RICHMOND HILL
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Staff Report for Budget Committee of the Whole Meeting

Date of Meeting: May 6, 2025
Report Number: SRCFS.25.020

Department: **Corporate and Financial Services**
Division: **Financial Services**

Subject: SRCFS.25.020 – 2024 Investment Portfolio Results

Purpose:

To report on the performance of the City's Investment Portfolio for 2024, as required by Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001*.

Recommendation(s):

a) That staff report SRCFS.25.020 to be received for information purposes.

Contact Person(s):

- Bernard Yu, Financial Management Advisor, Ext. 5430
- Muhammad Raza, Manager Fiscal Strategy and Long-Term Planning, Ext. 6307
- Gigi Li, Director, Financial Services and Treasurer, Ext. 6435
- Sherry Adams, Commissioner, Corporate and Financial Services, Ext. 2521

Report Approval:

All reports are electronically reviewed and/or approved by the Division Director, Treasurer (as required), City Solicitor (as required), Commissioner, and City Manager. Details of the reports approval are attached.

Key Messages:

- The City's investment portfolio realized investment income of $40.3 million, which equated to an income return of 5.94%. The addition of $24.1 million based on positive mark to market adjustments resulted in a portfolio total return of 9.49%.
- Canada's economy grew by 1.5% in 2024, while its unemployment rate increased from 5.8% to 6.7%, as labour market conditions softened.
- Inflation based on the change in annual CPI (Consumer Price Index), declined from 3.4% beginning of the year to 1.8% at the end of the year. As a result, Bank of Canada delivered 5 rate cuts totaling 175 basis points in 2024, which brought the Overnight rate from 5% to 3.75%.
- There is significant uncertainty on the global economy including Canada, in 2025 and beyond due to the re-emergence of U.S. based tariffs, which occurred from changes in trade policy from the new government administration.
- Financial markets have experienced great volatility as asset prices reflect new concerns about the outlook on economic growth and inflationary pressures.

Background:

In accordance with reporting requirements of the *Municipal Act* and the City's Investment Policy, the Commissioner of Corporate and Financial Services and/or Treasurer is required to provide an investment report to Council at least annually. This is to provide an update on the status of the investment holdings including an analysis of the investment activity undertaken in the preceding fiscal year. The report contains the following:

- A statement about the performance of the investment portfolio during the calendar year 2024;
- A description of the estimated proportion of the total investments that are invested between long term and short term holdings and a description of the change, if any, in that estimated proportion since the previous year's report; and
- A statement by the Treasurer as to whether or not, in his or her opinion, all investments are consistent with the Investment Policy and goals adopted by the City.

The City's investments are governed by the *Municipal Act* and its Investment Policy, which establishes the guidelines in ensuring effective and professional management of all of the City's funds.

The objectives of the City's Investment Policy, in order of priority are:

1) Compliance to statutory requirements;
2) Preservation and security of capital;
3) Maintenance of necessary liquidity; and
4) Realizing a competitive rate of return.

Discussion:

The City's investment portfolio realized investment income of $40.3 million, which equated to an income return of 5.94%. The Treasurer is of the opinion that the investment portfolio and all transactions undertaken in 2024 adhered to all required standards of the *Municipal Act,* Investment Policy and goals adopted by the City.

Economic Conditions and Financial Markets

There was major progress on inflationary pressures subsiding globally, which marked a pivotal point for interest rates. As inflation continued to decline towards the common 2% target, central banks recognized the need to refocus on economic growth. The inception of an interest rate cutting cycle became a major driving force in supporting consumer demand.

Resiliency in the U.S. economy led to another robust year of economic expansion, which resulted in real GDP growth of 2.8%. This was an acceleration from the previous year of 2.5% (Source: U.S. Bureau of Economic Analysis). Increases in consumer spending, business investments, exports and government spending, contributed favourably. Although not as strong as the prior year, the labour market remained healthy while the unemployment rate increased from 3.8% beginning the year to 4.1% at year-end (Source: U.S. Bureau of Labor Statistics).

