# University of Toronto Asset Management Corporation

2004 Annual Report

## Mission

The University of Toronto Asset Management Corporation strives to create added value by providing both current and future financial resources for the University and its pension funds that will contribute to globally recognized education and research.

We will strive to provide state of the art investment management with diligence, competence and the highest of professional conduct, and continually seek out and formulate the best investment ideas into prudently managed portfolios that optimally balance risk and return.

## Table of Contents



# UTAM Annual Report 2004

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All market values and returns mentioned in this report are in Canadian dollar terms, unless otherwise stated.

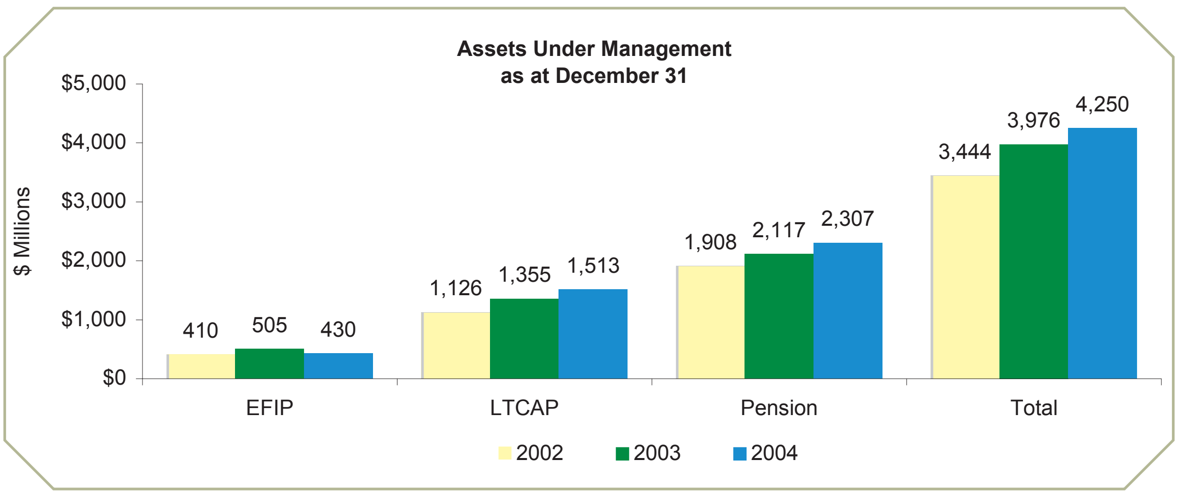
## INTRODUCTION

The University of Toronto Asset Management Corporation (UTAM) was established by the University in April 2000. UTAM is an investment management subsidiary wholly owned by the University and governed by its own Board of Directors. The UTAM Board is responsible for the oversight and direction of UTAM and reports on the investments under management to the Business Board of the University of Toronto.

The audited financial statements for the operations of UTAM for the year ended December 31, 2004 are presented at the end of this report. The assets invested by UTAM, discussed below, are held by the University of Toronto and are reported, as applicable, in the University's financial statements, and in the University of Toronto Pension Plan and OISE Pension Plan financial statements.

## ASSETS UNDER MANAGEMENT

**Exhibit 1**




UTAM oversees the University of Toronto's three pools of assets, which in total were valued at $4.25 billion at December 31, 2004 ($3.98 billion at December 31, 2003), an increase of 6.9%.

The Pension Master Trust (Pension) investment fund combines the assets of the University of Toronto Pension Plan and OISE Pension Plan. The market value of these assets at December 31, 2004 was $2.31 billion, an increase of $190 million (9.0%) over the previous year-end.

The Long Term Capital Appreciation Pool (LTCAP) essentially represents the endowment fund of the University. The market value at December 31, 2004 was $1.51 billion, an increase of $158 million (11.7%) over the previous year-end.

The Expendable Funds Investment Pool (EFIP) consists of expendable funds that are pooled for investment for the medium term. The nature of the use of these assets means that the total can fluctuate significantly over time. The market value at December 31, 2004 was $430 million, a decrease of $75 million from the previous year-end.

I am pleased to report that 2004 was a successful year for the University of Toronto Asset Management Corporation. UTAM was established in April 2000, which we now know was the top of the equity market worldwide. Markets have gradually recovered from the two-year decline that followed, and both 2003 and 2004 have provided good gains for the University's endowment and pension funds.

