Legislative Assembly of Alberta

The 30th Legislature
Third Session

Standing Committee
on the
Alberta Heritage Savings Trust Fund

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7:45 a.m.

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Alberta Heritage Savings Trust Fund

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Jones, Matt, Calgary-South East (UC), Deputy Chair

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Standing Committee on the Alberta Heritage Savings Trust Fund

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Brittany Jones, Senior Manager, Portfolio Analytics and Research

Alberta Investment Management Corporation
James Barber, Co-chief Investment Officer
Sandra Lau, Co-chief Investment Officer
Amit Prakash, Chief Fiduciary Management Officer

7:45 a.m. **Monday, May 30, 2022**

[Mr. Rowswell in the chair]

The Chair: Okay, everyone. I'd like to call this meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund to order and welcome everyone in attendance.

My name is Garth Rowswell, MLA for Vermilion-Lloydminster-Wainwright and the chair of the committee. I'm going to ask members that are joining the committee at the table to introduce themselves for the record, and then I'll go and see who's joining by videoconference. I'll begin to my right.

Mrs. Allard: Good morning, everyone. Tracy Allard, MLA for Grande Prairie.

Ms Jones: Good morning, everybody. Brittany Jones, government of Alberta.

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

Mr. Robe-From: Good morning. Nelson Robe-From with the Auditor General's office.

Mr. Ireland: Good morning. Brad Ireland with the Auditor General's office.

Mr. Eggen: Good morning. My name is David Eggen. I'm the MLA for Edmonton-North West.

Ms Gray: Good morning. Christina Gray, MLA for Edmonton-Mill Woods.

Mr. Koenig: Good morning. Trafton Koenig with the Parliamentary Counsel office.

Ms Robert: Good morning. Nancy Robert, clerk of *Journals* and committees.

Mr. Huffman: Good morning. Warren Huffman, committee clerk.

The Chair: Okay. We'll go virtually now to the MLAs that are online.

Mr. Jones: Matt Jones, MLA, Calgary-South East.

The Chair: MLA Hunter.

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

Ms Phillips: Shannon Phillips, Lethbridge-West.

Mr. Singh: Good morning, everyone. Peter Singh, MLA, Calgary-East.

The Chair: Okay. Then we'll invite the people from AIMCo to introduce themselves.

Mr. Prakash: Good morning. Amit Prakash, chief fiduciary management officer.

Ms Lau: Good morning, everyone. Sandra Lau, co-CIO, head of public investment, AIMCo.

Mr. Barber: Good morning. James Barber, co-CIO, head of private investments.

The Chair: Okay. They've already introduced themselves, so we're good.

There are no substitutions today, so we don't need to do that.

A few housekeeping items to address before we turn to the business at hand. Please note that microphones are operated by the *Hansard* staff. Committee proceedings are live streamed on the Internet and broadcast on Alberta Assembly TV. The audio- and videostream and transcript of the meeting can be accessed via the Legislative Assembly website. Members participating remotely are encouraged to have your cameras on while you're speaking and your microphones muted when you're not speaking. Remote participants who wish to be placed on the speakers list are asked to e-mail or send a message in the group chat to the committee clerk, and members in the room are asked to give a signal to the chair or the committee clerk. Please set your cellphones and other devices to silent for the duration of the meeting.

A draft agenda was distributed to all members. Does anyone have any changes or additions to the draft agenda?

Seeing none, would someone like to make a motion to approve the agenda?

Mrs. Allard: So moved.

The Chair: MLA Allard. All in favour in the room? Anybody opposed? All in favour online? Any opposed? Okay. Thank you. The motion is carried.

And minutes. Next we have the draft minutes of our January 25, 2022, meeting. Do members have any errors or omissions to note?

Hearing none, would someone like to make a motion to approve the minutes?

Mrs. Allard: So moved.

The Chair: MLA Allard. All in favour in the room? Okay. Any opposed? All in favour on virtual? Any opposed? Okay. Thank you. The motion is carried.

The Alberta heritage savings trust fund third-quarter report for 2021-22 was released on February 24, 2022, and the report was posted to the committee's internal website. As many members are aware, the Alberta Heritage Savings Trust Fund Act mandates that the committee receive and review the quarterly reports on the operations and results of the heritage fund.

Before turning to our guests, I'd like to thank AIMCo for their written responses to questions asked at our last meeting, on January 25.

I would now turn it over to Treasury Board and Finance and AIMCo to begin their remarks on the third-quarter report and then open the floor to members to ask questions.

Mr. Epp: Thank you, Mr. Chair. Good morning to everyone. It's good to be here and talk about the heritage fund again today. The first thing I need to note is that we discovered an error in the statements that we distributed. Near the top of page 2 in the first table, called 12-month Rolling Returns as at December 31, 2021, the policy benchmark line you'll see is 11.9, 12.9, 13.9 per cent. Life isn't that clean, that it goes up by 1 per cent every year. Something happened, and we will be distributing corrected statements later today and posting them online. My apologies for that.

The fund performed well in the third quarter, and it earned a return of 6 per cent during the quarter. Many of us would love to have a 6 per cent return for the whole year, so the fund had a very good quarter. This is about 1.5 per cent above the fund's passive policy benchmark. So far during the fiscal year the fund has earned a return of 14 and a half per cent compared to 9.4 per cent on the fund's benchmark. In other words, the fund would have earned 9.4 per cent had it been invested passively during the first nine months of this fiscal year. Another way of looking at it is that AIMCo added or improved the fund's return by 5.1 per cent so far this year.

While short-term results are important, the fund is invested for the long term, and investment returns over an extended period of time are more important when evaluating fund performance. Over the last five years the fund has earned a return of 8.8 per cent, 40 basis points above the 8.4 per cent return on the fund's policy benchmark. In the last 10 years the fund's return has been 10.2 per cent, exceeding the benchmark return of 9.5 per cent by 70 basis points.

The heritage fund has two investment objectives which are used to evaluate performance. The first objective is to earn a real rate of return of 4.5 per cent over five years; in other words, a return that is 4.5 per cent above the rate of inflation during the five-year period. During the last five years the fund has exceeded this objective by 2 and a half per cent. The markets have been very strong during the last five years, and the fund has benefited from that. Inflation was 1.8 per cent annually over the last five years, so the target return was 6.3 per cent.

The second objective is for the investment manager, or AIMCo, to add 100 basis points, or 1 per cent, in value-added through active management. Actual value-added during the five-year period was .4 per cent, 60 basis points below value-added target. Now, I will note that this is a difficult target and a challenging target to meet, and we are working with AIMCo to improve the value-added.

Lastly, in terms of income earned, the heritage fund has earned $2 billion so far this year. Of this amount, approximately $440 million is expected to be retained by the fund for inflation-proofing, and the remaining $1.6 billion will be transferred to the government's general revenue fund.

This concludes my remarks. Thank you.

The Chair: Okay. Well, thank you very much.

Now we'll go to AIMCo for their report.

Mr. Prakash: Good morning. I will start and then turn it over to my colleagues James and Sandra for their brief prepared remarks. It is a pleasure to be here this morning. As part of my remarks I will speak to two specific topics.

7:55

One is corporate strategy. AIMCo reviewed and refreshed its corporate strategy over the last couple of months in consultation with clients, in consultation with other stakeholders. Now we're squarely in the mode of implementing the strategy, and at a high level the strategy has three main pillars. The first one is clients, where we will push to become a more client-centric organization and to deliver on the promises to our clients; the second is to continue to grow and evolve a customizable investment platform that allows us to do that effectively and transparently; and, lastly, do that with a team where we are focused on developing a high-performing, client-first culture.

The second update for the committee is that our CEO had announced, again, late last year some of the executive positions that needed to be filled on the back of retirements, departures, et cetera. These included the chief risk officer, the head of human resources, the chief technology officer, et cetera. I am pleased to announce that by the end of this week all of the positions – all of the executives will be in their seats. Then the last executive appointment, the head of human resources, will start in the middle of July. At that point the executive team will be in place, and that will further reinforce and abet our ability to execute on the corporate strategy.

With that, I will turn it over to Sandra for her remarks. Sandra.

Ms Lau: Thank you, Amit. Thanks, everyone, and thanks for having us today again. Just a quick intro: co-CIO Sandra Lau of AIMCo, head of public investment, 25 years' investment experience and 23 years' experience with AIMCo. Prior to my appointment I served as AVP of fixed-income assets within AIMCo, overseeing $45 billion of public and private fixed-income assets on behalf of the AIMCo client. Again, just really pleased to be here today to share with you and report to you the heritage trust fund performance as of quarter 3 for December 31, 2021. Like Lowell shared with you, it really marks a strong quarterly performance and translates to an extremely strong fiscal year-to-date performance, 12-month rolling performance, and extending into five-year and 10-year performance as well.

