INFORMATION REPORT

TO: Chair and Members Audit and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: February 17, 2010	
SUBJECT/REPORT NO: Reserve/Revenue Fund Investment Performance Report - December 31, 2009 (City Wide) (FCS09090(a))	
SUBMITTED BY: Roberto Rossini General Manager Finance & Corporate Services	**PREPARED BY:** Gerald T. Boychuk 905-546-4321
SIGNATURE:	

Council Direction:

Not Applicable.

Information:

The investment portfolio for the City's Reserve/Revenue Fund (comprised of reserves/revenue funds, capital account balances and unused operating funds) had an earnings rate of **4.26%** for the 12 months ending December 31, 2009, and an average earnings rate of **4.13%** over the past five years. Bond lending revenues of $97,365 are included in the rate of **4.26%.** The earnings rate includes interest and lending revenues but excludes realized and unrealized capital gains/losses.

The City's portfolio generated approximately $42.9 million in interest, realized capital gains, lending revenue and bank interest over the last 12 months ending December 31, 2009. The average dollar amount generated over the last five years is $32.9 million. Earnings in 2009 were buoyed by a record $10.2 million in realized capital gains. The total return of $42.9 million was realized on an average investment at cost of $750,642,769. The actual return on asset cost was 5.72%.

For the 12 months ending December 31, 2009, the overall return (which includes interest, bond lending revenues, realized and unrealized capital gains/losses) was **4.92%**; whereas, the benchmark return was **1.72%**, resulting in an out-performance by 320 basis points. Over the past five years, the overall return has averaged **4.91%** per annum, outperforming the average benchmark return over the same five-year period of **4.56%** by 35 basis points.

By comparison, the overall returns for the ONE Funds portfolios (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers' Association), over the 12 month period ending December 31, 2009, were 3.35% for bonds and 0.75% 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 **3.10%** or 182 basis points less than the actual return of 4.92%. On an average portfolio balance of $778 million, an increase of 1.82% return translates into a revenue increase of approximately $14.2 million.

Investment Return Indicators (for information purposes only)
(to December 31, 2009)

	12 Months ended 12/31/2009	**12 Months ended 12/31/2008**	**12 Months ended 12/31/2007**	**12 Months ended 12/31/2006**	**12 Months ended 12/31/2005**
Policy Target	1.72%	9.17%	4.50%	3.91%	3.48%
City's Portfolio	**4.92%**	**6.73%**	**3.67%(1)**	**3.32%**	**5.90%**
The One Fund – Bonds	3.35%	8.08%	3.84%	2.62%	2.09%
The One Fund – Money Market	0.75%	4.00%	4.39%	3.83%	2.52%
Dex - Short Government	1.94%	10.16%	4.53%	3.88%	2.23%
Dex – Mid Governments	1.57%	11.66%	4.52%	3.91%	5.43%
Lending Revenue	$97,365	$84,071	$61,220	$36,918	$44,596
Earnings Rate (Excludes Capital Gains/Losses)	**4.26%**	**3.61%**	**3.30%(1)**	**4.79%**	**4.71%**
City's Return ONE Fund Investment (Equity)	**31.18%**	**-19.04%**	**-0.15%**		

(1) The earnings rate in 2007 was adjusted for an allowance of $14.4 million due to ABCP holdings. This allowance is an estimate only and actual results may differ due to realization from these holdings.

As at December 31, 2009, the duration of the portfolio was 3.8 years compared to 3.4 years as at December 31, 2008. The total value of the portfolio was $704,847,459, a decrease of $71.8 million compared to December 31, 2008, mostly due to the result of keeping higher balances in the City's bank accounts rather than investments in the Reserve fund. Virtually no additional money market securities were purchased in 2009 because Treasury Bills and Bankers' Acceptances were yielding less than the rate earned on the City's bank account. The total value of the portfolio includes $80.1 million of restructured notes received in exchange for the previously held Asset Backed Commercial Paper (ABCP) as well as $9.9 million in Devonshire Trust ABCP which has not been restructured. Unrealized capital gains totalled $19,178,619. Capital gains of $10,163,629 were realized over the last 12 months, which represents the highest amount of capital gains for Hamilton. Capital gains, normally, are in the $300,000 to $5 million range for a typical year.

