Legislative Assembly of Alberta

The 30th Legislature
Third Session

Standing Committee on the Alberta Heritage Savings Trust Fund

Tuesday, June 28, 2022
9 a.m.

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Standing Committee on the
Alberta Heritage Savings Trust Fund

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Standing Committee on the Alberta Heritage Savings Trust Fund

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Ministry of Treasury Board and Finance
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Brittany Jones, Trader, Money Market, Capital Markets

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

9 a.m. **Tuesday, June 28, 2022**

[Mr. Rowswell in the chair]

The Chair: 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 chair of this committee. I'd ask the members and those joining the committee at the table to introduce themselves for the record, and then I will call on those joining by videoconference. We'll begin to my right.

Mr. Eggen: Hi. 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.

Ms Lau: Good morning, everyone. Sandra Lau, co-CIO, AIMCo.

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

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

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

Mr. Koenig: Good morning. I'm 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: Would you like to introduce yourself?

Ms Jones: Hi. Good morning. Brittany Jones, Treasury Board and Finance.

The Chair: Okay. Thank you.

On Teams, we'll start with Dan Williams.

Mr. Williams: Dan Williams, Member of the Legislature for Peace River. I am in my constituency with poor connectivity, so if I don't turn on my camera when I speak, I apologize.

The Chair: Okay. Thank you.

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

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

Mr. Hunter: Good morning. Grant Hunter, MLA for Taber-Warner.

The Chair: I think that's got all of us. Oh, and Janet Laurie. You're on mute there. There you go.

Ms Laurie: Good morning, Mr. Chair. Janet Laurie, communications with the Legislative Assembly Office.

The Chair: Okay. Thank you very much.

For the record I will note the following substitutions: we have MLA Williams for MLA Jones, and MLA Allard will be deputy chair.

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

Now we just had Mr. Epp come in. If you could introduce yourself, please.

Mr. Epp: My apologies, Mr. Chair. Lowell Epp, assistant deputy minister, Treasury Board and Finance.

The Chair: Okay. Thank you very much.

Okay. We'll go to the approval of the agenda. Are there any changes or additions to the draft agenda?

If not, would someone like to make a motion to approve the agenda? MLA Eggen. Any discussion on that? All in favour in here? Okay. All in favour online, please say aye. Anyone opposed anywhere, say nay. That is passed.

Approval of the minutes. Hon. members, we have the minutes of our last meeting, on May 30, 2022, to review. Are there any errors or omissions to note?

If not, would a member like to make a motion to approve the minutes? MLA Gray. All in the room in favour, please say aye. Anyone online in favour, say aye. Okay. Any opposed anywhere, please say nay. Okay. That is approved.

Okay. Hon. members, we now turn to the 2021-22 annual report of the Alberta heritage savings trust fund. The committee clerk received the draft of the annual report from Treasury Board and Finance on June 22. That report was made available to the committee members on the internal website. I'll note for everyone's information that this report is confidential until it is approved by the committee.

Before we hear from our guests, I would like to briefly review the committee's mandate with respect to the fund's annual report. As stated in section 6(4)(b) of the Alberta Heritage Savings Trust Fund Act, one of the functions of this committee is to approve the fund's annual report. Furthermore, section 16(2) of the act requires the committee to review and approve the report and furnish copies to the Clerk and all Members of the Legislative Assembly on or before June 30, after which the report shall be made public.

At this time the Treasury Board and Finance officials will provide an overview of the annual report, followed by remarks by AIMCo, and then we will open the floor to questions from committee members. Carry on.

Mr. Epp: Thank you, Mr. Chair. It's certainly my pleasure to be here. Good to see you all again. I'm very pleased to tell you that at the close of this year the heritage fund recorded its highest value ever, at $18.7 billion. The $18.7 billion is made up of $20 billion in assets or investments under management and $1.2 billion to be paid to the general revenue fund in due course from last year's earnings. In addition, the fund has earned positive net income in 13 consecutive years since 2008-09, and markets have had a very good run during that time. The market value loss that we saw in 2019-20 as a result of the pandemic was quickly reversed, and during that year, even though the fund lost value, we still earned about $1.2 billion in investment income.

Over the last five years the heritage fund has earned an annualized market value return of 7.6 per cent. This return is 1.2 per cent above the fund's long-standing target return of inflation plus 4 and a half per cent. This is measured over a five-year period. The return from active management investments over the last five years has added .4 per cent in value versus the passive benchmark. This is .6 per cent below the fund's aggressive target to earn an annualized 1 per cent return from active management, again over a five-year period. In terms of investment income, the fund has earned $7.3 billion in the last five years, $1.6 billion of which has been retained by the fund for inflation-proofing and, of course, helped it hit its record-high value.

The one-year performance numbers show that the fund had an excellent year in '21-22, earning a market value return of 11.8 per cent. This return is lower than the 14.5 per cent that we reported after three quarters, but unfortunately a number of events, market and otherwise, such as inflation concerns, rising interest rates, the war in Ukraine, and rising energy prices had a negative impact on the markets. The fund's value declined by about 2.3 per cent during the final quarter, but, all things considered, earning an 11.8 per cent return is a very good return for 2021-22. This is particularly true when compared to the passive benchmark for the fund. The benchmark return on the fund was 6.6 per cent. In other words, the value added through active management was 5.2 per cent. Net investment income for the fiscal year was a little under $2 billion, the fourth-highest level in history and the highest amount in the last five years.

Due to higher inflation the fund will retain more of this income for inflation-proofing. That amount is $705 million. This is the largest inflation-proofing amount since inflation-proofing began in 2005-06. As typically is the case, the return from equity investments was the best among the three primary asset classes. Equities earned 18.4 per cent over the year, a return that was 9 per cent higher than the benchmark return of 9.4 per cent. The most significant contributor to both returns and value-added with the equities asset class came from private equities. Private equities earned an incredible return of 37.1 per cent, 28.1 per cent higher than its benchmark.

9:10

Inflation-sensitive and alternative assets earned a return of 15 per cent during the fiscal year versus a benchmark return of 9.3 per cent. Renewable resources had the strongest return among the asset subclasses, but real estate and infrastructure investments also posted double-digit returns.

Fixed-income returns were not so good. They were negative due to rising interest rates and inflation fears. The fund's fixed-income portfolio lost 2.2 per cent during the year, which is 1.1 per cent better than the negative 3.3 per cent benchmark return.

Over the last five years equities have performed the best, which we would expect, with a return of 10.4 per cent. This is followed by inflation-sensitive and alternative assets at 6 per cent and fixed-income assets at 2.8 per cent.

In closing, although the heritage fund is often ignored and many Albertans don't even know that it exists, it has made an important contribution to the province's finances. Over the last 46 years it has transferred $47 billion in investment earnings to government and government priorities. We are very fortunate to have this fund.

Thank you, Mr. Chair.

The Chair: Thank you very much.

We'll carry on with AIMCo, please.

Mr. Prakash: Thank you, Mr. Chair. Good morning, all. We are really pleased to be here in person and sharing our insights and outlook with you. I will start my prepared remarks by giving the committee an update on the organization, followed by my colleague Sandra, who will review performance, describe the drivers of that performance, and, as well, provide a market outlook.

In terms of the organization, in terms of AIMCo, the first thing I wanted to start with is that we'd shared with you that late last year and going into the early part of the year we had reviewed and refreshed our corporate strategy. This is a strategy that looks out over the next five years, and a centrepiece of that strategy was the need for us to become a more client-focused, clientcentric organization. A big component of that is the ability that we deliver a consistent, reliable service to our clients as well as earn and retain the trust of our clients.

In that space some of the things that we've been doing that we thought will be helpful to share with the committee: first and foremost, we've spent a lot of time with our clients better understanding their investment needs and objectives and reaffirming some of the more detailed requirements around risk tolerance, around risk preferences, around excess return targets, et cetera. That is simply around the thesis that the better we know, the better a job we would do in delivering on those requirements.

A couple of other things of note. We've established working forums where we interact with the clients, both at the strategic level as well as on more granular topics, and that's something that's been going on for the last six months. Then, lastly, we've been engaged with our clients on a whole host of consultations, both to provide visibility to clients in terms of how we're approaching topics as well as soliciting their input and ultimately being transparent in terms of how we operate. Some of the outcomes of this consultation have led to a revamp of our equity offerings, and that is something that is ongoing. It will improve the choice that clients such as yourselves have as well as simplify our platform. So equities is first; fixed income is behind. There are a couple of other strategies we're engaging with clients on and a review of benchmarks.

