Legislative Assembly of Alberta

The 29th Legislature
Second Session

Standing Committee
on the
Alberta Heritage Savings Trust Fund

Wednesday, January 11, 2017
1:30 p.m.

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Alberta Heritage Savings Trust Fund

Coolahan, Craig, Calgary-Klein (ND), Chair
Schreiner, Kim, Red Deer-North (ND), Deputy Chair

Cyr, Scott J., Bonnyville-Cold Lake (W)
Dang, Thomas, Edmonton-South West (ND)
Ellis, Mike, Calgary-West (PC)
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McKitrick, Annie, Sherwood Park (ND)
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Turner, Dr. A. Robert, Edmonton-Whitemud (ND)
van Dijken, Glenn, Barrhead-Morinville-Westlock (W)**

* substitution for Scott Cyr
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Standing Committee on the Alberta Heritage Savings Trust Fund

Participants

Ministry of Treasury Board and Finance
Rod Babineau, Manager, Portfolio Analysis, Capital Markets
Lowell Epp, Assistant Deputy Minister, Treasury and Risk Management
Stephen J. Thompson, Executive Director, Capital Markets

Alberta Investment Management Corporation
Dale MacMaster, Chief Investment Officer
Kevin Uebelein, Chief Executive Officer

1:30 p.m. **Wednesday, January 11, 2017**

[Mr. Coolahan in the chair]

The Chair: Good afternoon, everyone, and Happy New Year. I'd like to call this meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund to order.

My name is Craig Coolahan. I'm the MLA for Calgary-Klein and chair of this committee. I would ask that committee members and all attendees around the table introduce themselves for the record, please, starting on my right.

Mrs. Schreiner: Good afternoon. My name is Kim Schreiner, MLA for Red Deer-North.

Mr. Hunter: Grant Hunter, MLA for Cardston-Taber-Warner.

Mr. van Dijken: Glenn van Dijken, Barrhead-Morinville-Westlock.

Mr. Uebelein: Kevin Uebelein, AIMCo.

Mr. MacMaster: Dale MacMaster, AIMCo.

Mr. Epp: Lowell Epp, Treasury Board and Finance.

Mr. Thompson: Steve Thompson, Treasury Board and Finance.

Mr. Babineau: Rod Babineau, Treasury Board and Finance.

Mr. Robe-From: Nelson Robe-From, office of the Auditor General of Alberta.

Mr. Ireland: Brad Ireland from the Auditor General's office.

Dr. Turner: Bob Turner, Edmonton-Whitemud.

Mr. Dang: Thomas Dang, Edmonton-South West.

Mr. Horne: Trevor Horne, MLA for Spruce Grove-St. Albert.

Ms McKitrick: Annie McKitrick, MLA for Sherwood Park. Bonjour.

Ms Sorensen: Rhonda Sorensen, manager of corporate communications and broadcast services for the LAO.

Mr. Koenig: Trafton Koenig with the Parliamentary Counsel's office.

Dr. Massolin: Good afternoon. Philip Massolin, manager of research and committee services.

Mr. Roth: Good afternoon. Aaron Roth, committee clerk.

The Chair: Thank you.

Anyone that's on the phone, introduce yourself, please.

Mr. Ellis: Mike Ellis, Calgary-West.

The Chair: Thank you.

For the record I would like to note that pursuant to Standing Order 56(2.1) Mr. van Dijken is officially substituting for Mr. Taylor and Mr. Hunter is officially substituting for Mr. Cyr.

A couple of housekeeping notes before we begin. The microphone consoles are operated by *Hansard* staff, so there's no need to touch them. Please keep your phones on silent for the duration of the meeting. Audio of committee proceedings is streamed live on the Internet and recorded by *Hansard*. Audio access and meeting transcripts can be found on the Legislative Assembly website.

The first item at hand is the approval of the agenda. Is there any discussion around today's agenda? Seeing none, would somebody like to approve the agenda?

Ms McKitrick: I'll move to approve the agenda.

The Chair: Thank you.

Moved by Ms McKitrick that the agenda for the January 11, 2017, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adopted as circulated. All in favour? Any objections? On the phone? Thank you. That motion is carried.

The next item is the minutes from the September 12, 2016, meeting. Are there any corrections, omissions, or any discussion around these minutes? Seeing none, I ask that somebody move to accept the minutes from the previous meeting.

Dr. Turner: I so move.

The Chair: Dr. Turner moves that the minutes of the September 12, 2016, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adopted as circulated. All in favour? Any objections? On the phone? Seeing none, that motion is carried.

The Alberta heritage savings fund second-quarter report for 2016-2017 was released on November 28, 2016. Committee members were sent a notification of its release, and the report was posted on the committee's internal website. The Alberta Heritage Savings Trust Fund Act mandates that one of the functions of the committee is to receive and review quarterly reports on the operation and results of the heritage fund. We are pleased to have Mr. Kevin Uebelein and Dale MacMaster from AIMCo and Mr. Lowell Epp, Mr. Stephen Thompson, and Mr. Rod Babineau from Treasury Board and Finance here to assist with our review. Once these presentations are concluded, we'll have a question-and-answer session for the committee members.

At this time I'd like to turn the floor over to Mr. Epp.

Mr. Epp: Thank you, Mr. Chair, and thank you for having us. Good afternoon. I'm here this afternoon on behalf of Minister Ceci, who sends his regrets. Before you is the 2016-17 second-quarter report for the Alberta heritage savings trust fund, which was released publicly on November 28 as part of the overall government second-quarter update. I will briefly go over some of the highlights in the report, and then I will turn it over to my colleagues from AIMCo for some comments from their perspective. As mentioned, after that we will certainly be willing to take questions.

