



FOR INFORMATION

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TO: Business Board

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DATE: April 19, 2023 for April 26, 2023

AGENDA ITEM: 4

ITEM IDENTIFICATION:

Semi-Annual Update on Investment Performance and Responsible Investing Activities to December 31, 2022

JURISDICTIONAL INFORMATION:

Under Section 5(1)(b) of the Business Board terms of reference, the Board reviews regular reports on matters affecting the finances of the University, including reports on investments.

GOVERNANCE PATH:

- 1. Business Board [for information] (April 26, 2023)**

PREVIOUS ACTION TAKEN:

The UTAM financial statements for the year ended December 31, 2022 were approved by the UTAM Board at its meeting of March 20, 2023. However, the UTAM Board has not yet approved the complete Annual Report, including the summary of annual investment activities, governance, risk management, portfolio performance, and responsible investing activities. Therefore, the 2022 UTAM Annual Report, including the UTAM audited financial statements for the year ended December 31, 2022, will be provided for information at the next Business Board meeting on June 20, 2023.

HIGHLIGHTS:

In 2022, UTAM managed two distinct portfolios of assets under an investment management agreement between the University and UTAM:

- Long-Term Capital Appreciation Pool (“LTCAP”), which consists of certain endowment assets of the University of Toronto as well as other long-term assets; and,
- Expendable Funds Investment Pool (“EFIP”), which consists of short-term working capital assets of the University.

UTAM, which was formed in April 2000, is a separate non-share capital corporation controlled (effectively owned) by its members who are appointed by the University of Toronto. UTAM is registered with the Ontario Securities Commission in the category of Portfolio Manager. UTAM’s primary mandate is to manage or see to the management of, the investment funds that are delegated to it by the University of Toronto.

Investment Performance

The University has established an investment target for LTCAP at an annual investment return of 4.0% plus the increase in CPI, net of fees and expenses, over ten year periods. For the year ending December 31, 2022, the target investment return (including CPI) net of fees and expenses was 10.5% (2021: 8.8%). The actual investment return for the year was -8.9% (2021: 14.9%) for LTCAP. The actual investment return for the Reference Portfolio was -13.0% (2021: 10.2%). (Note that the Reference Portfolio is a theoretical public market passive portfolio that assumes a traditional 60%/40% equity/fixed income asset allocation and does not include any allocation to alternative assets or strategies).

In 2022, the actual LTCAP return was higher than the Reference Portfolio return by 4.1 percentage points (-8.9% *versus* -13.0%) but it was less than the target return by 19.4 percentage points (-8.9% *versus* +10.5%).

Over the 10-year period ending December 31, 2022, LTCAP outperformed its target return by 1.8 percentage points per annum and it outperformed the Reference Portfolio by 1.9 percentage points per annum, adding more than \$523 million in additional value to the LTCAP portfolio compared to what would have otherwise been achieved under the passive investment approach of the Reference Portfolio.

The actual return for the Expendable Funds Investment Pool (EFIP) in 2022 was -2.9%, which exceeded the target return of -3.0% by 0.1 percentage points. Over the last 10 years, the actual return in EFIP has exceeded the target return by 0.3 percentage points per annum.

Responsible Investing

UTAM continued to progress its responsible investing activities in 2022. We set a new carbon footprint reduction target of 50% by 2030, using 2019 as the baseline date. Similar to 2021, the

2022 carbon footprint is calculated on equity, equity-like securities (i.e., private equity and real estate via proxy) as well as corporate bonds, which together comprise approximately 70% of LTCAP's net asset value. As discussed in the attached presentation, we made considerable progress in terms of reducing the carbon footprint in 2022. We also made good progress towards achieving the fossil fuel divestment targets. We eliminated all direct exposure to fossil fuel companies within the 12 month target set by President Gertler and despite the indirect exposure remaining constant at 2% of LTCAP, we reduced the exposure on a dollar basis. Offsetting the reduced dollar exposure were two key factors: (i) the very strong relative performance of fossil fuel companies as the MSCI All-Country World (ACWI) Energy sector index returned +33% in 2022 compared to the -18% return of the overall MSCI ACWI; and (ii) the lower denominator of LTCAP as the assets in the portfolio declined during the year, driven primarily by its performance. We continue to engage with our managers to further reduce LTCAP's exposure to fossil fuel companies in the coming years.