Now, in terms of a little bit of the economics backdrop and the market backdrop over what we see in the last quarter, or the Q3 of 2021, and even over the 2021 12-month horizon, we actually witnessed quite a lot of topical issues: more optimistic with the reopening of the economy that we saw in the middle of 2021 and later on of the emergence of the omicron variant in the later part of the year, more uncertainty of the inflation pressure, and also economic recovery turned into more uncertainty of the monetary policy. I would say that, with this type of backdrop, the market was actually very resilient. The overall stock market return: about 6 per cent over quarter 3 and translating into almost 17 per cent of the 2021 stock market performance in general.

The interest rate market, the bond market, has been pretty flat over quarter 3; however, the 10-year interest rate in Canada actually went from 70 basis points to 1.4 per cent over the year, just partly to do with the more hawkish tone of the central bank in an attempt to control inflation, leading to a negative return of the overall public fixed-income market that we saw. Like Lowell shared with you, this translates to an extremely strong quarterly performance of the heritage trust fund. I will highlight two things. Especially over the last 12 months, as of December 31, 2021, the fund returned, again, an extremely strong return of 19 per cent, outperforming the benchmark by 8.3 per cent. This translates to an extremely strong 10-year long-term return of 10 per cent, a value-added of 70 basis points. The value-add target, like Lowell shared with you, is a very tough target; however, our 70 basis points of a value-add is almost hitting a top-quartile manager performance over a long term, so this is really a result that we are pretty pleased to share with you.

In terms of the performance, actually the strong performance, from the heritage trust fund, every asset class within the product and within the portfolio contributed to this type of strong performance, I would say, especially from asset classes such as real estate, private equity, infrastructure, and public equity.

On the private side we actually see a lot of improvement on the valuation. We also took the opportunity to sell down some of the asset, realize some of the gain with a couple of extremely strong investments that we have invested on behalf of our client over the last couple of years. The public equity market continues to be strong. However, the team actually added an additional 5 per cent of the value-add to the public equity portfolio and are delivering strong results to the client because of the prudent portfolio construction and stock selection that we did on behalf of the client.

A lot of you will be aware that as we turned into 2022, the market took, actually, a fairly sharp turn because of the continuous inflation pressure that we see. With geopolitical uncertainty, the Russia-Ukraine situation, the COVID-related lockdown in China, there is more inflation pressure and the uncertainty, even, of the market's economic recovery. The central bank actually turned way more hawkish into 2022 with the attempt to control inflation. The market was actually generally very concerned with the central bank being too late or being too aggressive with the attempt, and that may even lead to a recession environment or, even worse, a stagflation environment.

As you can probably see, in 2022 the market actually turned more volatile, and we also saw a very sizable sell-off in both stocks and the bond market. With this backdrop, as a long-term investor we continue to be laser focused on how we invest in the best interests of our client.

I will ask my colleague James Barber to comment on what the top risks are we are focusing on and how we position ourselves in this type of backdrop. James.

Mr. Barber: Good. Thanks, Sandra, and good morning. My name is James Barber, co-CIO and head of private investments at AIMCo. Maybe, given that it's the first time I'm meeting with this committee or presenting to them, I'll give a quick background. I've spent more than 25 years working in investment management and financial services in a number of different roles spanning across multiple asset classes, asset allocation, research, portfolio management, investment process, risk management roles. Prior to this, I was the EVP responsible for public equities at AIMCo and, before that, spent about 10 years at Russell Investments as the CIO of the equity platform there. I'm excited to be working with Sandra as co-CIOs as we kind of lead the investment team and develop the platform and prepare us to be able to deliver outstanding investment results over the coming years.

As Sandra mentioned, we're moving into an environment where, certainly, the way I think of it, you know, the expected returns have come down and the expected risks have gone up. As we think through that framework, there are a couple of key ways we think of the risks, and it's really across three kinds of dimensions. One is the economic risks, the second would be the geopolitical risks, and the third would be other related risks around cybersecurity. Obviously, COVID would fit into that as well as market liquidity disruption.

Within the economic risk perspective, a couple of key points we're really focused on there. Obviously, stagflation is front and centre. This is not something we've experienced for multiple decades but is very real, where we have rising inflation and falling growth, and that is a particularly challenging scenario. The central bank policies, you know, are currently very active. Some may argue that they've been a little late to the party in terms of actually tapping conditions and now find themselves in a really difficult position with slowing growth and having to raise rates to tame inflation. With respect to that, also related would be risks related to currency and the stability around the dollar as well as, certainly, some of the pay currencies from the emerging market side as well as what China does with its own currency.

From a geopolitical perspective, two big issues are front and centre. Obviously, having a prolonged Russa-Ukraine war is not conducive. Now, while this has a relatively small impact on the financial markets, both of those countries representing very small investable portions certainly in the public markets, both in equity and fixed income, I think what we're quickly realizing is that those have a much more significant impact on the underlying economies in terms of energy security as well as food. That is something that's being propagated throughout the system and causing some supply shortages and price spikes as a result of that.

8:05

The second is China and the implications of their political and economic policy. Clearly, you know, in the middle of a COVID-related lockdown it is adding to potential risks around economic activity and trade and supply disruptions, but also longer term strategically the politics, specifically as it relates to Taiwan, is a potential flashpoint.

In terms of the third pillar, obviously, you know, COVID is clearly something we've been dealing with for two years now. While many markets and countries seem to be through the worst of that, there are still many parts of the world that are under lockdown or dealing with significant issues around that. So you might ask: how do we position ourselves through that? We are currently relatively cautious. We're using about 66 per cent of our active risk budgets, so lower than expected or normal. We have a comfortable position in terms of stress liquidity, where that ratio is about 300 per cent, so, you know, somewhat cautiously positioned. I think part of that is being able to be benefiting over the last several years in terms of the recovery and in terms of the strong markets that currently are being much more cautious in increasing the risks.

Tactically we're fairly neutral relative to the benchmark at a mass allocation perspective. We have some reduced equity market exposure, and we have some tail-hedging positions in place to protect on the downside, which have proven to actually be value-adding this year. These were things that were done towards the back end of last year.

On the public fixed-income side we're shorter duration and, you know, favouring shorter maturity credit risk over longer duration, making sure we have plenty of liquidity in that, and building out a diversified portfolio across different credit spaces.

In the private mortgages similar themes there, where we're preferring higher quality. Those people that have lower leverage are the ones that we're focusing on. We're trying to expand the geographic presence there as well, and a theme across a number of asset classes is really expanding across a broader impact region in the assets. Public equities is an area where we've, you know, focused on having higher quality, reducing the equity beta, and lower volatility of operating margins, and that's enabled us to not only do relatively well last year but into this year. As the markets have been, obviously, sold off, we have still been able to outperform in that environment.

Infrastructure. When we talk about some of the private asset classes, infrastructure is also higher quality, with more corelike assets and opportunities. We don't believe we're getting paid for taking on higher risk in many of these assets, so we feel like it's not prudent to do that, and we'll wait until we think we can get compensated for that. Similarly, in real estate, you know, we've been moving towards residential and industrial areas that have greater ability to adjust to high inflation, meaning that their rentals and the leases reset more quickly. So if your lease is renegotiated every year, it gives you a capacity to increase that. If you have a five-year lease or a 10-year lease, it's obviously very difficult to keep up with inflation in that environment, so the portfolio has been positioned much more towards the shorter duration of those assets.

In the private debt and loans book, that is primarily focused on the private credit side of things, typically more floating rates, shorter duration, and high-yield credits. That portfolio is also looking to increase their impact exposure, currently only around 8 per cent of the portfolio, so in the coming years they should look to increase that. Finally, the private equities side is an area where we continue to increase capital deployment through our fund program, focusing on the middle market and buyouts. That strategy has been performing very well. Some of the capital has been returned probably a little quicker given the buoyant markets we've had over the last year, so we, you know, continue to grow in the growth equity, in the secondaries market, and developing some of the best relationships we have to continue to deploy capital and also look for opportunities that broaden out that book geographically.

With that, I will kind of pause and maybe hand it back to the chair.

The Chair: Okay. Thank you very much for your presentations.

Before we open it up to the floor for questions, I just would like MLA Rehn to introduce himself as well.

Mr. Rehn: Good morning. Pat Rehn, MLA, Lesser Slave Lake.

The Chair: Okay. Thank you very much.

The way we'll handle the questions: we'll just alternate back and forth. There'll be an initial question and then a follow-up after that.

We'll start with MLA Phillips.