We've been on this journey, if you will on this renewed journey, for the last six-plus months, and therefore we also sent a client survey out to just gauge and solicit feedback specifically on how we're doing and get a sense from our clients which pieces are working, which pieces are not working. Happy to report that all of our clients, 100 per cent of the clients, responded. To the question of whether we're headed in the right direction and would these changes lead to better service and support for our clients, 84 per cent said yes and rated us seven or above on a scale of one to 10. Certainly, encouraged by that. There are some areas that we need to get a lot better at, and included in that is risk reporting, timeliness of some of the information that we provide to our clients as well as portions of our responsible investment, or ESG, reporting. We're very committed to working with our clients and improving in the areas that they reflected as well as building upon the areas that we're doing well.

Two other things. With the lifting of the restrictions of the pandemic, like many other organizations, we also are heading back to the office. We're encouraging employees to be in the office twice a week, plus there are obviously times when we would ask them to come in for group events, corporate-wide meetings, et cetera.

We've also taken the opportunity to implement what we refer to as a results-only work environment, and this effectively is a system that places a lot of autonomy and authority with the employees in terms of how they operate; the idea being that this leads to a better engaged and more productive team as well as allows us to attract and retain talent in a market which is very competitive.

Lastly, a quick update on the executive hiring. Over the next couple of weeks the last of the executive hires will be complete, so we will have the entire roster of the executive team in place. The more recent hires include the chief technology officer, the head of real estate, and, as I've mentioned, the head of human resources will join us in the next couple of weeks.

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

Sandra.

Ms Lau: Thank you. Thanks, Amit. Hi, everyone. Really pleased to be here to meet all of you in person after two years and pleased to report back the performance of the heritage trust fund for the fiscal year-end of March 2022. Like Lowell mentioned, the fund earned a very strong return of 11.8 per cent, outperforming the passive benchmark by close to 5.2 per cent, despite a very challenging economic backdrop that presented itself during the last quarter of the fiscal year.

Over the last five years the fund actually delivered an annualized return of 7.6 per cent; over the last 10 years, an annualized return of 9.3 per cent; both outperforming the benchmark of 40 basis points and 60 basis points respectively.

I will comment that for most of the fiscal year the effect of the pandemic, inflation, and central bank policy continues to play out in the background; however, most of the significant events actually occurred in the last quarter of the fiscal year. The Russia and Ukraine situation, continued high inflation concerns, China's zero-COVID policy, and especially with the accompaniment of the central bank high interest rate policy, all led to a lower market return in the last quarter of the fiscal year. With that backdrop, yet the fund finished with a very strong year of a strong positive return, and I would say that all the asset classes of AIMCo contributed to this strong total return and relative return.

9:20

In terms of fixing them, interest rates actually went higher in the second half of the fiscal year; 10-year government bond yield went from 1.5 per cent to 2.5 per cent within six months. Rising interest rates will of course lead to a negative return of the fixed-income benchmark, leading to minus 2.2 per cent. However, the fixed-income asset class actually outperformed the benchmark by 1 per cent because of a disciplined approach of being short in duration and focusing on higher quality, investment-grade credit in terms of public credit, private debt and loan, and private mortgages.

Like Lowell mentioned, the biggest contribution of the total return is equity as a class, the public equity and private equity jointly generating a return of 18.4 per cent, outperforming the benchmark of close to 10 per cent despite the market disruption during the last quarter, that I talked about earlier on. This is resulting from the strong overall market performance most parts of the year and also with the team approach, again, of the discipline of investing with the public equity focus on value, strong growth, value in strong quality, stock overgrowth, and also focusing on actively managing the portfolio despite the market sell-off during the last quarter.

The other highlight is our private equity portfolio. The private equity portfolio outperformed the benchmark by close to 28 per cent, delivering a 37 per cent return. This is more due to the asset valuation of the private equity, also because of the active exit strategy of our private equity portfolio. One of the good examples is one of the investments that we have: it's called Hayward. It's essentially a commercial and residential swimming pool company. They are the global designer, manufacturer, and marketer of a broad portfolio of pool equipment and associated automation systems. The asset: we invested for five years, and the COVID situation and work from home has actually given a good lift for the asset itself. The asset went to IPO, giving the asset a five-time multiple of a return with a five-year holding period for our clients.

In terms of inflation-sensitive assets, which are mostly on real estate and infrastructure, it continues to do well, with a double-digit return, most of the value-add of the infrastructure coming from the resilience of the asset that we have such as transportation, utilities during the pandemic, and also extreme, strong demand for this type of asset class over the last couple of years. Real estate continues to do very well given that the team proactively managed the asset even before COVID. The team has been very focused on adding into industrial logistic alternative strategies such as data centres and live science. All contribute to the good return of the program.

In terms of market outlook, the first half of the year has been difficult for a lot of investors. For six months of the time we saw negative benchmark return for stocks and bonds, which is very unusual. Usually, in a normal time, stock and bond returns would move in the opposite direction. This more reflects the concern of the aggressive central bank action and also the market and rising concern of a recession coming our way.

As recently as two weeks ago we saw U.S. CPI sitting at a high level of 8.6 per cent, a 40-year high that we've ever seen. A week after, the Federal Reserve came with a 75-basis-point, one-time interest rate hike. The last time the fed central bank did it was actually in 1994 with a 75-basis-point hike. The biggest concern in risk coming our way is still in the inflation and policy area. Too little of the central bank policy is a risk of inflation running too high. Too aggressive of a central bank policy will lead into a recession in which the market continues pricing in for this type of risk. Both we see in the market and also in the equity market.

Geopolitical concern continues to be a risk over a short and medium term, which will add more risk to inflation and market volatility. The volatility of a market and how the market unfolds is basically data dependent; it depends on the inflation data that we will be seeing. The AIMCo team has continued to be laser focused on managing and mitigating this type of risk by focusing on diversification of the asset class, our strategy, prudent underwriting process, stress testing our portfolio, and continuous revising of our thesis and our theme.

Last but not least, this kind of market challenge a lot of times only presents a good opportunity. As such, we are having a very disciplined approach to maintain good liquidity for our clients, and we are ready to react when opportunities present themselves.

That will conclude my presentation.

The Chair: Okay. Well, thank you very much for your presentations and all that information.

I noticed that MLA Rehn has joined the meeting online. So if you want to introduce yourself, please.

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

The Chair: Okay. Thank you very much.

What we'll do is that we're going to ask questions, and we'll go back and forth between the two sides here. We'll wrap up close to 9:30 because we've got other business to deal with in between. What am I saying? Sorry. It's 10:30. That'd be a quick one, a quick question. Yes. Sorry about that. We'll start with MLA Hunter, and then we'll go to MLA Eggen and then to MLA Allard. Is MLA Hunter available?

Mr. Hunter: Can you hear me?

The Chair: Yeah. Can now.

Mr. Hunter: Sorry. My Internet is a little spotty today. I'm not sure why either, but I can't turn on my camera. Is that okay, Mr. Chair?

The Chair: Yeah. We'll have to go with that.

Mr. Hunter: Okay. I guess my first question – first of all, I'm pleased to see the gross investment earnings were $948 million higher than is estimated in Budget 2021, but I wanted to know: what factors would you say made it possible for the fund to outperform the expectations this year?

Ms Lau: I think that there are all the factors that I described earlier for this year. Is the question asking for this year, how the fund will outperform, or last year attribution?

Mr. Hunter: The 2021.

Ms Lau: All the other factors that we described earlier for each of the asset classes actually outperformed significantly versus the benchmark of performance. Fixed income outperformed because of a short-duration bias and also our focus on high-quality credit on each of the asset classes.

Public equity outperformed significantly because of the disciplined approach on how we manage our stock portfolio, proactively focused on the value and the quality stock, staying away from technology and growth stock.

Private equity: we have a good return because of the asset we owned and also the exit of some of the assets that we have such as Hayward, ERM, and also having a good result.

Infrastructure program: we have a good valuation uplift from the pandemic from 2020 and '21, so that gives us a very good valuation. Also, we have a couple of the asset classes, especially in infra. Because of the high demand of this asset the valuation continues to improve, giving us a very positive performance.

Last but not least, real estate. Real estate actually outperformed because the team proactively, ahead of the curve, identified a lot of good alternative asset classes. Stayed away from retail, office, pre-COVID and more heavily investing in industrial, logistic, identified alternative strategies such as data centre, health science. All of these are actually contributing to a very good performance and relative outperformance of the portfolio relative to the benchmark.