2004 was the first year that our President, Felix Chee, was able to devote himself to UTAM on a full-time basis, and he has been very active. There have been some personnel changes, which are never easy and not surprising, but the UTAM team appears to be stronger than ever. Felix is doing a great job managing our assets.

Our Board of Directors has been expanded and bolstered by the addition of four new people. Mr. William Hewitt and Mr. Robert Morrison joined our Board in May. These two gentlemen held very senior financial roles in the Canadian life insurance industry and both are eminently well equipped to contribute to the Board's decision-making. Both have joined the Audit and Compliance Committee and are providing strong support to its Chair, Professor Eric Kirzner.

UTAM's Board was further strengthened by the addition of the Honourable Frank Iacobucci, Interim President of the University of Toronto, who is ably filling the seat held by the former President Robert Birgeneau. Professor Birgeneau played an active role at UTAM during his tenure, and I wish him every success in his new role as Chancellor of the University of California at Berkley.

Finally, in December, Mr. W. David Wilson, Vice-Chair of the Bank of Nova Scotia and CEO of Scotia Capital, joined the Board as the cross-appointment between the Board and the University's Governing Council. This outstanding appointment will add even further strength to an extraordinary group of directors.

I would like to thank Ms. Andrea Rosen for her very valuable service on the Board and on its Audit and Compliance Committee. Upon the birth of her second daughter, Andrea decided, regrettably, not to continue on the Board for 2004, as she decided to take leave from her very senior role at the TD Financial Group.

UTAM is well situated in our unpredictable world with an asset mix of stocks, bonds, private equity funds, real-asset funds, hedge funds and a diverse currency mix. The fund is managed with a view to long-term performance.

I would like to thank the staff of UTAM for their very hard work, and I would like to thank my colleagues on the Board of Directors for the contribution of their extraordinary expertise and seasoned wisdom, for many stimulating discussions, and for the support they so graciously give to their Chair. My special thanks to Vice-Chair Joseph Rotman, Audit and Compliance Committee Chair Eric Kirzner, and Compensation Committee Chair Tom Simpson.

**Ira Gluskin**
Chairman

Amidst choppy financial markets and geopolitical turmoil, UTAM had another successful year in 2004. Both LTCAP and Pension returns were better than their benchmark. From a peer universe comparison basis, both funds were again in the 1st quartile.

2004 also saw some significant strategy changes. First, we unwound our investments in virtually all of our direct hedge funds and moved into absolute return hedge fund-of-funds. This change reflected prudence to leverage the necessary knowledge and infrastructure critical in this area. An extensive search was conducted and to date four fund-of-funds have been selected.

In 2004, an overall strategy for Private Equities and Real Assets was approved by UTAM's Board and subsequently six new commitments totalling some $89 million have been made. The strategy provides a roadmap for our activities over this wide and diverse space of alternative investments.

2004 was also a year of organizational changes, both in terms of personnel and our management process. John Lyon joined UTAM in May 2004 as Managing Director of Investment Strategy, and has contributed significantly to enhancing our investment process and management reporting. Our focus has moved from one that primarily dealt with external manager selection to one that focuses on portfolio strategy, both at the overall portfolio level and for each asset class.

Looking forward to 2005, UTAM will continue to innovate in order to generate competitive returns in increasingly volatile and uncertain markets. Specifically, we will be initiating a program to separate market returns from value added by active management. This program will enhance our performance as well as creating greater portfolio management flexibility. As always, our mantra is to be nimble, smart and cost effective.

We continue to enjoy and are highly appreciative of the support from our Board of Directors and also the University. I would like to take this opportunity to welcome all the new Board members and to express our appreciation to all Board members for the wise counsel that they openly and generously provide.

The success that UTAM has enjoyed in the past two years is in no small part the result of the dedication and effort of the staff. I thank them for their contribution and now look forward to 2005 with momentum and confidence.