Although the inflation trend continued its downward trajectory through evidence of smaller percentage year over year increases in the Consumer Price Index (CPI), the rate of decline in the U.S. was much less relative to other developed countries. U.S. CPI decreased from 3.4% beginning the year and reached as low as 2.4% in September, before settling at 2.9% at year-end. (Source: U.S. Bureau of Labor Statistics). Housing related inflation, which includes shelter costs and utilities remained the most persistent among keeping the metric elevated.

In addition to sufficient progress made on lowering inflation, the renewed focus on sustaining employment levels deemed that interest rates no longer needed to be that restrictive. The Federal Reserve reduced the range of its policy rate by 100 basis points towards the end of the year, which brought it to 4.00% to 4.50%. This level was still assessed as being appropriate to guide inflation back down towards its 2% target over time.

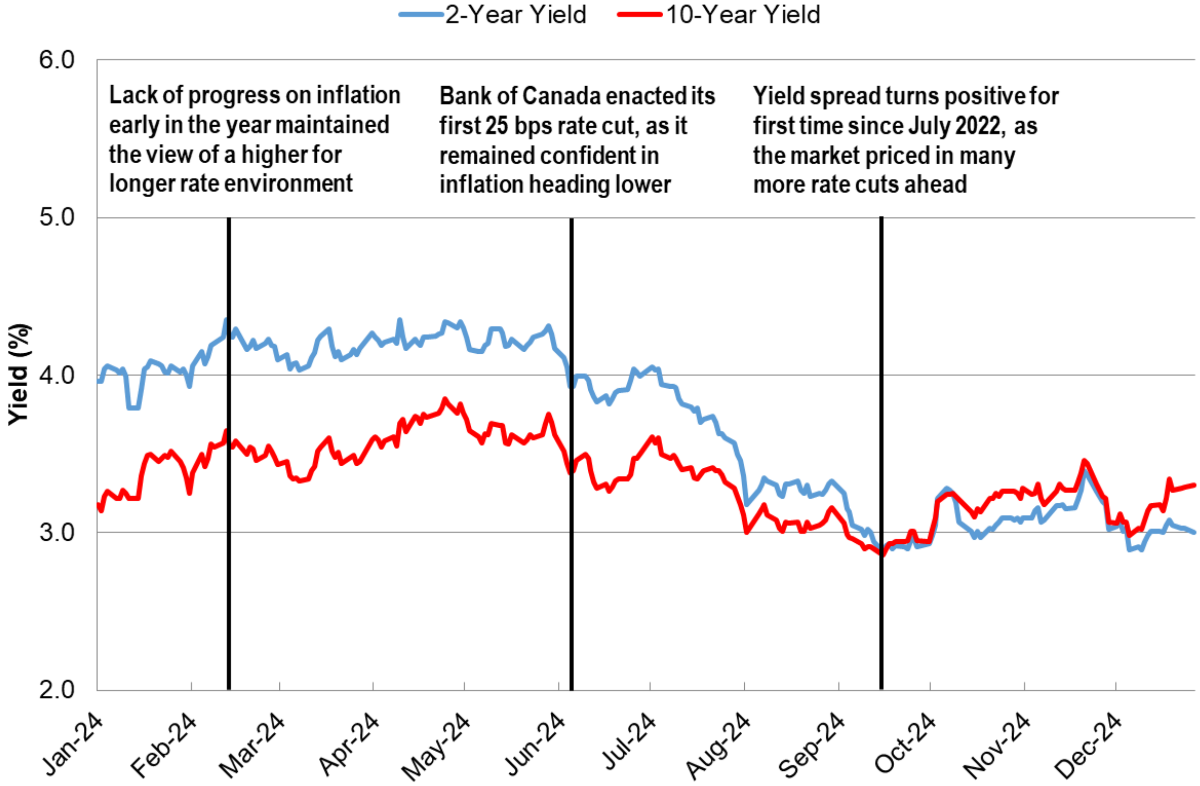
The same positive macroeconomic backdrop from the prior year carried well over into and throughout 2024, which continued to sustain favourable investor sentiment. This narrative was repeatedly backed by a robust consumer spending-driven economy in the U.S. with positive global spillover effects and interest rate cut expectations. It had once again translated into strong returns for both fixed income and equity markets including Canada.