For the six months ended September 30, 2016, the fund earned a return of 4.7 per cent. If you'd made that amount over a full year, that would equate to 9.6 per cent annualized. The fund had a market value at September 30 of $18.6 billion. As of the quarter end the fund had generated $1.1 billion in net income. The fund, as you know, transfers all of its accounting income to the general revenue fund annually, less an amount held back for inflation-proofing.

The fund records market-value gains in assets like real estate and infrastructure as they occur on a market-value basis but does not include them in income until they are realized or until those properties or assets are sold. Therefore, the fund's income will benefit this year from transactions that were made during the year but where gains have been made and accrued over a number of previous years. As always, please note that the income reported for the year will change based on market fluctuations before the final number is realized for fiscal 2016-17.

The fund's strong equity returns of 7 and a half per cent over the first half were led by Canadian equity returns of 9.8 per cent, driven largely by metals and mining as well as the energy sector.

Fixed-income returns were a respectable 4.9 per cent over the same period as bond yields fell, and when interest rates fall, that's good for the prices of bonds.

While we are here to present the release of the second-quarter returns, as always, it is important to remember that the mandate for the heritage fund is to invest for the long term. If we look at the longer term performance of the fund, we see that the five-year annualized rate of return as of September 30, 2016, was 12.2 per cent while the 10-year return was 7.3 per cent. These returns are well above the target rate of return for the fund of Canadian consumer price inflation plus 4 and a half per cent. The value-added by AIMCo for these periods was .8 per cent and .4 per cent respectively.

I will now turn it over to Dale to provide his comments.

Mr. MacMaster: Thanks, Lowell. Perhaps I'll just add a little colour to Lowell's comments. For the six months ended September 30, the return was 4.7 per cent versus 5.3 per cent for the benchmark, slightly trailing the benchmark over that short period. As Lowell pointed out, we're long-term investors, so we don't get too fussed about short-term results.

But I should inform you, though, that a good portion of the portfolio, 40 per cent roughly, that's in illiquid securities really only gets marked with a sharp pencil about once a year. We're just going through that process now of valuing those illiquid assets. If we look to the end of December, for the three quarters ending December 30, those returns for the heritage fund would look more like 7.4 per cent versus a benchmark return of 7 per cent. Those numbers are unofficial. They're not audited yet. We're in the process. But I just wanted to give you some indication of the direction of the portfolio as we moved into year-end.

As Lowell pointed out, on page 1, more importantly, are the long-term numbers, which we're very proud of, both on absolute returns over five years and 10 years but also the value-add that AIMCo has been able to generate over and above the benchmark. We believe that, you know, the investment strategies that we employ always need to be looked at through the lens of a long-term perspective.

At various meetings that I've attended here in the past, I've cautioned about the forward-looking returns and how I think they're going to be challenged as we move into 2017, and there are a couple of reasons for that. We've enjoyed very high absolute returns over the last 10 years as bond interest rates have declined. It looks today like interest rates have bottomed after a 35-year bull market, and we're now on the path to slightly higher rates as the Federal Reserve in the United States has embarked on a period of monetary tightening. We've now seen two rate increases in the U.S., and we expect three to four increases in 2017. That is driven by a stronger economy and higher inflation there, and that's only been sort of pushed even to a greater extent with the new government in the U.S. As a result, bond returns are going to be challenged in an environment where rates are moving higher.

1:40

The second piece of the puzzle is equity market return. We've enjoyed a very nice bull market over the last eight years, the second longest in the post World War II period, and valuations are now stretched. The exuberance by investors in the market is evident, and we also have, again, rising interest rates. If you look at each expansion period since the Second World War, typically the business cycle comes to an end when we move interest rates higher, and that's where we are today. That's why we're cautious about returns going forward, primarily because of challenges in fixed-income and equity markets.

Perhaps I'll leave it at that and take questions.

The Chair: Any questions? I'll keep a list.

Mr. Dang.

Mr. Dang: Thank you, Mr. Chair. Thank you to everyone that has come today to present. Your remarks are very insightful, and I'm pleased that we have the opportunity to review these results. I do have a couple of questions regarding the current investment landscape, and I'm just wondering: given the heritage fund's mandate and the long-term investment horizon, could you provide some additional comments on how managing the fund during these challenging economic times is being handled?

Mr. MacMaster: Sure. Well, first of all, our colleagues in Finance work to develop a long-term strategy to meet the objectives of the fund, and that's executed through the asset mix that is given to AIMCo to invest. As part of that asset mix we have, as I pointed out, roughly 40 per cent in illiquid assets today.

Beyond that, you know, positioning, AIMCo will make certain strategic and tactical allocations within the portfolio as well and develop strategies to add value. I would say that in today's environment, which, I pointed out, is challenging, with low interest rates likely to rise in equity markets, we're focused on a couple of different areas – more absolute return strategies, shorter duration assets, floating-rate assets, more credit – and focused, again, on the illiquid side of the asset mix in infrastructure and real estate, where we can get paid a rent or an income stream that's partly based on inflation, and we think that'll certainly help the portfolio. The 40 per cent illiquids is a good thing. Many of our clients have moved more to the illiquid asset classes over the last few years, and that's a good thing.

Mr. Dang: Thank you.

Just one follow-up, Mr. Chair. I just want to know: how's the fund being positioned to address any significant global challenges like global geopolitical risks?

