



# York University Endowment Fund

## **Annual Investment Report to the Board of Governors**

For Year Ended December 31, 2014

Board Investment Committee, June 5, 2015

Board of Governors, June 22, 2015

## **York University Endowment Fund**

### **Annual Investment Report**

#### **For Year Ended December 31, 2014**

The Endowment Fund (the Fund) is a pool of commingled assets held for the endowments in long-term investments. The endowments are mainly permanent gifts and bequests to York University received from donors enhanced where eligible with matching capital from University and government programs. University-designated endowments held for support of specific priorities are invested alongside donor-endowed assets. Annual distributions are produced by the Fund for support of scholarships and academic chairs.

The Fund is governed by objectives and constraints as documented in the Statement of Investment Policies and Procedures (the Policy). The Board of Governors annually approves the Policy and any changes to the investment strategy or asset mix as proposed by the Investment Committee. The Investment Committee oversees the investments, portfolio managers and implementation of investment strategy.

The Fund assets are allocated for investment to eight portfolio managers each assigned with distinct mandates. All mandates are actively managed with the exception of one-half of the Canadian bonds which is invested to track a passive strategy.

#### **The Fund and Markets in Review - 2014**

The market value of the Fund as at December 31, 2014 was \$434.1 million, an increase of \$28.8 million over the December 31, 2013 valuation of \$405.3 million. The increase in 2014 was composed of inflows from donor contributions of \$4.9 million and investment income and capital appreciation of \$28.5 million, net of outflows of \$2.9 million for endowed spending and \$1.7 million for covering investment expenses.

The Fund one-year rate of return as at December 31, 2014 was 9.70% compared to 17.3% as at December 31, 2013. The Fund performance for 2014 fell short of the benchmark one-year return of 10.64% by 0.95%.

The Fund four-year rate of return as at December 31, 2014 of 9.92% exceeded the annualized benchmark performance for the same period of 9.42% by 0.50%.

Major equity markets during 2014 returned 14.4% as measured by key indicator, MSCI World Index. The return was dominated by the US equity markets (S&P 500, 23.9%), followed by Canadian equity (S&P/TSX, 10.6%), and trailed by emerging markets equities (MSCI Emerging Markets, 6.6%) and Europe, Australia and Far East equities (EAFE, 3.7%). US dollar appreciation of 10% relative to the Canadian dollar contributed to strong performance of US equities (S&P 500 in CAD 23.9% and in USD 13.7%), as the American economy showed signs of gathering strength and momentum. Slowdowns in China and other emerging economies exacerbated a sudden decline in oil prices as demand fell with no curbs in global production quota. The oil price decline negatively affected the value of the Canadian dollar and equity index returns due to the heavy influence of energy in the Canadian economy.

Fixed income markets surprised investors as major central banks continued to hold rates low, quelling the market's expectations for interest rate increases any time in the near future. Long duration bonds strongly outperformed, returning 17.5%, due to capital appreciation while short bonds eked by with a total return of 3.1% reflecting the prolonged low interest rate environment. The broad Canadian bond market return, measured by FTSE TMX Universe Bond Index, was 8.8%, reflecting appreciable return due to falling yields.

During 2014, the negative value added to the Fund total return of 0.95% was a product of underperformance from three of the five equity portfolios, managed by Canadian, US and global equity managers, combined with the impact of the tilt toward short-term bonds implemented in the Canadian fixed income class in 2013. Positive added value from two of the smaller portfolios, managed by Canadian and emerging markets equity managers, moderately mitigated the effect of specific portfolio underperformance. The Committee-approved underweight in Canadian fixed income, the lowest returning asset class, was a notably positive contribution more than offset the short-term bond tilt.

The currency hedging strategy further tempered results in 2014 as hedging foreign currencies to the declining Canadian dollar subtracted 1.4% from total fund return as measured by the effect on the benchmark return of excluding the impact of hedging. The currency manager contribution was slightly positive.

Direct expenses charged for investment management, custody, performance measurement and consulting provided to the Fund in 2014 were \$2.8 million, a total expense ratio of 0.66%.

The remainder of this Report reviews the Policy, Fund investment strategy, asset mix and investment manager split. Performance of the Fund to December 31, 2014 is reviewed on relative and comparative terms. The Investment Committee's activities conducted during 2014 and those planned for 2015 are summarized in the final sections.

## Endowment Fund Asset Mix

The Policy asset mix (Figure 1) effective throughout 2014, states the target asset classes and weights set out in the Statement of Investment Policies and Procedures.

**Figure 1**

**Policy Asset Mix - 2014**

<u>Asset Class</u>	<u>Target Weight</u>	
<b>Equities</b>		
Canadian	15%	
US - Small/Mid Cap	20%	
Global	25%	
Emerging Markets	<u>10%</u>	<b>70%</b>
<b>Fixed Income</b>		
Canadian Bonds	25%	
Global High Yield Bonds	<u>5%</u>	<b>30%</b>

The Policy asset mix, determined through a periodic process involving an asset-liability study that incorporates projections for capital markets returns over a ten-year horizon, is chosen for its expected ability to meet the Fund's investment objective of funding endowment commitments each year into perpetuity. The asset mix is geared to provide income to the University for the annual payouts to support endowed spending and to preserve the value of endowed capital.

The current asset mix was developed initially in 2008, then updated in 2010 to incorporate currency hedging for managing the growing risk arising from large non-Canadian currencies exposures.

At the end of 2014, after completion and recommendations to the Committee produced from the asset-liability study of 2013, a revised Policy asset mix and performance benchmark were adopted in the revised Statement of Investment Policies and Procedures.

The Fund's actual asset mix compared to the Policy asset mix weights effective throughout 2014, including currency overlay, as at December 31, 2014, is shown in Figure 2.

**Figure 2**

**Actual Versus Target Asset Class Weights - December 31, 2014**

<u>Asset Class</u>	<u>Market Value (\$Mil)</u>		<u>Actual Weight</u>		<u>Target Weight</u>		<u>Over/Under</u>	
<b>Equities</b>								
Canadian	65.6		15%		15%		0%	
US Small/Mid Cap	99.4		23%		20%		3%	
Global	103.8		24%		25%		-1%	
Emerging Markets	36.1	<b>304.9</b>	8%	<b>70%</b>	10%	<b>70%</b>	-2%	<b>0%</b>
<b>Real Assets</b>								
Canadian Real Estate	2.4	<b>2.4</b>	1%	<b>1%</b>	0%	<b>0%</b>	1%	<b>1%</b>
<b>Fixed Income</b>								
Canadian Bonds	77.9		18%		25%		-7%	
Global High Yield Bonds	47.3		11%		5%		6%	
Short-Term Investments	3.1	<b>128.3</b>	1%	<b>30%</b>	0%	<b>30%</b>	1%	<b>0%</b>
<b>Currency Hedge</b>								
	(1.5)	<u>(1.5)</u>	-1%	<u>-1%</u>	0%	<u>0%</u>	-1%	<u>-1%</u>
		<u><b>\$ 434.1</b></u>		<u><b>100%</b></u>		<u><b>100%</b></u>		

The Fund's asset class weights are permitted to vary within a range of +/- 5% of the target weights and are rebalanced periodically back to the target. An exception during 2014, approved by the Committee, was an underweight in Canadian bonds representing an advance reallocation that was permitted for readying the Fund for the revised asset mix and benchmark coming into full effect in 2015. A mid-year allocation to the new Canadian direct real estate asset class is tracking a 0% total fund benchmark weight which shall be the case until the allocation reaches a meaningful level for inclusion in the composite benchmark, estimated at 5%.

The University has engaged eight investment managers to manage nine specialty investment mandates. A further allocation for handling the Fund's operating liquidity in a short-term investment fund is assigned to the Canadian bond manager. Each manager is selected for their specific investment expertise. Each manager's specialty mandate is established to prescribe the asset class, investment objectives and constraints, and

performance benchmark for each portfolio. Managers, asset class mandates, market values and fund weights are shown in Figure 3. The currency overlay, composed of liquid three-month foreign exchange forward contracts, is reported on a marked-to-market basis.