The Canadian economy also recorded a faster pace of expansion than the previous year, as it grew 1.5% in 2024 (Source: Statistics Canada), which was slightly higher than the prior year of 1.1%. Lower borrowing costs contributed to an increase in household spending and housing activity that spurred greater momentum heading towards the end of the year. Evidence of weaker employment levels was reflected in the unemployment rate that saw a material increase from 5.8% beginning the year to 6.7% at year-end (Source: Statistics Canada). This was one of the major factors that prompted Bank of Canada to proceed with its first interest rate cut on June 5th of 25 basis points.

There was significant progress on inflationary pressures subsiding, especially in the 2nd half of the year, as CPI (Consumer Price Index) declined from 3.4% beginning the year and reaching the central bank's 2% target in August for the first time in over 3 years. Inflation hovered around 2% since before settling at year-end of 1.8% (Source: Statistics Canada). The decline of overall CPI was reflected in the major underlying components that were below their historical averages, alongside shelter inflation that was also easing, albeit slowly.

The Bank of Canada's assessment of the inflation outlook during mid-year that already suggested downward momentum, renewed its need to also balance slowing employment growth. They deemed that its monetary policy no longer needed to be as restrictive given their increased confidence that price pressures will continue declining towards their 2% target. As a result, the central bank first reduced its Overnight rate of 5% by 25 basis points in June, followed by an additional 150 basis points of cuts, which further decreased its Overnight rate to 3.25% by the end of the year.

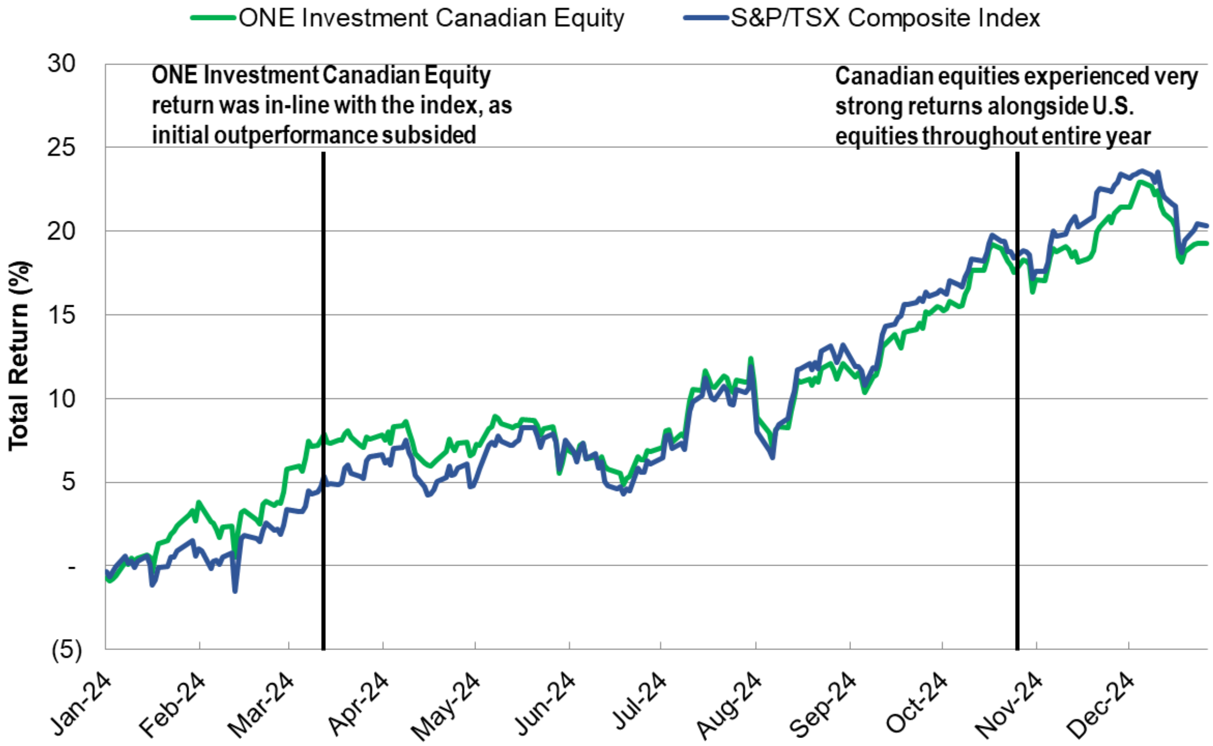
Chart 1 – 2 Year and 10 Year Government of Canada Bond Yields in 2024