Mr. Prakash: I'll add just one more remark. Outside of the outperformance details that Sandra provided, one of the things that makes portfolios such as yours resilient is the design of the portfolio, and that's really hard to do last minute. The fact that you have exposure to private equity, the fact that you have exposure to private debt and loan inherently makes the portfolio much more balanced, and therefore when these opportunities arise, you know, that gets reflected in performance.

Thank you.

The Chair: Do you have a follow-up or a second question?

Mr. Hunter: Yeah. Thank you. First of all, I wanted to say that I do appreciate that you're getting those higher returns for your clients and for Albertans. I know that my own RRSPs didn't perform that well, so I do appreciate that you guys are doing as well as you are.

Now, I see on page 10 of the annual report that the fund's investments expenses were $9 million higher than the previous year. What would you say were the main factors that contributed to such a difference?

9:30

Ms Lau: I can address that. It's actually in addition to attracting and retaining our own talent of the investment professionals within our team. AIMCo actually has a lot of good partnerships in terms of external manager partnerships out there. They are best in class that help us to source assets and manage asset and external manager relationships that we have. This will give us the benefit for some of the asset classes to tap in the area that we have less exposure to and provide us the good skill set from the external manager and having exposure to some of the opportunities.

On the cost front – and this is more related to the outperformance of the external manager, more reflected with the strong performance they bring to the table. The performance you see from the heritage trust fund is actually net of all the fees, so the majority of the cost related to that is the management fee because of the strong performance that the manager brought to the table. The $9 million is related to that, and I would take your attention to actually translate to the basis points. If we compare the 2020 and '21 numbers, the investment expense ratio is more or less the same, at 90 basis points. That reflects that this fee is only being paid to the manager only if they outperform. So it's only the performance-based variable fee leading to the increase of $9 million.

The Chair: Thank you very much, and . . .

Mr. Hunter: All right. Thank you, Mr. Chair.

The Chair: Yeah. Thank you, MLA Hunter.

Just on the process of this, we'll have the initial question and then a follow-up, and then we'll continue on like that.

Next we go to MLA Eggen.

Mr. Eggen: Thank you, Chair, and thank you to both TBF and AIMCo for your fulsome reports. My question is in regard to something that I brought up in the last meeting of the committee, and I asked Treasury Board and Finance a number of questions related to cryptocurrency and the government's position on cryptocurrency. That was on May 30, and it was the committee's expectation that we would get a response within 30 days. I know it's two days before that, but just about to hit the deadline. My first question would be, then, to TBF: if you are preparing for the committee answers to those questions, when are you planning to give us that information, or could you give it to us now?

Mr. Epp: We are preparing a return or an answer, pardon me, a response. We don't have it ready quite yet, and we hope to produce it within the next couple of days.

Mr. Eggen: Okay. That would be great. I'm just curious then – when I did ask that question, of course, we had had another Finance minister, and now of course we have an interim Finance minister. As you are gathering your responses, that we'll get in the next couple of days, which is great, I'm just curious to know if there was any change in regard to the position of government around cryptocurrency from the previous Finance minister, and I would just like to know, when we do get the response in the next couple of days, if this will be a response that reflects the previous minister's position or the new minister's position.

Mr. Epp: The response will reflect the new minister's position. I think you asked something else about . . .

Mr. Eggen: No. That's fine. Yeah. Thank you.

The Chair: Thank you.

I will go to MLA Allard.

Mrs. Allard: Good morning. Thank you, Mr. Chair, and thank you to everyone for your excellent presentations. I just wanted to ask a couple of questions regarding inflation. Seeing that inflation is a very prevalent topic in financial markets today and certainly, as mentioned in your presentation, is impacting returns that we're seeing – although I did hear some inflation-proofing planning on the part of AIMCo, so thank you for that – I just wanted to, for the benefit of Albertans, ask a little bit more about what your strategy is to inflation-proof the fund. I heard you talk about not being in retail as much and going to larger industrial projects if I heard that correctly. Do you see any challenges to your inflation-proofing plan given the supply chain issues and the economic recovery with COVID? That's my first question.

Thank you, Mr. Chair.

Ms Lau: Sure. I can address that. A couple of areas of addressing inflation, of course, is starting with the asset mix, in which the heritage trust fund has a very strong asset mix of allocating inflation-sensitive assets, which is mostly the infrastructure and real estate portfolios. Those assets have the benefit of hedging inflation, and especially on infrastructure it's more on the utilities and also transportation and some of the energy-related, supported by a highly regulated business and contract model, that the inflation cost and the inflation is being held strongly in the infrastructure asset.

Similarly for real estate. A diversified real estate portfolio on any sector, such as industrial, retail, multi-unit residential, those especially with rent, is being able to reflect the inflation changes. Real estate continues to be a very strong asset class of inflation hedge in general. So those two asset classes provide a strong hedge for the inflation of the fund.

Now, the second derivative of inflation then is high inflation leading to a high interest rate and more volatility in the other risk assets such as stocks and other risk assets that we have. The second derivative of managing that is, number one, prudently managing the interest rate risk, because high inflation usually means more aggressive central bank policy leading to a high interest rate. AIMCo has been very prudently managing the interest rate risk of the fixed-income portfolio, focusing more on shorter interest rates, floating rate notes to hedge away the interest rate risk because of inflation, risk assets such as public equity because a potentially high interest rate leads to maybe a sell-off and revaluation of the risk asset. As such, we are very mindful and careful to manage that second derivative of inflation, leading impacting the portfolio of being short in duration and more careful and cautious on how we invest in the public equity portfolio. Also, on the total technical level, we are always mindful of being under weight in bonds and under weight in stocks as we go into the inflation cycle.

All this management comes from the higher level of portfolio diversification, the active management of the asset mix, and, last but not least, how we are prudently managing each of the asset classes with the inflation backdrop in mind. This thesis continues to be stress tested. Our risk team has been continuously helping us to stress test the portfolio of different scenarios to see the outcome, and this theme and thesis continues to be re-evaluated on a regular basis.

The Chair: A follow-up?

Mrs. Allard: Perfect. Thank you. A follow-up, Mr. Chair. Again, as I mentioned earlier, inflation is top of mind certainly for constituents in my area of the province and, I would say, for economists the world over right now. I notice in the fund there's about 30.8 per cent of the assets that are inflation sensitive, as you mentioned in your presentation, and there are also alternative investments there. I'm just wondering if you can provide an overview of some of the alternative investments contained in this category.

Also, with respect to your comments around continuously reviewing your policy and your investment strategies on inflation, if you can speak a little bit to the potential for stagflation, and what is the plan for the fund if we get into that situation?

Thank you, Mr. Chair, and thank you for your answer in advance.

Ms Lau: Sure. Going to your first question, the illiquid asset class or alternative assets is exactly the inflation-sensitive asset class that I point to. Real estate, renewable resources are the two asset classes I was referring to. The return on this asset is expected to outperform with an inflationary environment given the revenue streams that are closely correlated with inflation. Infrastructure: again a long-term, equity-oriented position, an asset class with a high barrier to entry with a regulated return, long-term contract, that provides good inflation. Again, the real estate portfolio: like I said before, by giving you a diversified sector mix and geographic exposure, we actually have real estate portfolios in different sectors and also in different geographic regions such as the U.K., Europe, and the U.S. This type of diversification within the portfolio itself is not only giving you inflation protection but also is a diversification of different inflation in different countries, giving you a diversification asset on the strategy investment. That's what we have on the asset side.

9:40

Now, on the next question on stagflation, on the process you were referring to, the team has continuously been analyzing the latest developments and has been consistently underwriting this thesis because the market is constantly changing. I remember six, nine months ago we were just talking about inflation and maybe stagflation. Now the concern is less of stagflation; the concern is more about recession. So the team continuously re-evaluated the changes and economic backdrop of these types of changes in the market and rewrote our thesis and positioned ourselves accordingly, probably most of the position in coming from the mix of stock and bonds. Given they are in the public market, we are more nimble and flexible if we need to constantly adjust the asset mix, prudently putting some hedges on to protect and further protect the portfolio.

Those are the constantly evolving processes with which we assess our portfolio day in and day out. The portfolio is constantly stressed every day with the risk team, and we look at the risk that we have. This is all taken into consideration as we manage our portfolio every day.

The Chair: Okay. Thank you.

Our next question will come from MLA Gray.