**Figure 3**

**Specialty Mandates and Asset Allocations - December 31, 2014**

<u>Investment Manager</u>	<u>Mandate</u>	<u>Market Value (\$ Mil)</u>	<u>Weight</u>
<b>Equities</b>			
Foyston, Gordon & Payne	Canadian	31.0	7.1%
Mawer	Canadian	34.6	8.0%
Westwood	Small/Mid Cap US	99.4	22.9%
Aberdeen	Global	103.8	23.9%
Aberdeen	Emerging Markets	36.1	8.3%
<b>Real Assets</b>			
Bentall Kennedy	Canadian Real Estate	2.4	0.6%
<b>Fixed Income</b>			
TD Asset Management	Canadian Bonds	77.9	17.9%
Stone Harbor	Global High Yield Bonds	47.3	10.9%
TD Asset Management	Short-Term Investments	3.1	0.7%
<b>Currency Hedge</b>			
Mesirow		(1.5)	-0.3%
		<u>\$ 434.1</u>	<u>100.0%</u>

## Endowment Fund Performance Objectives

The Fund's return objective is quantified in the form of a performance benchmark and is a weighted composite of total returns produced by specified capital markets indices. Each component index broadly represents an asset class as defined in the Policy asset mix and is a transparent and reproducible sample of publically-traded investable equities or bonds for a specific country or area. A Canadian real estate benchmark index is set to be introduced in the performance benchmark once the allocation to real estate investments reaches the meaningfully measureable level of 5% of total fund. The benchmark composition during 2014 is depicted in Figure 4.

**Figure 4**

**Performance Benchmark 2014**

<u>Asset Class</u>	<u>Weight</u>	<u>Index</u>
Canadian Equities	15%	S&P/TSX Composite
Small/Mid Cap US Equities	20%	Russell 2500
Global Equities	25%	MSCI World
Emerging Markets Equities	10%	MSCI Emerging Markets
Canadian Bonds	25%	FTSE TMX Canada Bond Universe
Global High Yield Bonds	5%	Citigroup High Yield Market Capped

The Fund return objective is to meet or exceed the four-year annualized rate of return of the Policy composite benchmark for the same period over most four-year annualized periods as measured year to year.

Fund performance is expressed as a total rate of return, gross of fees, in Canadian dollars. Fund rates of return are calculated by an independent performance measurement provider, BNY Mellon Global Risk Solutions.

## Evaluating Endowment Fund Performance

Performance evaluation is conducted regularly on a monthly basis. The total fund rate of return is compared to the return of the composite benchmark and reported for intervals spanning one month to ten years. A formal performance evaluation is conducted semi-annually for review by the Committee that focuses on one-year and four-year returns to assess recent performance and longer-term success toward meeting Policy objectives. The results of individual portfolios and managers are reviewed, incorporating comparisons to performance statistics for portfolio risk and return and to the objectives and targets specified in each of the investment manager specialty mandates.

Figure 5 shows the Fund's performance record for the most recent one year (2014) and annualized periods up to ten years (2005-2014), providing a snapshot of the longer-term success of the investment program

**Figure 5**

**Endowment Fund Long-Term Performance**

Annualized Returns for Periods Ended December 31, 2014

	<u>1 Yr</u>	<u>2 Yrs</u>	<u>3 Yrs</u>	<u>4 Yrs</u>	<u>5 Yrs</u>	<u>6 Yrs</u>	<u>7 Yrs</u>	<u>8 Yrs</u>	<u>9 Yrs</u>	<u>10 Yrs</u>
<b>Fund</b>	9.7%	13.4%	13.1%	9.9%	10.5%	12.3%	7.1%	6.2%	7.1%	7.6%
<b>Benchmark</b>	10.6%	14.3%	13.3%	9.4%	10.1%	11.7%	6.8%	6.2%	6.9%	7.3%
	-0.9%	-0.9%	-0.2%	0.5%	0.4%	0.6%	0.3%	0.0%	0.2%	0.3%

Success over the longer term is attained through managing a variety of factors. Investment program developments are initiated in response to shifts in the investment environment, changes in the cashflow characteristics of the endowment fund and evolving risks affecting various components of the Fund. The Committee has concentrated on diversifying among selected strategies and managers that align with the investment objectives of preserving capital through a range of capital market outcomes while sustaining a regular stream of inflation-adjusted spending over the long run.

