Caisse de dépôt et placement du Québec

Fixed Income

HIGHLIGHTS

FIXED INCOME	5 years	2016
$89.5 B Net assets as at December 31, 2016	3.7% