

INVESTMENT COMMITTEE ANNUAL REPORT

For the Year Ended March 31, 2016







Investment Committee Annual Report For the Year Ended March 31, 2016

Contents

Message from the Board Investment Committee Chair	4
Executive Summary	5
Investment Policy & Risk	6
Major Initiatives during the Year	7
Endowment Funds	8
Non-Endowed Funds	12
Going Forward	14

Message from the Board Investment Committee Chair

I am pleased to present the annual report on the University of Alberta's Investment Committee for the year ended March 31, 2016. The investment assets under the governance of the Investment Committee were \$1.96 billion at March 31, 2016, of which \$1.15 billion represented endowments. These assets generated nearly \$36 million for program spending purposes such as scholarships and research.

The Unitized Endowment Pool's (UEP) rate of return for the year was -0.4%, comparing favourably to the benchmark return of -4.4%. The Non-Endowed Funds returned 0.6%, compared to their benchmark return of -0.5%. The low returns for this fiscal year follow three years of very strong performance. Over the four years ending March 31, 2016 the annualized rate of return for the UEP was 10.4%.

The Canadian equity market with its high exposure to commodities significantly underperformed global developed equity markets this past fiscal year. Fixed income markets on the other hand posted modest positive returns. The UEP benefited from being broadly diversified across global markets and asset classes.

During the year commitments were made to real estate, private equity, and emerging market public equity managers to further transition the UEP's asset mix towards the policy targets. An assessment of the University's investment management function against the best practices for funds of comparable size was completed with the assistance of an independent external consultant. There were no areas of significant concern or deviation from best practice noted. The Investment Committee and Management have developed a multi-year work plan to address those areas where there is scope for improvement.

In the coming year, the Investment Committee will undertake a comprehensive externally facilitated review of its Statement of Investment Principles and Beliefs. This will then serve as the foundation for an updated asset allocation study. A key area of focus will be to ensure that the investment portfolios' risk profiles remain appropriate for the University while meeting spending requirements in what may be a future lower return environment.

On behalf to the Investment Committee, I would like to acknowledge Management's hard work and dedication this past year. I would like to thank and recognize the long-term service and contribution of retiring members: Barbara Belch (15 years service) and Ken Bancroft (19 years service).

Dave Lawson, CFA
Chair, Board Investment Committee, University of Alberta

Investment Committee 2015 - 2016

Appointed

Dave Lawson, Chair

Jim Drinkwater, Vice-Chair

Ken Bancroft

Barbara Belch

John Butler

Jane Halford

James Heelan

Allister McPherson

Sandy McPherson

Ex-Officio

Michael Phair

Ralph Young

Dr. David Turpin

Executive Summary

The investment assets of the University of Alberta that are under the governance of the Investment Committee had a total market value of \$1,958 million as of March 31, 2016 (2015 - \$1,982 million) and consist of Endowment Funds and Non-Endowed Funds, as summarized in Exhibit 1.

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.

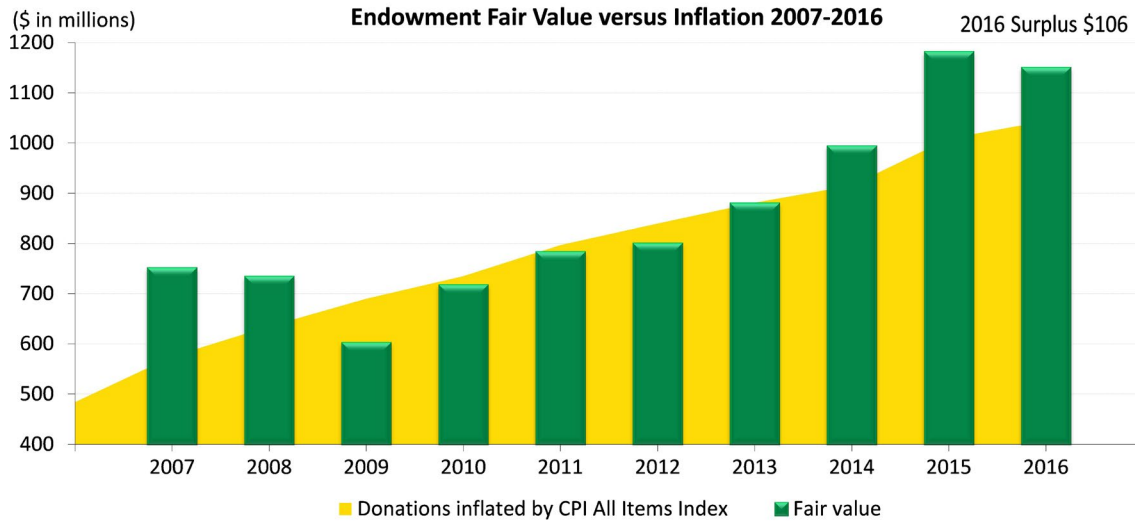
Non-Endowed Funds are predominately short-term in nature. Consequently the primary investment focus is on money market securities and deposits to provide liquidity and preservation of capital.

