EQUITY

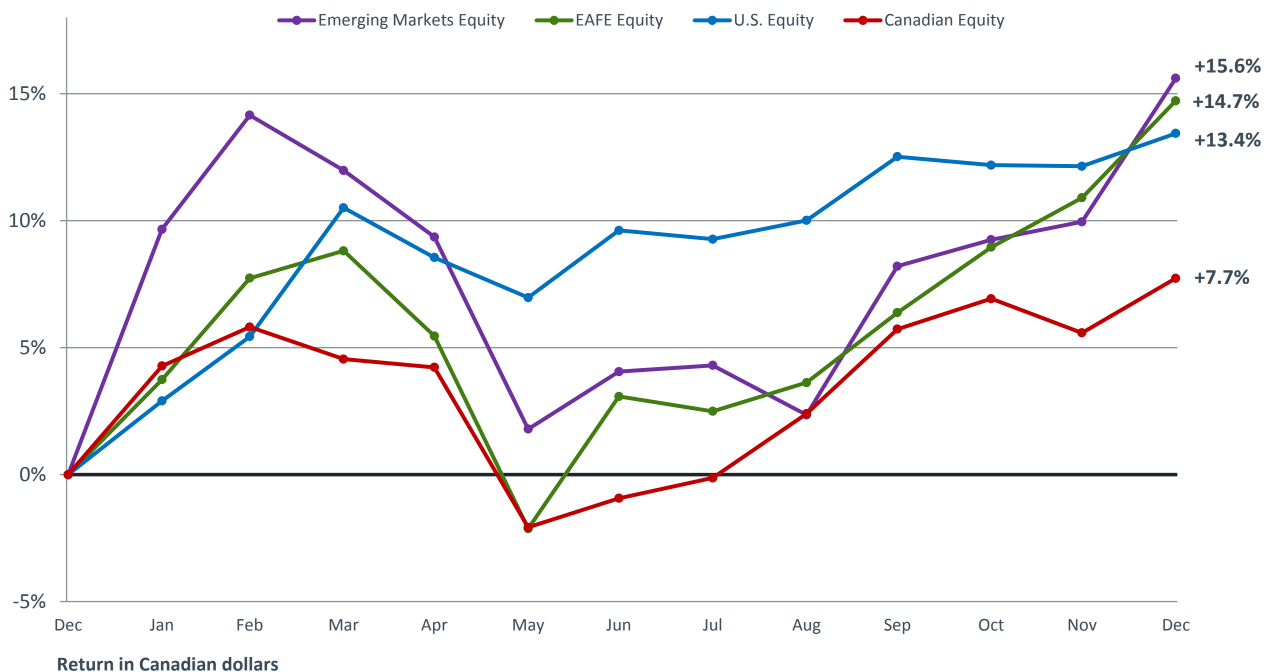
DESCRIPTION

The Equity asset class consists of six portfolios: Canadian Equity, Global Equity, U.S. Equity, EAFE (Europe, Australasia, Far East) Equity, Emerging Markets Equity and Private Equity.

The Canadian Equity, Global Equity and Private Equity portfolios, which have $53.6 billion in net assets, are actively managed. The U.S. Equity, EAFE Equity and Emerging Markets Equity portfolios, which have $28.7 billion in net assets, are index-managed.

MARKET CONTEXT

After getting off to a promising start, the stock markets lost steam in the second quarter, as Europe's difficulties came to the forefront, notably its deteriorating public finances, problems with Spain's banks and the impending election in Greece. Equities fell sharply in May, when a simple, co-ordinated resolution to the crisis seemed increasingly less likely. The diverging views held by euro zone governments and institutions, coupled with the slowdown in China, created concerns about a global recession.



Nevertheless, optimism returned to the markets and the S&P 500 Index reached a new peak in September after the European Central Bank vowed to do whatever it takes to preserve the integrity of the euro zone and the U.S. Federal Reserve announced a third program of quantitative easing (QE3), stating that it would continue as long as necessary. The recovery in the U.S. real estate sector as well as the improved employment picture also pushed the markets up. A degree of uncertainty remained about the approaching fiscal cliff. Even so, the markets performed well toward year-end when an agreement seemed imminent.