Ms Gray: Thank you very much. Good morning. Thank you, everyone, for being here. It's good to see you in person for this meeting. Certainly, we've talked at length at this committee about AIMCo's performance and the performance expectations, including talking about our passive benchmarks and our active benchmarks a number of times. Our expectation is that AIMCo will beat the passive benchmark by 1 per cent. Over the past five years you're at 40 basis points over the benchmark, and over the last 10 years you're at 60, so not hitting that mark. The organization is falling short of those expectations. Certainly, what we have in this fiscal year is different from that, but we are looking at long-term goals. Of course, the fees we are paying, that Mr. Hunter was asking about, are for the benefit of that active management.

So my question is just around: given the risk profile of the heritage savings trust fund why would you say we are not hitting the active management targets that have been set, and do you see those active management targets as being realistic? I noted that during his report Mr. Epp referred to it as an aggressive target, but my understanding is that this is a target that's been committed to a number of times. Is it a reasonably set target?

Mr. Prakash: Thank you for the question. We invest on your behalf over the long, long term. The expectation and objective is that we will meet both the excess return target as well as deliver the market return in addition to the excess return, consistent with the exposures that you and other clients seek. Particularly, as you correctly sort of pointed out, you know, one does need a longer horizon for those numbers to be achieved. Given what we've had and literally coming through the pandemic and now the geopolitical issues, the impact on performance, particularly over shorter windows, can be challenging. Having said that, over longer periods of time, one is confident that one could achieve that over time.

In terms of how aggressive this is: if you want to speak to that a little.

Mr. Epp: I can certainly speak to it. We set the target way back in 2007 or 2008, and the target was based on a consultant's report that said a privatized AIMCo could deliver 200 points of value-added. We were a little skeptical, and we set it at 100 basis points. We know it's aggressive. Looking back historically, it is aggressive, but we believe that continuing to push a high target is better than a lower target.

Ms Gray: Thank you for that. I agree, based on the conversations that I'm having within the investment community, that the fund's target that returns be at least 1 per cent higher than the returns of a passive managed portfolio, given the risk profile for the heritage savings trust fund, is a good one.

My follow-up question would be: what analysis does AIMCo do relative to competitors within kind of this risk profile group to compare performance and how the heritage savings trust fund is measuring up when it comes to beating the benchmark? Who are the heritage savings trust fund's competitors – maybe not even competitors but just similar products in the market – that you look to when we're evaluating our own performance, and are there relevant metrics you can share with the committee?

Mr. Prakash: Certainly. We look at institutional pools of capital comparable, certainly not identical but similar institutional pools of capital, and recognize that when we do this comparison – different policy mix, different implementation, et cetera – there's a lot of noise, but having said that, at a high level we look at that on a regular basis. We report it to our board as well, so we are cognizant of those comparators. But equally and perhaps more importantly, when we are doing this comparison, we're also looking to see if there are certain ideas, certain exposures that, you know, we should be looking at that we don't have in our tool kit, if you will.

Just by way of a bit of a walk down memory lane, so to speak, the addition of private debt and loans came up. One of the things post the financial crisis was that the balance sheets of a lot of the banks were being thinned, and therefore there was room for private credit to step into that space. You know, that was attractive. The work that we're doing on renewables: that is another aspect.

In addition to comparing the numbers, it is to see if there are insights and ideas that we can glean and incorporate and then present to our clients to further that discussion.

Ms Lau: Maybe I will add to Amit's comments. We're always very aware and focused on what our peers in Canada or globally are doing. I guess the asset mix of the heritage trust fund: we can always compare ourselves to the other maple peers, the CPP and other pension funds. I would say that the performance, especially last year – I don't have the long-term performance – has compared pretty much very favourably, but sometimes we need to be mindful of different reporting cycles; December year-end, March year-end. Some of the funds have an August year-end.

Also, it's still difficult to get to the fine details of the fund asset mix. Probably you can read in the annual report the asset mix; however, there are a lot of differences within the fund such as the use of leverage, the currency, the policy, hedging versus no hedging. It's a lot of moving parts to make an exact apples-versus-oranges comparison.

One of the comparisons we use a lot is called the CEM survey. That compares the global endowment funds or pension funds out there. That includes quite a big universal size of different styles of pension and endowment funds. We look at the funds' performances over a longer term, less so on 10 years. The funds' top quartile relative returns tend to be around 70 basis points net of fee, so that gives us some of the guidelines, if the reasonableness of 100 basis points is probably within the range, that it's reasonable with the CEM survey. So those are a lot of different reference points that we point to. But, again, the trick or challenge of comparing that is the actual other type of investment activity such as leverage and currency, which is more challenging to understand beyond the annual report you can get from public info.

9:50

Ms Gray: Okay. Thank you very much.

The Chair: Thank you.

We'll go on to MLA Williams.

Mr. Williams: Thank you, Chair. If it's all right with you, I'm probably going to leave my camera off. I've had connectivity difficulties.

The Chair: Yes. That's fine.

Mr. Williams: Thank you.

I wanted to talk a bit about how the report explains that the fund is "Alberta's primary long-term savings vehicle," and I want to talk about that in relation to inflation. The report indicates that the ministry set a real return expectation for the fund equal to 4.5 per cent greater than the inflation rate over five years. So my question is: can you explain how the heritage trust fund has fared over the last five years compared to the real return target?

Mr. Epp: During the last five years the heritage fund has earned 7.6 per cent. Inflation has been approximately 1.9 per cent, I believe, leaving a benchmark, if you will, or a nominal return target of 4 per cent, so we've outperformed that target by 1.2 per cent.

Mr. Williams: What challenges do you see in the next five years with inflation at the rate it's at now in terms of being able to meet that target?

Mr. Epp: Well, an inflationary environment is a difficult investment environment. You know, if you look back at the '70s and '80s, the last time that Canada and much of the world faced high inflation, you will see that equity returns, among other things, were not very good. Fixed-income returns eventually were good with extremely high interest rates, but if you were on the other side of that trade before they went up, you lost a lot of money on fixed income. It will be a challenge depending on how long inflation sticks around and how severe it is. It's one of the reasons we have a significant allocation to inflation-sensitive assets. It is precisely to protect future Albertans, if you will, and the income that future Albertans will rely on if inflation hits and is significant.

The Chair: Thank you.
I will go on to MLA Eggen.

Mr. Eggen: Thank you. We seem to have a theme around inflation, which, of course, is affecting affordability for everyone in this province and further afield. I would also like to ask around the risks to the portfolio in regard to inflation. In your report you write that "performance within this asset class is expected to be challenged in the [following] quarters as further interest rate hikes are likely." I'm just reading this as that you only expect interest rate hikes over a relatively short term, for a few quarters. Other people speculate otherwise. So if I can ask just directly: when are you projecting to see the Bank of Canada's overnight rate hitting a peak, and at what level do you see Canada's inflation rate peaking and when? I know this is speculative, but you know I bet you've thought about it.

Ms Lau: All right. I will give it a try. That's a loaded question. Currently the general front-end rate, or the overnight rate, is about 1.5 per cent in Canada, probably 2 per cent in the States because the U.S. has been more aggressive in hiking interest rates. Bank of Canada will be next, coming up. Usually the market expectation will be more aggressive this time, 50 basis points to 75 basis points. That's what's priced in.

The central bank no doubt is – right now they are fighting inflation. The mission of the central bank: they have said it loud and clear. It's one mission: they have to put inflation under control. So the central bank will be very aggressive for the next little while to make sure inflation comes under control. However, again, sometimes in – the inflation scenario we are having here is supply shock inflation, where the central bank coming in and using monetary policy is more pushing demand to drive inflation lower, driving the demand lower and even trying to increase the unemployment rate to slow down the economy, driving down inflation.

Now, the question is how far the interest rate can go or will probably go. It's a tricky question because right now the market thinks: well, 2.5 per cent, 3 per cent is the terminal rate. It's usually the stabilized rate. You can bring inflation down and stabilize the job market. However, it doesn't look like inflation is under control because of a second supply shock, because of Russia, Ukraine, and the energy crisis. So central banks need to be more forceful. Now the new estimation is that maybe the central bank will need to go to 4 per cent in the front end. There is a risk to come along with it, and the central bank is aware that they need to be very mindful because with the 3 per cent and even going to 4 per cent you are really running a risk of bringing a recession to the economy.