Exhibit 1					
	2016			2015	
Non-Endowed Funds			Millions		
Liquidity	\$	534		\$	527
Yield		65			54
Return Seeking		209			220
		808			801
Endowment Funds		1,150			1,181
	\$	1,958		\$	1,982

Endowment Funds - Highlights

- The UEP returned -0.4% during the year following three straight years of double digit gains. During the year most global equity markets posted losses, while returns for fixed income were positive.
- As shown in Exhibit 2 on the following page, the market value of the Endowment Funds decreased to \$1,150 million, down \$31 million from the end of fiscal 2015. This decrease is comprised of the \$36 million spending allocation, \$7 million administrative assessment, \$6 million for investment management costs and \$4 million in investment losses, less \$22 million in new contributions.
- During the year, the real value of the endowments decreased by 5.8%. This decrease was due to the aforementioned return of -0.4% on the investment assets less total expenditures of 4.1% and inflation of 1.3%. The value of the Endowment Funds over their cumulative inflation adjusted objective decreased to \$106 million as at March 31, 2016 (2015 - \$172 million) or 10.1% (2015 - 17.0 %).
- For the fiscal year, \$36 million was made available for program spending on academic programs, chairs and professorships, research and scholarships, an increase of \$2.4 million from the previous year.
- More progress was made in restructuring the investment portfolio as contemplated by the Investment Policy. In the growth strategy an additional specialist manager was retained to focus on publicly traded companies in emerging markets and commitments to three private equity investments and a private equity European real estate investment were finalized. Allocations to natural resource and oil and gas equities were brought towards their targets in the inflation sensitive strategy.
- The fund's benchmark returned -4.4%, indicating UEP outperformance of 4.0% on a one year basis. On a ten year basis the fund has outperformed its benchmark by an annualized rate of 0.7%.

Exhibit 2



Non-Endowed Funds - Highlights

- The Non-Endowed Investment Pool (NEIP) recorded an overall return of 0.6% for the year versus a 2015 return of 4.7 %.
- 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.

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 private equity energy funds.
- Deflation hedging assets are those that remain liquid and 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 or investment strategies 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 cash flow requirements, the liquidity strategy is focused primarily on the preservation of capital and invests predominantly in government and Canadian bank issued money market securities maturing within one year.
- In order to enhance the earnings of the Non-Endowed funds, while remaining focused on the preservation of capital, the yield strategy invests in government and Canadian bank issued bonds maturing within five years.
- To further enhance the long-term earnings potential of the Non-Endowed funds, the return seeking 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

During the year, a new equity investment manager was retained for an emerging market equity mandate. This strategy will be fully funded in the coming year. The growth strategy also saw new commitments to three private equity funds. It is anticipated that the overweight allocation to global equities will be maintained given that commitments to private equity are called over a period of years.