## Annual and Four-Year Annualized Performance

Figure 6 shows annual one-year returns for ten years, 2005 to 2014, and the four-year annualized return to December 31, 2014 relative to the Policy benchmark. Currency strategy was introduced as an integral element of investment strategy and is included in terms of impact since 2010. For information, in Figure 6, the Fund return is also shown with the effect of currency hedging stripped out of the Fund and benchmark returns for the relevant years.

Figure 6

	Endowment Performance - Annual Returns										Annualized Four Years
	Annual Returns for One-Year Periods Ended December 31										
	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2011-14</u>
<b>Fund</b>	9.7%	17.3%	12.5%	0.8%	12.8%	21.7%	-19.1%	-0.3%	15.1%	12.0%	<b>9.9%</b>
<b>Benchmark</b>	10.6%	18.1%	11.4%	-1.5%	12.9%	20.2%	-18.6%	1.9%	12.7%	11.6%	<b>9.4%</b>
	-0.9%	-0.8%	1.1%	2.3%	-0.1%	1.5%	-0.5%	-2.2%	2.4%	0.4%	<b>0.5%</b>

The one-year total rate of return as at December 31, 2014 was 9.7% compared to the benchmark rate of return of 10.7%. Excluding the impact of currency hedging, the Fund one-year return was 11.1%, compared to the benchmark return excluding hedging of 12.1%. Currency hedging of 50% of foreign exposures during 2014, a year of rising foreign exchange rates, mainly the appreciation of the USD to all world currencies including the Canadian dollar, decreased overall results.

The 1.0% shortfall versus the benchmark in 2014 is attributable to the underperformance of active managers, the key factors being an underweight in US equities and the impact of falling oil prices in the energy complex.

Over four years to December 31, 2014, the annualized return for the Fund was 9.9%. This result exceeded the Policy benchmark four-year annualized return of 9.4%, achieving the objective gross of fees.

Capital markets returns for the principle indexes composing the performance benchmark for the past four calendar years and annualized for the four-year period are shown in Figure 7.

Figure 7

	Index Returns (CAD)				Annualized Four Years
	Annual Returns				
	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2011-14</u>
<b>Equity Indices</b>					
S&P/TSX Composite	10.6%	13.0%	7.2%	-8.7%	<b>5.2%</b>
Russell 2500	16.7%	46.0%	15.3%	-0.1%	<b>18.4%</b>
MSCI World	14.4%	35.2%	13.3%	-3.2%	<b>14.1%</b>
MSCI Emerging Markets	7.0%	4.3%	16.0%	-16.2%	<b>2.1%</b>
<b>Fixed Income Indices</b>					
FTSE TMX Canada Bond Universe	8.8%	1.2%	3.6%	9.7%	<b>5.1%</b>
Citigroup High Yield Markets Capped	11.1%	13.4%	12.2%	8.4%	<b>11.5%</b>

## Total Fund Comparative Performance

Aon Hewitt provides comparative data for a peer group proxy of Balanced Funds. Comparative performance results for one-year and multi-year periods ended December 31, 2014 are presented in Figure 8.

The Balanced Funds peer group is provided for comparison as constituents are most likely to have common asset mix characteristics with the Endowment Fund. Differences in asset mix will tend to cause the largest divergences in returns among peer group members followed by the impacts from currency strategy and active management. The statistics presented in Figure 8 exclude outlier returns that fall outside the range of 5<sup>th</sup> to 95<sup>th</sup> percentiles.