Ms Phillips: Yeah. Hi. Good morning. Thank you for that pretty detailed overview. Some of the questions I noted down around inflation, Mr. Barber, you have touched on already. I just want to go into inflation a little bit, and maybe you can provide us with a little bit more detail. You talked a little bit about repositioning some of your investments in the real estate space in this period of higher sustained inflation, but we know that reality also has an effect on things like fixed income and so on. Can you tell me a little bit more about repositioning the fund for this period of higher sustained inflation? Along with that, if you could maybe talk a little bit about how you're seeing higher sustained inflation in other places?

We know that Canada is actually, I think, less affected than some other places. I was just looking at Germany's inflation numbers yesterday, for example. If you could talk to me a little bit about some of your global investments and how they are being repositioned because of this higher period of sustained inflation.

Mr. Barber: Sure. Thank you for the questions. I'll make a couple of quick remarks, and then I'll hand it over to Sandra to comment as well, particularly on the public fixed-income portfolio and how we've adjusted that.

I think one of the challenges we find with inflation right now – there are typically three drivers of inflation. It's either because of increasing monetary supply or easy monetary conditions; the second would be supply-side shock, so you would have a shock in oil supply that gets cut off, and that could cause prices to increase; and then the third is excess demand growth. If you think about what's happening with COVID, as we're coming out of the doldrums there, the demand is increasing.

The challenge we face right now, when we look at inflation, is that all three of those have been contributing. We've had very easy monetary conditions for a number of years, which have pushed up asset prices and pushed up inflation, we've had multiple supply shocks from COVID and from Russia-Ukraine, and we've had this excess demand, all happening simultaneously.

One of the concerns we have with inflation is that it is pretty widespread. It's in the energy complex, which then finds its way through the economy, anything that gets transported. It is in anything that is imported on the supply side. It's impacted by food, tracing that back to Ukraine. We're finding that it finds its way into wages and wage expectations and demands as well. It's actually going to be, I think – we're most certainly past that stage where people were talking about this as transitory and temporary. It's going to take a little bit of time and, unfortunately, a little bit of pain, I think, to actually modulate and moderate that inflation.

It is global in nature. Some counties are, obviously, more impacted than others. You know, Europe, particularly with their dependence on the energy sector and exposure to that, has been probably impacted a little more negatively and partly because they've had lower growth to start with as well. The tension we're facing is inflation and growth as well. So that's maybe a little bit more colour on inflation and how we see the backdrop.

In terms of the positioning with respect to – I think you asked around real estate. That is something that, as you can imagine, is a long-term investment program, so it evolves slowly. Over the last couple of years we have been moving that portfolio more towards things like residential, more towards things like industrials, and even within industrials it might be some of the other asset classes like getting exposure to life sciences, getting exposure to data centres, getting exposure to the entertainment industry in terms of producing content and studios and things like that. It's certainly broadening out the diversification in the portfolio and moving towards things where we see significant demand growth and shorter duration on assets. That's a multiprogram and a multiyear strategy.

Maybe back to you, Sandra, in terms of the fixed income.

Ms Lau: Yeah. I will be extremely quick for this question. Thanks for the question. In terms of this asset allocation perspective I think that the portfolio has actually very well positioned itself for inflation, especially if you think of real estate assets, infrastructure assets. They are designed for inflation protection.

8:15

Now, most of the assets will be coming from fixed income, which is a very right call, because in a rising inflation environment interest rates usually get higher and are usually negative for fixed-income assets, so the shift of the fixed income into the real estate, the infrastructure asset is actually a very prudent call in asset mix for protecting the portfolio going forward in the inflation-sensitive environment.

The other question that I want to touch on is about inflation around the world. It's true that we're seeing dispersion of inflation around the world: 8 per cent in the U.S., 6 per cent in Canada, even low inflation in China. This actually leads to more different types of monetary policy or political diversion across different countries and further emphasizes the importance of geographic diversification, and this is the importance of how to construct a good portfolio and prudent portfolio as we go for a consistent, long-term return for the client.

The Chair: Okay. A follow-up question, MLA Phillips?

Ms Phillips: Just real quick on currency and how you're seeing the Canadian dollar reacting to all of this. It seems to be a little bit different than in previous times when we've had $100 and some-odd barrel WTI. So if you could talk a little bit about that and how we can better understand that dynamic.

Ms Lau: Yeah. I will comment on this. The Canadian dollar dynamic sometimes is a question about the Canadian dollar itself or the U.S. dollar. In this case, with the geopolitical concern – the Russian-Ukraine situation, the China economic backdrop – the U.S. dollar is the safe haven asset, that flight to quality. As such, the U.S. is very strong versus the rest of the world in terms of currency.

With this backdrop the Canadian dollar, especially with the energy prices concern, is actually extremely strong, and out of all of the foreign currencies versus the USD, the Canadian dollar is actually one of the strongest dollars performing in this cycle, which is very good to see, good for the Canadian market and good for the Canadian backdrop in general. This is similar to what you see in other commodity-heavy countries such as Canada, Australia. This is the backdrop we are seeing out there.

The Chair: Okay. Thank you very much.

Our next question will come from MLA Allard.

Mrs. Allard: Thank you, Mr. Chair. Good morning. Thank you for being here. I'm just going to go back to some of the basics from the start of your report. Page 1 of the report states that the "Heritage Savings Trust Fund returned 6.0 per cent during the 2021-22 third quarter" and has outperformed "its passive benchmark by 1.5 per cent." What factors would you say explain the differences in return between the fund and the benchmark over the last year, and are those changing given the stagflation environment, potentially, that we find ourselves in?

Mr. Barber: Sure. I'll start from that. In terms of that quarter in particular we saw, you know, strong returns in the asset markets benefiting from a recovery in economic activity, relatively easy monetary conditions, and strong growth in profits and earnings. Typically we saw most risk assets, both across the public side and the private side, actually performing really well. We saw on the private side a number of investments which were actually exited or IPOed and benefited from that in terms of the market actually realizing the investment value and distributing that back. So those were some positive perspectives.

One of the things we've actually – as we moved through the last year, we became increasingly cautious in the portfolio positioning, so we rebalanced both on the public side and the private side, too. But certainly in the public equities, which is a big part of the book, that is more defensively positioned, so going from being more a pro growth, positive market outlook, it has become a little more cautious. We reduced our equity exposure, and we reduced the equity beta, reduced the equity risk, increased the quality of that.

What we've seen year to date in a market that's, you know, sold off double digits: we've actually been able to add value in that environment as well. I think it's probably been, actually, a really good environment for active managers to be able to participate in that recovery and make sure that we're getting paid for the risks we're taking on but, as we've moved through the cycle, to become more cautious and actually be able to navigate this in a reasonably robust way at least to date.

The Chair: Okay. Thank you very much.
A follow-up?

Mrs. Allard: Yeah. Thank you. I note in the opening remarks that the five-year and 10-year returns were very solid, and they both achieved higher than the benchmark. Again, in this current situation one of the benchmarks that I understand was more challenging to achieve was that additional 1 per cent active management increase. I'm wondering, given how volatile the markets are, if there's opportunity there. You know, how realistic is that goal right now? I know that sometimes that provides some opportunity for some arbitrage that was unexpected, but timing is everything, and I don't know how nimble the fund is to move assets quickly. I was just curious how realistic that is given this environment.

Ms Lau: Well, maybe I will address that. Thanks for the question. I think the 100 basis point target is more a longer term target that we have to target for. Like in the opening remarks Lowell has shared with you, this is a tall order, the target. I will share with you that this type of target is almost like a top decile long-term fund performance that's expected. As such, this is really a target that is a very challenging target, but at the same time for the 10 years we've delivered so far, we actually delivered 70 basis points.

With the market getting more volatile, this is more of a stretch target we are shooting for. As the market continues to evolve, the target of what we are achieving is one side of the equation. However, for AIMCo's role to deliver the good, risk-adjusted returns on behalf of its clients, we are laser focused on different investments, different cycles, different backdrops. We continue to be dynamically changing our investment strategy, portfolio construction with the attempt to deliver this type of good performance and value for the client despite the different economic backdrops we are facing.

Mr. Prakash: I'll just quickly add one or two other aspects which are really important in this context. As an investment manager it is really important that we are looking beyond the here and now. The 70 basis points we're very proud of, but that's in the rear-view mirror. Looking at new ways of building portfolios, looking at incorporating newer technologies, which are state of the art in terms of how we are looking at data and how we're handling data, and, secondly, again, continuing to look at the entire globe as the opportunity set rather than in a narrow way: we've done that in the past, and we'll continue to push to do that in the future as well.
Thank you.

The Chair: Okay. Thank you.
Oh, go ahead.