(Yields sourced from Bank of Canada)

As highlighted in the chart above, both short and long term interest rates trended higher throughout the first half of the year, before turning sharply lower. The initial assumption that the Bank of Canada would need to maintain their restrictive monetary policy by continuing to hold its Overnight rate quickly reversed course. Economic growth was slower than the Central bank's forecast, while labour market conditions softened including increasing evidence that inflation would sustain its downward momentum. The 2 Year and 10 Year Government of Canada bond yields decreased precipitously, as expectations surrounding more rate cuts were incorporated. In order to prelude a greater economic slowdown, the Bank of Canada reduced its policy rate by 50 basis points in each of its October and December announcement.

Chart 2 – Canadian Equities Performance in 2024



(Prices sourced from ONE Investment and TMX Group)

ONE Investment is a co-mingled investment program that is specifically designed and catered to Ontario municipalities, which is jointly operated by LAS (Local Authority Services) and CHUMS Financing Corporation (a subsidiary of the Municipal Finance Officers' Association of Ontario). This is the only eligible investment vehicle the City can participate in to obtain direct exposure to equities and is managed by a 3rd party investment manager.

As illustrated in the chart above, the 'ONE Investment Canadian Equity' fund returned 20.6% (Source: ONE Investment) for the year on a total return basis, which included dividends reinvested. The S&P/TSX Composite Index, which represents the benchmark for the overall Canadian equity market, returned 21.7%. (Source: TMX Group). Although the fund's performance was largely in-line with the index, it slightly underperformed the benchmark by 1.1%. The top performing sectors were information technology, which was supported by optimism surrounding artificial intelligence, followed by financials.

Investment Portfolio Results

In 2024, the City's investment portfolio realized total income of $40.3 million based on an average portfolio balance of $678.3 million, which resulted in an income return of 5.94%. The average balance is only used for the return calculation, as it provides the best measure by incorporating the number of days the balance was held at specific levels during the calendar year. This incorporates the amount and timing of all investment purchases, maturities and sales. The income return reflects investment income earned on all investments and directly translates to the amount of interest allocated between the operating budget and reserve funds.

Short term investments have a term of 1 year or less including cash balances and long term investments have a term of over 1 year. The following table provides a summary of the breakdown for investment income realized between short term and long term investments.

Table 1 – Summary of Portfolio Income Return

Year	Investment Term	Average Balance ($ millions)	Investment Income ($ millions)	Portfolio Income Return
2024	Short Term	199.0	10.9	5.50%
	Long Term	479.3	29.4	6.12%
		678.3	**40.3**	**5.94%**
2023	Short Term	188.1	10.4	5.55%
	Long Term	462.8	16.0	3.46%
		650.9	**26.4**	**4.06%**

The year over year increase in the average portfolio balance was driven by a greater retention of cash balances that comprises short term investments, while adding to long term holdings. The yield earned on the City's cash balances was more competitive than alternative short term offerings from various institutions. Given the high probability that interest rates have already reached their peak levels, this presented an opportunity to lock in higher yields before they declined amidst a declining rate environment, as illustrated in Chart 1.