**Felix P. Chee**
President and CEO

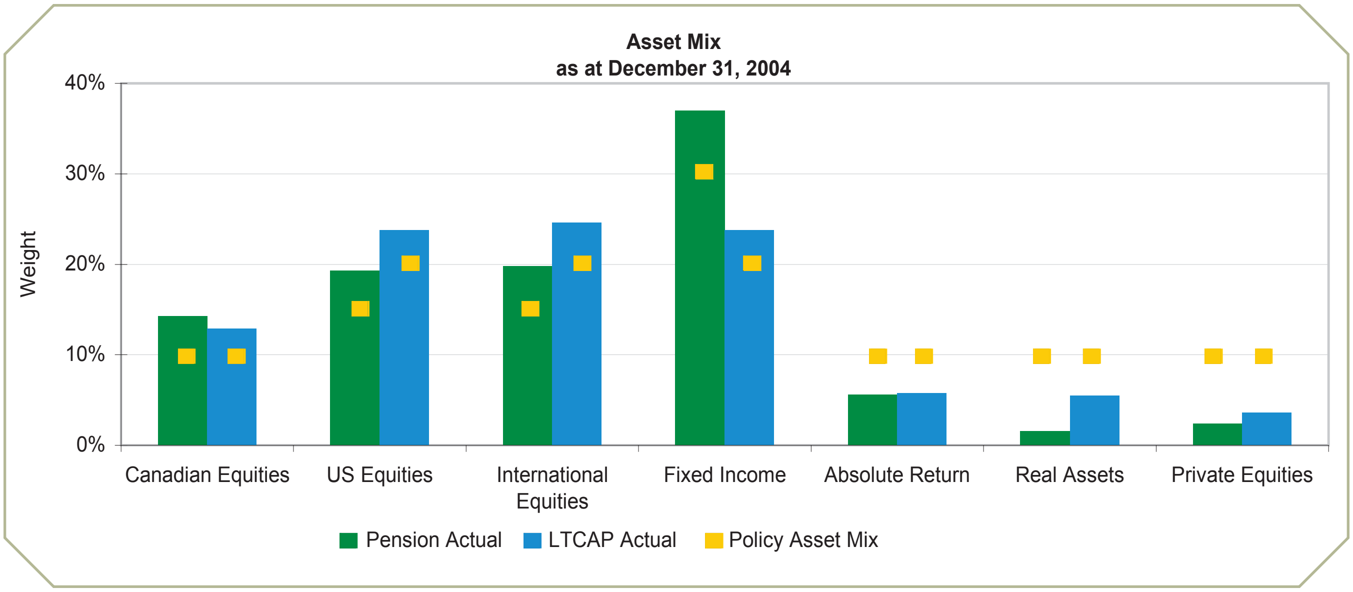
The investment objectives, in terms of risk and return, of the portfolios overseen by UTAM are reviewed on an annual basis by the University, which establishes these parameters.

| | Pension | LTCAP |
|---|---|---|
| **2004** | | |
| Return Target | 7% nominal return plus fees and levies | 4% real return plus fees and levies |
| Risk Tolerance | 10% annual standard deviation of nominal returns | 10% annual standard deviation of nominal returns |
| **2005** | | |
| Return Target | 4% real return plus fees and levies | same as 2004 |
| Risk Tolerance | same as 2004 | same as 2004 |

For EFIP, the return requirements were previously set as an absolute return level for the year. However, a comprehensive review and asset modeling of EFIP, and the investment objectives for that portfolio, was completed in 2004.

As a result, the return requirement was changed from an absolute level to 1-year Treasury Bills plus 50 basis points, with a moderate tolerance for risk.

**Exhibit 2**




## POLICY ASSET MIX

UTAM develops and executes appropriate investment strategies, including the policy asset mix, based on the risk and return parameters established by the University. The policy asset mix of the portfolios is periodically subjected to a comprehensive review, in conjunction with the liability requirements of the portfolios. In 2004, it was only considered necessary to undertake a full review of EFIP, which resulted in a number of changes to the policy asset mix for that portfolio for 2005. For Pension and LTCAP, the policy asset mix remains the same for 2004 and 2005.

The return requirements and risk tolerance for Pension and LTCAP are essentially the same. Therefore, the policy asset mix of these two portfolios is very similar, the key difference arising because the Pension portfolio was subject to foreign content restrictions. As a result, the policy asset mix weights for US Equities and International Equities in the Pension portfolio are each 5% less than in LTCAP, with the 10% difference allocated to Fixed Income (5% for nominal bonds and 5% for real return bonds).

For both Pension and LTCAP, the portfolios can be viewed as essentially "balanced funds", which would traditionally have about a 60% allocation to equities and 40% to fixed income. The resulting 3:2 ratio (i.e. 60:40) is approximated in the policy asset mix for these asset classes. The introduction of a 30% target weight in Alternative Assets (Absolute Return, Real Assets and Private Equities allocations of 10% each) provides the opportunity to benefit from diversification, through lower correlations, and enhanced return potential. In addition, the Absolute Return allocation provides the opportunity for lower volatility and the Real Assets allocation provides a hedge against inflation.