Mr. Barber: A final comment, if I can, just on this market volatility. I think our focus is really trying to understand the difference between what the underlying fundamental value is and how the market is pricing it, so just trying to not necessarily time those markets and that value that way but really focus that if we have opportunities – and we've seen this particularly on the private side, where somebody is offering to buy some of our assets at what we think is an inflated price – we're willing to sell them. If somebody's willing to sell something well below fair value, we're willing to buy that, so really thinking about the natural evolution of volatility – I mean, it sounds very simple – to try and sell high and buy low, just as you would through that volatility period. You saw a number of investments that were realized last year which we sold sooner than we would have expected, but that was partly because the offers were really, really attractive.

The Chair: All right. Thank you. Good answers.
MLA Eggen.

Mr. Eggen: Thanks, Chair, and thanks, everyone, for your report. I would like to talk about valuations to some degree. Clearly, you had quite a good quarter, and at least to some degree that was buttressed by private equity holdings and space. I also know that private equity is kind of hard to value – right? – because, you know, the markets are less liquid and so forth. I'm just curious to know how you backstop your valuations for private equity. How do investment managers like AIMCo go through a valuing process for those holdings, and do you contract out some of that to help with your valuations?

8:25

Mr. Barber: This is, obviously, a really, really important topic and a really important question. For us, the starting point is making sure that, you know, we want to have those valuations reflect fair value, and we want to have appropriate governance and oversight. The starting point is that, actually, the investment team has nothing to do with the valuations. We might have our opinion on what we think the value is, but the valuation process is run independently. That valuations team reports in to the CFO, so they run a rigorous process around valuations, and that is done, really, to try and establish the fair economic value of the asset.

They have multiple approaches. They are using external parties to help validate and make recommendations on those valuations. It is, you know, trying to fulfill the purposes of independence working with external parties, so there are kind of two levels: one, using external vendors to appraise assets, and second, even internally within AIMCo it's run as a separate process under the CFO. Then that goes up to the board. There's a valuation committee that's chaired by the CFO. They report in to the audit committee and have some independent view there.

Typically those assets are – you know, you use multiple approaches. They think about the income, they think about a market-based approach, and they look at a cost-based approach. The frequency of the valuation process differs depending on the assets, but it's suffice to say that it's regular with market practice in that perspective.

The other comment maybe I'll make as it relates to perhaps some of the thoughts and concerns. The private equity returns last year, which we think were abnormally good, were really a function of liquidating a number of assets. The comments I made a little bit earlier: if somebody comes and actually offers you to buy the asset at a price, you would sell it.

There were a couple of investments maybe worth touching on. One was Hayward, which was actually an IPO. This wasn't us really appraising the value of the investment; the IPO happens, and it gets priced by the market. It's actually transaction based, and then it becomes a public mark to market, so that's not necessarily our assumptions. There was another one on ERM, which was also a transaction where we sold the assets to KKR.

A reasonable proportion of that investment performance was actually not a change in valuation methodology or a change in valuations. It was actually investments exited, and they were exited at a premium. That helped drive the performance. The bulk of the return wasn't from a change in valuation methodology or approach. A lot of it was actually the underlying performance of the investments and the assets in terms of growth of revenues and growth of profitability.

Mr. Eggen: Thank you. I think that kind of answers my supplemental as well. I mean, I just want to make sure there's, like, a check and a balance to guard against systematically mispricing these things. Clearly, if you are using some external sources or, you know, doing an audit that includes other opinions, then I think that is the way to go, obviously. Yes. That's all I've got.

The Chair: You're good? Okay.

Next we'll go to MLA Jones.

Mr. Jones: Thank you, and thank you for your presentation. Inflation-proofing is required by legislation to protect the fund from losing real purchasing power over time. Can you provide the amounts the general revenue fund is projected to receive from the income generated this fiscal year and the amount that will be retained for inflation purposes?

Mr. Epp: There we go. We only have numbers up to the end of December. We have not yet calculated the final numbers for the year. The report, as I mentioned before, says that we've earned about $2 billion through the third quarter. Approximately $440 million would be retained by the fund, meaning that approximately $1.6 billion will be transferred to the general revenue fund.

Mr. Jones: Yeah. Now, specifically, can you explain how this amount is calculated or what is the mechanism? How do we determine what is retained for inflation-proofing? And then, also, do we expect smaller transfers to the general revenue fund going forward as more is essentially required to be retained for inflation-proofing?

Mr. Epp: The inflation-proofing is calculated by multiplying the consumer price index over the last 12 months by the value of the fund. Certainly, if the consumer price index continues to go up, we will have to draw more out. Assuming the returns stay around the same and not increase because of inflation, yes, we'll be drawing out less.

Mr. Jones: Okay. Second question. The ministry set a real return expectation for the fund, which I believe is 4 and a half per cent greater than inflation over a five-year period. Simple first question: what was the return of the heritage fund over the last five years, and how did that compare to that target real return?

Mr. Epp: The return over five years was 8.8 per cent, and the CPI plus 4 and a half was 6.3 per cent, so we're about 250 basis points, 2.5 per cent, above our target.

Mr. Jones: Again, can you explain how this target is determined, how frequently it's revisited, and comment on the appropriateness of the target given that inflation is rising so rapidly?

Mr. Epp: Good questions. Historically this was set when AIMCo was first created and probably before that. When the fund was created, it was based on what endowments in Canada – university endowments, for example – expect over the long term from a real-rate-of-return perspective. We believe it's reasonable, but it is, again, going to be challenging in the next few years as inflation takes off. You're going to have returns probably pressured downward as rates go up, and you will have the opposite happening, inflation going up and the requirement being pushed up.

Mr. Jones: A quick second supplemental: do other funds that have similar mechanisms use some form of a more variable number? I mean, 4 and a half per cent is just a static number over inflation, so I'm wondering if there are some weighted averages or something that other funds are using that are more appropriate to the changing circumstances, because I imagine this will be very difficult to hit.

Mr. Epp: Well, it is common for other endowments to take the last three years' average value of the fund, so if the fund is growing, you're actually not transferring 4 and a half per cent but 4 and a half per cent of a lower average. That's one thing. Some funds – and you'll hear about some university endowments. When returns are off, they will cut the contributions from their endowment funds going into the university's budget. They have flexibility, as would the government in this case. There is no law saying that we have to retain all the income – pardon me. We have to retain income; that is part of the law. But there's no law saying that we can't disburse more than otherwise or less than otherwise.

Mr. Jones: Thank you. Those are my questions.

The Chair: Thank you.

Yeah. Just for future reference we'll have one question and then a supplemental.

Our next questioner is MLA Gray, and if you have two, then we'll allow you two supplementals.

Ms Gray: I appreciate that, Chair.

Mr. Eggen: We don't want to be unfair.

Ms Gray: No.

Thank you very much, and thank you, everyone, for your presentations so far this morning. Lots of really good discussion at the meeting today. I do want to acknowledge the very positive turnaround we're seeing recently at AIMCo, the strong performance over the last quarter and beyond.

8:35

Certainly, we've talked in this committee many times about our view that AIMCo should be delivering benchmark returns plus 1 per cent, and even during this meeting we've talked about those value-add targets as being – I think the language I've heard is "very tough" and "a tall order." Over 10 years you're at 70 per cent of that target, and over the last five years you're at 40 per cent. Certainly, in the short term we're seeing really, really positive things and a definite turnaround, but with that 40 per cent and 70 per cent we're still not quite there, so my first question for AIMCo is: really at a high level, what do you think is going right with the organization right now that has led to the recent improvement in these results?

Mr. Barber: I can comment on that. I mean, I think the first point is that we are a long-term investor, and even though five years seems like a long time, in the scheme of the variability in markets it can be a shorter time. I think, as we've set some of these objectives and measure the CPI plus 450 over a five-year rolling average, the idea is to smooth out any particular year and get you a longer term value-add. I think, certainly, as a long-term investor, you know, being able to have the fortitude and focus on the long horizon and hold the line even when there's pressure has proven to be very valuable, and we saw that in the results there.

I think we should certainly give credit to Dale MacMaster, the CIO, and the whole investment team for actually being able to navigate through what was a really challenging time and being able to come out of that delivering the amazing results they did in the previous years. I think that's, you know, something to make sure – it's making the right decisions when it's actually really difficult that counts. I think the investment team navigated that really well. That also helps build confidence and conviction in the overall strategy with time. I think that's one piece.

The second part of this is that what we're also observing is that as the capital markets are evolving and changing, the role of private investments is increasing at a rapid rate, and that is providing significant opportunities to capture investments that may not be priced in the public markets and is an opportunity for greater value-add. Something that we've been investing in for years and we'll continue to invest in is building out those programs across infrastructure, across private equity, across private debt and loans. Those are some areas that we have – you know, if you go back five years or more, we had very little in private debt and loans. That's grown to be a significant part of the portfolio and has delivered outstanding results and is really well aligned with the investment objectives.

