector and overweight allocations to forestry products and other non-mining stocks. An overweight to Consumer Staples stocks was also accretive.

In aggregate, global equity (including emerging market and natural resource equity) underperformed the MSCI World benchmark for the fiscal year, returning 17.6% or 4.7% under the benchmark. This was fourth quartile performance. In aggregate the active investment strategies were more conservatively positioned than the broader market. The return from stock selection was slightly negative this year and the effect of sector allocation was a larger detractor to returns.

Canadian fixed income returned 8.3%, 10 basis points above the benchmark FTSE TMX Canada Federal Universe Index return of 8.2%. This represents a fourth quartile ranking for fixed income portfolios in the Canadian Fixed Income Master Trust Universe. The majority of the fixed income asset class was invested passively in a FTSE TMX Canadian Universe Bond Index fund until November. Afterwards fixed income assets were transitioned to Government of Canada bonds only. The transitioned portfolio lagged the index for the fourth quarter of the year as it was managed to have shorter duration and interest rates declined.

The UEP invests in both Canadian and US real estate. On the Canadian side, the investment is in an open-ended core diversified real estate fund. This fund returned 6.9%, which matched the IPD Realpac Canadian Property Index. Most of the fund holdings are office, apartment, retail and industrial buildings located in Ontario, Alberta, and BC. The main US real estate investment is in an open-ended core diversified fund. This fund returned 25.9% to the UEP in Canadian dollar terms. This manager invests across the United States in all four major real estate categories. The University continued to fund its capital commitments to a private (closed-ended) real estate fund that specializes in a value added strategy focused on office properties. During the year one building was sold and proceeds from the sale were distributed to investors. The primary target markets for this fund are six major supply-constrained US cities.

Absolute return strategies in aggregate performed well during the year. The hedge fund of funds investment strategy returned 3.8%, while the managed futures fund of funds investment strategy returned 34.1%. These investments are both in Canadian dollar hedged share classes. The hedge fund of funds return was well below the Hedge Fund Research Fund of Funds Composite Index return of 5.4%. The managed futures component performed strongly as the underlying managers were correctly positioned to profit from currency and fixed income trends during the year. Managed futures fund of funds outperformed the HFRX Macro / CTA Index of 10.0%.

The Endowment Fund had a strategic long-term Investment Policy to hedge 50% of the non-Canadian dollar denominated portion of the portfolio back to Canadian dollars through an actively managed currency overlay strategy. After considerable research and discussion it was concluded that for Canadian based investors, hedging currency exposure will not reduce the volatility of overall portfolio returns, and that under most market conditions the fund should not hedge its foreign currency exposure. The active currency overlay was terminated in the fall of 2014. Significant hedging losses were avoided during a period of Canadian dollar weakness in the latter part of the fiscal year. During the year the currency hedging program contributed 1.0% to the portfolio's return.

Other Perspectives on Relative Performance

The University of Alberta participates in benchmark studies sponsored by the Canadian Association of University Business Officers (CAUBO) and, in the United States, the National Association of College and University Business Officers (NACUBO) in conjunction with Commonfund. The most recent published data from these organizations is for the periods ending December 31, 2013 and June 30, 2014 respectively. This data may make shorter-term comparisons less than informative due to timing. The University's ten year return of 6.4% for the period ending December 31, 2013 exceeded the CAUBO 10 year median return of 6.3%. The University's 8.2% return for the ten year period ending June 30, 2014 exceeded the NACUBO 10 year median return of 7.0% in US dollar terms.