Mr. MacMaster: Well, that's a good question. Those are very difficult to predict, and therefore, you know, to position the portfolio for. As long as I've been investing, there's always been a risk, certainly, in geopolitics and challenges with, you know, Russia, China, the Middle East, terrorism, and so on, but as investors we need to focus on the long term, put our heads down, continue to look for undervalued assets, and put those funds to work in that form and manage as best we can around these risks but understand as well that without any risk, there's no return.

Mr. Dang: Thank you.

The Chair: Thank you.

Mr. van Dijken.

Mr. van Dijken: Thank you, Mr. Chair. You talked about the bond yields possibly going lower in the asset mix that we have with regard to your equities and other items. Who sets that target asset? Is that strictly a management thing? Also, a question with regard to bonds: what types of bonds are we primarily at risk with?

Mr. Epp: As far as who sets the policy, the policy is set by the Minister of Finance, and this particular investment policy fundamentally was adopted in 2011. It has gone through what I would call some relatively minor changes but largely is what was adopted in 2011, with the greater emphasis on the illiquids, reduced emphasis on fixed income at that time. One other change at that time was a reduced exposure to Canadian equities. We have 8 per cent. It used to be – and my memory is probably wrong – in the 20, 25 per cent range prior to this. That is set. That is the responsibility of the minister.

The second part of your question?

Mr. van Dijken: What kind of bonds?

Mr. Epp: Yeah. What kind of bonds? I'll pass over to Dale.

Mr. MacMaster: Right. Within the policy mix that AIMCo receives, you know, AIMCo is allowed to move the asset mix around a little bit, tactically, to add a little value. To answer your question, it's primarily invested in Canadian bonds.

I should add, too, that the interest rate environment in Canada is somewhat different from the U.S. The U.S. economy is moving at quite a nice clip, and inflation is picking up. Canada, unfortunately, hasn't participated to the same extent, and we think interest rate increases will lag by quite a margin in Canada. We're not actually foreseeing any rate increases in Canada in 2017. Nevertheless, the bond yield curve will shift higher to a certain extent in sympathy with the U.S.

The Chair: Thank you.

Mr. Hunter.

Mr. Hunter: Thank you, Mr. Chair. On page 14 of your report it talks about the divestment of exposure to derivative financial instruments, and it shows a reduction from $308 million to $43 million. Do you foresee a bubble in the derivative market? Why was there that divestment?

Mr. MacMaster: First of all, I don't see a bubble in the derivative markets at all.

Secondly, our derivative exposure can move around in a couple of ways. Primarily we're using derivatives to hedge currencies. In a portfolio we could also be using derivatives to get a cheaper exposure to certain market exposures that we'd like to get, that we can achieve more efficiently, say, than buying stocks or bonds outright. So these numbers can move around quite a bit. But if you consider a portfolio, say, of $18 billion of assets, you know, you can see that these movements are relatively small in the context of that.

Mr. Hunter: Okay. Thank you.

The Chair: Thank you.

Dr. Turner.

Dr. Turner: Thank you, and thank you to AIMCo as well as the Treasury Board officials for coming in. Actually, as an Albertan I'm quite comfortable with the results that are coming in, and I'm saying that because it isn't just the trust fund that you're looking after; it's the pension liabilities that this government has. By the sounds of it – maybe I'll ask the question. Are the returns that we're getting for the trust fund reflected in the returns that the government is getting on its pension assets?

Mr. MacMaster: Well, the asset mix, as you can well imagine, differs from client to client. You know, pension funds versus endowment funds are slightly different, so the returns, therefore, will be slightly different. All of these various accounts invest primarily in the same pools that AIMCo manages, so they do benefit in the returns, but the actual rate of return varies depending on the weights in all of those assets.

Dr. Turner: Right. Certainly, that 4.5 per cent, I personally would be very comfortable with in my investments. Actually, we were joking about this, but maybe you guys should set up an ETF that we could buy into.

Let's go back to the serious business of bonds. In September, Mr. MacMaster, you stated that the future definitely looked very challenging. In your remarks today you repeated that. Can you give us some context about how long you think it's going to remain challenging? What are the strategies that you're using to – I guess, if we're not using derivatives, what are the other strategies that we might use to counteract some of those challenges?

Mr. MacMaster: Sure. It's a good question. You know, we really don't know how long these periods are going to last. You know, nobody has a crystal ball. These are best estimates. No one really has the ability to forecast markets, but we can recognize certain patterns and valuations and see familiarity with the previous business cycles. That's what raises the concern. But when it comes to these, you know, one still has to take a long-term view. So if you look at your policy, you really want to be making big policy decisions based on what you see in the business cycle, where you are in the business cycle. You really need to be focused on the long term. But that said, AIMCo tries, tactically, taking a small amount of risk, to tilt the portfolio to add a little bit of value.

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For instance, in the last couple of years with the challenging environment and interest rates we've primarily been short. In other words, we usually would have fewer bonds in the portfolio and more in equities, and that's benefited the portfolio. You know, as an investor you can't throw the asset mix out and try to time the market. You really need to be focused, but we can try to tilt the portfolio, you know, to suit the business environment we're in.

Dr. Turner: Okay. Could I ask just one more short question? In a previous iteration of this committee I had asked whether AIMCo was looking at investing in the aggregates of farmland, and it sounded as though that might have been one of the things you were talking about earlier.