I think that as a team and an organization we continue to invest in some of the asset classes and some of the areas where we think we have a greater chance of adding value. We have, as an organization, you know, been focused on making sure we build the right team and culture to deliver on that proposition, and certainly part of Sandra's and my mandate for leading the investment team is thinking carefully about that platform and the investment strategy. What are the things that are going to be really important for us over the next five and 10 years to be able to deliver value? I think, you know, we're excited and the team is excited for really leaning into some of those things. Investing in talent, investing in some of the technology and data that supports our platform, continuing to globalize our geographic expansion are all going to be really important drivers of success in the future.

Ms Gray: Oh, thank you very much for that.

Certainly, I think we're very pleased to see the short-term positivity, very interested in, as a long-term investor, seeing AIMCo beating that benchmark by 1 per cent and keeping that as our expectation. Are there any obstacles that you can identify to hitting that benchmark return? Certainly, you've talked about the work that's happening to update team and culture, the role of private investments. Are there any barriers or obstacles that you see, looking at that perspective as a long-term investor, to hitting the benchmark and beating that benchmark by 1 per cent?

Mr. Barber: Maybe just responding to some of your thoughts there, I think the capital markets are competitive, and the industry is competitive. I think, certainly, we're competing for talent, and we're competing for opportunities in the capital markets, so having the best people in place, having the systems and the data and the technology to support that is critical. Being able to do that better than the competing organizations is really important, so we're really focused on developing our unique culture, the talent pool, but also the infrastructure to execute on that.

Then, you know, I would add: one other piece which I think a lot of people have been thinking about is just the role of climate change and the energy transition. What that means for the underlying economy and what opportunities that presents and what risks that poses for people is also going to be a big area where there are a lot of unknowns today. We're learning more every day about that, and we're taking an investment-led approach on that. But I think that will also be a big unknown or a big theme that will be playing its part over the coming years, that AIMCo needs to make sure we are well versed and educated and understand.

Ms Lau: I guess one of the most important, critical missions to achieve the target is that every cycle of the market and every sale of the market just create a lot of good opportunity. Critical to our success is being able to be nimble, flexible, with the right talent and the culture to look beyond what the market is showing us today and look for a new investment idea and thesis, and that's what AIMCo has always strived for. Like James alluded to, for the future state of: what is the strategy to fight inflation? Better technology. Technology continues to be a theme. The team has continued to work hard to identify new theses, to continue to add value for the client, because of the backdrop which has created more opportunity for a flexible investor to gain a better risk-adjusted return for the client.

Ms Gray: If I may?

The Chair: Yep. You bet.

Ms Gray: Thank you.

I may be hearing you too literally, because I used to be a database developer and programmer. When you were talking about technology and infrastructure, at these committee meetings in the past I understood that AIMCo was undergoing some major IT projects to update your systems. Am I understanding that you are literally connecting that to your ability to hit these targets? Would you be able to let us know if those major IT projects, which we talked about I'm going to guess probably half a year ago, maybe a bit longer ago, have successfully concluded? Or are they ongoing? I think our understanding was that there were some projects that had really been going on for quite a long time. If you can report back to that.

Mr. Barber: Sure. The first point is that I think you're absolutely right, that from an investment perspective we think that to be able to make higher quality decisions and make them in a more timely manner – the underlying data and technology is a critical part of that in supporting our portfolio managers and our research house in making the right decisions in a timely manner. That's a critical part of our strategy, and it's something we have invested in and something that we will continue to invest in.

There were a number of projects which you may be referring to, particularly on the risk side, which were concluded and went live basically in January of this year, so that was a big effort and big investment made over multiple years. That was successfully concluded and implemented, and it's a first stage kind of in moving to the next chapter of that and the conversation that we're having. We're excited that we have a new chief technology officer. He will be joining us actually later this week, I believe, as a first official day. They will be an important partner to work with the investment team to help think about: how do we make sure that we have the right infrastructure and platform in place to support the investment decision-making and portfolio management processes? Some of those have been closed off and completed, but this is going to be an active area for us over the coming years.

Mr. Prakash: Just to add, we also have, in terms of some of the major projects, work ongoing to enhance and improve our performance and analytic systems. That's a project that is ongoing and will be delivered over time. But to echo James, this is an ongoing enhancement across the platform in addition to some of the more visible system deliverables.
Thank you.

The Chair: Okay. Thank you very much.
Our next question comes from MLA Singh.

8:45

Mr. Singh: Thank you, Chair. I would like to extend my appreciation for the presence of the representatives from the Ministry of Finance and AIMCo. This has been a great and informative presentation and discussion. My question is on page 10, that explains that there are three levels of fair value hierarchy to describe the quality and reliability of information used to estimate the fair value of investments. Level 1 would be the ones with the highest quality and reliability, and I see on page 10 that the real estate investments are the largest type of investments in the level 3 category. What is AIMCo's confidence in the value of the fair value, and how can we know the value is accurate and reliable?
Thanks.

Mr. Barber: Yeah. Thank you for the question. With respect to all our investments, particularly the ones that don't have, you know, effectively, daily market-based pricing available, it becomes harder to estimate the fair value, right? There's no doubt about that. The way we approach that is particularly having, one, segregation of responsibility, so the person making an investment decision or being responsible for managing a portfolio has absolutely no say in what the valuation is determined to be. The valuation is determined by an independent valuation committee that sits under the chief financial officer, and that is, first, certainly an independent process internally, but then they rely heavily on external appraisers to value those buildings or those investments and provide their recommendation.

They typically use what would be called a market approach, which would be one of the approaches to get at a value or an estimated value, where they would look at, you know, similar buildings, similar comparables, similar recent trends and other prices and then try and infer that on a like-for-like basis and estimate it. That would be called the market-based approach that they would use to do it.

They would then use an income-based approach, which is looking at the underlying cashflows and rents and expenses and the net operating income of the building to understand, "What are those incomes, what are they today, and how would we project them into the future?" and then discount them to get back to a value.

And then they would also look at, you know, a cost-based approach of, like: we own a building, and what would it cost to replace that and rebuild it in terms of a replacement cost? And then they use that to triangulate and say: okay; given these multiple approaches, what do we think is fair value?

I certainly have confidence in the work that's done leveraging external third-party professional appraisers, but then the process that's done to actually review that – I've reviewed some of the minutes and the materials that go into the preparation for those meetings. They are very extensive. Asset by asset, each one is written up, is documented, is discussed in the valuation committee and approved. It's then audited independently, so there's an internal audit function that oversees the process to make sure that they're following the policy that's set, and then that goes up to the board, and the audit committee then evaluates those and audits to make sure that the valuation committee is actually doing what they're doing and that the assumptions are fair and valid in that process.

I actually have, you know, a high degree of confidence in the approach. The process is – it's almost confidence in the process and the policy and the approach as against any one number, and I think that's what's actually more important. We own hundreds of properties across geographies and across time, so really having a robust approach to that is critical because time will vary, the assets will vary, the market conditions will vary, but having a robust process, for us, is key. I would say that I have high confidence in that, and that's something that is reported and publicly available if there are others that you would like to speak to on that topic.

Mr. Singh: Thanks for answering.
I see equity investments have a great potential to retain compared to the other asset classes and also pose a higher risk, especially global development ones. What risks does the fund in equity investment face, and how does AIMCo manage such risk?
Thank you.

Ms Lau: Maybe I will take that question. Thanks for the question. Actually, equity risk, like any other type of risk asset, carries a different kind of risk and return profile. Equity is no different than the other. It is being impacted by different types of risk such as the macroeconomic backdrop, country risk, industry sectors, and, actually, even for the country or the company level of the metrics of a company's balance sheet, the industry they're in, and going into other types of risks such as demand-supply technicality, fund flow, and liquidity premium. All will impact the risk premia of what equity will earn over a risk-free interest rate.

Now, that said, AIMCo is managing the equity risk, like all the other risks that we are managing within AIMCo, with a full risk-disciplined approach. We approach with a very full top-down, bottom-up approach, with prudent portfolio construction, diversification on how we set up our portfolio with proper risk control and limits on how we manage the equity portfolio. When the team does the due diligence or, actually, invests for any single stock or any investment, we do a full bottom-up approach, looking at the company dynamic, the balance sheet, and the health of the company. That's all built in for a full approach where we look at the assessment.

We are never being complacent; we continuously underwrite and stress test our portfolio and look at the portfolio from a broad stream of considerations. When the timing is uncertain, we constantly prudently put a hedge onto the portfolio to protect any risks that we want to protect during different economic backdrops. This is all being done with full collaboration with the investment team and risk team and builds upon the strong governance and the risk culture and the collaboration between the risk and investment dynamic that we have within AIMCo.