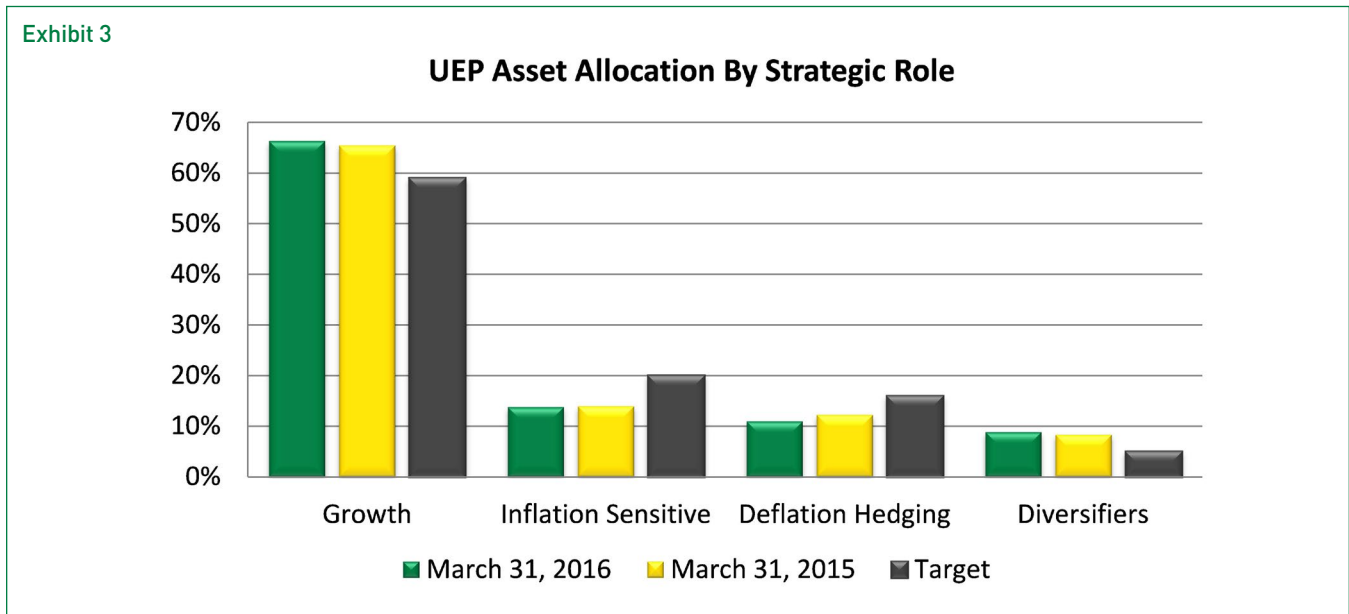
The inflation sensitive strategy saw a new commitment to a private equity European real estate investment, which will be funded through a rebalancing of the Canadian real estate allocation.

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.

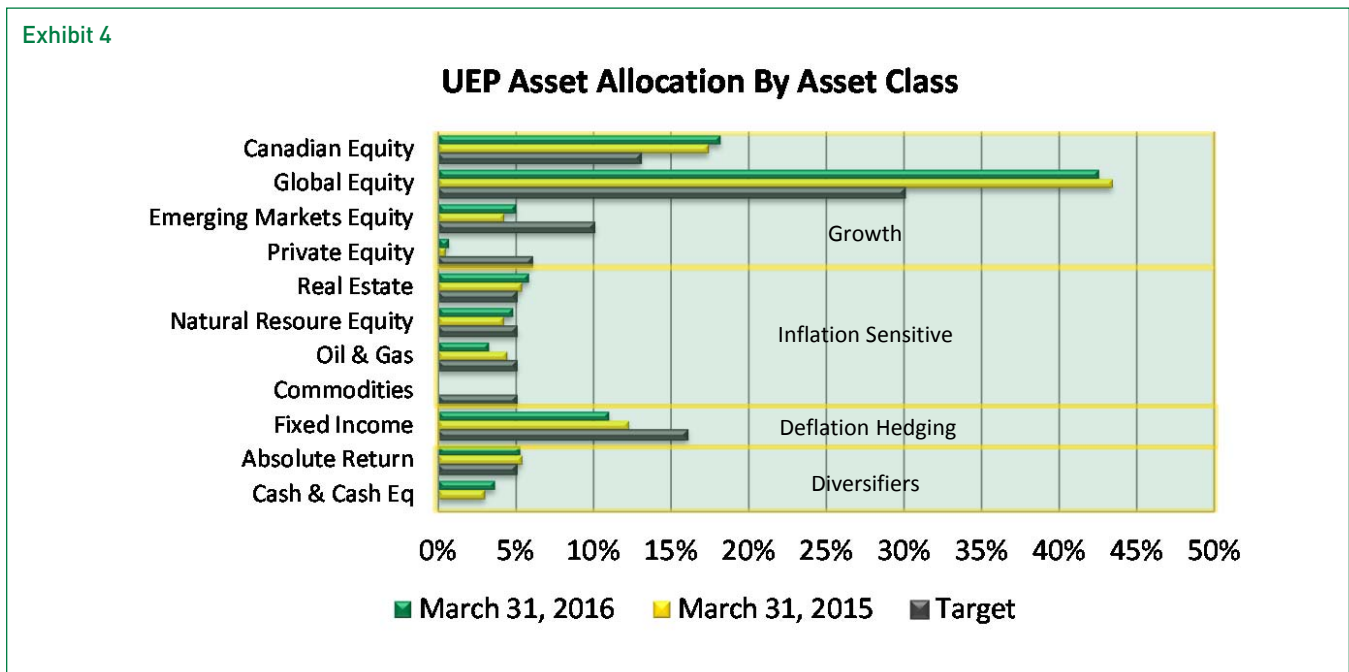
In the diversifiers strategy, a redemption notice was submitted to a hedge fund of funds. Redemption proceeds will be received in the coming year.