Mr. MacMaster: Yes, we continue to look at farmland as a potential investment, you know, probably within our timber asset class, but, again, it's an area that has seen increases in prices, and we tend to be investors that move in when we see attractive valuations. We continue to examine that as an asset class. In Canada, of course, there are various restrictions on institutional investors owning agricultural land as well that make it challenging, but we continue to examine that area.

Mr. Uebelein: But it is asset classes like farm assets, infrastructure, and timber that are only accessible to large-scale and long-term investors like AIMCo, and that's what affords us, if we do it correctly, if we do it thoughtfully, and if we buy low and sell high, like we all should be doing, to have a competitive edge over other institutional investors with shorter time horizons or less scale that doesn't allow them to develop those skill sets because these are highly specialized skill sets.

Dr. Turner: Thank you.

The Chair: Thank you.

We're going to go to the phone. Mr. Ellis, do you have any questions?

Mr. Ellis: I do. Thank you, Chair. Whenever you're ready.

The Chair: Proceed.

Mr. Ellis: Okay. Thank you. Gentlemen, thank you for being here. My question pertains to the United States. Obviously, there is a new President that's about to take office, and he brings his own set of values and concerns. Did this cause you guys, as far as investment, to invest further into the United States or pull back? How did this affect your decision-making when investing in the United States?

Mr. Uebelein: In terms of our short-term investment in the United States, I will absolutely let Dale answer that although I think he's going to come back to the same message that he did before, which is that movements like this may affect our tactical asset allocation but not our long-term horizon whatsoever. When we look at what has evolved since the election in the U.S. though, we are taking a somewhat more cautious approach in terms of the so-called Trump dividend or Trump rally than many other investors.

If you look at this, there are a couple of issues that come to my mind, and Dale can correct me or give his views as well. One is that there's a real question of the extent to which any of these Trump policies will actually be happening, the extent to which he can or will implement them.

The second is that even to the extent that they are, in my view, there may be a short-term benefit that accrues mostly to the U.S., but many of these policies, whether it has to do with protectionism or trade barriers or rolling back environmental laws, these may have a short-term positive impact to the U.S. economy but, frankly, a longer term negative impact to the global trajectory of growth. We're cautious about any market uplift from the so-called Trump effect, so we're not tactically trying to take advantage of that.

Mr. Ellis: Thank you. I understand it now.

If I can just ask one more question, Chair, if you're okay with that.

The Chair: Yes. Go ahead.

Mr. Ellis: Well, I guess my question has to do with regard to inflation and, of course, even just jurisdictional inflation, whether it be here in Alberta, the United States, other parts of Canada, or around the world. How much of an impact does that have on your decision-making when investing?

Mr. MacMaster: Well, I think it has a significant impact. I started my career in fixed income. In fixed income the bond markets are largely driven by interest rates and monetary policy and, therefore, the direction of inflation and interest rates. You know, interest rates and, therefore, inflation are very important when it comes to asset investing, and there's a big impact on equities as well. Certainly, if you lower the discount rate that you use to value the cash flows from any asset, when you lower that rate, the value goes up, and if you increase the rates, then the values go down.

So interest rates are important; therefore, inflation is important. We've gone through a period of a number of years where we've actually had central banks concerned about deflation coming out of the credit crisis with all the excess capacity that existed in the world and then also those deflationary demographics, you know, that have been in place. Japan is a case in point, but we see that in North America and Europe as well with aging populations and then the impact of technology. So there have been these forces of deflation at work.

But now, eight years into the business cycle, we're finally starting to see inflation percolate, primarily in the U.S. Last month we saw wages increasing in the U.S. at 2.9 per cent, the highest in eight years. We've seen, you know, job growth in the U.S., 150,000, 160,000 per month for a couple of years now. So all the signs are in place for, in the U.S. at least, higher growth and higher inflation, and that's why the Fed is raising interest rates, and that has a very, very important impact on investing from every standpoint, even emerging markets. You know, a rising interest rate environment in the U.S., a stronger U.S. dollar: that compromises emerging markets. So very important.

Mr. Ellis: Good. Thank you very much.

Thank you, Chair.

The Chair: Okay. Thank you.

Ms McKitrick.

Ms McKitrick: Thank you. I always appreciate your explanations when you're answering questions because I think you're giving us a lot of useful information not only on how you make decisions but what's important to the province and its economic well-being. So thank you.

I'm interested in the Alberta growth mandate that AIMCo has. I understand from the report that you've made one additional investment during the second quarter. As we know, the Alberta growth mandate was established as part of Budget 2015, and I appreciate the sure and steady progress that has been made on this, but I was wondering if you could discuss the investment that you made over the last quarter and the reason and the importance of this investment that says Pine Cliff.

Mr. MacMaster: Sure. Maybe I'll just start by saying that to date – this is more up-to-date information than we have in the second quarter – we've invested $176 million in the Alberta growth, which included some investments.

Mr. Uebelein: Through calendar year-end.

Mr. MacMaster: Yeah, through calendar year-end.

Ms McKitrick: Okay.

Mr. MacMaster: I wanted to highlight that.

Mr. Uebelein: Well, second quarter, only one; third quarter, which you will see those numbers in printed form about three months from now – yeah – about $80 million additional, so almost a doubling.

Ms McKitrick: Okay. How about the particular investment in this group called Pine Cliff, I think it's called? Can you give us some background on the company and the reason for the investment, and how it will be for the Alberta growth mandate?

Mr. MacMaster: Sure.

Ms McKitrick: Okay.