Investment income earned on both short and long term investments reached a new record. Strategic investments were made in the first half of the year in short term securities to hedge against lower interest earned on cash balances in anticipation of rate cuts. As a result, the investment portfolio was still able to earn a 5.50% income rate of return on its short term holdings, just slightly below that of the prior year. This was highly favourable considering the Bank of Canada cut interest rates by 125 basis points, which incrementally reduced the cash yield the City could earn, based on the equivalent decrease in its bank prime rate.

Following back-to-back years of strong double digit percentage equity market returns, long term income came in far above expectations and was mainly attributed to capital gains realized in its ONE Canadian Equity holdings. This is representative of securities sold within the fund by the portfolio manager that generated $11.9 million of capital gains and is reported to all municipalities that are invested. Hence, this is treated as additional investment income realized for the City, but not expected to be recurring, especially of this material amount.

In order to facilitate objective performance measurement, the second method of evaluation is total return. This combines realized investment income with mark to market adjustments, which reflects the change in market values of the underlying securities in the investment portfolio. This provides a performance assessment with a market benchmark based on industry standards.

In 2024, the total return of the investment portfolio was 9.49%, after incorporating a positive market impact. The following table provides a summary of the breakdown.

Table 2 – Summary of Portfolio Total Return

Year	Average Balance ($ millions)	Investment Income ($ millions)	Portfolio Income Return	Mark to Market ($ millions)	Portfolio Total Return
2024	678.3	40.3	5.94%	24.1	9.49%
2023	650.9	26.4	4.06%	30.0	8.68%

A year over year increase in investment income was largely driven by long term investments through capital gains incurred in the City's ONE Investment Canadian Equity holdings as cited previously. The positive mark to market further enhanced the portfolio's performance, when incorporating the market value change of the underlying securities.

The strong positive mark to market and resulting portfolio total return in 2024 reflected the similar economic landscape from the prior year, which was underpinned by a strong U.S. economy, while accompanied by easing financial conditions globally, particularly in Canada. This contributed to a rebound in household spending through lower borrowing costs. The continued appreciation in asset prices delivered favourable returns in both fixed income and equity holdings of the City's investment portfolio.

As outlined in the Investment Policy, the most suitable benchmark is a combination of the FTSE (Financial Times Stock Exchange) Canada Debt Market Indices and the S&P/TSX (Standard & Poor's/Toronto Stock Exchange) Composite Index. Both are leading indicators used in measuring Canadian market performance for fixed income and equities. The total return of the City's benchmark was 6.87%, which the City's investment portfolio exceeded by 2.62%, as presented in the next table.

Table 3 – Portfolio Total Return and Benchmark Total Return

Year	Portfolio Total Return	Benchmark Total Return	Difference
2024	9.49%	6.87%	2.62%
2023	8.68%	7.39%	1.29%

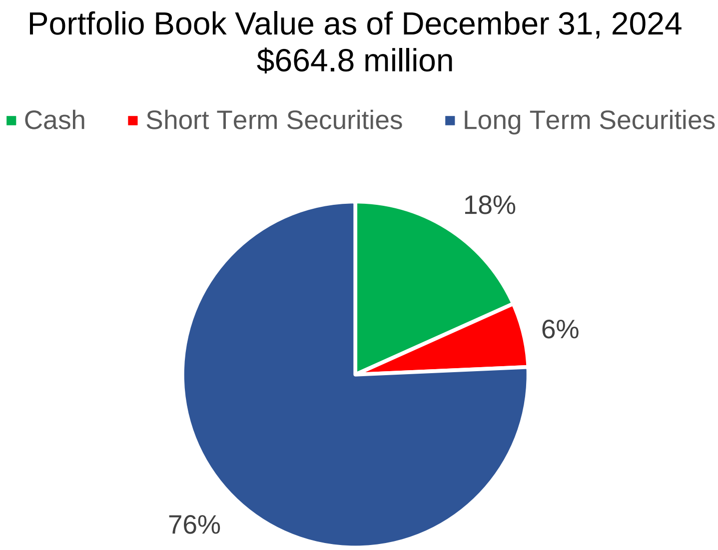
One of the main factors that contributed to the outperformance against its benchmark were attributed to a higher portfolio duration. This translated to a higher sensitivity to changes in interest rates and resulted in greater returns compared to the benchmark, especially as short to medium term yields were lower in the year.

