EQUITY

DESCRIPTION

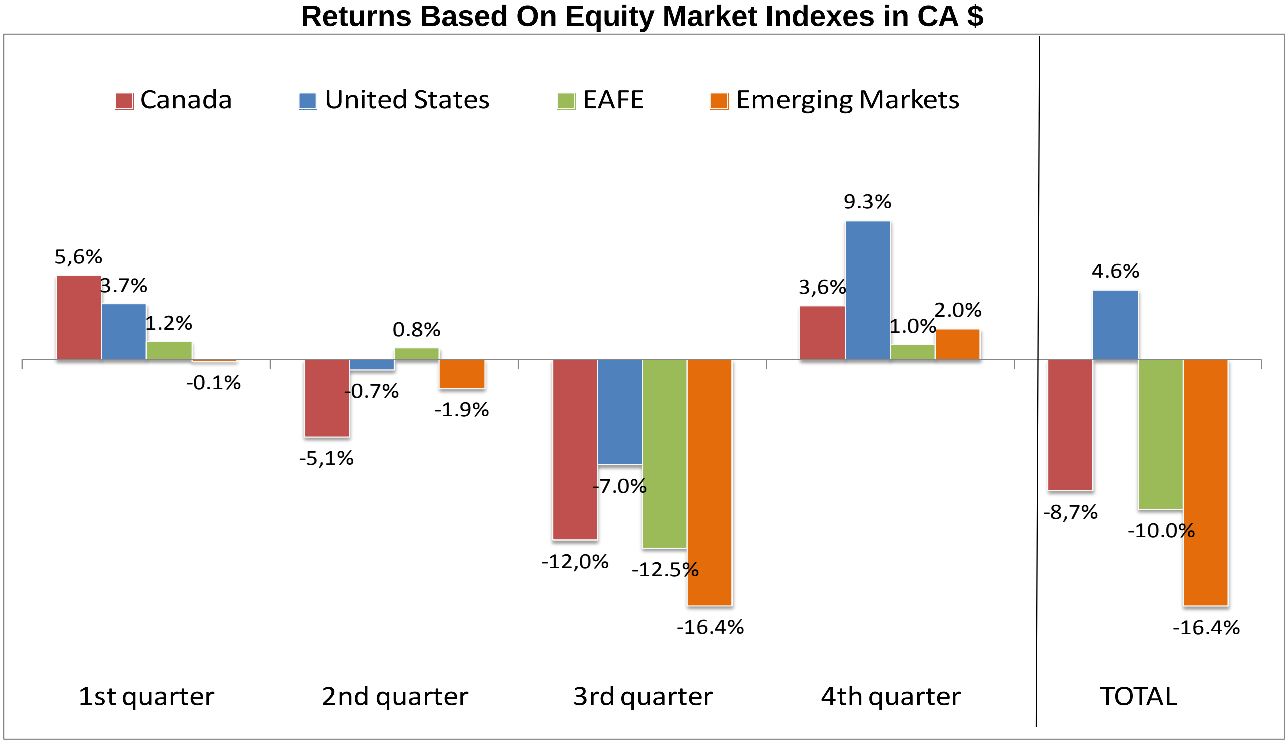
The Equity category consists of seven portfolios: Canadian Equity, Global Equity, Québec International, U.S. Equity, EAFE (Europe, Australasia, Far East) Equity, Emerging Markets Equity and Private Equity.

The Canadian Equity, Global Equity, Québec International and Private Equity portfolios, which have $49.7 billion in net assets, are actively managed. The U.S. Equity, EAFE Equity and Emerging Markets Equity portfolios, which have $23.1 billion in net assets, are index managed.

MARKET CONDITIONS

After a rather promising start to the year, most equity market indexes recorded heavy losses in the third quarter. These losses were especially related to the uncertainty caused by the European sovereign debt problems, the political debate in the U.S. regarding the raising of the debt ceiling, followed by the downgrade of sovereign debt from AAA to AA+, and the threat of an economic slowdown in emerging countries.

Returns Based On Equity Market Indexes in CA $



In total, and in spite of average earnings increases recorded by publicly listed companies, most of the major equity market indexes declined in 2011. The Canadian market (S&P TSX) is down 8.7%, the MSCI EAFE declined by 10.0% while the MSCI EM (emerging markets) is down 16.4%. Among the EAFE markets, European markets were particularly hard hit, with declines of close to 15%. The S&P 500 is the only major equity market index to end the year in positive territory (4.6%).

European markets were especially hard hit by the euro crisis, which created some very serious concerns regarding the health of eurozone banks. Emerging and Canadian markets saw declines as a result of uncertainty regarding global economic growth. The U.S. market resisted these pressures due to its more defensive sector mix and year-end U.S. economic news that reassured investors.