As simple as the Canadian market – the Canadian market is really housing market driven. A big part of the Canadian economy, you can argue, is housing market consumer driven. By having inflation or interest rates too high, too aggressive, too fast to 4 per cent, it will have a very negative impact on consumers. With that in mind, that consumers always – with the burden on the consumer of the housing market and the equity market correction, that's already cut in, the wealth effect of consumers. High interest rates will also have more burden on the consumer for a mortgage, and the consumer, also feeling the inflation impact already of high energy, food costs, is cutting spending because of that.

My view is that – does the central bank need to go all the way to 4 per cent? Not necessarily. By having the interest rate at a 3 per cent, 3.5 per cent handle, probably it can do enough to slow the economy because of the consumer behaviour, maybe bringing down inflation gradually.

The trick and the challenge of the central bank is how fast inflation will come down. If there are more external shocks coming our way, the central bank will need to go harder, but if everything is still priced out as it is where we are right now, no more external uncertainty, I think and I hope that inflation will show some improvement at year-end. Then the central bank aggressively hiking interest rates right now – interest rates will usually take 12 months to kick in. So by that time the economy effect will be more observed in the market, and if there are no more exogenous events or geopolitical events, then, hopefully, inflation will come back down under control at year-end. Then the central bank will be taking the foot off the gas pedal a little bit on hiking interest rates.

I hope I answered your million-dollar question.

Mr. Eggen: Thank you. There are a couple of insights there that I think all of us need to be mindful of. First, increases to the central bank's interest rates take time to demonstrate their effects, right? We can't be too hasty in our judgment. I know that inflation is now projected at 7.7 per cent based on Statistics Canada's information last week, and I did also note that our government of Alberta is still predicting inflation at roughly 3 per cent, so obviously they have to make an adjustment. Perhaps they will do so this morning when they have their fiscal update. I hope they do, anyway, to reflect reality.

My follow-up question is back to AIMCo, of course. Of course, you are a long-term investor, and, you know, inflation doesn't look that transitory. What are you doing – you've already sort of answered this first part – to mitigate against the risk of higher inflation?

10:00

You did mention also, in your answer to the first question, that you would look to have some liquidity to take advantage of the situation. I'm just curious to know where you might go in regard to taking advantage of the higher inflation and some liquidity to make investments for Albertans.

Ms Lau: Yeah. Thanks for the question. Actually, with the asset correction, even for the last three months, coming down aggressively, we see some of the sector – like, different asset classes are actually starting to present value. For something as simple as a fixed-income portfolio, shorter maturity, a very high-quality investment-grade liquid bond, it's trading at a wider spread. It is actually presenting value. If you compare it with the – where the interest rate is right now, adding in the corporate spread, maybe you can buy an investment-grade corporate bond for three years at 4 per cent. It may not be a bad return after all.

Same for public equity. For the asset valuation, there are a lot of sectors that have corrected significantly, up to 30 per cent, already. Some of the bigger tech companies or even bigger cap stocks: they have had a major correction already, and sometimes it presents value, especially for some of those companies that have a more stable cash flow. They can pass on the inflation to the end user, have a low volatility of operation margin and a stable gross margin. There are some good companies that exist out there providing opportunity.

Now, in terms of the private side, it is actually interesting on the other end of the spectrum. Inflation, actually, with the risk of events, for a lot of investors having the appetite to have risk off, provides a lot of secondary, even private investment. There are a lot of interesting opportunities in secondary private equity, secondary private credit, just because there are investors on the other side maybe having less liquidity, needing liquidity, and more looking for a sell on some of the higher quality. We are keeping focused, even sometimes on the secondary market, even in the private market, to look for some of the opportunities.

The other opportunity we are looking for is different geographic regions. There is major disbursement of the economic recovery in different regions: developing markets, emerging markets, Asian markets. The recovery path and the asset valuation will be significantly different across different regions. For AIMCo, being global and looking for diversified opportunities around the world, there are some pockets of value in different regions of the market starting to present value. So just to give you some examples of some of the opportunities that we are looking at.

Mr. Prakash: I'll just slide in one quick comment. One of the lengths that we bring to a portfolio such as yours is to, again, balance the near with the longer term. For example, this morning the 10-year break-even expected inflation rate in the U.S. is running at around 2 and a half per cent. That's where that security is trading, if you will. Another fact with this is that another security that trades, that market participants utilize, is the five-year forward inflation. That number is running around 2, 2 and a quarter per cent at the moment. Therefore, many of the opportunities that present to ourselves in the short term relative to, you know, what the longer term outlook is – getting that right is, again, something that we bring to bear on portfolios such as yours.

Mr. Eggen: Thank you.

The Chair: All right. Thank you very much.

We'll carry on with MLA Singh.

Mr. Singh: Thank you, Mr. Chair. I would like to extend my appreciation for the presence of the representatives from the Ministry of Finance and AIMCo.

I see on page 10 that private equities comprised 8.7 per cent of the fund in March 2021 but had increased to 9.4 per cent in March 2022. This has been the main change I see on the chart. Why did AIMCo decide to increase the percentage of private equities and decrease the assets of the emerging markets from 4.5 per cent to 3.5 per cent?

Ms Lau: Thanks for the question. In terms of equity exposure, and correctly so, the private equity exposure actually increased versus the emerging markets equity. Two reasons I will address. Number one, as you are aware, is that the performance of private equity is extremely strong, and emerging market equity has a negative return. As such, just because the assets going high in private equity versus the emerging markets is a drop in asset valuation, that probably reflects the changes from 2021 to 2022.

The second reason is also as part of the intent and the way we want to position the portfolio itself. Private equity has always been very strong as a class that we focus on and that we like and favour. Private equity is an investment in the assets of a private company, and for some of the asset classes we focus on a lot, IT, consumers, and health care being the top three asset classes, those are the asset classes where we expect in general a higher return versus from public equity over a long run. We have had this program for a long time. We like the growth potential for the underlying companies, especially for the AIMCo approach, how we manage this asset.

We always team up with very strong partnerships out there, and we always have co-investment, direct investment. Through our due diligence and the impact of the portfolio company, together with our partners we can always create a lot of good value in these asset classes, away from a traditional public equity investment. This is a good asset class that we always like, that we always want to grow, and indeed for the last year it is actually a strong demonstration of how strong this program has been, generating a 37 per cent return, like the asset I shared with you, Hayward, which is a century-old swimming pool company. When we bought that a long time ago, five years ago, we did not know COVID was happening, but just because of COVID, working from home has actually given us a six-times multiple of a return because of the company going IPO.

The other investment we have that is actually worth mentioning is an asset we call ERM, Environmental Resources Management. We sold this asset to private equity firm KKR. ERM is the world's largest pure play sustainability consultancy, with operations in over 40 countries and 5,000 partners out there. Again, just because we early on identified this opportunity, it's allowed us to harvest a very handsome return for this type of investment. Our exit is close to a two-times multiple for this type of investment.

Now, on the private equity side, this is an asset class we continue to like. Last year we demonstrated that this is a strong program. Especially in terms of the emerging market in public equity, it's a challenging backdrop. Over the last year, especially with high inflation, with the challenging developing market and even the global markets such as China, with the high U.S. dollar – this is always the traditional backdrop that is least favoured for emerging markets. As such, we proactively actually tilted away from the emerging market at the same time. As you see, the changes on those two asset classes is an approach, part of our active management and reflecting the valuation changes as well.

Mr. Singh: Thanks for answering here.

On page 13 I see that under fixed income there are 61 per cent assets in Canadian public fixed income, 19 per cent in private mortgage, 17 per cent in private debt and loan, and 3 per cent in cash assets. Can you explain the performance of fixed-income investments in each asset category under this class?

10:10

Ms Lau: Sure. Within fixed income we actually have three subasset classes, what we describe as public fixed income, private mortgages, and private credit, or what we call private debt and loan. Each of the asset classes performed differently during the last year.

In public fixed income, which is more focused on high-quality government bonds and corporate bonds, we actually slightly underperformed the benchmark by about 20 basis points. The portfolio has a more disciplined approach, focusing on high-quality, short-maturity credit, focusing on shorter duration debt, and as such over the last year, despite a challenging backdrop of the fixed-income rate environment, the team managed to, by more hugging the benchmark, deliver a benchmark return.

In terms of private mortgages, it's invested in commercial mortgages that we have. It's a diversified pool of global mortgages in Canada and an opportunistic basis in the U.S. and Europe. This is a pool that, again, is focusing on very high-quality mortgages, but most of the value-add of the mortgages is actually coming from the short duration. We kind of focus on a shorter maturity of mortgages. The performance of the mortgages pool is flat, close to zero. However, this strategy outperformed the benchmark by close to 3.4 per cent.