Endowment Funds

Endowment investments are categorized by Strategic Role in Exhibit 3.



Investments are also categorized by Asset Class in Exhibit 4.

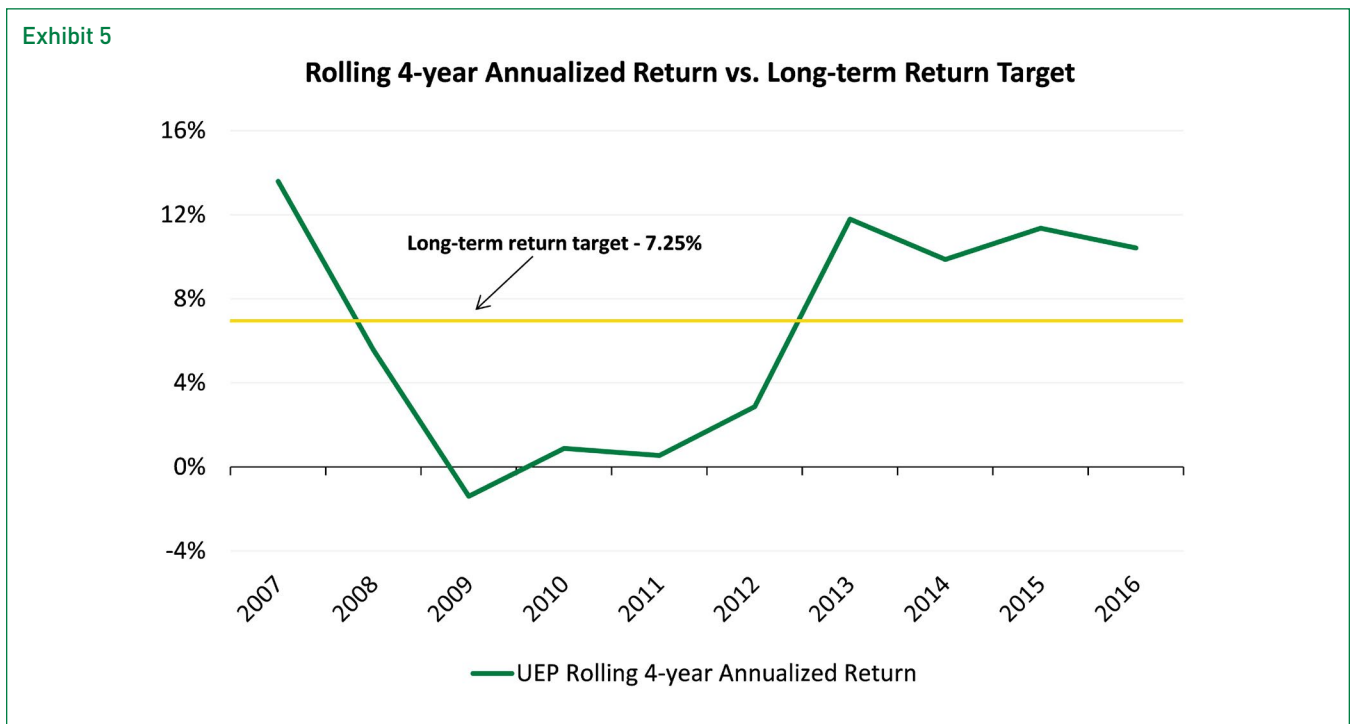


Investment Performance Relative to Objectives

The UEP recorded a return of -0.4% for the year ending March 31, 2016, falling short of total spending plus CPI of 5.4%. This followed three years in which investment returns surpassed total spending plus CPI by a healthy margin. The four year annualized return for the period ending March 31, 2016 was 10.4%, while annualized spending plus CPI for that time period was 5.8%. The return of -0.4% reflects:

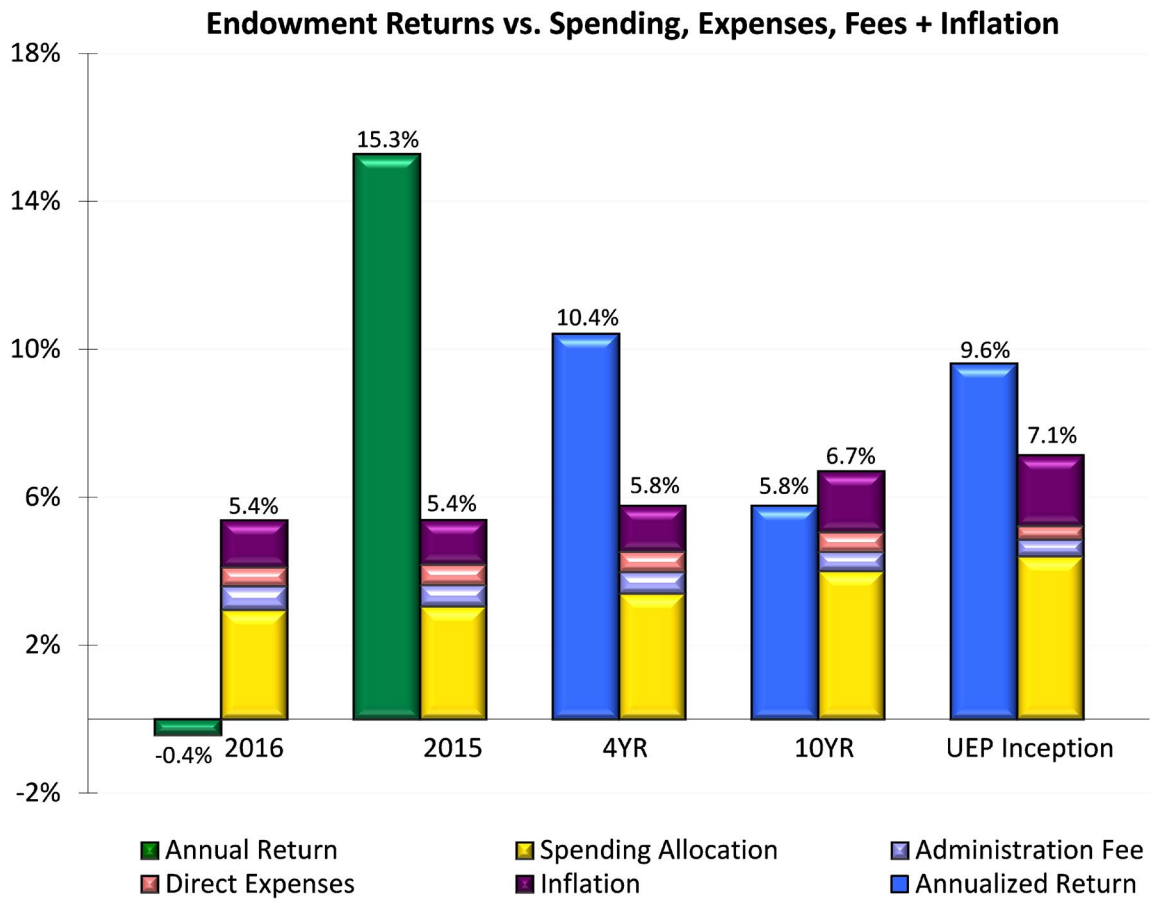
- weak global equity markets,
- falling commodity prices, and
- a high allocation to public equities.

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.