HIGHLIGHTS

Specialized Portfolio Returns
Year ended December 31, 2011

		Weight[1]	Net Investment Results	Return	Index
	$ billions	%	$ millions	%	%
Equity					
Canadian Equity	18.6	11.7	(2,133)	(10.6)	(8.2)
Global Equity	10.9	6.8	(683)	(5.7)	(5.1)
Québec International	4.5	2.9	87	1.6	1.9
U.S. Equity	8.1	5.1	319	4.6	4.6
EAFE Equity	9.1	5.7	(962)	(9.6)	(10.0)
Emerging Markets Equity	5.9	3.7	(1,040)	(16.4)	(16.4)
Subtotal – Equity Markets	**57.1**	**35.9**	**(4,412)**	**(7.2**	**(6.3)**
Private Equity	15.7	9.9	1,113	7.1	7.4
Total	**72.8**	**45.8**	**(3,299)**	**(4.2)**	**(3.4)**

[1] Compared to the Caisse's net assets

The overall return for the Equity category is therefore -4.2%, which is 0.8% less than the benchmark index.

CANADIAN EQUITY

- The Canadian Equity portfolio generated a return of -10.6%, for net investment results of -$2.1 billion. This return is 2.4% below the benchmark index.
- This return is well below the 4.6% return for U.S. equity and confirms that Canadian equity markets are closely tied to emerging markets (return of -16.4%). The sector mix for the Canadian equity market represents a heavy exposure to the financial (29%) and materials (21%) sectors. Fear of a financial crisis and concerns regarding global economic growth, in particular in emerging economies, had an especially hard impact on the returns of companies in these sectors, which also explains the negative return posted by the Canadian market.
- The portfolio return is nonetheless below that of the index, mainly as a result of:
  - Certain long-term portfolio positions relating to urbanization in emerging countries and strong demand for basic materials underperformed in 2011. However, these positions paid off well in the long term and should continue to do so in the future.
  - The portfolio's under-exposure to companies paying high dividends, which resisted pressures very well in 2011 due to the major drop in interest rates.
- In early 2011, the Morningstar National Bank Québec Index, reserved exclusively for Québec companies, was incorporated into the Canadian Equity portfolio benchmark index in order to better represent the reality of the Québec economy in this portfolio. The value of investments in Québec grew by $589 million during the year and has increased by $1.2 billion since the end of 2009. Québec securities account for 21% of the Canadian portfolio at year end, up 4.2% in the past 12 months.

GLOBAL EQUITY

- The Global Equity portfolio generated a return of -5.7%, which is 0.6% below the benchmark index.
- The variance with this index is mainly attributable to positions in the healthcare, industrial products and natural resources sectors.
- In 2011, the management team completed the implementation of its new external management strategy, targeting specialized managers in countries such as China, India or Brazil, or exposure to specific economic sectors.

QUÉBEC INTERNATIONAL

- The Québec International portfolio generated a return of 1.6 %, which is close to the benchmark index.
- This return is better than the return for the Global Equity portfolio, mainly due to the high rate of return for the portfolio's bond component. The absence of emerging countries in the portfolio was also a favourable factor in 2011.

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

- These portfolios, which are index managed, generated returns of between -16.4% and 4.6% during the year, which is in line with their benchmark index.
- Equity markets in emerging countries, Japan and the euro zone had an especially difficult year, with returns of between -12.2% and -16.4%.

PRIVATE EQUITY

- The Private Equity portfolio posted a return of 7.1%, which exceeds the return for equity market indexes but is 0.3% less than the return for the portfolio benchmark index.
- A total of 80% of the portfolio's performance is attributable to leveraged buyout financing activities and, especially, investments in funds.
- There were two phases in the Private Equity market in 2011. The first six months were marked by a high level of activity characterized by many refinancings, mergers and acquisitions and initial public offerings.
- There was a complete turnaround of the situation in the latter half of the year.
    - The financing market had completely dried up.
    - There was a considerable slowdown in activity for mergers and acquisitions and initial public offerings.
    - However, the market conditions favoured development capital transactions since companies sought solid partners to realize and ensure their future growth.
- Holding companies were very active on financial markets, carrying out refinancings while making the most of low rates and reviewing their loan maturities. The management team also took advantage of favourable market conditions to re-position the funds portfolio due to transactions on the secondary market, generating net inflows in excess of $1 billion. These two factors contributed to improving the portfolio quality and therefore reducing risk.
- New portfolio investments totaled $2.5 billion: $1.3 billion in direct investments, including $649 million in Québec and $1.2 billion in funds.