Last but not least is our private credit portfolio. This is a portfolio similar to the private equity book that we like to grow. It's a very strong asset class. The asset class is focused on a floating rate. A floating-rate investment is not sensitive at all to the interest rate, so it actually gives us a very good performance to start with. Also, the team has been very disciplined on how we invest. We invest on a strong cash-flow asset. It's a very diversified pool of different asset classes, leveraged financing, structured credit, and fund financing. The discipline of this fund is actually demonstrated, even over the last year. In this more challenging environment we have close to zero loan loss in this type of portfolio. The program actually delivered 8.7 per cent over last year, strongly outperforming the benchmark. So the fixed-income mix for those three asset classes jointly actually contributed a very strong outperformance despite a challenging negative backdrop of the rates environment.

Mr. Singh: Thank you. I appreciate the answers.
Thank you, Mr. Chair.

The Chair: Okay. Our next question will come from MLA Gray.

Ms Gray: Thank you very much. I'd just like to continue along the lines of my last question. Thank you very much for the responses that were provided. You spoke about the CEM survey, the comparison to other peers – thank you; "peers" was a better word than "competitors" – within the sphere, and I believe that you referred to having some of those comparisons in the short term but not the long-term comparisons available for us here. Looking at the CEM information, it doesn't appear that it's easily and publicly available for me as a member of this committee to review and to better understand. Certainly not here at this meeting, but would it be possible to get more information about those comparisons? It may be something we might need to go in camera for. Like, I don't know if you're allowed to publicly share that. But as a member of the committee I'd like to better understand those comparisons.

Mr. Prakash: We'll take that away as a follow-up item and then revert to the committee. You're right. We'll also just confirm what is in the public domain and what we're able to share, but to the extent we're able to, absolutely.

Ms Gray: I would appreciate that. I think that would be great.
Then looking for more information during the questioning and looking at some of the work CEM has done, I am looking at the global pension benchmark transparency project, which has run in 2021 and now 2022. One of the things it focuses on is evaluating the performance and transparency across global offerings and investment firms with a strong focus on, well, many different factors but the one that jumped out to me was governance. Our heritage savings trust fund section, page 6, on governance: very high level, just referencing kind of the legislation. But when it comes to governance, we're aware that you've had a lot of changeover with your executive team. There's a new CEO. You're looking at your five-year strategy review. So my question for you would be – I think we will find more of that information in the AIMCo annual report, which I don't believe is out yet. Is the AIMCo annual report, which I think does influence kind of the heritage savings trust fund and provides more detail – when do you anticipate publishing that, and will we see more improvements in the transparency, those governance disclosures, in this year's annual report? Is that in line with some of the new strategic focus that you've been telling us about here today?

Mr. Prakash: The annual report will be published imminently. You'll see all the details that we've done historically. The desire and our focus is to continue to become more transparent not only in the annual report but in our multilateral, bilateral engagements with clients and other stakeholders. That's the direction that we are firmly committed to and the direction we're going in. Then, lastly, to the extent that there are still areas we could share with clients, again, happy to add those on a bilateral basis or more comprehensively at the annual report.

The Chair: Thank you.
Next on the question list is MLA Rehn.

Mr. Rehn: Yeah. Good morning. Thank you, Mr. Chair, and thanks to all the members who've attended this morning and for answering our questions and enlightening us. I want to talk about the different challenges the world has been facing the last two years. How did the pandemic impact the fund's performance over the last year, and has the fund recovered from these impacts?

Ms Lau: Do you want me to take it?

Mr. Epp: I can take that, at least to start.
The last year has been very good, and the pandemic – I think one of the results that we've seen in the market is that the economy has come back much stronger than expected. There were negative results in the first year of the pandemic, certainly, but most of those have been recovered if not exceeded by now.
I don't know if you have anything to add.

Ms Lau: Yeah. I concur. The pandemic impact was probably less so in the last year, and it continues to have good performance. As Lowell demonstrated, even last year's return and this year's return have been always positive returns.
The residual pandemic impact really still remains, probably as you can see, in the first three months of 2022 in China. The pandemic and the COVID impact is resurfacing in China, and it's more the second derivative of the pandemic. When there is a pandemic event in China, further lockdowns, a zero-COVID policy in China, and leading to – again, going back to the inflation question, it's the inflation impact.
I would say now that the pandemic impact is less so on being impacted but is more on how we recover from inflation, how we recover from the supply chain challenge, and now the next wave of the geopolitical event that we are seeing.

Mr. Prakash: Just to add a bit of colour in terms of how it's impacted the portfolio, for example, clearly, the pandemic, you know, it goes without saying: big human tragedy and has impacted everyone across the board in a difficult manner. But the types of investments that have done well – so think about the huge move towards e-commerce, Amazon, and the others. The investments in logistics, distribution centres, for example: those types of investments have been attractive for the portfolio.
Sandra talked about Hayward swimming pools, a good solid company, but all of a sudden because of the work from home, you know, that did really, really well. So all of that is to say that clearly, obviously, it's difficult on a personal, on a people front, but there are pockets of opportunities within the portfolio, within the investment universe that are attractive notwithstanding the pandemic.

10:20

Mr. Rehn: All right. I was also wondering: what strategies did AIMCo implement to mitigate the impacts of the pandemic, and how has the Russian-Ukraine conflict impacted the fund's performance, if it has at all?

Ms Lau: I would go for the second question first, on Russia and Ukraine, the unfortunate event of Russia and Ukraine happening during February of earlier on. AIMCo really has minimum exposure to Russia or Ukraine. We only have probably less than $100 million in exposure, more through the passive index portfolio that we have; that is, if you own the index, you will own part of the exposure because Russia is within the index. That only accounts for about 15 basis points of the public equity or even less and six basis points of the total fund. AIMCo has a full discipline approach when looking at countries and assessing the risk, and as such we have no exposure direct to Russia. There is a minimum exposure of that.

Indeed, for the Russian and Ukraine situation we have been proactively aware of the risk of the geopolitical event and the risk potentially coming to the market, and we have been proactively positioning ourselves in being actually under weight in stock because we know, if that would even happen, there is a risk the equity market will sell off, and we will also be more cautious with the fixed-income exposure as well. Those are the exposures of Ukraine and Russia that we don't have exposure to.

But, again, the other exposure that we have through Russian and Ukraine is the globalization risk, inflation risk, the energy risk. Those different aspects have different impacts to the portfolio in terms of the energy sector, inflation rates, again, risk asset, and AIMCo's approach is a top-down, bottom-up approach that makes sure we have a diversified portfolio to handle and mitigate the risk, diversify the strategy, constant stress test, and a lot of those risks we actually put on an extra monitoring process.

As simple as the Russia-Ukraine situation is, we constantly think of: who are the second and third derivatives of the exposure? Other countries or companies may have exposure to Russia and Ukraine. We are constantly in touch with all our counterparties that we do business with to see if they have a Russia-Ukraine situation. Last but not least, we are very mindful, again, with the counterparty risk, all the parties we trade with, and the overall equity conditions. Those are a lot of different actions we have taken during the March time. AIMCo actually took a proactive step. On March 1 we shared that we will be taking a proactive step, that we will be divesting from Russia if the condition permitted. We actually also took a step to declare that we also divested from Russia, and we are one of the first couple of pension funds to do so.

Mr. Rehn: Maybe I'll just finish up, then. I've got three short questions, and I'll just start, then. How are high world oil prices impacting the fund?

Ms Lau: A higher oil price can impact the fund in different ways, and maybe I will just describe it at a higher level. The direct impact will obviously be to the energy sector. I think that, for the higher oil prices, probably it will be a very positive tailwind for the energy sector or even commodity-related sectors or industry. So that's one of the impacts that will be a positive tailwind for the direct exposure.

Secondly, for a fund like the heritage trust fund that has a Canadian exposure and currency exposure in Canadian dollars, stronger energy implies stronger for Canada and the Canadian dollar. As such, by looking at the heritage trust fund, there is still quite a lot of exposure, especially currencywise in U.S. dollars and Canadian dollars. That's actually positive for the fund because with the Russia-Ukraine situation it's led to a lot of currency depreciation in a lot of different regions, but the Canadian dollar, U.S. dollar are holding very strong with that. So that is actually a good impact for the fund.

The third derivative of it – again, I may sound like a broken record – is how it's impacting inflation. I'm not going to repeat the script again, but it's a different layer of direct and indirect exposure that we are very mindful on how we impact the fund.