As shown in Exhibit 6 on the following page, the UEP has, since its April 1989 inception, produced an annualized return of 9.6%. This return has exceeded annualized total spending plus inflation of 7.1% over that time period. This objective has also been achieved over most other time frames in the graph below. The shortfall in returns over total spending plus inflation for the 10 year annualized period reflects 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 by Management together with active management decisions by our investment managers.

Exhibit 7

UEP Investment Policy Benchmark

MSCI Canada IMI	15%
MSCI World IMI	39%
MSCI Emerging Markets IMI	10%
IPD/Realpac Canada Property Index	5%
S&P Global Natural Resources Index	5%
Dow Jones North America Select Junior Oil/Gas Index	5%
FTSE/TMX All Federal Bond Index	16%
HFRI Fund of Funds Composite Index	5%
	100%

With its -0.4% return, the fund outperformed its benchmark by 4.0% or 400 basis points. There were two main reasons for this outperformance. First, active Canadian, global and emerging markets equity investment managers, in aggregate, outperformed the benchmark and contributed 310 basis points to total outperformance. Second, the underweight allocation to the poorly performing emerging market equities, global natural resources and energy, in aggregate, contributed a further 60 basis points to total outperformance. Lastly, cash holdings were slightly accretive to relative performance in this challenging return environment. This and several other factors in aggregate represent the remaining 30 basis points of outperformance.

Canadian equities gained 1.3% for the year, outperforming the S&P/TSX Composite Index benchmark by 7.9%. This was a high first quartile ranking in the BNY Mellon Canadian Master Trust Universe of peer Canadian equity managers. The lack of exposure to the very poorly performing Health Care sector, and an overweight to the strong performing Consumer Staples sector were major contributors to outperformance. Stock selection in many sectors, with the exception of the Materials sector, was also accretive.

In aggregate, global equity outperformed the MSCI World benchmark for the fiscal year, returning 2.3% or 3.1% above the benchmark. This was a first quartile performance. In aggregate the active investment strategies were more conservatively positioned than the broader market. The outperformance was the result of selecting managers who have lower volatility and focus on capital preservation in times of fluctuating markets.

Emerging market equities returned -1.9% for the year, outperforming the MSCI Emerging Markets Index by 7.9%. This was also a first quartile performance. This performance largely reflects the outperformance of one manager as the second emerging markets mandate was partially funded late in the fiscal year. Financials and health care were drivers of performance, while the utilities sector was the main detractor.

Canadian fixed income returned 1.7%, 30 basis points above the benchmark FTSE TMX Canada Federal Universe Index return of 1.4%. This represents a first quartile ranking for fixed income portfolios in the Canadian Fixed Income Master Trust Universe. This internally managed portfolio outperformed the index through duration management throughout the year.

The UEP invests in both Canadian and US real estate, which in aggregate returned 8.0%. The US open ended core diversified real estate fund performed in line with its benchmark returning 16.1%. The Canadian open ended core diversified real estate fund returned 4.8%, trailing its benchmark by 3.0%. A large underweight to retail properties and challenges in the Alberta office market contributed to the underperformance. Commitments continued to be called by the private (closed-ended) real estate fund that specializes in a value added strategy focused on US office properties. The fund is now nearly fully invested and is performing in line with expectations.

The weakness in commodity prices during the year contributed significantly to the poor performance of the ETFs that are being used for maintaining market exposure to global natural resource equities and junior North American oil and natural gas companies. The returns for these three ETFs were -13.6%, -29.0%, and -37.3% respectively. In aggregate the investment in these three ETFs detracted approximately 2.0% from the UEP's overall performance.

Absolute return strategies in aggregate performed poorly during the year, with an investment loss of -5.1%, which slightly outperformed the Hedge Fund Research Fund of Funds Composite Index return of -5.4%. The hedge fund of funds investment strategy recorded an investment loss of -3.0%, while the managed futures fund of funds investment strategy posted a loss of -7.3%.

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, 2014 and June 30, 2015 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, 2014 was comparable to the CAUBO 10 year median return of 6.5%. The University's 5.9% return for the ten year period ending June 30, 2015 trailed the NACUBO 10 year median return of 6.2% in US dollar terms.