**Figure 8**

**Balanced Funds - Comparative Analysis as of December 31, 2014**

	<u>Annual Returns (%)</u>				<u>Annualized Returns (%)</u>			
	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2 Yrs</u>	<u>3 Yrs</u>	<u>4 Yrs</u>	<u>10 Yrs</u>
<b>Percentile Rank</b>								
5th (highest)	13.1	20.6	12.4	4.3	16.3	14.8	12.1	8.3
25th	11.9	18.3	10.7	1.2	14.3	13.1	9.7	7.6
50th (median)	10.9	16.1	9.1	(1.0)	13.6	12.3	8.7	7.0
75th	9.8	14.7	8.1	(3.4)	12.8	11.3	7.9	6.5
95th (lowest)	8.1	13.1	5.8	(8.2)	11.5	10.3	5.7	5.2
<b>Comparative</b>								
York University	9.7	17.3	12.5	0.8	13.4	13.1	9.9	7.6
Quartile Rank	Q4	Q2	Q1	Q2	Q3	Q1	Q1	Q1

The Fund's one-year rate of return of 9.7% ranked in the fourth quartile in 2014. The Fund's comparatively poor positioning relative to peers, follows three years of comparatively strong performance (1 first quartile and 2 second quartile years). This comparative result is partially explained by manager underperformance and to a greater degree explained by asset mix. York's mix had higher exposures to emerging markets and shorter bonds, and lower exposures to US equities and longer bonds relative to the typical balanced fund representative of pension fund policies.

## Endowment Growth

Over the five years since 2010, the Endowment Fund has grown from contributions by \$20 million. The Fund's market value, inclusive of contributions, investment income and capital appreciation and net of distributions for endowed spending and investment expenses, has grown by \$114 million.

**Figure 9**

**Endowment Pool Growth (\$ Millions)**

	<u>Market Value</u>	<u>Corpus</u>	<u>Adjusted Book Value</u>
December 31, 2014	434.1	264.9	na
December 31, 2013	405.3	260.5	281.3
December 31, 2012	350.5	256.5	277.3
December 31, 2011	326.4	250.2	271.0
December 31, 2010	320.0	244.9	265.7



Endowment Fund corpus constitutes the historical value of capital received from donors plus the historical value of capital matches from government and University matching programs.

Book value, shown in Figure 9, was the measure of corpus plus an allocation for inflation protection built up in the years prior to 2009, that was used for recording endowment capital in the book-value based dollarized endowment accounting regime formerly used by the University. This was replaced effective with the fiscal year beginning May 1, 2014 following conversion to a unitized market value system for endowments and is shown to illustrate its relationship to corpus, which is the primary measure of historical value.

The change in the market value of the Fund during calendar 2014, shown in Figure 10, reviews the cashflow and earnings effects on value.

<b>Figure 10</b>	
<b>Change in Total Fund Market Value (\$ Millions)</b>	
Market Value, December 31, 2013	405.3
<b>Contributions:</b>	
Donations	4.9
Reinvested Distributions	2.9
<b>Withdrawals:</b>	
Distributions and Expenses	(4.8)
<b>Earnings:</b>	
Investment Income and Market Appreciation	<u>25.8</u>
Net Change	<u>28.8</u>
Market Value, December 31, 2014	<u>\$434.1</u>

To track the market value, unit holdings and historical values of each individual endowment, the University uses the services of an expert external endowment accountant. At the end of 2014, over 2,000 individual endowed accounts were in existence.

### **Investment Oversight**

The Investment Committee conducts activities in accordance with its terms of reference and the Board-approved Statement of Investment Policies and Procedures. The Committee's responsibilities are principally fund governance and investment strategy. Activities include regular monitoring of assets and performance, oversight and selection of portfolio managers, development of investment strategy and asset mix, review of fund expenses, and quarterly reporting to the Board. The Committee undertakes further initiatives as deemed timely and in the best interests of the Endowment Fund and its beneficiaries.