The original ABCP notes, in the amount of $87 million, were restructured on January 21, 2009. Arrears in interest of $4.18 million have been received on these notes, and the Court approved interest on the restructured MAV notes has been received. One restructured MAV3 note of $5.5 million has been fully repaid except for $71,156. One restructured note in the amount of $1.656 million has been written off against capital gains realized in 2009. The bulk of the restructured notes are expected to mature at or near par in 2016. The original Devonshire Trust notes in the amount of $10 million have not been restructured and are the subject of litigation between the City and Deutsche Bank. The Municipal Act has been amended, along with the City's Statement of Investment Policy and Procedures, to accommodate the retention of the restructured MAV notes and the original Devonshire Trust note.

The City began subscribing to the ONE Funds equity account in June 2007 and deposited $200,000 per month until December 2008. Investment in the fund was resumed in February 2009, but because of the uncertainty of the length of the recession, reduced to $100,000 per month. Over a period of 29 months ending November 30, 2009, the City has deposited $4.8 million. As at December 31, 2009, the market value of the City's investment in the ONE Funds Equity Fund was $4.817 million. Over the past 12 months ending December 31, 2009, the return was 31.18%.

The performance of the City's portfolio is attributed to the extension in duration (3.8 years as at December 2009 versus 3.4 years as at December 2008) and to holdings in the portfolio of Schedule-I Canadian bank deposit notes and Provincial bonds in the 5 to 10 year term. The exposure to bank notes and Provincial bonds added value as yield spreads tightened after having reached historically wide levels during the height of the crisis. Additionally, the portfolio benefited from the purchase of Canada bonds with term to maturity of 10 years, and then, as rates on Canada bonds began to rise in the

second half of 2009, they were switched (and sold at a profit) into Provincial bonds with term to maturity of 10 years which were offered at historically wide spreads. A reduction in the portfolio's holdings in money market securities, which offered returns less than 0.50%, also contributed positively to the better performance.

The composition of the City's fixed income portfolio was 100% bonds and 0% money market securities as at December 31, 2009, compared to 75% bonds and 25% money market securities as at December 31, 2008.

The chart below illustrates the changes in Canadian interest rates over the past 24 months:

CANADIAN INTEREST RATES			
Maturity Term: Canada Benchmark	**Interest Rate January 2, 2010**	**Interest Rate January 2, 2009**	**Interest Rate January 2, 2008**
One Month (T-Bill)	0.14%	0.83%	3.71%
2 yr	1.45%	1.10%	3.75%
5 yr	2.76%	1.70%	3.87%
10 yr	3.61%	2.69%	3.99%

By the end of 2009, helped largely by huge government stimulus and ultra-loose monetary policy, the worst financial crisis since the Great Depression had abated and the global economy was showing signs of recovery, with most developed countries (including Canada) having come out of recession in the third quarter of 2009.

Following the lows reached in global equity markets in March 2009, financial markets began their latest rally and risk aversion declined significantly. By the end of 2009, most global equity markets (including the S&P/TSX Composite) rallied about 50% or more from these lows. In 2009, commodity prices on average rebounded sharply, rising 50%; benchmark U.S. crude oil prices rose 78%; and the price of gold rose 25%. The Canadian dollar (alongside the move up in commodity prices) closed at 1.05 USD/CAD on December 31, 2009, up 14% over 2009. Although Government of Canada bond yields rose over 2009 as risk aversion waned, credit spreads in corporate, provincial and federal agency bonds staged a sharp contraction from the historically wide levels at the start of 2009, finishing at the end of 2009 at levels above, but not far from, pre-financial crisis levels.

Currently, concerns center on the sustainability of the stimulus-driven recovery given that private demand (and credit availability) is weak and unemployment remains stubbornly high in both Canada and the U.S. With inflation expectations currently contained, and a strengthening Canadian dollar, the Bank of Canada at its most recent meeting on January 19, 2010 reiterated its conditional commitment to hold the policy rate at 0.25% until the end of the second quarter of 2010. Similarly, the Federal Reserve in the U.S. said at its last meeting on December 16, 2009 that economic conditions are likely to "warrant exceptionally low levels of the federal funds rate for an extended period".

Recently, the International Monetary Fund acknowledged faster than expected global economic recovery, but cautioned governments against paring their anti-crisis measures too quickly for fear this may set off another downturn. In Canada, short-term rates are expected to rise in the second half of 2010, and if inflation expectations remain contained, longer rates will not rise as quickly leading to flattening of the yield curve. Longer term rates are not expected to decline significantly unless long-term deflation unfolds.

Investments for the City portfolios will be focused on the highest credit quality bonds issued by either governments, major Canadian banks, and now may include eligible corporate bonds with a minimum rating of single A and a term of 5 years or less. Opportunities will be taken to shorten slightly the duration of the portfolio as longer term rates are anticipated to increase as the economy recovers.