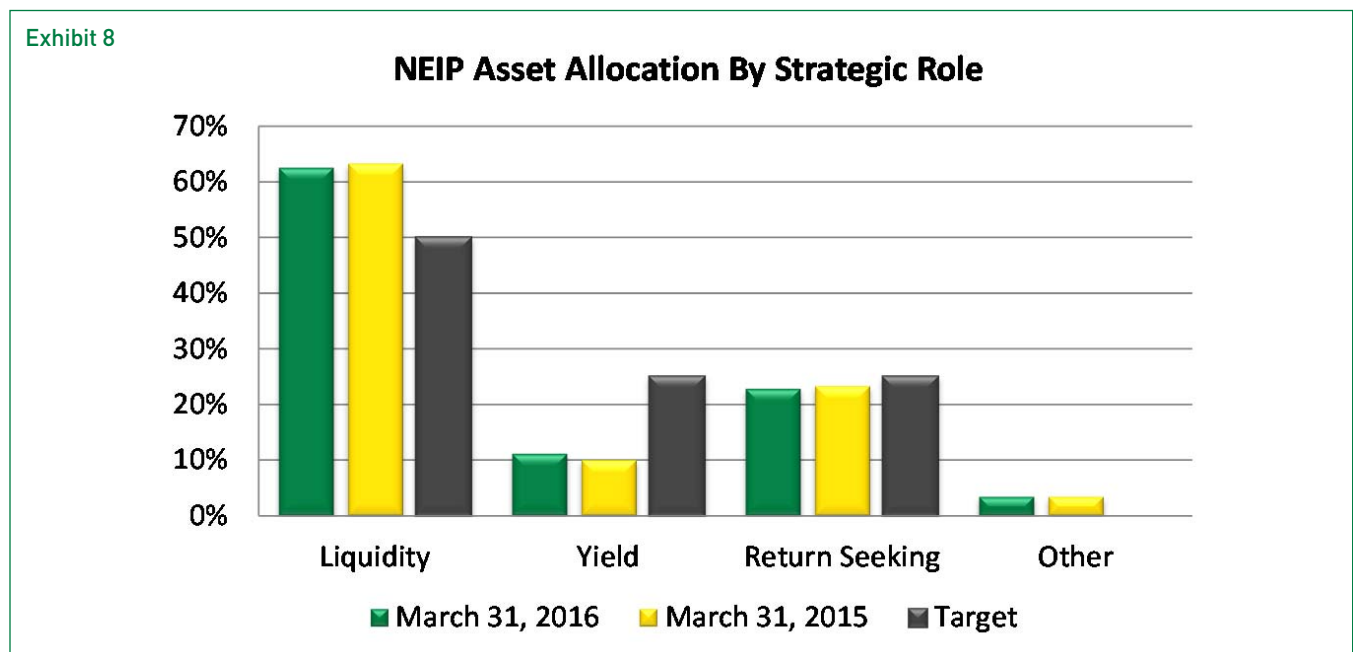
Costs

The fund incurred direct expenses (investment management and custodial fees) of \$6 million or 0.5% of the average market value of the fund. As part of a process of monitoring and managing costs, Management participated in the 2014 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 in line with those expected for funds of similar size and structure. This marks an improvement from prior years and reflects the cost saving measures that have been implemented by Management.

An administrative fee to support centrally funded indirect costs associated with endowment programs is charged to the endowments. For 2016 this amounted to \$7 million, representing 0.6% 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.