## Review of Investment Committee Activity – 2014

During 2014, the investment-related activities were conducted by the University in 2014 with the oversight of the Investment Committee:

- Hiring of new Canadian Direct Real Estate Manager, Bentall Kennedy, and preliminary allocation to the BK Prime Canadian Real Estate LP.
- Revision of Statement of Investment Policy and Procedures to incorporate changes to the asset mix, target weights, and performance benchmark were presented to and approved by the Board of Governors. The asset mix revisions were:
  - addition of a combined 10% allocation to Canadian Real Estate and Global Real Estate, both identified as types of Real Assets. The target weight of 10% is to be phased into the benchmark in stages as underlying capital is allocated to investment;
  - 5% reduction to Canadian Equity for a revised allocation of 10%;
  - 5% reduction to Global Equity for a revised allocation of 20%;
  - 5% increase to Global High Yield Bonds for an allocation of 10%; and
  - 5% reduction to Canadian Bonds for an allocation of 20%.
- Fund reallocation to accomplish the asset mix revision was conducted progressively through the year. The allocation to the Real Estate class is to be funded from the Canadian Equity and Global Equity classes.
- Revision of the currency hedging strategy from an actively-managed to passively-managed mandate and the adoption of asset class specific hedge ratios as follows:

Foreign Equity Exposures	0% hedged
Foreign Real Assets	50% hedged
Foreign Fixed Income Exposures	100% hedged

During 2014, the long-anticipated and planned conversion of York's 2,000-plus endowment accounts into a unitized pool structure was accomplished. Significant changes to accounting and reporting features for administrative oversight, providing information to the University community and for presentation to donors were introduced. These endowment-centric activities focused on replacing the legacy dollarized system with a market value based unitized system for the endowed accounts valuation and replacing the external service provider from book-basis recordkeeping to a Subfund accounting system.

The introduction of a the distribution reserve and the process of setting aside amounts monthly are components of the new system that will allow for the University to provide pro-rated distributions to new endowments based on number of months held in the pool. New endowment capital in the past had to be invested for minimum 12 months, and up to 24 months depending on timing of entrance into the fund, prior to receiving initial endowment spending allocation (the distribution).

The introduction of the Smoothed Banded Inflation methodology for calculating the distribution to endowed account holders was initiated with a baseline payout rate of \$3.90 per unit for initial distribution in 2015-16. The distribution amount was implemented with approval of the Investment Committee, Finance and Audit Committee, and Board of Governors following a detailed analysis of impact on University and individual endowment spending needs. The inaugural market-value based rate will result in greater amounts of funding being distributed for spending.

Responsible investment program initiatives and developments are ongoing. Administration provided support to the newly-formed York University Advisory Committee on Responsible Investing during 2014 and the Investment Committee reviewed the inaugural YUACRI Annual Report at its September meeting.

Two amendments were incorporated into the 2014 revision of the Statement of Investment Policies and Procedures that support the functional role of YUACRI; these were:

- A separate section on Responsible Investing was introduced and incorporated under Strategy to enhance the message that Environmental, Social and Governance (ESG) factors are important and integral considerations in manager selection and monitoring. It was clarified that the impact of ESG factors and considerations in security selection fall in the domain of each investment manager. The expectation that investment managers will engage with corporate managements to directly review and discuss ESG-related corporate activities was introduced.
- A separate section on Voting Rights was formed forming the basis for proxy voting activities and their development.

### **Plan for Investment Committee Activity – 2015**

Planned investment-related activities in 2015 are:

- Review and upgrade of the formal evaluation reports provided semi-annually by the external investment consultant.
- Review and revision of the Canadian fixed income benchmark to align with liquidity requirement properties of the Fund.
- Search for global real estate manager to be conducted in tandem with the pension fund.

Planned endowment-related activities in 2015 are:

- Review of direct impact on the community of the change in endowment structure and payout methodology together with the 2016-17 payout rate setting process.
- Communications and education sessions with the community and enhanced reporting to donors to support the transition to unitized pool and revised payout methodology.