2022 UTAM Annual Report

Beginning with the 2022 Annual Report, in addition to our usual review of investment activities, governance, risk management and portfolio performance, we will now present content that previously had been covered in our stand-alone Responsible Investing Report: detailed analysis of how environmental, social and governance (ESG) factors are considered in our investment decision-making and stewardship activities. Combining these two reports reflects a fundamental belief that producing them separately, while it had practical advantages, created an artificial distinction – because we believe that sound investing is, by definition, responsible investing.

Further to these changes, UTAM's Financial Statements, the Carbon Footprint Report and the Task Force on Climate-Related Financial Disclosures (TCFD) Report are published separately from the Annual Report and will be posted as supplements on UTAM's website. The purpose of this is to make these items more easily accessible and accordingly reduce the bulk of the Annual Report.

As noted previously, the 2022 UTAM Annual Report and the supplements will be included for information in the materials for the next Business Board meeting.

FINANCIAL IMPLICATIONS:

See above.

RECOMMENDATION:

For information.

DOCUMENTATION PROVIDED:

- *Semi-annual Update on Investment Performance and Responsible Investing Activities to December 31, 2022.*

Semi-Annual Update on Investment Performance and Responsible Investing Activities

For the Period Ending December 31, 2022

Chuck O'Reilly, CFA
President and Chief Investment Officer, UTAM

April 26, 2023

Presentation to Business Board

Assets Under Management

	Dec 31, 2021	Dec 31, 2022
LTCAP	4,179	3,783
EFIP ST (short-term)	2,401	2,959
EFIP MT (medium-term)	638	909
Total	7,218	7,650

- Over the past 12 months, total assets under management increased by 6.0% to approximately \$7.7 billion. The drop in market value due to challenging capital market conditions in 2022 was more than offset by net cash inflows into EFIP.

Performance: LTCAP and EFIP

Periods ending Dec 31, 2022

	H2 2022	1 Year	5 Years	10 Years
LTCAP	2.4%	-8.9%	5.4%	8.2%
EFIP Total	0.7%	-2.9%	1.1%	1.4%
EFIP ST	1.2%	-0.7%	1.5%	1.6%
EFIP MT	-1.2%	-10.0%		

- In H2 2022, LTCAP returned 2.4% recouping some of the losses from earlier in the calendar year. EFIP, in aggregate, was up 0.7% during H2. Despite the challenging market conditions in 2022, the returns for longer holding periods (5-years and 10-years) remain positive for both LTCAP and EFIP.
- All investment returns for LTCAP and EFIP presented above and throughout this presentation are net of all investment fees and expenses, including UTAM fees. Return figures for periods greater than one year are annualized.

Performance: Evaluating Returns

The previous slide showed the returns of all portfolios. But how do those returns relate to what was available in the capital markets, and how much did UTAM add or detract with its active management approach? The following definitions are required to answer these questions:

Reference Portfolio: Passive, easy to implement, low-cost, simple and appropriate for the Endowment's long-term risk and return objectives. The Reference Portfolio represents the returns available in the capital markets for a broadly diversified portfolio. The primary means of assessing the success (or failure) of UTAM's active management approach is obtained by comparing Endowment's returns to Reference Portfolio returns and by comparing EFIP ST and MT returns to their Target Returns.

Target Return: The long term return objective for each portfolio. For LTCAP the target return is CPI + 4% (i.e., inflation + 4%). For EFIP ST it is 50% FTSE ST Universe + 50% 1-month Canadian BA. For EFIP MT it is the FTSE Canadian All Corp BBB Index. All targets are net of all investment fees and expenses.