For EFIP, the change in return target to 1-year Treasury Bills plus 50 basis points has resulted in a more fundamental change to the policy asset mix. There is now a larger allocation to the Absolute Return category, with an average target weight of about 25-30%, which would potentially rise to about 40% at the expected annual low-point in total EFIP assets. The Fixed Income portion of EFIP will be more heavily oriented towards shorter term holdings than was previously the case, but still targeted at investment grade holdings. The net result is expected to be lower volatility.

### ACTUAL ASSET MIX

There are two key sources of divergence between the policy asset mix, or target weight, and the actual asset mix.

Firstly, UTAM management has the discretion to diverge from the policy asset mix to a pre-determined modest limit, which depends on the size of the target weight (i.e. more latitude for larger target weights).

Secondly, participation in certain asset classes (e.g. Private Equities) requires significant time and effort to source and fund investments, compared to public market securities. As a result, holdings accumulate slowly over time such that the actual asset mix builds gradually towards the policy asset mix. This situation applies to UTAM's Private Equities and Real Assets categories, which are each comprised of private market investments. In the interim while holdings are built up in these asset classes, UTAM allocates the shortfall from the target weight, on a pro rata basis, to the public market equities and public fixed income asset classes. This reallocation process creates near-term target weights (not shown in Exhibit 2) that provide the flexibility for a disciplined build-up in the Private Equities and Real Assets holdings over time, towards the policy asset mix shown in Exhibit 2.

Absolute Return holdings can be built up to target levels more quickly than Private Equities and Real Assets holdings. The shortfall from policy asset mix at year-end simply reflects the temporary impact of a partially completed transition from hedge funds to hedge fund-of-funds holdings in this category.

### FOREIGN EXCHANGE EXPOSURE

The underlying philosophy at UTAM is to exploit global opportunities. This focus results in foreign exchange exposure. To control the volatility from foreign currency fluctuations impacting overall returns, a hedging policy with varying hedge ratios for different asset classes was established in 2003.

The hedge ratios for the applicable benchmarks are:

i) 50% for Equities and Real Assets;
ii) 100% for Non-Canadian Fixed Income; and
iii) 75% for Absolute Return.

The 50% hedge ratio for Equities and Real Assets reflects a "minimum regret" outcome on hedging. For Fixed Income, where stable returns are desired, the 100% hedge ratio insulates the asset class from foreign exchange fluctuations but expands the opportunity set for bonds to the global bond markets. The 75% hedge ratio for the Absolute Return category recognizes that the strategies employed reflect both bonds and equities. An active overlay strategy, within operating limits, is employed in managing the foreign exchange exposure. The results of this active overlay strategy are provided in Exhibit 5.

UTAM evaluates investment performance in two key ways:

i) versus passive index returns (benchmarks) at the portfolio and asset class levels; and
ii) versus peers on overall portfolio level performance.

## PERFORMANCE VERSUS BENCHMARKS

All three portfolios (EFIP, LTCAP and Pension) outperformed their benchmarks in 2004 at the total portfolio level, net of all fees and expenses (see Exhibits 3 and 4). This was achieved against a backdrop of choppy markets, significant restructuring of our portfolios and an overall defensive posture in the underlying holdings.

At the individual asset class level, all outperformed their respective benchmarks except US Equities, Nominal Bonds and Absolute Return (see Exhibit 5).

Within equities, Canadian Equities performance was exceptional, given solid results from certain active managers. The reverse was exhibited in the US Equities market, where active managers broadly underperformed. In International Equities markets, the results were mixed among our active managers. A number of manager changes were made in 2004 and an in-depth review of our active manager line-up will be undertaken in 2005.

Part of our Equities program is invested synthetically using index futures. Given the uncertain markets, our synthetics program was oriented towards a defensive posture in large capitalization indexes. Overall, the synthetic program met the benchmark.

For Fixed Income, we achieved outperformance on our allocation to Real Return Bonds. This partially offset our deliberate defensive posture on Nominal Bonds, where we kept duration short and credit quality high.

2004 was not a banner year for Absolute Return Hedge Funds. Low equity market volatility, tight credit spreads and low interest rates were not conducive to hedge fund performance generally. The most significant change in 2004, however, was our transition to Absolute Return hedge fund-of-funds from direct hedge funds. This change diversified our exposure considerably, made the portfolio less directional relative to equity markets and will improve the management of the Absolute Return program in various ways. The benefit of this change is reflected in a current portfolio that has significantly lower volatility.