The added weighting to fixed income securities in the corporate sector relative to the government sector also benefited the portfolio. As the economic outlook remained favourable, corporate bonds provided greater returns than government bonds.

Lastly, the portfolio added to its position in the ‘ONE Canadian Equity’ fund during periods of market declines for greater portfolio diversification and long term capital growth. As highlighted in Chart 2, although the ‘ONE Canadian Equity’ fund slightly underperformed the S&P/TSX Composite Index by 1.1%, this was more than accounted for by well-timed purchases that contributed favourably to the results.

The book value of total investments held at year-end, which represented the cost of all holdings was $664.8 million, which included cash balances totaling $121.6 million, short term holdings of $40.0 million and long term holdings of $503.3 million. This translated proportionately to the total portfolio balance of 18%, 6% and 76%, respectively and illustrated in the following chart.

Chart 3 – Portfolio Breakdown of Cash, Short Term and Long Term Holdings



The portfolio held a higher cash balance at the end of 2024 of $121.6 million than the prior year of $95.3 million. A year over year increase in cash balances was partially offset with the decrease in short term holdings, which declined from $50 million to $40 million or 8% to 6% of the total portfolio. The lack of liquidity premium offered in short term securities and higher cash flow requirements from upcoming capital expenditures, clearly suggested greater retention of cash balances was most financially sound.

Looking at 2025 and Moving Forward

The initial optimism surrounding the new government administration following the 2024 U.S. presidential elections, was focused on deregulation, lower taxes and an overall pro-business regime. This has since quickly dissipated early in the new year, as U.S. trade protectionism resurfaced and akin to the same global trade concerns during President Trump's first term in office. The imposition of new tariffs on all nations including Canada has undoubtedly led to reciprocal tariffs that continues to significantly challenge the economic and inflationary outlook. The motive from the U.S. perspective underlying these actions correspond to reducing the trade deficit, correcting unfair trade practices, raising government revenues and restoring domestic manufacturing. The major differences compared to the initial trade dispute back in 2018, are that current tariffs apply across all goods including energy and to many countries. This is especially critical at a time when inflationary pressures remain elevated with concerns of it moving even higher, while abruptly slowing economic growth. This is a more prominent issue in the U.S. where inflation is much more pervasive, such that there is limited scope for the Federal Reserve to cut interest rates, in order to stave off an economic downturn.

Although the initial trade dispute between Canada, U.S. and Mexico was resolved following the new CUSMA agreement signed in 2019, which resulted in tariffs being lifted. Current tariffs applied to Canada include 25% on Canadian exports including steel, aluminum products and automobiles, in addition to 10% on energy products. (Source: Government of Canada). It remains highly uncertain whether any imminent resolution will be reached, including the duration to reach upon a new agreement. As much as the absolute tariff in itself is damaging to the Canadian economy, the constantly changing political narrative from the U.S. makes it difficult for businesses to conduct their operations and plan ahead.

Global financial markets have reacted aggressively, as equities have sold off dramatically from recessionary fears that continue to intensify. The sharp declines are reminiscent of the volatile periods seen during the 2008 Global Financial Crisis and 2020 Global Pandemic. In a period where financial conditions are stressed, global central banks would typically enact interest rate cuts, in order to support the economy by stimulating demand through lower borrowing costs. However, this would be counter-productive to their efforts in bringing down inflation, which remains far above their 2% target.