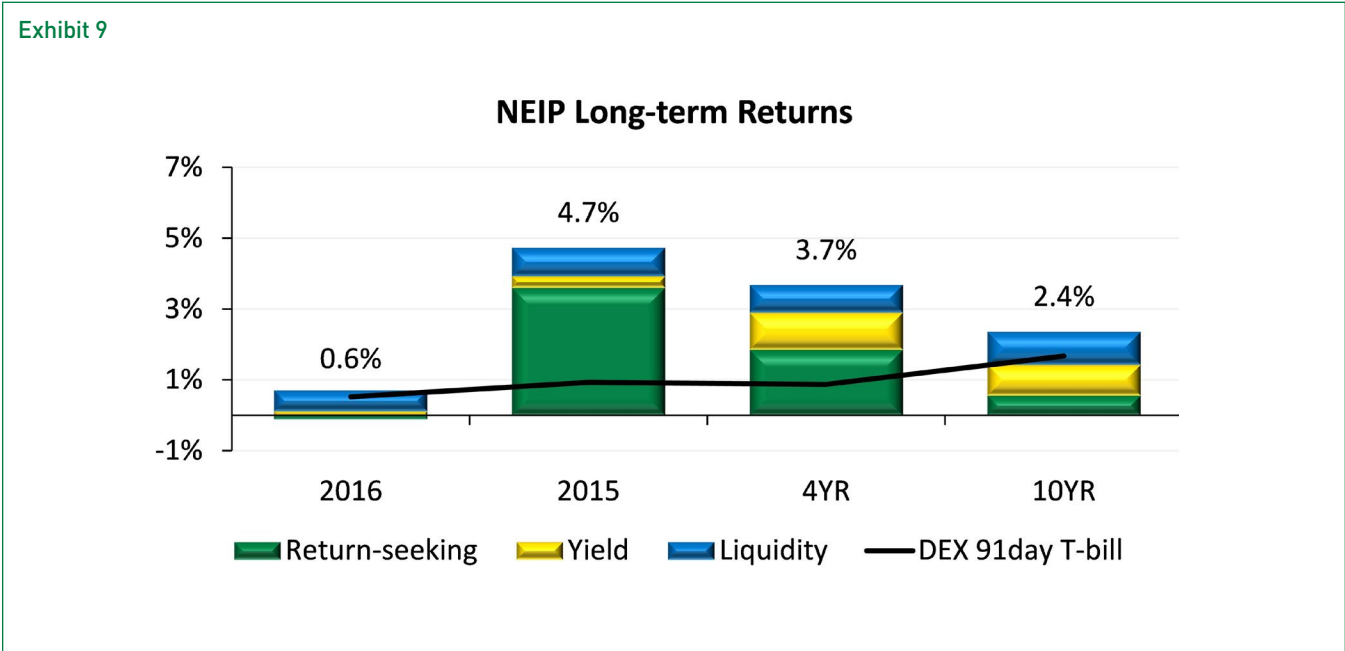


Investments in the liquidity strategy account for 63% of NEIP holdings. By focusing on investments of up to one year in bank and provincial issuers, the liquidity strategy returned 0.9% and outperformed the benchmark FTSE TMX Canada Treasury 91-day Index by 0.4% during the year.

NEIP's yield strategy returned 1.0% for the fiscal year, falling 0.1% short of the benchmark FTSE TMX Short-Term Bond Index. Holdings in the mid-term strategy had a higher average credit quality than the benchmark and earned a lower yield.

The allocation to the return seeking strategy, or UEP, had an investment return of -0.4%, which detracted from the NEIP's overall performance. For risk management purposes one half of prior years' returns in excess of UEP spending allocation has been set aside in a reserve that amounts to 10% of the investment.

The NEIP has benefited from its allocations to the yield and return seeking strategies over the longer term. The 10 year annualized returns fully reflect the impacts of the asset backed commercial paper holdings and the global financial crisis. Over this time period the NEIP returned 2.4%, outperforming the FTSE TMX Canada Treasury 91-day Index by 0.7%.



Going Forward

Despite this year's investment results the real value of the UEP remains healthy. In what may be a future lower return environment, increased emphasis will have to be placed on ensuring that the Investment Policy, together with the Spending Policy, continue to 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 2017 fiscal year:

- Complete a comprehensive externally facilitated review of the Investment Committee's Statement of Investment Principles and Beliefs,
- Complete an updated asset allocation study to ensure that the spending requirements can continue to be met with an investment risk profile that is appropriate for the University,
- Recruit one additional professional staff member and one support staff member to better position the Investments & Treasury team to meet the challenges of an increasingly complex investment program,
- Restructure the investment mandates within the diversified strategy to partially offset the equity market risk in the UEP,
- Engage a consultant to assist Management in the construction of a private equity program with a focus on primary fund commitments,
- Continue to increase the investment manager monitoring and compliance capabilities,
- Continue to assess the ongoing appropriateness of all existing investment strategies and mandates,
- Continue developing a risk budgeting framework for all aspects of the investment strategy including the performance monitoring process, and
- Investigate alternative investment mandates that would be suitable for the NEIP's yield strategy.





Investments & Treasury

Financial Services
3rd Floor Administration Building
University of Alberta

Ron Ritter
Director, Investments & Treasury
P: 780.492.9987
E: ron.ritter@ualberta.ca