Costs

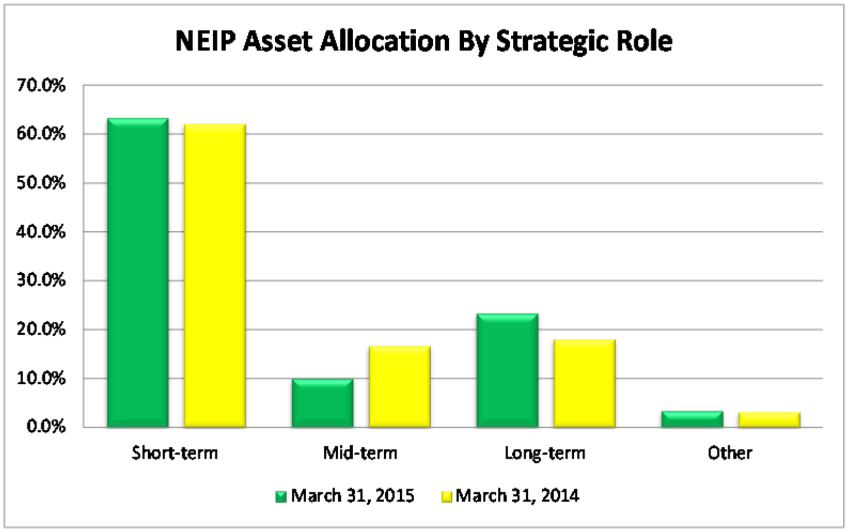
The fund incurred direct expenses (investment management and custodial fees) of $6.1 million or 0.56% of the average market value of the fund. As part of a process of monitoring and managing costs, Management participated in the 2013 CEM Survey. CEM Benchmarking Inc. is a Toronto based firm that specializes in measuring the performance and costs of pension plans, foundations, and endowments. The report found that the UEP's actual costs were 17.8 basis points higher than expected for funds of similar size and structure. The higher cost is primarily attributable to the funds' use of an active currency overlay strategy and the emphasis on active investment strategies. Recently implemented changes; such as the move to internal fixed income management and the termination of the active currency overlay mandate are expected to have a positive impact on costs.

An administrative fee to support centrally funded indirect costs associated with endowment programs is charged to the endowments. For 2015 this amounted to $6.5 million, representing 0.60% of the average market value of the fund.

Non-Endowed Funds

The Non-endowed Investment Pool (NEIP) represents the University's operating, capital and restricted funds as summarized in Exhibit 8.

Exhibit 8



Investments in the short-term strategy account for 63% of NEIP holdings. By focusing on investments of up to one year in bank and provincial issuers, the short-term strategy returned 1.2% and outperformed the benchmark FTSE TMX Canada Treasury 91-day Index by 0.3% during the year.

NEIP's mid-term strategy returned 3.1% for the fiscal year, falling 0.8% short of the benchmark FTSE TMX Short-Term Bond Index. Gains realized through the redemption and sale of the majority of the ABCP holdings had a positive impact on relative performance. Other holdings in the mid-term strategy had duration shorter than the benchmark and detracted from relative performance as yields declined in the second half of the fiscal year.

Exhibit 9

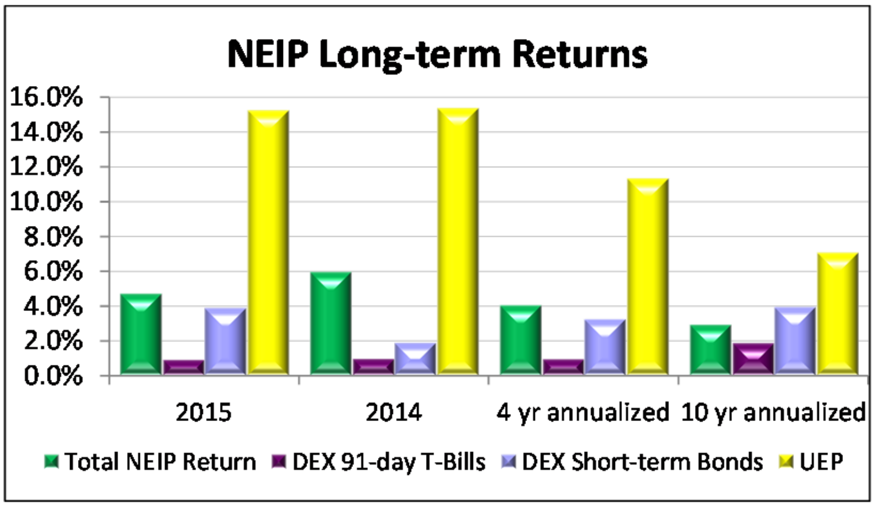
Returns - NEIP	Year Ending March 31				Annualized
	2015 %	2014 %	2013 %	2012 %	4YR %
Short-term (combined)	1.2	1.3	1.2	1.3	1.3
DEX 91-day index	0.9	1.0	1.0	0.9	1.0
Mid-term bonds (combined)	3.1	18.0	10.8	6.3	9.4
DEX short-term bond index	3.9	1.9	2.9	4.4	3.3
Long-term (UEP)	15.3	15.4	12.2	3.0	11.3
UEP Benchmark	16.9	17.0	10.3	2.5	11.5
Overall Return	4.7	6.0	3.5	2.1	4.1
MTU Median	1.2	1.2	1.2	1.2	1.2