Mr. Singh: Thanks for answering, Mr. Chair.

The Chair: Thank you very much.
Our next question comes from MLA Phillips and then MLA Hunter. Go ahead, MLA Phillips.

Ms Phillips: Thank you, and thanks for the answers so far. About a year and a half ago – I guess it was in the fall of 2020 – it was sort of announced that there would be an investment review of AIMCo. At the time the CEO observed that the investment thesis and policy and allocation that derives from that policy comes from the government of Alberta, and the GOA indicated that they were doing an investment review. So I'm wondering, from AIMCo's perspective, if you can tell me if there have been changes in asset allocation and overall investment policy as a result of that review.

Mr. Prakash: I can start, Sandra, and then the Treasury Board and Finance team may want to add. Thank you for the question. That is work that is ongoing with the Treasury Board team. We are taking a pretty broad – we are sort of under their guidance, doing a fairly broad review of the asset allocation, including looking at different long-term forecast assumptions, looking at different configurations, different assumptions on inflation, et cetera, to develop insights and, ultimately, recommendations that the Treasury Board and Finance team would deliberate on and then utilize as appropriate with them. It is a process that's ongoing right now, and we'll be happy to report, from our perspective, to the extent when it's complete.

Ms Phillips: Good. So at that time there was some observation that perhaps switching to some aspects being passively managed – there was some chit-chat around that. I'm wondering if you can provide me a little bit more insight into those deliberations. I can see where maybe in the first quarter of 2021 that looks good, because equities are on a tear, but they're kind of not now. Can you just tell me a little bit about where you were looking at those passive approaches and where they'd be most beneficial in the kinds of market volatility that we're seeing now?

8:55

Mr. Prakash: Good question again. We've been working with clients, the heritage fund team, in addition to other clients on reviewing our investment platform, and one of the deeper dives was on the equity platform, so we are going through a revamp, if you will, of the platform.

One of the first set of deliverables of the review was the offering of indexed equity solutions, and those have been available on the platform for about four months or so now. The second part of the process is reviewing the active equity solutions relative to what we had in the past, again, evolving them into a form that is more suitable given client feedback, and then, lastly, an absolute return solution, which has also been on the desired list from some of our clients.

In terms of the changes that are affected by this, most of the clients' sense is that they would look to assess the changes once the platform is ready, which it would be by the early part of Q4 this year.

Last but not the least, outside of what's changing on our platform, which is under way, the big part of the asset class review typically is looking over a much, much longer horizon and therefore working equally on what the right mix is in addition to, you know, what the right vehicles are. The first part of the process – that's the review that I was referring to – is ongoing. The vehicle is, if you will, a second aspect to the review.

The Chair: Okay. Thank you very much.

Our next question comes from MLA Hunter.

Mr. Hunter: Thank you, Mr. Chair, and thank you, AIMCo and Treasury Board, for being here today to present. I want to just ask a question about the Russian invasion of Ukraine and how that's affecting your investment strategy. Now, you did talk about divesting from any Russian assets. How has that affected the fund? What was the amount that was divested? Can that be presented here today?

Ms Lau: Yeah. I will address the question, and thanks for the question. Actually, the Russia-Ukraine situation: AIMCo has a relatively nonmaterial exposure to Ukraine and limited exposure to Russia. When the situation evolved, we actually – most of the exposure is in the public equity position, more reflecting the Russia index exposure within the index composite. The exposure of Russia at that time was pretty minimum, close to maybe less than 20 basis points within the equity portfolio, which translates to maybe five, six basis points of the total fund level, so it's relatively immaterial. We actually also addressed, soon after, the divestment plan of the Russian exposure. That was the action being taken.

I would also say about how it impacts the portfolio: we look at it in a different perspective. The direct exposure of Russia or the second derivative of any other holding that has some second derivative of the exposure to Russia: the exposure is pretty minimum, and we constantly monitor that as well. How it impacts the portfolio: I would say that before the Russian event happened, we were very mindful and cautious with the geopolitical events anyway, like James alluded to. As such, we really construct our portfolio – it is very defensive, being underweight in stock and being underweight in bonds and going into the market conditions. We actually positioned ourselves pretty well when we go into the Russia-Ukraine situation.

Even with the risk of further inflation, the stagflation risk coming up, and what we alluded to, we have been constantly evolving the market backdrop with this type of geopolitical event and positioning our portfolio accordingly to mitigate any potential risk or any economic uncertainty. Other risk monitoring: we have been monitoring the liquidity risks of the market, the function of the financial stability of the market, and making sure that the liquidity of the market is in good shape, and we also consistently stress test our portfolio to make sure we stay on top of the portfolio, or every single investment we are on.

Mr. Hunter: Okay. Thank you. I appreciate that.

What would the risk be to our portfolio if we had to divest from China? Now, obviously, that is a difficult question to ask, but given some of the geopolitical talk that we've heard, I'm just interested to know how that would affect our fund.

Ms Lau: In terms of divestment from China it is actually a very interesting topic and discussion. So far the fund's direct exposure to China is relatively minimal. I think that the direct exposure to China is about less than probably 1 per cent or even 70 basis points or so. This is the investment in China. However, how big China is as a country or actually into the rest of the world, how it's connected together, the second derivative of China exposure is more pronounced. It's any portfolio: any company will have any relationship with China, any supply chain relationship with China. The second derivative of the exposure would be more worth considering.

As far as direct interaction with China or direct investment in China, the fund actually has a relatively small position in China directly.

The Chair: Thank you.

Our next question comes from MLA Eggen, and then we'll go to MLA Rehn. Go ahead.

Mr. Eggen: Thank you, Chair. I would like to ask anybody who would answer about cryptocurrency. You hear a lot about it these days, and quite frankly I'm confused and maybe other people are, too, right? I'm just curious, on a basic level, if there is any, or what portion of the fund is allocated to, cryptocurrency. You know, I hear people talking about using cryptocurrency as a hedge against inflation, right? I know that you are one of our largest portfolio managers in the country. I'm just curious what your opinion is on this and, you know: why do funds such as AIMCo not invest in cryptocurrency as a principal asset class? What insight can you perhaps provide for us here this morning?

Mr. Epp: Well, I can start . . .

Mr. Barber: I guess I could start and . . .

The Chair: Excuse me. We have Lowell Epp going first, and then we'll come back to you. Sorry.

Mr. Epp: I can answer the first part of the question, which is: is there any allocation made to cryptocurrency? No allocation formally is made to cryptocurrency.

Mr. Eggen: Yeah. That's what I thought. I thought so. Maybe James could, you know, tell us why.

Mr. Barber: Is that the billion-dollar question? Look, I think that it's obviously a rapidly evolving landscape in that space, and I think, certainly, from an asset allocation perspective, an investment strategy perspective, it's hard to argue that it would meet many of the criteria that we would use to evaluate the investment and that it would have fundamental value associated with it. So I think it's something that is actually not in the portfolio, but it's not on the to-do list either of something that we feel like we really have as a part of the portfolio.

There is an aspect – and this is, I guess, less about the crypto and more about the blockchain and more about decentralized finance and how that evolves. It is something that is rapidly evolving. The regulators and the banks don't seem to have a problem with it and the speed and the requirements around regulation and transparency and all the things that are required for a good, robust financial and banking system. You know, the fact that people can go and issue their own currency, effectively, that doesn't have any kind of sovereign attributes or any ability to regulate it or any legal protection to regulate it, is somewhat challenging to me. But the underlying technology of being able to reduce costs of transactions, provide increased transparency, and provide increased interoperability are all features that are attractive.

So I think, as we think through the financial system, it's having implications in terms of assets, asset exchanges, asset registers, insurance industry, you know, you name it, across the board. I think it is something that is worth staying on top of and learning and understanding what those implications are, but certainly as a stand-alone asset, it strikes me as more speculative than a true investment at this stage.

9:05

Mr. Eggen: Yeah. I concur. Certainly, couldn't you learn some of those best practices and fluidity, you know, attributes of cryptocurrency without having to detach an investment, especially a public investment like AIMCo, from a sovereign currency? I mean, it just seems to be defying gravity. You answered the question to some degree, but if you were in a position where you were compelled to invest in cryptocurrency, what would your advice be, right? Is it a place where AIMCo or public monies should be invested in at this point?

Mr. Barber: Well, I guess the answer would be that I do not believe it's a place that we should be invested in currently. I mean, I think that's the simple answer to that.

Mr. Eggen: Thank you.

The Chair: All right. A pretty short answer.

Mr. Eggen: It's a big one.

The Chair: Yup. You betcha.

Okay. MLA Rehn, you're next.

Mr. Huffman: He's muted.

The Chair: Is he muted? Oh.