Performance: Actual vs Target

Periods ending Dec 31, 2022

	H2 2022	1 Year	5 Years	10 Years
Actual Portfolio Returns				
LTCAP	2.4%	-8.9%	5.4%	8.2%
University Target Returns				
CPI + 4%	3.4%	10.5%	7.2%	6.4%
Actual minus Target¹				
LTCAP	-1.0%	-19.4%	-1.8%	1.8%

Note 1: Due to rounding in this table and others in this report, some values may differ from the results of simple addition or subtraction.

- LTCAP's Target Return is a long term objective. When comparing the performance of LTCAP to the Target Return, it is most appropriate to assess it over long-term periods.
- As a result of the recent capital market environment, LTCAP has underperformed the Target Return over the 5-year period but outperformed over the 10-year horizon.

Performance: Reference vs Target

Periods ending Dec 31, 2022

	H2 2022	1 Year	5 Years	10 Years
Reference Portfolio Returns¹				
LTCAP	3.2%	-13.0%	3.9%	6.3%
University Target Returns				
CPI + 4%	3.4%	10.5%	7.2%	6.4%
Reference minus Target				
LTCAP	-0.2%	-23.5%	-3.3%	-0.1%

Note 1: Reference Portfolio adopted in March 2012 for LTCAP. Policy Portfolio used for prior periods. Returns are net of all investment fees and expenses, including UTAM costs.

- The Reference Portfolio's 10-year return is within 0.1 percentage points of the Target Return.

Performance: Actual vs Reference

Periods ending Dec 31, 2022

	H2 2022	1 Year	5 Years	10 Years
Actual Portfolio Returns				
LTCAP	2.4%	-8.9%	5.4%	8.2%
Reference Portfolio Returns				
LTCAP	3.2%	-13.0%	3.9%	6.3%
Actual minus Reference (UTAM value-add)				
LTCAP	-0.8%	4.1%	1.4%	1.9%

- In H2 2022, LTCAP underperformed the Reference Portfolio by 0.8 percentage points. Aside from H2 2022, LTCAP has outperformed the Reference Portfolio over all time periods presented above, including by 1.9 percentage points per annum over the 10-year period ending December 31, 2022.

Performance: UTAM Value Add in Dollar Terms

Periods ending Dec 31, 2022

	H2 2022	1 Year	5 Years	10 Years
UTAM Value Add (%)				
LTCAP	-0.8%	4.1%	1.4%	1.9%
UTAM Value Add (\$ millions)¹				
LTCAP	-34.0	171.1	283.3	523.1

Note 1: Dollar value add results are computed as the arithmetic sum of monthly dollar value add. This allows for consistent aggregation of results across multiple reporting horizons. Compounded dollar value add results will differ depending on the starting date and horizon of the calculation.

- Dollar value-add in H2 2022 was -\$34 million. Over the full calendar year, on a simple arithmetic basis (i.e. without including the impact of compounding) the dollar value add was \$171.1 million. Importantly, the 10-year dollar value add of LTCAP exceeded \$520 million.

Performance Efficiency

Periods ending Dec 31, 2022

	5 Years	10 Years
Sharpe Ratio		
LTCAP	0.5	1.0
Reference Portfolio	0.3	0.7
Information Ratio		
LTCAP	0.6	0.9

- Risk-adjusted performance metrics, such as the Sharpe and Information Ratios, provide information on returns earned per unit of risk taken.
- Over the 5 and 10 year horizons, LTCAP had higher Sharpe Ratios than the Reference Portfolio as well as attractive Information Ratios.