Currency was once again a significant issue in 2004. Our active currency manager contributed positively for the year, as shown in Exhibit 5.

Exhibit 3

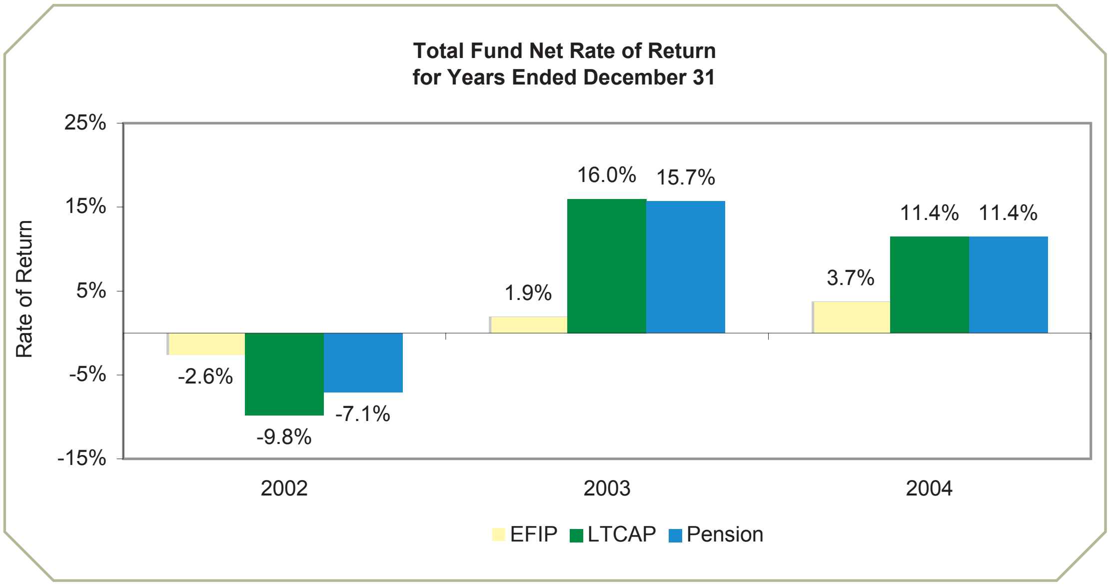
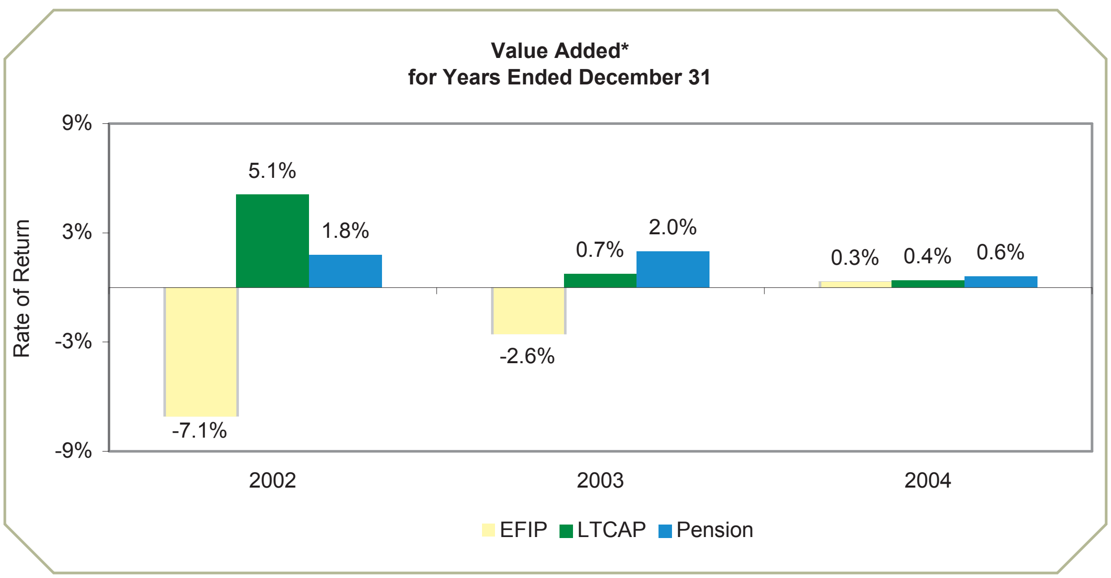



