# Appendix A

# REPORT TO GRACE UNITED CHURCH COUNCIL FROM INVESTMENT ADVISORY WORKING GROUP, MAY 2022

## 1.0 Investment Vehicles Considered

Our group considered the following as possible vehicles for investment:

- chequing account(s)
- high interest savings accounts
- GICs
- bonds
- equities (individual stocks, pooled funds, mutual funds, Exchange traded funds (ETFs)

High interest savings accounts and GICs are much more attractive now that interest rates are moving up toward more normal rates.

Bonds are administratively difficult to own separately but could be owned within pooled or mutual funds or in ETFs. Bonds (other than short term) may be a losing investment for the next few years as interest rates rise and the value of bonds drops. Thus, we feel that GICs may be the preferred option with a less than normal allocation to bonds.

Equities can be owned separately but our preference is to get diversification by owning a fund or funds (e.g. pooled, mutual, ETF).

## 2.0 Research

The group considered the following:

- Grace's Operating Account and Church Funds reported in the 2021 Annual Report with total asset of about $550,000
- Dunlop United practices for investing their funds (Sec. 3.0)
- Sarnia Community Foundation (Sec. 4.0)
- RBC Wealth Management Dominion Securities (Sarnia) proposal for Grace (Sec. 5.0)
- Steadyhand Investments (Toronto), a mutual fund provider that invests in pooled funds (Sec.6.0)
- Mawer, a very large low-cost mutual fund manager based in Calgary (Sec. 7.0)
- GICs and high interest on-line savings accounts, (current rates and banks offering these products) (Sec. 10.0)

## 3.0 Dunlop United Church

Dunlop outlines three options:

- Commercial financial Institutions,

- Invest with a Foundation (e.g. Sarnia Community Foundation or United Church Foundation),
- Do investing ourselves (the Dunlop choice)

Dunlop has a separate investment committee that manages investments and monitors performance. Its assets are invested in GICs and a high interest savings account with a credit union AND in a brokerage account (Q-Trade) invested in a changing mixture of ETFs, GICs, mutual funds and money market. Overall asset mix is 60% cash and fixed income and 40% equity.

Our sense is that the Dunlop approach is more complicated and labour intensive than Grace would want. It requires a separate, dedicated and knowledgeable group to manage effectively. It works for them, but our group feels that their first listed option of using outside firms offers simplicity and is more suitable for Grace.

### 4.0 Sarnia Community Foundation (SCF)

We met with and received a report from SCF. We currently have about $50,000 in a funds with SCF (60/40 equity/fixed income spit). It pays 3.5% annually if we chose to get it. Alternatively, the income can be left in to grow. Starting in 2023 under the new federal budget this goes to 5%. Grace can add funds to what is already with SCF. Once funds are invested in the Foundation one cannot get the principal back. SCF can however, offer a separate flow-through arrangement where the funds can be recovered if needed. SCF has a good long-term return from their invested assets of about 8%.

### 5.0 RBC Dominion Securities

We solicited and received a 21-page proposal from RBC Dominion. It proposes that Grace have a 60/40 separate equity/fixed income portfolio. (We could pick a different ratio.) This would be invested in 4 different cash investments, 5 different GICs, 3 different mutual and ETF equity funds and two specific stocks. The investments are diversified by market sector, currency and geography. Overall yield is projected at 3.3% or $13,000 based on a $400,000 portfolio. The management expense for the equity component is 1.5% and there is no management cost for the GICs.

### 6.0 Steadyhand Investments

We stumbled upon Steadyhand in our search for a pooled fund manager. Pooled funds typically have lower fees than mutual funds. A highly respected pooled fund manager we approached had a much higher minimum investment than Grace will have but suggested that Grace investigate Steadyhand which offers mutual funds that invest in pooled funds managed by various respected large money managers.

Steadyhand (steadyhand.com) was founded by Tom Bradley in 2007. He was the CEO of PHN Investments before it was acquired by RBC. It had an excellent track record as a mutual fund manager. Steadyhand has 8 different mutual Funds and one of these, the Builders Fund, may be suitable for Grace. It is a Global Equity Fund. Using the

Steadyhand option Grace would have its fixed income separately outside of Steadyhand in high interest savings and GICs. and the equity with Steadyhand. The I0 year annualized return to March 31, 2022, on Builders Fund has been 8% after embedded management expense. Steadyhand has a basic administration fee per fund (MER) that is reduced as total funds invested increase and as clients stay longer with the firm. Currently the net reduced MER for Builders Fund would be 1.45% if Grace were to have $250,000 invested. (Steadyhand also has an Income fund that, depending on the income/equity asset mix, could be added as a companion fund with Builders Fund.)