Are you talking?

Okay. Maybe we'll go on to MLA Allard, and then we'll come back to Pat after.

Mrs. Allard: Sure. Thank you, Chair. Again, thank you for being here this morning. These questions are a little bit more broad and historical, just for the benefit of Albertans who ask these questions often of MLAs. We often get compared to Norway in terms of how the fund has performed and how the fund has grown or how the fund has not grown, but it's a very different thing, a province versus a country, so just for clarity for those that ask these questions: how much has been transferred to the general fund over the fund's life? Do we have that information? It may be coming from Lowell. I know that this is more a government question and it depends on the government of the day, but what are the funds generally used for? I get those questions quite a lot as a member of this committee, so just for the benefit of the public.

Mr. Epp: Approximately $42 billion has been transferred, I believe. Is that correct?

Ms Jones: It's $45.8 billion as of last . . .

Mr. Epp: It is $45.8 billion – I stand corrected – as of last year. What is it used for? Well, it's used as part of the general revenues of government, so it's used for the same things as tax revenues or any other revenue from government: schools, hospitals, social services, et cetera.

Mrs. Allard: Perfect. Thank you. If I can follow up, Mr. Chair.

Again, drawing back on that comparison between Alberta and Norway, which comes up quite regularly as a member of this committee – unfortunately, I answer that question far too often – I guess one of the questions I get is: what would the size of the fund be had governments of the past not decided to put it into general revenue? I know that's sort of theoretical because it depends on rates of return and a whole bunch of other things where, you know, we have that data in hindsight, but there were a lot of decisions that were made that we can't undo. So is there a general estimate of the potential size of the fund if all of that income that had been generated had remained in the fund and had grown with the fund?

Mr. Epp: We don't do those kinds of estimates because there are so many assumptions you would have to make. For instance, you have to think about what else would have changed had we kept more in the heritage fund. For instance, taxes might have gone up. If taxes had gone up, oil companies may not have invested as much in Alberta, leading to less royalties. That's a simple example, but you have to make assumptions on what other things change and how that would have impacted the fund. There are just too many assumptions to come up with anything accurate.

Mrs. Allard: Perfect. Thank you, Mr. Chair. I appreciate the answer because it is a very complicated question. You know, there's a bit of a domino effect in terms of: if, then, what else would have happened? So I appreciate that.

I think that's all I have at this time. Thank you, Mr. Chair.

The Chair: Thank you very much.

Our next question comes from MLA Gray.

Ms Gray: Thank you very much, and thank you, everyone. This has been a lot of really good discussion this morning. This is a little bit of a slightly different direction, but there's been a long tradition in Canada that elected leaders don't bring the decisions of the Bank of Canada into the political arena, but in the last little while it seems like that tradition might be changing. Central bank policy has enormous impacts on both the fund and capital markets generally. Nationally we've seen some of our politicians, one of the contenders for Leader of the Official Opposition calling for the governor to be fired. Provincially the Minister of Finance has certainly taken some shots, made some comments, implied that the decision-making at the bank has been a big problem, and we know that the bank's decisions impact the fund.

My question to both TBF and AIMCo: through the pandemic and the extraordinary decisions the Bank of Canada has made, what would be your assessment of their performance? Then, further to that, to TBF as the spokesperson for the government of Alberta: what is the government's position on removing the governor of the Bank of Canada, and can you share more fulsomely the government's position given the minister's repeated comments during question period?

Mr. Epp: Well, I can answer the second part. There is no official position of the government. We have done no analysis, in my division, of the impact of changing the governor or anything along those lines. Sandra?

Ms Lau: Yeah. I will quickly comment on the central bank in general. I think the central bank strives for independence on the assessment. Just looking at the backdrop over the last couple of years, it's a difficult task for any central bank because of the backdrop we are seeing with the COVID situation, inflation pressure, and whether inflation being transitory is a constant challenge that the central bank has to adjust, with the dual mandate of the employment level and also price stability. I think the central bank over the last couple of years is really in the most difficult task to achieve those objectives. Not to mention, just in the middle of COVID we also had the Russia-Ukraine situation further introduce more pressure into inflation.

This is a very difficult task that the central bank is facing right now, whether the monetary policy or the pace, the increased interest rate can be too fast, too soon, or too aggressive. It can actually drag the economy into recession. I think it's a risk right now. It's too early to say if they're doing a good job or not a good job, but I have to say that it's actually a challenging task. Not to mention, in Canada we also have a housing market concern. If the interest rate is being increased too fast, too soon to control inflation, then we have a second problem that in the Canadian market we have to deal with. Simply put, it's the housing market conditions.

I think the central bank is in a very challenging position. I really have a lot of a wait-and-see approach to see how they deliver going forward.

Ms Gray: Thank you. I appreciate that, and I think you're absolutely correct about it being a very challenging position. I appreciate that Mr. Epp's division has done no analysis, but the minister is commenting and is commenting in public, so my question is, understanding that we can't necessarily have a full answer at this point: would it be possible for the department to follow up in writing, and of course confer with the minister, just to let the committee know what the government of Alberta's position on removing the governor of the Bank of Canada is; why the government of Alberta has broken the contemporary decision of not making comments on central bank decision-making; and if the goal is a change in central bank policy, what the preferred change in direction would be, and what impact that might have for the heritage fund?

9:15

Mr. Epp: Those are going to be fun to answer, especially that last one. We will do so.

Ms Gray: Thank you so much. Thank you.

The Chair: Thank you.

Any other questions? I have no one on the list right at this moment. MLA Rehn?

Mr. Rehn: Hi. Yes.

The Chair: Okay. Go ahead. Yeah.

Mr. Rehn: Yeah. I'd like to thank everyone for attending this morning and having this informative discussion with us. I would like to know about interest rates, inflation increases. How do you see these affecting your investment strategies going forward?

Ms Lau: I think that for the inflation environment and interest rate, we are no doubt in a high-inflationary environment and even a higher rate environment where potentially the central bank attempts to control inflation. Now, our best case scenario: probably the inflation may be getting a peak level and, after an interest rate of 3 per cent, is getting to a level that may be able to control inflation. But that said, there's still a little bit of uncertainty on the market in how it will unfold over time.

As James alluded to earlier, we are basically very disciplinedly managing our asset with the backdrop of this environment. To position ourselves for a higher interest rate, we have been staying away from longer duration assets, focusing on a floating-rate asset. We have also been actively moving away from fixed income and technically under weight in fixed income on behalf of the client.

Higher interest rates may also impact more volatility in the equity market. As such, we have also been more under weight in equity allocation, prudently putting tail hedge into the portfolio, because higher rate, higher inflation just introduce more volatility into the market. We also actively shift most of the assets, a lot of assets, and are prudently looking for illiquid assets to protect for inflation, such as infrastructure and real estate asset classes to protect for inflation.

Last but not least, when the team is looking for the underlying investment, we tend to focus a lot on more inflation-proof assets, and some of the investment is more tilted towards value, quality, and strong cash flow. That will protect the portfolio and go over the long term, especially with the recent sell-off in the market. It is actually a more prudent, better risk-adjust value we find to invest on behalf of our client.

The Chair: A follow-up.

Mr. Barber: If I could just add some comments. I think the one piece as we grapple through, you know, high inflation and rising interest rates is how that gets connected to growth, right? I think we can all realize that when you go to the pump, gas is more expensive and it eats into disposable incomes, so as rates rise and inflation rises, it is a drag on growth. That is the big question: to what extent does the recovery from COVID off-set? And the positive momentum in the economy: to what extent does that weigh in? As your growth falls, that impacts the valuation of your risk assets, whether that be the real estate market or underlying companies and company profitability. That is certainly one of the risks that we're closely evaluating and thinking about in the portfolio strategy and one of the reasons why we focus on trying to earn higher quality assets and less leverage and things like that in the portfolio, to navigate a slowing growth environment.

Mr. Rehn: Thank you.

The Chair: MLA Rehn, go ahead.

Mr. Rehn: Yeah. I have two questions left, so my second-last question is: have there been specific sectors that you have been divesting from, and why?

Mr. Barber: I'm not sure whether there would be sort of divesting, necessarily, but there's certainly – you know, in any given period there will be some industries or sectors where we are reducing our position and others where we're increasing our position, as against divesting. So we're not explicitly divesting of any sectors, but certainly our overweights and underweights will vary as we navigate through time and as we kind of consider that risk-reward trade-off.

Ms Lau: I would say that AIMCo actually has an internal responsible investment policy, so there are some sectors that we are not investing in such as tobacco and some of the weapons industry. That is under our policy, that we will not invest in that.