Despite the turmoil on the markets, most of the equity indexes were up in 2012. That being said, the Canadian market underperformed the other regions, mainly because of its sector composition.

HIGHLIGHTS

Returns on specialized portfolios
For the year ended December 31, 2012

	Net assets[1] $ billion	Weight[2] %	Net investment results[1] $ millions	Return %	Index %
Equity					
Canadian Equity	22.0	12.5	1,279	6.6	7.7
Global Equity	13.8	7.8	1,575	14.0	13.6
U.S. Equity	10.2	5.8	1,075	13.5	13.4
EAFE Equity	9.8	5.6	1,246	15.2	14.7
Emerging Markets Equity	8.7	5.0	1,024	15.8	15.6
Subtotal Equity Markets[3]	**64.5**	**36.7**	**6,646**	**11.9**	**12.0**
Private Equity	17.8	10.1	2,133	13.6	14.1
Total[3 4]	**82.3**	**46.8**	**8,779**	**12.2**	**12.4**

[1]Net assets and net investment results are net of operating expenses.
[2]Percentage of the Caisse's net assets.
[3]The Québec International portfolio was closed out on November 30, 2012. Its contribution is included in these figures.
[4]Possible discrepancies in the totals (dollars or percentages) are due to rounding.

For 2012, the Equity asset class generated $8.8 billion of net investment results and had the highest overall return of the asset classes, at 12.2%, underperforming its benchmark index by 0.2%.

CANADIAN EQUITY

- The Canadian Equity portfolio returned 6.6%, for net investment results of $1.3 billion, underperforming its benchmark index by 1.1%.
  - The underperformance is due exclusively to security selection in the materials sector. The portfolio is positioned to benefit from urbanization in emerging economies. Although it lagged in 2012, this investment theme has a promising long-term outlook.
- For 2012, the Canadian market underperformed the international markets mainly because of:
  - The preponderance of companies in the materials and energy sectors, which generally underperformed.
  - Canadian financial sector securities, which had a strong 17.6% return but significantly underperformed the financials of the other developed countries, which advanced about 30% as they rebounded much more significantly from their sharp declines of recent years.

GLOBAL EQUITY

- The Global Equity portfolio returned 14.0%, for $1.6 billion of net investment results. It outperformed its benchmark index by 0.4%.
  - Its outperformance is due mainly to the security-selection strategies used by the portfolio management team for the various sectors, including energy and healthcare.
  - A new management mandate geared mainly to companies offering a stable, predictable return on invested capital was introduced into the portfolio during the year. This mandate is designed to reduce the portfolio's volatility while maintaining a high return, and it served as the basis for the creation of the Global Quality Equity portfolio as at January 1, 2013.

U.S. EQUITY, EAFE EQUITY AND EMERGING MARKETS EQUITY

- These index-managed portfolios returned 13.5%, 15.2% and 15.8%, respectively, all slightly outperforming their benchmark indexes.
- Of the 45 countries in this investment universe, 42 had a positive performance in 2012.
- In the developed countries, Germany advanced by a solid 28.0%, whereas Spain, which was hit hard by its public-finance problems, returned only 0.7% on the year.
- Five of the six main emerging markets, representing about three-quarters of the investments, had returns ranging from 14.1% to 23.2%. Only Brazil had a negative return (-2.2%), mainly because of the substantial devaluation of its currency.

PRIVATE EQUITY

- This portfolio returned 13.6%, for $2.1 billion of net investment results, and underperformed its benchmark index by 0.5%.
    - Almost half of the increase in the portfolio's value is due to leveraged buyouts. Investments in development capital and distressed debt are the other main contributors to the return.
    - During the year, the portfolio was repositioned, notably through the $1.5-billion transaction in Quebecor Media, which helped reduce the portfolio's concentration risk.

- For this type of less-liquid assets, performance has to be assessed over a longer period. Since the Caisse reorganized its operations in the summer of 2009, this portfolio has had an annualized return of 18.3%, outperforming its benchmark by 6.0%.
    - The return is due mainly to the operational performance, debt reduction and strong earnings of the companies in the portfolio. Moreover, they carried out loan refinancing to take advantage of low rates and review their maturities.