## 7.0 Mawer Mutual Funds

Mawer (**mawer.com**) has excellent performance with relatively low management expense ratios (MERs). On the independent Morningstar 5-star rating system the funds that Grace would use are either 4 or 5-star funds. It manages its own mutual funds and funds for pension plans and insurance company branded mutual funds with 90 billion under management. Its management style is long term value investing.

Grace does not have enough to invest directly with Mawer but can buy and own Mawer funds though an on-line bank brokerage (e.g. RBC Direct. Bank, Scotiabank's iTrade, CIBC's Investor's Edge). The potential Mawer funds for Grace are Canadian Equity (4-star), Global Equity (5-star) and Balanced Fund (5-star) with respective 10-year annualized performances to March 31, 2022, of 10.7%, 13.7% and 8.7%, and respective Management Expense Ratios of 1.14%, 1.31%, and 0.9%. With the Mawer option one can combine high interest savings and GICs (outside of Mawer) with Mawer's Canadian Equity and Global Equity Funds or use the Balanced Fund for greater simplicity.

## 8.0 Administrative Considerations

Our belief is that a group of volunteers cannot be expected to have the interest, time, or expertise to do hands on financial management. In addition, this is an onerous obligation to assign to volunteers. Thus, we feel that Grace should strive for simplicity in the choice of assets and the systems for administration. This simplicity principle is reflected in our bank accounts + GICs + not more than two funds approach.

It is necessary to sign documentation with each bank or investment dealer. Under our scenario this would be with a bank or banks handling current accounts (already in place), bank(s) with a high interest savings account and GICs (e.g. Oaken group). In addition, documentation would need to be signed if Grace uses a bank brokerage (e.g. RBC Direct, iTrade, Investors Edge), OR uses a firm like Steadyhand.

The transfer of funds between chequng and on-line savings accounts is achieved on-line and is administratively simple.

## 9.0 Recommendation of a Manager

We also considered using exchange traded funds (ETFs) instead of RBC Dominion Securities or Steadyhand or Mawer. Their advantage is much lower fees. A disadvantage is that, since they replicate the market indexes, they have much more volatility than a focused value-oriented manager. Also, ETF funds do not normally evaluate the Environmental, Social and Governance (ESG) practices of the companies they hold (as do firms like Steadyhand and Mawer). Most mutual funds do not equal the performance of the indexes but the ones we have identified do as well or better over the long term.

We have rejected the RBC Dominion Securities option since it is more complicated than we would like and does not offer the long-term track record that our other two choices have.

Between Mawer and Steadyhand we have decided to recommend Mawer. Mawer's advantages include:

- lower MER
- much larger firm with a longer track record
- better long-term performance record
- a superior selection of funds providing flexibility as market conditions and Grace's needs change (specifically Canadian Equity, Global Equity, Bond and Balanced)

Mawer's possible disadvantages are:

- the need to use an on-line brokerage to buy and hold the mutual fund units
- the lack of the ability to get advice directly from Mawer (offset by the great website and the fact that the use of one fund minimizes the need for advice).

At present we recommend the use of a single fund (Balanced Fund).

## 10.0 GICs, High Interest Savings Accounts, Oaken Financial (oaken.com)

Interest rates have started to increase towards more "normal" levels. A comparison of three on-line and two regular bank rates on May 5, 2022, is:

| Bank | high interest savings | 1-year GIC | 2-year GIC |
|---|---|---|---|
| Oaken(on-line) | 1.6 | 3.1 | 3.7 |
| EQ Bank (on-line) | 1.5 | 3.1 | 3.75 |
| Tangerine* (on-line) | 0.1 | 2.9 | 3.1 |
| RBC | 0.3 | 2.5 | 2.75 |
| Scotiabank | 0.35 | 0.4 | 0.7 |

(*Tangerine is an on-line bank owned by Scotiabank. It often has "teaser" rates on its high interest savings. Currently it has a special high interest rate of 2.25% for 150 days. Teaser rates can be administratively awkward to track and manage; we are not recommending them).