Like I addressed earlier, the recent divestment of Russia was a recent decision that we made of divesting from this segment. As the market continues to evolve, as the war continues to evolve, we will continue to visit that. However, a choice and a policy on a lot of segments is more voice over exit. We believe that making a good impact and influence on some companies on some segments will be more impactful than just divesting, so we will continue to follow any developments closely and make prudent decisions and policy as we go.

The Chair: Thank you.

MLA Rehn, we'll come back. I know that you said that you had another question, but we'll go to MLA Eggen now, and we'll come back to MLA Rehn for the final question.

Mr. Eggen: Okay. Thank you, Chair, and thank you for everyone's comments here this morning. They were quite refreshing. We've covered a lot of ground. Let me ask my last question, two parts together, a question for AIMCo and TBF. It's a bit personal, but I think it's interesting. I'm just curious to know: what keeps you up at night when it comes to the fund? I know we've talked about lots of international uncertainty, but, I mean, what do you think some of the markets are that we're missing right now, missing in terms of governance at AIMCo, X factors that all of us, you know, perhaps should pay mind to? What can we do to help? Don't stay up all night when you can't go to sleep.

Mr. Epp: Well, I can start. As far as I'm concerned, in the short term it would be equities. If you look at the '70s, when there was high inflation, equities did not perform well, a very low return through the decade. A low return through an entire decade, that sort of thing: well, it's what I worry about, and it would have a significant impact on the fund.

Mr. Eggen: Yeah. I agree.

AIMCo? What's going on up there?

Ms Lau: I echo what Lowell mentioned. My top risk is geopolitical risk. The backdrop of Ukraine and Russia is actually taking the geopolitical risk to the next level. Geopolitical risk, especially the relationship of China, being the second-biggest economy in the world and the biggest holder of U.S. reserve: this risk is top and front and centre of what I would say would keep me up at night. It will impact inflation risk, equity risk, interest rate risk, and every single risk metric we talk about. We are seeing a massive trend of deglobalization and are still uncertain how this will unfold, and just watching the Russia-Ukraine situation and how sanctions unfold, financial sanctions or different types of sanctions, I think the geopolitical risk of China and the rest of the relationship is something that I personally focus a lot on.

Mr. Prakash: I'll just add one quick point. Outside of market and investment risk, I mean, the other part that's really big is the risk that we have in terms of our employees as they go back postpandemic into the new flex, hybrid, the huge vocabulary that is being described. Like many other organizations, we've taken the first step in that direction, but that is something that'll be critical over the next little while as we move forward into this new world, so to speak.

Thank you.

Mr. Eggen: Thank you.

Mr. Barber: For me, when I can't sleep, I guess it's probably wondering whether, you know – we've had probably the last let's call it four decades now of pretty robust growth, low rates, low inflation, increasing asset prices, increasing valuations, multiples, lots of prosperity – we are indeed in some kind of inflexion point where actually we have higher rates, lower growth, lower valuations, and less prosperity. I think that is a real risk and something that sort of keeps me up a little bit. Like, are we actually sort of at a major inflexion point, or is this something that we can continue to sort of muddle through and get back on track of having sort of reasonable economic growth and continue for the financial system to operate the way it is and not get disrupted and effectively increase the cost of capital?

9:25

The Chair: Is that it?

Mr. Eggen: Yeah. Thank you.

The Chair: Okay. MLA Rehn, for your final question.

Mr. Rehn: Yeah. Thank you, Mr. Chair. Are there any specific sectors or companies that you're investing in that you're particularly bullish about, and why?

Ms Lau: There is within the overall portfolio, especially for our potential rising rate environment – it's actually prudent for a client, especially the sectors on private credit market. The reason this mix stands, because on – James alluded to a higher rate environment and volatile equity market and the last couple of decades of a higher return.

We are going into maybe a lower return environment, but the benefit of the private credit market is that actually they are floating rate in nature, not sensitive to interest rates. Because they are private in nature, a lot of times the manager can actually roll up their sleeves and better construct a deal with strong protection behind and, with a prudent underwriting process, can actually construct a very good, high-quality, not sensitive to rates portfolio with a strong absolute return. An absolute return of maybe 5 or 6 per cent on a portfolio is actually a very strong portfolio with a backdrop of the market we are seeing, with low-rate and higher rate environment, maybe low returns, single-digit return on stocks and bonds and being even a volatile market.

This segment is actually a constantly developing segment of the market over the last many years. We have been actively involved in the market, and we have been consistently growing this market, that we really have a high conviction on. I would say that this is one thing, one of the segments that we like a lot, and we continue to encourage our clients to look into this segment of the market.

Mr. Barber: I would add to that. Some areas that we've been excited about: certainly, on the private equity side we see a lot of businesses that are in that sweet spot of having, you know, established products and services and capability but really growing and scaling less, sort of in the mid-market buyouts and growth side, lots of good opportunities, particularly as the impact that software and technology are having on business and business models and the ability to earn good profit margins and scale that across a big market opportunity – we continue to see all kinds of applications for technology and software solving real business problems in different industries, so that's been an area that we've, you know, allocated capital to for a couple of years now and continue to be excited about, so I'd point to that as one.

The second is that with respect to real estate we've also found and been excited about a number of opportunities where we've been investing in things like data centres as well as thinking on the industrial property side, and logistics and industrial real estate has actually been another area which we have been investing in and are excited about in terms of how the economy transforms over time and we're able to supply capital and invest in expanding those kinds of capabilities.

The Chair: All right. Thank you very much, MLA Rehn.

That concludes our discussion on the report. I'd like to thank our guests from Treasury Board and Finance and AIMCo for giving us very detailed explanations today and great answers to good questions and also the office of the Auditor General for being present here today. You're welcome to leave the meeting now or remain if you would wish. You can carry on your day if you want. Thank you very much.

Mr. Prakash: Thank you, Mr. Chair. Thank you, committee members.

Mr. Barber: Thank you.

The Chair: Okay. I'll now look for a member to move a motion to receive the fund's 2021-2022 third-quarter report. MLA Eggen. All in the room in favour? I'm sorry. Okay. MLA Eggen: that

> the Standing Committee on the Alberta Heritage Savings Trust Fund receive the 2021-2022 third-quarter report on the Alberta heritage savings trust fund.

Any discussion? No. Online? Okay. Thank you.

In the room, all in favour? Any opposed? Online, all in favour? Any opposed? Okay.

> That is carried.

Okay. The annual report for the committee. Members, section 6(4)(c) of the Alberta Heritage Savings Trust Fund Act requires the committee to report to the Legislative Assembly on whether the mission of the heritage fund is being fulfilled. The last report to the Assembly was made on June 1, 2021, which covered the activities of the committee in 2020. The draft of this report was posted to the committee's internal website for members to review, and the report covers the activities of the committee during the 2021 calendar year. Do members have any questions or comments regarding the draft 2021 annual report of the committee?

Hearing none, I'll look now for a member to move a motion to approve the draft report.

Mrs. Allard: So moved.

The Chair: MLA Allard: that

> the Standing Committee on the Alberta Heritage Savings Trust Fund approve the draft annual report of its activities during 2021.

Any discussion?

None. Okay. In the room, all in favour, say aye. Any opposed, say nay. Online, anyone in favour, say aye. Anyone opposed, say nay. Okay.

> That's carried.

Okay. Other business. MLA Gray.

Ms Gray: Thank you, Mr. Chair. I think as MLAs we all know that the work we do could not happen without the support of the amazing people at the Legislative Assembly Office, particularly the House services team that supports the Legislature and our committee business. This morning I found out that someone we've all relied on for a long, long time, our committee services co-ordinator, Leah – this is her final committee meeting because she is moving on to new things.

Leah, can I say where you're going?

Ms Kirtio: Sure.

Ms Gray: She's leaving us for AIMCo, guys. All of us see the work that Leah and the others on the research and committee services team do day in and day out, and we couldn't do what we do without your support. Leah in particular is always just someone who brings a lot of joy and positivity to the work she does. I'm particularly thinking about during estimates, when she is flying nonstop to make sure all those simultaneous committee meetings are running smoothly. So on behalf of all of us I just wanted to say thank you, Leah, for all the work that you've done over 10 years at the Legislative Assembly.

The Chair: Well done. Thank you for that. That was nice. Yeah.

Okay. The date of the next meeting will be at the call of the chair and will be to review the fund's annual report from Treasury Board and Finance.

If there's nothing else for the committee to consider, I'll call for a motion to adjourn.

Mrs. Allard: So moved.

The Chair: MLA Allard moved that the meeting of the Heritage Savings Trust Fund Committee be adjourned. All in favour? Online, all in favour? Any opposed anywhere? Okay. I guess we're good. That's carried. Meeting adjourned. We'll see you at the next one that we're going to have.

Thank you very much.

[The committee adjourned at 9:34 a.m.]

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