Definitions

- **Sharpe Ratio:** Average return (over the risk-free rate) earned per unit of risk taken (where risk is measured by Volatility)
- **Information Ratio:** Average return (over the Reference Portfolio) earned per unit of active risk taken (active risk is defined as Tracking Error)

UTAM Value-Add Contribution by Strategy: 10-Years ending December 2022 (LTCAP)

Attribution Effects by Strategy (estimated)	
10 years	
Alternative Credit	42
Absolute Return	40
Public Equity	60
Public Credit	6
Government Bonds	2
Real Estate	7
Private Equity	9
Other Effects	20
Total	187

- Over the past 10 years, all strategies contributed positively to value add.
- Other Effects include items such as FX differences and Asset Mix mismatches due to slippage. Over time, we have adapted our rebalancing approach in attempt to reduce such differences.

Performance: EFIP vs Target

Periods ending Dec 31, 2022

	H2 2022	1 Year	5 Years	10 Years
Actual Portfolio Returns				
EFIP ST	1.2%	-0.7%	1.5%	1.6%
EFIP MT	-1.2%	-10.0%		
EFIP TOTAL (weighted average)	0.7%	-2.9%	1.1%	1.4%
University Target Returns				
50% FTSE ST Universe + 50% 1-Mth BA ¹	1.2%	-0.9%	1.3%	1.3%
FTSE Cdn All Corporate BBB Index	1.6%	-9.8%		
Weighted Average	1.3%	-3.0%	0.9%	1.1%
Actual minus Target				
EFIP ST	0.1%	0.3%	0.2%	0.3%
EFIP MT	-2.8%	-0.3%		
EFIP TOTAL (weighted average)	-0.6%	0.1%	0.2%	0.3%

- 2022 was challenging for EFIP as rising rates drove negative returns in its fixed income strategies.
- Over the last 10 years, EFIP returned 1.4% per annum and outperformed its Target Return by 0.3 percentage points (i.e., per year).

Active Risk: Actual Risk minus Reference Risk

Dec 31, 2022

Active Risk Zone	Active Risk
Target Zone ("Normal")	$-0.50\% \leq \text{Active Risk} \leq 1.50\%$
Notification and Analysis Zone ("Watch")	$1.50\% < \text{Active Risk} \leq 1.75\%$
Mitigation Zone ("Alert")	$\text{Active Risk} > 1.75\%$

	Risk (Volatility %)
LTCAP (A)	9.9
Reference Portfolio (C)	9.0
LTCAP Active Risk (A – C)	0.9

- Active Risk for LTCAP remains well within the "Normal" Zone of -0.50% to +1.50%.

Current Asset Allocation and Limits: LTCAP

Dec 31, 2022

	Reference Portfolio %	Actual Portfolio %	Outside Full Bands?	--- Full Bands ---	
				Min %	Max %
Equity:					
Global	60.0	60.0	N	50.0	70.0
Fixed Income:					
Credit (Corporate Credit)	20.0	19.9	N	10.0	30.0
Rates (Government Bonds)	20.0	19.8	N	10.0	30.0
Total Fixed Income	40.0	39.7	N	25.0	50.0
Absolute Return Hedge Funds	0	13.3	N	0.0	15.0
Cash and Cash Equivalents	0	-13.3	N	-15.0	5.0
Total	100.0	100.0			
Currency Exposure:	32.4	32.7	N	25.0	40.0

- At the end of 2022, LTCAP was in compliance with all limits.

Responsible Investing Update

Fossil Fuel Divestment – LTCAP

Commitments	Status / Accomplishments
<p>Divest from all <i>direct</i> investments in fossil fuel companies within 12 months (of Oct. 27, 2021)</p>	<ul style="list-style-type: none"> Completed in early October 2022
<p>Divest from indirect exposure to investments in fossil fuel companies by 2030</p>	<ul style="list-style-type: none"> Indirect exposure to fossil fuel companies comprised 2% of LTCAP at December 31, 2022.⁽¹⁾ Despite the dollar value of exposure falling in 2022, the exposure as a percent of LTCAP remained unchanged. During 2022, the Equity and Fixed Income benchmarks in the Reference Portfolio began to transition to indexes that exclude fossil fuel companies. Most of passive equity and fixed income exposure was transitioned to ex fossil fuel indexes. At December 31, 2022, this exposure comprised more than 38% of LTCAP (2021: nil). Allocated capital to new public equity and private equity strategies that further the divestment objective. Partnered with an existing active corporate bond manager to launch a new ex fossil fuel strategy. Although not included in President Gertler’s divestment commitment, we also divested all material fossil fuel exposure from EFIP during 2022.