Mr. MacMaster: I'm just prying my notes here. There has been, I would say, somewhat of a theme in 2016 where we have been able to find, you know, companies in our own backyard here in Alberta that have been challenged in the capital markets in getting financing with the difficult environment in energy. As part of that, you know, banks have retreated, as banks typically do when the going gets tough. So we've been able to find very attractive assets at deeply discounted prices with very good management. That's the case in all of these, in particular, you know, Pine Cliff, Savanna, Journey, and several other investments we've made.

2:00

In the case of Pine Cliff, it's an Alberta-based energy producer. They're, you know, in exploration, development, production of natural gas and oil, founded in 2012, with a long-term view on the assets, and, again, challenged by the current environment. We were able to make an attractive investment. The investments we have been making are typically debt with a warrant type of investment, where we provide financing at what we think are attractive prices but protect ourselves with a debt instrument yet participate in the upside through warrants, and that's the case here.

With the current environment, you know, with energy prices starting to move higher now, that door has kind of closed a little bit, and companies seem to be in better shape and are finding alternatives. But I think there's a good example, for everyone to see, of how AIMCo likes to operate in finding very attractive assets at very good prices. This happened to be in our own backyard at a time when we wanted to put some money to work as well along with this program.

Mr. Uebelein: This is a situation where I'm really the wingman here because Dale has the details, but I feel like Dale is being perhaps a little modest in terms of talking about the capabilities of his investment team on transactions like this. He's factually absolutely accurate: the rigour and attention to detail on these transactions, the tracking and diligence of these management teams. Then what I find really impressive is the structuring of these transactions in ways that we feel buoy the balance sheet of the organizations so that they can withstand perhaps several more quarters of rough sailing but also give upside potential to our clients, including the heritage fund and our other institutional clients, so we have true upside potential in terms of the investment returns. These are all things that don't happen on autopilot, and as I watched them grind through all of those opportunities and come through with a few of what we hope to be real jewels, it's pretty impressive to me.

Ms McKitrick: Can I ask a follow-up question?

I really appreciate that, and I'm always reminded that in what you're doing for the heritage fund, you're also working with some of the other investors, so that's really good. I think you've kind of partly answered it, but I'm kind of interested in: do you have specific staff that have been assigned to the Alberta growth mandate? Is this how it's working in AIMCo, that you have staff that are looking specifically for potential investment under the Alberta growth mandate?

Mr. MacMaster: Yes. All of our staff are highly aware of this program, and all of the investors are acutely aware of this program, this policy. We do have one individual in particular who made these investments who's a key leader in this area. We have a number of people dedicated to this activity.

Ms McKitrick: Thank you very much.

The Chair: Thank you.

Mr. Hunter.

Mr. Hunter: Thank you, Mr. Chair. I read an interesting article the other day about the Canadian real estate bubble, and my question to you is: what risk of exposure do you hold in Canadian real estate instruments?

Mr. MacMaster: Okay. Well, first of all, I'm not sure where that article was. I wouldn't necessarily agree with there being a real estate bubble. People do like to talk about bubbles and see bubbles everywhere. I'm not so sure that Canada is in a real estate bubble. It does seem that in the residential area in certain places in Canada it does have some of those characteristics – I think now of Vancouver, for instance – but I'm unwilling to call it a bubble.

We have very little, you know, exposure to that. We are primarily commercial real estate investors with some residential, apartments and so on. In the total portfolio across AIMCo we run about $12 billion in real estate: $2 billion, roughly, is foreign, $10 billion in Canada. In the heritage fund – I think it might be in here – in total, we have $4 billion, 22 per cent, in real estate. So it's probably – well, we're saying that about 15 to 20 per cent of that is foreign and the rest in Canada. That gives you some idea.

Mr. Hunter: Okay. Thanks. I actually wasn't saying that I believe there's a bubble as well. I'm just saying that the article actually said that they believe there was a bubble.

Have you moved away from any of these instruments that you see as potentially risky since 2008?

Mr. MacMaster: Moved away from . . .

Mr. Hunter: These real estate instruments.

Mr. MacMaster: No; I wouldn't say so. In fact, with respect to real estate our clients have been moving to a greater extent into the illiquid area, including real estate. Our clients really like real estate. It's a great long-term investment with attractive returns both in income and capital gains if executed properly, so the direction has been to less in listed assets, in equities and fixed income, and more of real estate.

You know, what I would say is that since 2008 all investing is more challenged since prices have gone up, and real estate, like equities and fixed income, has seen an increase in valuations all around the world. What does that mean for AIMCo? It means we have to work harder to get the same sort of returns. We've got to scour the world looking for the best opportunities, whether they're in Europe or the U.S. or Canada, and also those opportunities within those geographies that offer the best risk-adjusted return. I guess what I'm saying is that it's harder today, and it's only getting harder. So rather than moving out of the asset class, it takes us longer to deploy.

Mr. Uebelein: Two more quick observations. Real estate – forgive me for saying this, because I know you know this – is not a homogeneous market. It's not even a homogeneous market in Canada, let alone globally, and it's not a homogeneous market even in specific cities like Vancouver. So when you ask the question "Have we stopped investing in certain things?" I think it is safe to say that we have not had interest in the current price level of Vancouver residential stock for quite a long time. We think it's, as they say, priced to perfection, but that doesn't keep us from finding other opportunities in other markets, in other sectors of real estate that we are still investing in. As Dale said, we have to work a lot harder. There's more sweat equity involved in terms of getting the returns whereas in a different part in the cycle you have to execute less sweat equity in terms of getting it.