Exhibit 4




** Value Added refers to the actual return, net of fees, less the benchmark return.*

**Exhibit 5**

**Rates of Return and Comparison to Benchmarks for Periods Ended December 31, 2004**

| | Rate of Return (%) | | Value Added* (%) | |
|---|---|---|---|---|
| | **1-Year** | **3-Year** | **1-Year** | **3-Year** |
| **PENSION** | | | | |
| Canadian Equities | 16.0 | 11.7 | 1.5 | 3.4 |
| US Equities (in USD) | 11.7 | 5.6 | -0.2 | 0.8 |
| International Equities | 12.0 | 2.5 | 0.1 | 0.4 |
| Fixed Income - Total | 11.3 | 9.5 | -0.3 | -0.1 |
| *Nominal Bonds* | *7.8* | *8.2* | *-0.9* | *-0.6* |
| *Real Return Bonds* | *17.6* | - | *0.1* | - |
| Absolute Return (in USD) | 5.7 | 6.5 | -0.5 | 0.4 |
| **Total Fund Unhedged** | **9.6** | **4.4** | - | - |
| *Currency Overlay* | *1.8* | *1.8* | *0.5* | - |
| **Total Fund Including Hedging** | **11.5** | **6.2** | **0.6** | **1.5** |
| **LTCAP** | | | | |
| Canadian Equities | 18.0 | 13.4 | 3.5 | 5.1 |
| US Equities (in USD) | 11.2 | 7.2 | -0.7 | 2.4 |
| International Equities | 12.0 | 3.5 | 0.1 | 1.4 |
| Fixed Income - Total | 12.5 | 10.3 | -0.6 | 0.2 |
| *Nominal Bonds* | *7.2* | *8.1* | *-1.5* | *-0.7* |
| *Real Return Bonds* | *18.0* | - | *0.5* | - |
| *High Yield Bonds (in USD)* | *11.9* | - | *1.1* | - |
| Absolute Return (in USD) | 3.6 | 4.5 | -2.6 | -1.6 |
| Real Assets | 11.9 | 7.7 | 6.3 | 2.1 |
| **Total Fund Unhedged** | **8.4** | **2.4** | - | - |
| *Currency Overlay* | *3.1* | *2.8* | *0.6* | - |
| **Total Fund Including Hedging** | **11.5** | **5.2** | **0.3** | **2.4** |

| **Asset Class** | **Benchmark** | | |
|---|---|---|---|
| Canadian Equities | S&P/TSX Composite Index | 14.5 | 8.3 |
| US Equities (USD) | Russell 3000 | 11.9 | 4.8 |
| International Equities | MSCI EAFE | 11.9 | 2.1 |
| Nominal Bonds | 50% SC Universe + 50% SC Long | 8.7 | 8.8 |
| Real Return Bonds | SC Real Return Bonds | 17.5 | - |
| High Yield Bonds (USD) | Merill Lynch High Yield Bond Index | 10.8 | - |
| Absolute Return (USD) | LIBOR (3-month) + 450 basis points | 6.2 | 6.1 |
| Real Assets | 50% NCREIF + 50% GSCI | 5.6 | 5.6 |

* Refers to the actual return, net of fees, less the benchmark return.

## PERFORMANCE VERSUS PEERS

The Total Fund relative performance, versus peers, of Pension and LTCAP was solidly in the 1st Quartile for 2004 on a 1-year basis, improving on the strong results in 2003. On a 3-year basis, the results in 2004 were notably improved for both portfolios over 2003.

**Exhibit 6**

**Peer Comparison Percentile Ranking***
**for Periods Ended December 31**

| | Pension | | | | LTCAP | | | |
|---|---|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2004 | | 2003 | |
| | 1-Year | 3-Year | 1-Year | 3-Year | 1-Year | 3-Year | 1-Year | 3-Year |
| **Total Fund** | **18** | **45** | **27** | **72** | **17** | **67** | **25** | **88** |
| Canadian Equities | 33 | 14 | 39 | 57 | 12 | 11 | 34 | 39 |
| US Equities** | 56 | 51 | 39 | 42 | 58 | 41 | 24 | 34 |
| International Equities** | 36 | 35 | 28 | 38 | 36 | 31 | 22 | 29 |
| Fixed Income | 2 | 13 | 19 | 33 | 1 | 4 | 4 | 9 |