Mr. Rehn: All right. Just to wrap things up: have they affected any Alberta energy holdings in particular, and has there been a shift in appetite for energy investments?

Ms Lau: I think our thesis of energy investment stays the same. When we look at the energy investment, this is obviously a very good tailwind on the energy investment, but our thesis is more or less the same. When we invest for the client, we look at the best risk-adjusted return for the client. It's return focused. When we look at any asset in different sectors, you name it, it's based on two things: does it fit our client on risk-and-return appetite? Does it fit for the product? I think our strategy on energy per se related doesn't change much because our ultimate focus is the best risk-adjusted return, that we identify opportunity for the client in different backdrops, to be honest.

Mr. Rehn: Thank you.

The Chair: Okay. Thank you.

We will go on to MLA Eggen.

Mr. Eggen: Well, thank you, Chair. I would just like to ask about one of the asset classes that maybe wasn't doing quite as well, what AIMCo characterizes as a strategic opportunity. This year I'm seeing – correct me if I'm wrong – the strategic opportunity class had a negative 9.8 per cent return versus the positive for the overall benchmark. That's quite a significant differential and probably brings down your overall number. Could have been even better without the strategic opportunity negative numbers. Over the past five years your return: 5.4 per cent of the benchmark, again, compared to 10.2 overall. It's quite a significant mix. I just want to ask, first of all, for the sake of everyone watching: what do you mean by strategic opportunities, and how do strategic opportunity deals form as part of your management?

Ms Lau: I will address that. Strategic investment is actually a very, very small exposure within the heritage fund, probably close to even less than 50 basis points. Those are the residual or some of the earlier on investments on the very early activity that AIMCo had. As I recall, this is as early as probably 10 years ago or even seven, eight years ago. Those are the assets invested earlier on as venture capital and some of the relationship investment that we no longer invested for a longer period of time. Those are basically the residual of assets that we no longer invest in those asset classes. It's more of the asset that we need to wait to play out, but we continue to manage and monitor the performance on those assets. Those are the assets that we have in the strategic opportunity, that we have no plan to continue to add to that particular asset class.

Mr. Eggen: So your plan is not to add to it but to maintain that space?

Ms Lau: We will maintain and actively manage the asset as we invested, either through a different way of exit or manage the asset by selling in different market conditions to wind down on that portfolio.

Mr. Eggen: Oh, wind down. Okay. Great. Thank you.

Mr. Prakash: Those are on run-off mode, so to speak.

Mr. Eggen: Right. Okay. Thank you.

The Chair: You can carry on with another question. Yeah. We have no more questions on our side at this point.

Ms Gray: Oh, much appreciated. This is great. I'd like to ask about risks to the fund and some of the issues you outlined on page 13 of the annual report. Around private debt you write, "Investments in private debt and loans consists of specialty loans and financing for corporations that do not meet the requirements of other financing structures and methods," which I think, if I've understood correctly, in plain language just means lending money to corporations who are having trouble raising capital and were having trouble raising capital when real interests have been zero or negative, so potentially high-risk propositions.

10:30

I note that 32.1 per cent of this debt isn't even rated, so my first question, in two parts, is: how concerned are you about rapidly increasing interest rates and their impact on these private debt placements, and if AIMCo decided to exit these positions today, would we be in a loss position or a gain position?

Ms Lau: Well, thanks for bringing it up. If I can, I will rewrite that sentence, actually, because that's not the intent of private debt and loan and private credit. Indeed, that sentence probably means "that do not meet the requirements of other financial structures or methods," meaning that it's not public. It's not issued in the public market. It's more issuing through the private market, that is not liquidly traded. However, it is private in nature, like all other private investment.

It also says that it does not meet the requirements of the other methods and probably is referring to: all those assets don't come with a rating. Usually public credit that is traded in the public market comes with a public rating. I think that's to differentiate from private credit. It's only traded as private, doesn't come with a rating, but the underlying quality of it, I would say, is a very high quality.

The equivalent rating of that: we actually look at those assets. We apply internal ratings with every single business, every single investment we invest in. It's a range from probably BB to BBB and maybe some with a single B, but as you can see, because of the private nature, you got compensated for that risk. It's actually very high quality.

The other metric of the quality of that pool is the leverage multiple. The leverage multiple for this type of pool is usually very low, a three- to five-times multiple. It depends on the asset. So the whole asset of investing in this asset is because it is private in nature. It gives you extra premium compared with the public credit market. Those are the markets that you can't find in the public market, and some of the issuers coming to that market you cannot find in the public market. It's actually a good way to diversify on the performance, to diversify on the underlying issuer, and to diversify on the underlying structure.

A lot of the underlying assets are actually sponsored by strong private equity firms, all the good private equity firms you know about. The purpose of this fund: one-third of it is to provide liquidity to the private equity firm to buy out on some of the private equity assets that you saw.

The other thing is the structural finance and net financing. Again, those are the spaces that usually are not easily tapped with the public market, but this is the space where you can go and compete with a lot of banks out there, look for interesting private opportunities.

Ms Gray: Okay. So the quality is high in this. How I interpreted that sentence is maybe not how it is being used. These are sponsored by private equity firms. Okay. That gives me a little bit more confidence in what's happening with this, so I appreciate that.

But the second part of my question was just around: with increasing interest rates or maybe just understanding when we have these investments that don't have those ratings, how do you stress test that portfolio, especially in the environment of higher interest rates going on, and how do you manage that risk given that it's of a private nature? Do you still have access to the same amount of information you might have had for a public asset?

Ms Lau: Yeah, we do. Two things. For each of the assets we have all the detailed information, the financial statement and the balance sheet, and we also have, for each of the assets, good info from the underlying issuer we lend money to. That's the difference on the public asset. With that, the team have put assets to assess the risks on a regular basis. This is constantly evaluated by the risk team as well. Each year we re-underwrite the book to reassign the rating to make sure, in looking at the balance sheet, the market backdrop, the microenvironment, that we reassign the internal rating and make sure it reflects the quality, that the whole bulk is moving in the direction and exhibiting the risk-and-return behaviour that we are looking for.

Mr. Prakash: One thing to just add for perspective. It is in a space like this that a fund such as the heritage trust fund and other institutional investors have a leg up compared to many of the other investors in that the horizon is longer and there is at the margin more appetite to participate in illiquid. So, all else equal, to the extent that there is a lot less competition, if you will, competing for the same deal, you know, that's attractive, and you can, in geekspeak, harness the risk premium that comes with these types of investments.

The second thing, again, by way of context, on why this space came up is that if you look at the data from 30, 40 years ago, a lot of the lending would happen by the banks, and this is effectively the banks streamlining the balance sheet and the private-credit participants stepping in to provide that credit and therefore exploiting those opportunities.

Ms Gray: Okay. I appreciate that. Thank you very much.

The Chair: We've got about three minutes left.

Mr. Eggen: Okay. Great. I would like to just quickly ask about your equity holdings. In the supplemental question I'll ask about foreign equity, but first I just want to focus on Canada. One of the larger stakes you have is in Shopify. You're an active manager, so you're not just buying the equities. I just see that year to date Shopify is down over 70 per cent, and it's the kind of stock that tends to do poorly as interest rates rise. In this context, can you share with the committee your views on a large holding like this and where you expect it to go? You can always answer that in writing if you want.

Ms Lau: Yeah. We will provide a response in writing together with the other feedback we'll provide.

Thank you.

Mr. Eggen: Okay. Yeah, because we're tight on time.

You know, just to follow up, when interest rates rise, cash flows are less valuable – right? – typically, so in terms of equity portfolios that means that in increased interest rate environments you would expect tech stocks to do comparatively poorly, but when we read the report here on page 17, we can see the global equity portfolio, and your top seven holdings are tech stocks. Again, AIMCo, as I understand it, is not an index fund, so you're not just buying into the market. Can you share why the fund's top holdings are aggressively in technology stocks, particularly as interest rates are increasing imminently and consistently? Again, you can just answer that in writing, please.

Thank you.

Ms Lau: Okay. We will do so. I suspect this is more about the passive side, like, more replicating the benchmark, but we will come back with a written response.

Mr. Eggen: Yeah. Sure. Okay. That would be great.

Ms Lau: Thank you.

The Chair: Okay. Go ahead.

Ms Gray: My question is out of the initial report that you gave, Mr. Prakash, and you were talking about improvements in interacting with clients, and you referred to working forums. I just was curious: what do you mean by working forums for interacting with clients? It was in your report, and you had just finished talking about meeting and understanding the investment requirements and the risk portfolios. I heard the language "working forums," and I wondered if that meant everything is in writing now or how this mechanism is improving things.

