FIXED INCOME

DESCRIPTION

The Fixed Income asset class helps reduce the level of overall portfolio risk and allows for better matching of clients' assets and liabilities. It also constitutes a substantial source of liquidity for la Caisse.

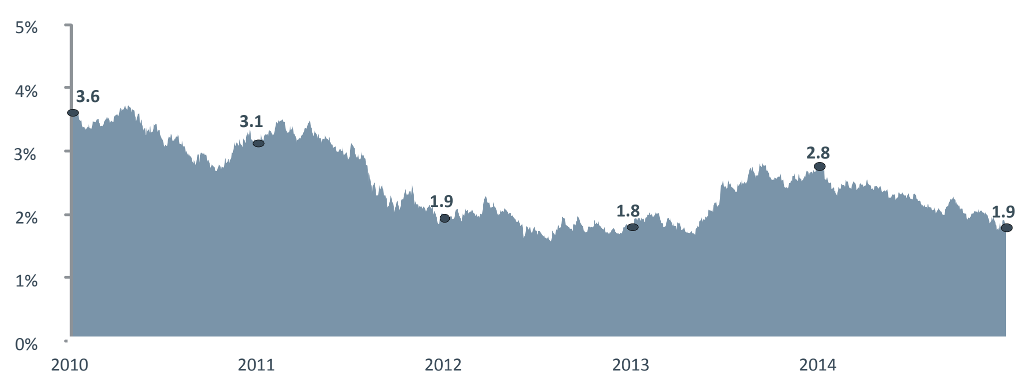
It consists of four portfolios. The Bond and Real Estate Debt portfolios, with net assets totalling $73.3 billion, are managed actively, whereas the Short Term Investment and Long Term Bond portfolios, with net assets totalling $9 billion, are indexed.

MARKET CONTEXT

An unprecedented number of monetary stimulus measures were deployed in the United States between 2011 and 2014. Meanwhile, in Europe, authorities of several countries focused their efforts on austerity measures while the European Central Bank (ECB) chose to inject liquidity into the financial system. The increased liquidity resulting from quantitative easing, as well as concerns about the risk of deflation in the euro zone and lower commodity prices, drove long-term interest rates down to record lows. The likelihood of monetary tightening in the United States continues to be very real, with the end of the Federal Reserve's asset-purchase program and the improving labour market.

After rising in 2013, Government of Canada 10-year bond yields ended 2014 at 1.9%, down close to 1% from the beginning of the year.

Government of Canada 10-year bond yields



HIGHLIGHTS

Specialized portfolio	At Dec. 31, 2014 Net assets ($ billions)	4 years Net investment results ($ millions)	4 years Return (%)	4 years Index (%)	1 year Net investment results ($ millions)	1 year Return (%)	1 year Index (%)
Bonds	62.9	10,385	5.6	5.2	4,626	8.2	8.9
Real Estate Debt	10.4	2,433	7.9	5.1	1,068	11.9	8.8
Short Term Investments	6.8	259	1.1	1.0	59	1.0	0.9
Long Term Bonds	2.2	938	7.9	8.1	342	18.2	18.4
Fixed Income	82.3	14,015	5.6	4.9	6,095	8.4	8.5

The Fixed Income portfolios took advantage of declining interest rates in recent years. Over four years, this asset class generated net investment results of $14 billion and its annualized return was 5.6%, or 0.7% above the benchmark index. In 2014, the Fixed Income asset class returned 8.4%.

BONDS

With net assets of $62.9 billion, this actively managed portfolio represented 27.9% of clients' total net assets at the end of 2014.

Over four years, it posted net investment results of $10.4 billion and an annualized return of 5.6%, outperforming its benchmark index by 0.5%. With the significant decline in bond yields in 2014, the portfolio generated a return of 8.2%.

Lower yields resulted in solid returns for bond indexes over the past four years. Corporate bonds recorded a 5.7% return and provincial bonds generated a 6.3% return while Government of Canada bonds returned 3.9% during the same period. The outperformance by provincial bonds is due mainly to their longer maturity. In corporate bonds, this outperformance is due to their higher current yields and tightening of credit spreads.

In 2014, the Bond portfolio's strategy was maintained to benefit from the economic upturn and the gradual normalization of interest rates over the long term. This strategy has two components:

– An overweight position in provincial bonds, particularly Québec bonds, and bonds issued by public and private companies, to obtain a higher current yield and to capitalize on narrowing credit spreads; and

– A positioning that anticipates potentially higher interest rates in developed countries over the long term.

REAL ESTATE DEBT

This actively managed portfolio consists of senior Canadian commercial mortgage loans on quality real estate assets.

Over four years, the portfolio's net investment results reached $2.4 billion. The annualized return was 7.9%, or 2.8% more than the benchmark index. More than half of this absolute return came from the current yield.

The portfolio's value added during this period came mainly from the current yield and from the narrowing of credit spreads, which were higher than those of the index.

In 2014, the portfolio returned 11.9%. Lower interest rates accounted for almost half of this result.

SHORT TERM INVESTMENTS

This indexed portfolio had an annualized return of 1.1% over four years and 1% in 2014. These results reflect the low level of short-term interest rates in recent years.

LONG TERM BONDS

This indexed portfolio corresponds to a little less than 1% of clients' net assets. Over four years, the portfolio generated an annualized return of 7.9%. The 18.2% return in 2014 was due to lower long-term interest rates.