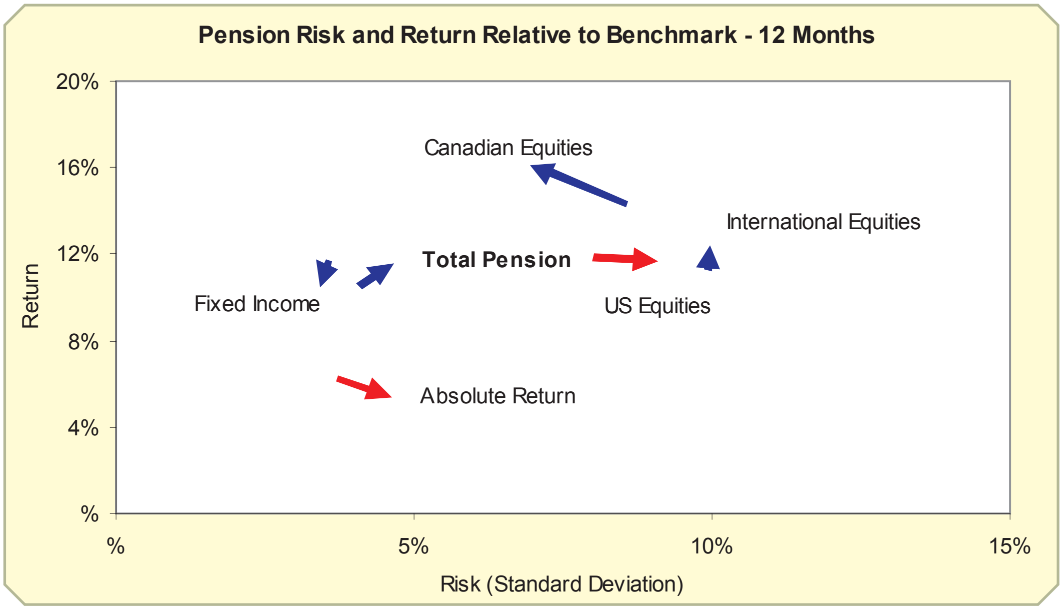
* RBC Global Services Balanced Fund and Asset Class Universes.
** Unhedged CDN$ returns.

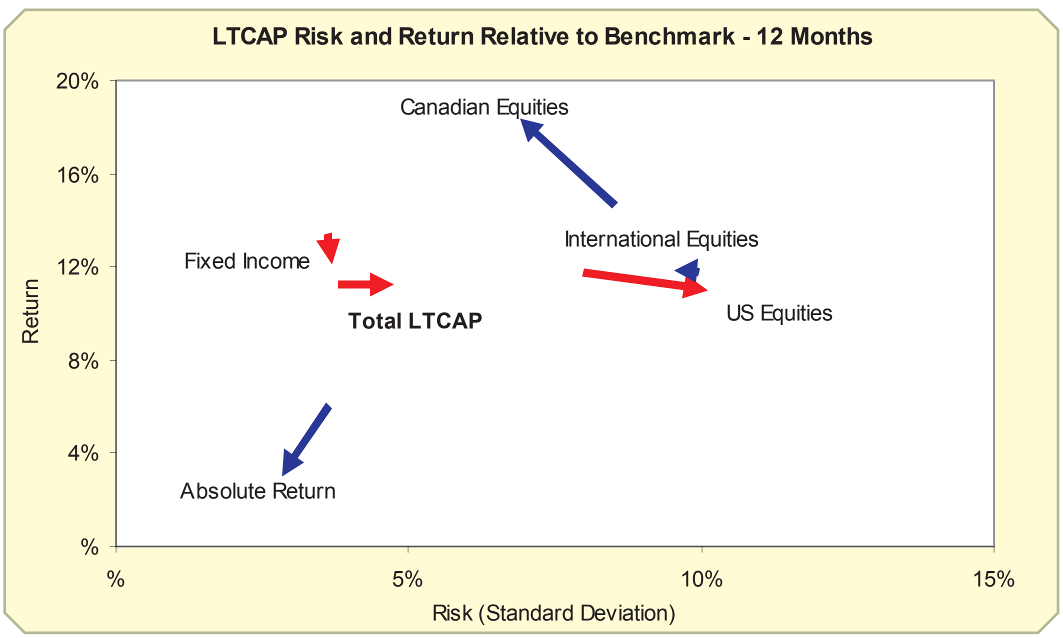
## RISK VERSUS RETURN

Exhibit 7 maps the actual versus benchmark risk/return position of Pension and LTCAP, and the individual asset classes within each of these portfolios. The base of each arrow represents the risk/return point of the benchmark, while the head of each arrow represents the actual position of the portfolio or asset class. The arrow's direction indicates how active management has altered the risk/return profile versus the benchmark. A blue arrow indicates that the actual portfolio, or asset class, has moved in the desired direction versus the applicable benchmark (e.g. higher return for the same or lower risk). A red arrow indicates that the actual portfolio, or asset class, was not ideally positioned relative to the applicable benchmark (e.g. lower return for the same risk).