<u>It is prudent for Grace to change its banking arrangements to get higher interest on surplus funds by using on-line banks like Oaken for savings and GICs.</u>

Oaken's rate for high interest savings will rise to about 2.5% by 2023. In 2023 its 2-year GIC rate will likely exceed 4%. We recommend an equal mix of 1-year and 2-year GICs to start; in this way each year the maturing GIC is renewed for 2 years to always get the higher 2-year rate.

Oaken offers on-line high interest savings and GICs at always competitive rates. Another good choice is EQ Bank. Oaken has two divisions, Home Trust and Home Bank that are both members of the Canada Deposit Insurance Corporation (CDIC). Thus, the maximum insurance of 100k is doubled to 200k This offers simplicity and avoids having to use multiple banks. Depending on the combined amount in high Interest savings and GICs it may be necessary to use two firm on-line banks at some stage to avoid exceeding the maximum 100k CDIC insurance coverage for any one institution.

### 11.0 Overall Asset Mix Illustration and Cash Flow

The following chart provides an illustration and projection of how Grace's 550k might be allocated. We are using RBC for chequing account, Oaken for high interest savings and GICs, Sarnia community foundation (SCF), and Mawer Balanced Fund.

| **Financial Assets** | **Cash** | **GICs** | **Bonds** | **Equity** | **Total** |
|---|---|---|---|---|---|
| Chequing | 30 (AVG) | | | | 30 |
| High Interest Savings | 70 (AVG) | | | | 70 |
| SCF | | | 20 | 30 | 50 |
| GICs | | 130 | | | 130 |
| Mawer Balanced | | | 81 | 189 | 270 |
| **TOTALS $ '000** | **100** | **130** | **101** | **219** | **550** |
| **TOTALS %** | **18** | **24** | **18** | **40** | **100** |

**NB** - With this illustration the total management expense is .9% of the amount with Mawer (270k), 1.5% of the amount with SCF (50k) and 0% for bank accounts and GICs, resulting in a weighted fee expense of .446% for the total 550k.

The proposed 40/60 equity/fixed income mix should allow some variation (e.g. 40 +/-5 and 60 +/-5) to provide administrative flexibility and simplicity given normal market variations.

Grace's Finance Committee and Trustees would recommend actual investment allocations.

### 11.1 Anticipated 2023 Cash Flow From Investments

Using these estimates the projected income for 2023 is:

- Chequing account $0
- High interest savings 70k @ 2.5% $1750
- GICs 130k @ 4% $5200
- Draw from SCF 50k @ 5% $2500

**SUBTOTAL INTEREST AND SCF DRAWINGS** = **$9450**

Mawer Balanced expected long-term return is 8-9% but Grace could budget to draw, say 6%, income annually on 270k = $16,200.
**TOTAL 2023 INTEREST INCOME AND POTENTIAL DRAWINGS = $25,650.**

Grace would need to formally decide whether or not to take regular drawings from the Mawer investment and also from the SCF investment.

## 12.0 Summary of Recommendations

1. Use a mix of chequing, high interest savings, GICs, Sarnia Community Foundation (SCF), and a mutual fund manager for Grace's financial assets.
2. Use normal chequing account + Oaken Financial and/or similar on-line firms for high interest savings and 2-year GICs. These funds are used for current cash, short and medium-term cash needs.
3. Adopt a policy of not exceeding the maximum Canada Deposit Insurance Corporation coverage of $100,000 with any bank holding high interest savings and GICs. (Oaken's two divisions Home Bank and Home Trust each offer $100,000 separately in CDIC coverage.)
4. Set up a bank on-line brokerage to hold the Mawer Balanced Fund which is invested in 30% fixed income and 70% Canadian, US and International equities.
5. Target an overall asset mix of 40% (range 35% to 45%) for equities and 60% (range 55% to 65%) for fixed income (cash + GICs + bonds). (Refer to the spreadsheet in section 11 to illustrate how this works with the assets proposed.)
6. Income on high interest savings, GICs and from the SCF is recommended to be budgeted to be taken as interest income in the annual budget. Grace needs to decide whether to budget to take annual drawings from the Mawer investment and the SCF investment or to let income and growth accumulate. (Refer to Section 11.1 for an illustration.)

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