Responsible Investing Update

Carbon Reduction

Commitment	Status
<p>In 2022, UTAM established a new carbon footprint reduction target, which is to reduce the carbon footprint of the LTCAP Sub-Portfolio (including equity, equity-like and corporate bond securities) by 50% by 2030, compared to the 2019 baseline carbon footprint.</p>	<ul style="list-style-type: none"> • Considerable progress has been made as the carbon footprint (tCO2e/\$M) fell by 41.3% from December 31, 2019 to December 31, 2022 (-16.3% in 2022). • Over the same 2019-2022 period, absolute emissions (tCO2e) fell by 31.7% (-25.3% in 2022). • We are working with our private equity and private real estate managers to provide actual emissions data for their portfolios as we continue to estimate these emissions using public market proxies. • Similarly, we have initiated conversations with private credit managers to provide emissions data for their portfolios. These strategies are currently not part of the Sub-Portfolio. • The 2022 absolute emissions and carbon footprint calculations and report are verified by PwC.

Responsible Investing Update

Sustainable and Low Carbon

Commitment	Status
Allocate 10% of LTCAP to sustainable and low carbon investment strategies by 2025	<ul style="list-style-type: none">• At December 31, 2022, exposure was 4.1%.• We continue to look for opportunities to expand the exposure to sustainable and low carbon strategies across multiple asset classes and investment programs.• UTAM's Responsible Investing Committee continues to review existing strategies for inclusion.• We are on pace to achieve this objective.

Responsible Investing Update

Engagement Highlights

Net-Zero Asset Owner Alliance Engagement Target

- In 2022, UTAM set an interim target to engage with 20 companies by 2025, with a focus on the ones that contribute most to the owned emissions in the LTCAP public equity portfolio.
- Our collaborative engagement initiatives (e.g., Climate Action 100+, Climate Engagement Canada, SHARE UNIE) and our 3rd party engagement providers (e.g., EOS at Federated Hermes) have engaged on our behalf with many of these companies including the world's top emitters over the past six years.
- Through the above-mentioned collaborative engagement initiatives, we are also active participants in a number of engagements, as we participate in agenda setting as well as direct dialogues with corporate management teams and board members.
- Moreover, we actively engage with our investment managers, who in turn engage with companies on our behalf.

Responsible Investing Update

Principles for Responsible Investment (PRI)

- At December 31, 2022, approximately 75% of LTCAP’s active exposure was managed by PRI signatories
 - Approximately 50% of our managers who are not signatories are either smaller firms (i.e., < US \$3B in AUM) or private market managers to which we do not expect to allocate further capital
- In H2 2022, after considerable delay, PRI released its 2021 assessment reports (for activities during calendar year 2020). Under PRI’s new scoring methodology, UTAM received five out of five stars on the Investment and Stewardship Policy module and four stars on each of the five asset class modules. We scored higher than median across all modules that we were required to report on, irrespective of comparison to a peer group of asset owners with similar AUM to LTCAP (“AUM: US \$1B to \$10B”) or a peer group that includes all asset owners (“AUM: All”).

Module	UTAM	AUM: US \$1B to \$10B	AUM: All
		Median	Median
Investment & Stewardship Policy	★★★★★ (93)	★★★ (57)	★★★ (62)
Listed Equities	★★★★ (78)	★★★★ (69)	★★★★ (71)
Fixed Income	★★★★ (81)	★★★ (58)	★★★ (62)
Private Equity	★★★★ (79)	★★★★ (67)	★★★★ (66)
Real Estate	★★★★ (80)	★★★★ (67)	★★★★ (68)
Hedge Funds	★★★★ (76)	★★ (31)	★★★ (42)