For 2004, most asset classes had a better risk/return profile then their passive benchmarks, US Equities being a notable exception, where returns were disappointing. In the Absolute Return category, there has been a discernable reduction in volatility relative to the individual hedge funds held in the portfolios in 2003. This is more evident in LTCAP than Pension due to the timing of transition to hedge fund-of-funds. Overall, the LTCAP return did not suffer, and the Pension fund return improved.

**Exhibit 7**


Pension Risk and Return Relative to Benchmark - 12 Months
20%
16%
12%
8%
4%
%
Return
Canadian Equities
International Equities
Total Pension
Fixed Income
US Equities
Absolute Return
%
5%
10%
15%
Risk (Standard Deviation)


LTCAP Risk and Return Relative to Benchmark - 12 Months
20%
16%
12%
8%
4%
%
Return
Canadian Equities
International Equities
Fixed Income
US Equities
Total LTCAP
Absolute Return
%
5%
10%
15%
Risk (Standard Deviation)

**Ira Gluskin**
**Chair of the Board of Directors**

Ira Gluskin and Gerry Sheff founded Gluskin Sheff + Associates in 1984. Ira continues to be President and Chief Investment Officer. Prior to 1984 Ira worked for a prominent life insurance company, a prominent research brokerage firm and a prominent mutual fund manager. All three have disappeared in the financial services consolidation that has occurred. Ira is active in a variety of business, community and cultural organizations. He is chairman of the University of Toronto Asset Management Corporation. Ira is Chair of the Investment Advisory Committee for the Jewish Foundation of Greater Toronto and a member of the Foundation Board. He is also a member of the Mount Sinai Hospital investment and Budget Committees, as well as being a member of its Foundation. Ira is noted for his outspoken and provocative views on all aspects of business and on the income trust and real estate sectors in particular.

Joseph L. Rotman, **Vice Chair**
Roy-L Capital Corporation, Chairman and CEO

Eric F. Kirzner, **Chair of the Audit and Compliance Committee**
Rotman School of Management, Professor of Finance

Thomas H. Simpson, **Chair of the Compensation Committee**

Felix P. Chee
University of Toronto Asset Management Corporation, President and CEO

William E. Hewitt
The Honourable Frank Iacobucci
University of Toronto, President

Anthony R. Melman
Onex Corporation, Managing Director

Robert W. Morrison

James J. Mossman
Retired Senior Managing Director and CIO of the Blackstone Group

Catherine J. Riggall
University of Toronto, VP Business Affairs

W. David Wilson
Bank of Nova Scotia, Vice Chair

Neil H. Dobbs, *Secretary*
University of Toronto, Deputy Secretary to the Governing Council

*Master Custodian*

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State Street Financial Centre
Toronto, Ontario M5C 3G6

*Auditors*

Ernst & Young
Ernst & Young Tower
Toronto, Ontario M5K 1J7

**Felix P. Chee**
**President and Chief Executive Officer**

President and CEO of University of Toronto Asset Management Corporation. He was previously Vice President of Business Affairs at the University of Toronto. Prior to joining the University of Toronto he held the positions of Executive Vice President and Chief Investment Officer at Manulife Financial; Senior Vice-President of Corporate Finance at Ontario Hydro Corporation; and Senior Investment Officer of the International Finance Corporation at the World Bank Group. He currently serves as director of The University of Toronto Innovation Foundation, MaRS, CenterPlate and also UTAM. Felix holds a Bachelor of Technology (Honours) from Loughborough University of Technology; a Masters of Science from the Imperial College of Science and Technology; and a Masters of Business Administration from York University.

John L. W. Lyon, CFA, CA
Managing Director, Investment Strategy

Jeffrey D. Sutcliffe, CFA, FCSI
Director, Fixed Income

Lisa Chung
Manager, Operations

Rabinder Grewal
Investment Analyst

Tanya Lai, CFA
Investment Analyst

Vera Lau, CCM
Investment Operations Coordinator

Jillian Miranda
Administrative Assistant

Michael Notto
Investment Analyst

Tiffany Palmer
Manager, Compliance

Maria Wus, CFA
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Roslyn Zhang, CFA
Performance Measurement Analyst

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