The other point, very quickly, is that whether or not it's a bubble, real estate has performed well, and that's part of those long-term performance numbers that we've benefited from over the last four or 10 years. In other words, it's diversification in action. We might not expect real estate to lead the pack, because it's had such a good run, over the next few years, but it doesn't mean that we zero it out. It means that we work a little harder. We may underweight it, with advice from the Minister of Finance, in terms of asset allocation.

The Chair: Good. Thank you.

Mr. Horne.

Mr. Horne: Thank you. I've been fighting a bit of a cough, and I feel one coming on, so if I pause, it's because I'm trying not to cough.

As members of this committee know, AIMCo is an active manager of funds, with the goal of outperforming asset managers who invest passively. In the newspaper I was just reading that investors, in particular individuals, are increasingly moving their dollars into cheap ETFs who track the major indexes. Now, with the shift of dollars into passive investments, what are the challenges and opportunities for large-scale active investors like AIMCo, and does this shift in any way change your investment strategy and outlook?

Mr. MacMaster: Sure. Well, we certainly believe in active management. I know there's a great trend right now in passive management, but we believe in active management, and our clients do as well. Our pension clients and, I believe, Finance as well believe that AIMCo has strategies in place that can add value over benchmarks, and I think that over the period of returns that we talked about earlier, we've shown that; you know, five years and 10 years. I've been part of AIMCo for 18 years, and over long periods of time we've added value. So we believe in that.

2:10

In some respects we really have advantages that, you know, those clients that participate in ETFs simply do not have. They can't access real estate and infrastructure and private equity and timberlands in any way, shape, or form to the extent we can at the cost we can. It's impossible. Roughly 40 per cent of the assets here in the heritage fund cannot be accessed by retail.

Then within the listed side, fixed income and equities, again, we have strategies that go way beyond anything you could see in an ETF. We've shown it; we believe in it. If anything, perhaps the ETF provides an opportunity. Like lemmings, you know, in some cases blindly going in as a passive investor, you get the Nortel effect. If you remember, Nortel at one point was 30 per cent of the Canadian equity index. You get these huge weights in securities that are really not very good.

The Chair: Thank you.

On the phone, Mr. Ellis, do you have a question?

Mr. Ellis: I'm good right now, sir. Thank you.

The Chair: Mr. van Dijken.

Mr. van Dijken: Yeah. Thank you, Chair. In just reflecting a little bit on your comments with regard to assets in the other jurisdictions – real estate assets in Europe, the U.S., and that type of thing – you talked a little bit about the Trump effect and that that could be a very short-term kind of an effect and so you don't really take that too much into consideration in short-term decision-making. Is that the same strategy we use with regard to, say, Brexit? Have there been any negative consequences from Brexit with regard to our investments there? I'm just looking at the report that was given pertaining to the London airport and that type of thing. Or is Brexit far enough along that you have a better indication as to the direction that we're going with that?

Mr. Uebelein: Good question.

Mr. MacMaster: Yeah, it's a good question. There were a couple of impacts from Brexit. Maybe I'll just address that and then talk about Trump after.

There was the immediate knee-jerk reaction with Brexit, which was, you know, widespread sort of panic overnight because it was an unexpected outcome, and markets don't like uncertainty. Stocks sold off quite heavily, and bond markets rallied, which is what you see in a crisis. Tactically what we do in those situations is that we go and buy. We bought equities, we sold bonds, and that worked out well for our clients short term. That's one aspect of it, which is the short-term, knee-jerk, panic reaction which we see fairly regularly in the market. We saw a little bit of it with Trump as well and used the same playbook, essentially.

Then there are the longer term impacts, which are more difficult to predict and more difficult to position for. Brexit remains to this day an unknown. You know, we don't even know whether they will actually leave the EU. They seem to be moving in that direction, but there's a lot of uncertainty around this. There's a lot of uncertainty as to how trade side agreements might be concluded with other countries outside of the EU and how quickly they can negotiate those trade terms, the timetable for this, the impact on markets. There are quite a few unknowns, and I think that the market is a little bit sanguine about it or a little bit complacent about it with respect to Brexit, in part because of Trump. Trump has taken over the news, it seems, around the world.

On Trump, I would just say there, you know, that Kevin said that we're very cautious on that. I would agree. The market has been jumping to conclusions ever since the election. Stock markets are rallying. Bond markets have sold off. The expectation is that the more favourable part of his platform, his perceived platform – the positives are the tax cuts and the infrastructure spending – will be enacted while the negative aspects, those negative growth policies like immigration and antitrade, will not. So that's why markets are moving in that direction. We would caution that it's still very, very uncertain times. The timing of these policies, when the U.S. is already expanding to such an extent that the central bank wants a tight race, is pouring fuel on the fire. You know, it's highly uncertain. We're taking it with a grain of salt and keeping the risk very close to home. Markets are richly valued and subject to disappointment.

On Brexit, we really haven't seen much in the way of negatives, say, on real estate. There were some very minor price adjustments. With the U.K., London, in particular, is a global city, a global financial centre, and it's going to take an awful lot for that to move to some of the other jurisdictions that people like to talk about, like Frankfurt. We see that as highly unlikely.

Mr. Uebelein: In fact, you know, if we look through the market reaction to Brexit and we look at those operating companies or assets that we hold in the U.K. and we study their operating results very closely, we continue to see the airport, in which we have a sizable investment, performing above its plan, so no decrement in terms of passengers or revenue or profitability.