(Median of Canadian Money Market Fixed Income Portfolios)

The allocation to the long-term strategy, or UEP, was increased by $40 million during the year, as part of the reinvestment strategy for proceeds from the redemption and sale of ABCP holdings. The UEP's 15.3% return contributed significantly to the NEIP's overall return of 4.7%. The allocation to the long-term strategy was rebalanced in February 2015 to $200 million (23% of NEIP), resulting in proceeds to the NEIP of $21.9 million. For risk management purposes one half of this amount was added to the reserve that has been established for the long-term strategy.

The NEIP has benefited from its allocations to the mid and long-term strategies. The 10 year annualized returns fully reflect the impacts of the ABCP holdings and the global financial crisis. Over this time period the NEIP returned 3.0%, outperforming the FTSE TMX Canada Treasury 91-day Index by 1.1%.

Exhibit 10



Going Forward

This year's strong investment returns have substantially restored the real value of the Endowment Funds from the damage of the global financial crisis. Continued implementation of the Investment Policy, together with the Spending Policy, will help preserve both the real value of the funds and intergenerational equity in endowment spending.

With the oversight of the Investment Committee, Management will undertake the following initiatives during the 2016 fiscal year:

- Continue to restructure the investment portfolio as contemplated by the Investment Policy as outlined in Exhibit 3 of this report,
- Conclude the search for a second emerging markets equity manager,
- Review the appropriateness of commodities as an asset class in the inflation sensitive investment strategy and either conduct a search for an appropriate investment strategy or revise the UEP target portfolio,
- Review the appropriateness of certain elements in the diversifiers strategy,
- Develop a medium to long-term strategy for allocating to private equity,

- Conclude an assessment of the University's investment management capabilities with the assistance of an independent external consultant,
- Increase the investment manager monitoring and compliance capabilities,
- Continue to assess the ongoing appropriateness of all existing investment strategies and mandates,
- Develop a risk budgeting framework for all aspects of the investment strategy including the performance monitoring process, and
- Increase the NEIP's allocations to the mid-term investment strategy.

Investment Committee Membership for the period June 2014 to June 2015:

Dave Lawson, Chair (external member)	James Heelan (Board member)
Jim Drinkwater, Vice-Chair (external member)	Allister McPherson (external member)
Ken Bancroft (external member)	Sandy McPherson (external member)
Barbara Belch (external member)	Douglas Goss (ex-officio)
John Butler (external member)	Ralph Young (ex-officio)
Jane Halford (Board member)	Dr. Indira Samarasekera (ex-officio)

Prepared for the Board Investment Committee by Financial Services – Investments & Treasury

Richard Allin, BComm (Alberta) - Cash Manager

Pamela Connors, Dipl. Admin (Nova Scotia Community College) - Cash Analyst

Richard Iwuc, BSc, MBA (Manitoba), CFA - Portfolio Manager

Phil Poon, BComm (Alberta) - Associate Director, Investments & Treasury

Ron Ritter, BComm (Alberta), CA - Director, Investments & Treasury

Chad Yaskiw, BComm (Alberta), CFA, CAIA - Senior Treasury Analyst