Economic data has begun to show early signs of deterioration, especially those related to consumer confidence and inflation expectations. The U.S. economy had strong momentum entering the new year but has since dramatically shifted as risks point towards that of a recession or stagflation, which is a combination of slow growth, high inflation and high unemployment.

Canada’s GDP growth was initially forecasted at 1.8% in 2025 (Source: Bank of Canada), as lower interest rates continue to strengthen demand for household spending, however, U.S. trade policy has become a significant source of uncertainty for the Canadian economy.

The Bank of Canada has further reduced its Overnight rate from 3.25% by 50 basis points to 2.75% since the beginning of the year. The constant change in tariffs has eroded consumer confidence and challenged the business outlook with respect to hiring and investment decisions. Following the end of the ‘Goods and Services Tax/Harmonized Sales Tax’ break in mid-February, which provided relief for various items including beverages and dining, inflation has inevitably picked up. Annual change in CPI has increased from the beginning of the year from 1.8% to 2.6% ending February (Source: Statistics Canada). The extent and duration of higher prices caused by tariffs remains unclear given the dynamic political environment, especially whether these would be more of one-time adjustments or beginning of a new upwards trend. Bank of Canada projected inflation to average 2.3% in 2025 per their ‘Monetary Policy Report’ in January, however, these figures are most likely to be revised higher in the months ahead.

There already has been numerous programs offered by the federal government to assist businesses and workers related to import duties. However, the negative impact on the Canadian economy is difficult to quantify including the appropriate monetary policy response from Bank of Canada. This is essential is supporting the labour market, while carefully ensuring higher long term inflation expectations does not structurally entrench for households.

Financial market conditions continue to be whipsawed by headline risks centered on global trade. The City's investment portfolio would be impacted by declines in equity prices, however, this would typically be offset by increases in its fixed income holdings. This is representative of a typical flight to safety for investors during times of market turmoil, especially as the preservation and security of capital takes greater precedence over realizing a competitive rate of return. On the contrary, these periods of market dislocations would also create value for the investment portfolio to capture over the long term. Staff will continue to monitor the global macroeconomic environment and market conditions to adjust accordingly in balancing out risks and opportunities to preserve capital and drive competitive returns.

Financial Implications:

The City's investment portfolio earned $40.3 million of investment income for 2024, which $10.9 million was from short term investments and $29.4 million from long term investments.

Relationship to Strategic Plan 2024-2027:

The investment performance demonstrated fiscal responsibility by effective use and application of the City's available monies through wise management of public funds. These results are reflected as positive based on preserving capital as a top priority, while maintaining a diversified portfolio to maximize current income and retaining growth potential to meet long term capital spending requirements. This relates to Pillar 3, 'Strengthening our Foundations, especially around Priority 1 in supporting the City's capital investments, based on evidence-based and data-driven decisions within the context of long term financial sustainability.

Attachments:

The following attached documents may include scanned images of appendixes, maps and photographs. All attachments have been reviewed and made accessible. If you require an alternative format please call the contact person listed in this document.

- Appendix "A" – Portfolio Breakdown by Sector
- Appendix "B" – Portfolio Breakdown by Term

Report Approval Details

Document Title:	SRCFS.25.020 - 2024 Investment Portfolio Results.docx
Attachments:	- SRCFS.25.020 - Appendix A - Portfolio Breakdown by Sector.pdf - SRCFS.25.020 - Appendix B - Portfolio Breakdown by Term.pdf
Final Approval Date:	Apr 22, 2025

This report and all of its attachments were approved and signed as outlined below:

Gigi Li - Apr 17, 2025 - 3:30 PM

Sherry Adams - Apr 17, 2025 - 3:49 PM

Darlene Joslin - Apr 22, 2025 - 7:46 AM