We have a large investment in rolling stock, you know, train cars: again, operating at plan, no decrement yet. While someone, because of uncertainty or fear around Brexit, may pay us less today, the underpinning operations of those businesses – and as Dale has already said, in our real estate the rent rolls are still strong; the rent rates are still the same. We don't see a decrement in the cash flow, operating fundamentals. We are super long-term investors. When we start seeing the operating fundamentals degrade against our plan, that will be a different story, but we have not seen that.

The Chair: Thank you.

Are there any other questions at this time?

Mr. Hunter: The Alberta climate action plan talks about being able to bring in more green energy projects. Is AIMCo going to be funding these projects?

Mr. MacMaster: AIMCo's mandate is to invest for economic return wherever that is. We have significant investments in renewable energy both here in Alberta – we did the TransAlta Renewables transaction – and around the world. We'll continue to do that. Our mandate is based on economic return.

Mr. Hunter: In other words, you're saying that the minister could not say to you: "This is the mandate of this government. We want you to not look the other way but be able to say that you're going to invest in these."

Mr. Epp: At this point in time the act of the Legislature that the heritage fund is vested under states that its mission is to achieve the highest possible long-term returns. It is not allowed by law to make what I will call noncommercial investments. AIMCo's mandate in its legislation says very similar things. So the Legislature has directed that it not subsidize or provide lower cost capital to any investment, be that in Alberta renewable energy or any other, whatever economic development plan, if you will. The basis upon which the Legislature has instructed both AIMCo and the heritage fund to be invested is a commercial basis, proper return for the risk taken.

Mr. Hunter: What you're saying is that if a bank wouldn't do it, AIMCo wouldn't do it.

Mr. Epp: That's what I'm saying because that's what the Legislature has said.

The Chair: Mr. van Dijken.

Mr. van Dijken: Thank you for that. It's interesting, the answer: if the banker won't do it, then AIMCo won't do it. But we heard a little earlier on about the Alberta growth plan and the investments that we've gone into that bankers were tending to shy away from. Now we're going there. So I guess there's a little bit of question about: if the industry is not prepared to make the investment, is AIMCo prepared to make the investment based on a policy of an Alberta growth plan? I would like to hear, you know, that we're following at arm's length with regard to investments in an Alberta growth plan, under those same guidelines. Is that how we're approaching the Alberta growth plan?

2:20

Mr. Epp: Absolutely. That's what makes it a bit of a struggle, if you will. The plan could be fully implemented – as was pointed out, we're making slow but steady progress, AIMCo is, in filling our mandate. That mandate would be easy to fill if we were willing to invest at noncommercial rates. Clearly, there are lots of opportunities to make bad investments, no shortage of those, but making good investments takes time and care.

Certainly, as we develop the mandate and kind of the guidelines, which have been shared with this committee, with AIMCo and have held many hours of discussions, the central point that we kept coming back to, both ministry officials and AIMCo officials, was that, first and foremost, commercially valid or good investments were the primary. That goal doesn't change under the Alberta growth mandate.

Mr. van Dijken: Just as a follow-up – you know, I'm not completely, fully informed on the act or the legislation – I need to ask the question, then, of the AIMCo representatives: do they feel that they are being allowed to do their job in a professional manner, without undue influence from government?

Mr. Uebelein: One hundred per cent. I would not sit here and look this group in the eye if we were being compromised in terms of our independence in investment decision-making. Agreeing on what that meant in light of this 3 per cent allocation was an exhaustive process. It isn't one that's, frankly, easy to define or describe, but it is a line that this government has not crossed. I would be the first to tell you if they did, because I wouldn't hang around here. I take it extremely seriously.

Mr. van Dijken: Thank you.

Mr. Hunter: Mr. Epp, maybe you could explain to this committee, then, to help us understand: how do we go into, say, facilitating this Alberta climate action plan, something like solar, where the best they can do is produce electricity at, like, 15.4 cents per kilowatt hour and we're selling into the Balancing Pool for 1.2 to 1.6 cents?

Mr. Epp: Well, I'm no expert on any of those topics. I can tell you that the heritage fund won't be investing in noncommercial investments. Decisions by the government on how to attract capital into alternative or green energy forms: those are beyond my purview. I'm sorry; I honestly can't make a comment.

Mr. Hunter: Thanks.

The Chair: Are there any other questions at this time?

Seeing none, I'm going to ask if a member would like to move that the committee receive the report. Ms McKitrick.

Ms McKitrick: Yes. I'd like to move that

> the Standing Committee on the Alberta Heritage Savings Trust Fund receive the 2016-2017 second-quarter report on the Alberta heritage savings trust fund.

The Chair: Thank you.

All in favour? Opposed? On the phone? That is carried.

Thank you to our presenters. The next topic of discussion is the recent public meeting, so you can stick around for that if you'd like, or you're free to go.

Hon. members, as you know, the public meeting of the heritage savings trust fund was held on October 27, 2016, from 7 p.m. to 9 p.m. The meeting was broadcast from the Federal building both online and also through Shaw TV. Members will have received an information update on the public meeting through the committee's internal website. I would invite Ms Rhonda Sorensen from Legislative Assembly Office communications to provide some comments and insight in regard to this public meeting.

Ms Sorensen: Thank you, Mr. Chair. Certainly, from our perspective, the public meeting went really well. The most substantive change this year over previous years was that the broadcast was done completely in-house, which led to more than $6,000 savings for the committee, which we saw as a real positive.

I think that the overall flow of the meeting went really well. The chair and the deputy chair, who, thankfully, had her voice that day, did a really good job, I think, of putting forward the online questions to the viewing audience. From a viewing perspective, there was a lot of interaction with the people who were online and in the audience, which, again, is very positive as far as communications is concerned.