Mr. Prakash: Maybe I was referring to working from home. Sorry. I garbled my words. I'm looking at my notes to see if I was referring to something else. Working from home. Sorry. Yeah. Not working forums.

Ms Gray: Oh. All right. So I misunderstood that. I appreciate that. Well, then, thank you for that clarification.

The Chair: Thank you.
If there are no more questions, then I'll call for a motion to approve the Alberta heritage savings trust fund 2021-22 annual report, and I see MLA Allard has a motion ready.

Mrs. Allard: Yes. Thank you, Mr. Chair. I would like to move exactly what you said, that

> the Standing Committee on the Alberta Heritage Savings Trust Fund approve the 2021-2022 draft annual report.

The Chair: Okay. Any discussion on the motion? Okay.
All in favour, either online or in person, say aye. Anyone opposed in either location, say nay.

> That motion is carried.

10:40

Now we'll carry on with the rest of our business. You can stay and listen if you want, or you can head out if you've got something else to do. I appreciate you guys coming, and we'll look forward to seeing you next time. Thank you.

Okay. Now, relative to the annual public meeting, we'll talk about date, location, and format here. Under section 6(4)(d) of the Alberta Heritage Savings Trust Fund Act the committee is required to hold an annual public meeting to inform Albertans about the status of the fund. This meeting has traditionally been held in October, before the start of the fall sitting of the Assembly, and it's held in the evening hours, from 7 to 9 p.m. However, the committee is not beholden to this. In order for the LAO staff to begin preparations, the committee will need to decide on a date, location, and format. To follow the usual practice of holding an evening meeting prior to the start of the fall session, the committee could consider Thursday, October 27, 2022, from 7 p.m. to 9 p.m. at the Edmonton Federal Building. Do members have any questions or comments relative to this date and time? Anywhere? Online? No? Okay.

We should also discuss an appropriate format for the meeting. Last year, due to the closure of the committee room galleries, in-person participation of the public was not possible. Now the gallery is open again, and members can attend in person. However, allowing public participation through a variety of methods such as telephone, e-mail, Twitter, Facebook, that we have had in recent years, has been an effective way to hear from Albertans. Therefore, I would like to suggest that in addition to members of the public attending the upcoming public meeting in person, the committee continue to accept questions by telephone, e-mail, or social media.

With these points in mind, I would like to open the floor to discussion on that part if there is any. Any objections? Okay.

All right. Given that – oh. Sorry. Did someone have something?

Ms Gray: No. No objections; just agreement on having maximum ability for Albertans to participate and that October 27 seems reasonable because session is intended to begin again the following Monday, right?

The Chair: Okey-dokey. Thank you.

Ms Gray: Thank you.

The Chair: We will now need a member to move a motion to set the date and time of the meeting. MLA Singh has a motion ready.

Mr. Singh: Thank you, Mr. Chair. I would like to move a motion that the Standing Committee on the Alberta Heritage Savings Trust Fund hold the 2022 public meeting at the Edmonton Federal Building and decide on the date and format at the committee's next meeting.
Thank you, Mr. Chair.

The Chair: I'd just like to consider, in order to give communications an opportunity to start to plan, if we could set a date and time, like October 27 from 7 to 9 p.m., like we had discussed a bit earlier, if that's okay. What do we do with that? Does that need an amendment?

Ms Robert: That's just a clarification.

The Chair: Just a clarification.
Would that be okay, MLA Singh?

Mr. Singh: That will work. Thank you.

Mr. Huffman: If we could reread the motion.

The Chair: Reread the motion? Okay. Well, I'll get the clerk to reread the motion to make sure it's okay for you, MLA Singh.

Mr. Huffman: Thank you, Mr. Chair. It would be that Mr. Singh moved that

> the Standing Committee on the Alberta Heritage Savings Trust Fund hold its annual public meeting on Thursday, October 27, 2022, from 7 p.m. to 9 p.m. here at the Edmonton Federal Building.

The Chair: Is that okay, MLA Singh?

Mr. Singh: Yeah. Thank you.

The Chair: Okay. Any discussion on the motion? All right. All in favour, either online or in person, say aye. Any opposed, say nay. Okay. Thank you.

> That is carried.

Communications plan. Turning to the communications plan, in years past the committee has directed LAO corporate communications to prepare a communications plan in support of the public meeting and authorized the chair to approve the plan after it has been made available to members for review. If members would like to take a similar approach this year, the committee could direct LAO corporate communications to put together a draft communications plan, including cost information about a moderated teleconference option. Once the plan is approved, the LAO could begin work on implementing the plan over the summer.

We have Ms Janet Laurie from LAO corporate communications joining us today, so if members have any questions, we could ask Ms Laurie to respond. Are there any questions relative to the communications? Go ahead, MLA Eggen.

Mr. Eggen: Sorry. Where is this person?

The Chair: Oh, she's online.

Mr. Eggen: Okay. Great. I could feel her presence.

Yeah. I'm just curious if you have any ideas about, you know, some variation on our outreach plan for the public in regard to the annual general meeting. I know that more people are talking about the heritage trust fund than in the past, I've noticed anecdotally, and I'm just curious if you have any ideas of how to reach the wider public more effectively.

Ms Laurie: Thank you very much, Member Eggen. Through the chair to you, I think what we've tried to do traditionally is incorporate many different communications channels to try to reach as broad an audience as possible. We would definitely employ a similar approach this year, and that comes back to the audience for this particular meeting being very diverse, so wanting to reach out to people via traditional advertising but also through social media, using our website to promote the meeting and traditional media relations as well. We would employ all of those different strategies to try and sort of cover as many audiences as possible, and that also speaks to what you've already discussed as a committee today in terms of having the meeting actually take place in person, if that's possible, using telephone, also accepting questions from the public via e-mail and through social media during the meeting so that we can make it as engaging and accessible as possible for all Albertans.

Mr. Eggen: Just to follow up on that, then. You know, I would encourage, as you said, all forms of media in diverse geographic areas as well so that we can use local papers in the regions. To have traditional print ads I think would be helpful – right? – to make sure we're catching all regions in the province.

Ms Laurie: Thank you, Member Eggen. Just through the chair to you, we typically advertise through Alberta's dailies to try to get the broadest reach in terms of those traditional print advertisings so that we do cover off diverse geographic regions throughout the province, but I'll certainly make a note that when we're looking at the plan this year, we'll investigate some costs about potentially even including smaller papers, because I think that's what you're referring to if I'm understanding correctly.

Mr. Eggen: Yeah. Not dailies, but you know weeklies and so forth in smaller markets. A lot of people read those papers, right? So there you go.

Ms Laurie: Yes. Thank you very much.

The Chair: Any other questions from anyone? Okay.

I think MLA Hunter has a motion prepared.

Mr. Hunter: I do, Mr. Chair. I move that the Standing Committee on the Alberta Heritage Savings Trust Fund direct LAO communications services to prepare a draft communications plan in support of the 2021-22 public meeting and that the chair be authorized to approve the communications plan after it has been made available for the committee to review.

The Chair: Okay. I don't think we have to have 2021-2022 in there because it's just a meeting on that particular day. It would be just 2022. Is that okay, MLA Hunter?

Mr. Hunter: Sure. That's fine.

The Chair: We're going to have the clerk read this into the record.

10:50

Mr. Huffman: Thank you, Mr. Chair. It would be moved by Mr. Hunter that

> the Standing Committee on the Alberta Heritage Savings Trust Fund direct LAO corporate communications to prepare a draft communications plan in support of the 2022 public meeting and that the chair be authorized to approve the communications plan after it has been made available for the committee to review.

The Chair: Okay. All right. Very good. Any discussion on that motion?

All right. All in favour anywhere, say aye. Okay. Any opposed, say nay.

> That motion is carried.

Thank you very much.

Any other business for discussion today?

Seeing none, the date of the next meeting. The date of the next meeting will be at the call of the chair, likely in September, at which we'll review the first quarter that will end here this week. We'll look at that in September and look at any final things we want to do for the public meeting at that time.

Adjournment. If there's nothing else for the committee, we'll need a motion to adjourn the meeting. MLA Eggen. All in favour anywhere, say aye. Any opposed, say nay. Okay. That's a wrap. Thank you, everyone, for your participation and good questions.

Thank you.

[The committee adjourned at 10:51 a.m.]

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