In terms of the other initiatives, they were pretty on cue with things that we've done in the past, and overall our bottom line came in significantly less than it has in previous years. Again, I would see that as a positive. We had about 28 questions coming in from members of the public, whether it be online or in the audience.

There were 18 that were e-mailed, several on Twitter, Facebook, and a number of them in person as well.

With that, Mr. Chair, unless there are any specific questions, I think overall it was a resounding success.

The Chair: Okay. We have had the opportunity to review your report, so if anyone would like to ask Ms Sorensen questions.

Ms McKitrick: I think, first of all, I would like to thank the staff of the LAO, who worked really hard, and I know there was a lot of time spent around Twitter and Facebook and taking questions and so on.

The Chair: I second that thanks.

Ms McKitrick: So thank you for the work. I especially also really appreciate the way that the staff managed the budget and really constrained the costs.

Given that the goal of having the meeting is always to try to reach many people in Alberta, both in the urban and rural areas, I was wondering if you could tell us if the committee was successful in this regard, you know, of . . .

Ms Sorensen: Of reaching that?

Ms McKitrick: Yeah.

Ms Sorensen: Certainly, from my perspective, Mr. Chair, if I may, I think the committee was successful. The number of people who tuned in, be it online or in person, was over a thousand, which is comparable with other years. In terms of where the questions were coming from that came to the committee during the meeting, the majority of the questions did come from Edmonton and Calgary, but we also did have questions coming in from St. Albert, Lloydminster, and Okotoks, so it kind of gives a bit more diversity throughout the province geographically.

Ms McKitrick: Good. Thank you. I know that you all worked really, really hard to ensure that diversity, so thank you again.

This is the second year that the annual meeting has been held in this building. I was also wondering if you could discuss some of the differences in costs between the way that it was held before and the way that it's being held now in this Federal building, in-house.

Ms Sorensen: Certainly. Although I can't speak to the overall costs that the committee incurs in terms of travel, by doing the broadcast in-house as opposed to kind of a road show and hiring that out, we saw a specific savings of just over $6,000 this year. The other costs in terms of travelling to other communities, Aaron might be able to touch on, but I would guess that they're quite significant when we're taking 20 people to a location.

Ms McKitrick: I noticed from 2014 to 2016, which is what you compared it to, that in 2014 the annual meeting cost over $42,000, but this year is was about $17,000. It was done in-house, in the Federal building, so it appears to me a real huge . . .

Ms Sorensen: Significant.

Ms McKitrick: . . . significant cost, yeah.

Thank you very much. I really appreciate the work you did on that to make it happen.

Ms Sorensen: Thank you, Ms McKitrick.

The Chair: Thank you.

Any other questions for Ms Sorensen? Mr. Horne.

Mr. Horne: Yeah. I just wanted to ask, well, one question that you haven't really touched on. Can you discuss what worked well with the communications plan and which of the various avenues that were pursued saw the best value in terms of cost savings?

Ms Sorensen: Yeah. I can touch briefly on that. From the people who did respond to the questionnaires that we put out there, we did see an overwhelming response that most people heard about the meeting through social media. Although I wouldn't want to commit today to any strategies for the next meeting, I can say with a hundred per cent confidence that we would likely increase that area next year, to promote more through social media.

Does that answer your question?

Mr. Horne: Yeah.

Ms Sorensen: Okay.

2:30

The Chair: Any other questions? Mr. Hunter.

Mr. Hunter: Yeah. I guess, Mr. Chair, the question is: the methods that you've used, did they actually reach the intended demographic groups that you needed to?

Ms Sorensen: You'll just have to excuse me for a moment because I wasn't the actual person doing the logistics on it, but I believe that the overall goal of the committee was to get as many people as possible involved, and I think that we saw that through over a thousand people participating or watching in some way. I guess I would leave that up to the committee to decide if they think that that is value for what they're putting forward.

Mr. Hunter: Well, actually, I guess my question is: what were the demographics? What was the breakdown?

Ms Sorensen: Oh, I'm sorry. I misunderstood your question. I don't have the actual demographic breakdown of, like, who the viewers were other than we know how many people tuned in on TV, but I don't know demographically who those people were. The only demographic that we do have is where the questions were coming from that were submitted to the committee, and that was Edmonton, Calgary, St. Albert, Lloydminster, and Okotoks, so there was an urban and rural mix there. If there are specific demographics you want me to look into, however, we can certainly dig a little deeper on that.

Mr. Hunter: Okay. Thanks.

Ms Sorensen: Did you want us to?

Mr. Hunter: Actually, because I'm not on this committee, I don't know if I could get that information.

The Chair: You can. You can ask for it.

Mr. Hunter: Yeah. I would actually like to know what the demographics are and how they broke down.

Ms Sorensen: Certainly.

Mr. Hunter: Thanks.

The Chair: Any other questions for Ms Sorensen on the public meeting? On the phone? Mr. Ellis.

Mr. Ellis: No questions. Thank you, Chair.

The Chair: Okay. Thank you.
Seeing no questions, then, we will conclude that portion of the meeting, and we will move on to other business. Is there any other business for today's meeting?
Hearing none, the next meeting of this committee will be polled shortly, and we will let you know when that will be.
Other than that, I will ask for a motion to adjourn. Moved by Dr. Turner that the January 11, 2017, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adjourned. All in favour? Any opposed? Hearing none, the meeting is adjourned.
Thank you.

[The committee adjourned at 2:32 p.m.]

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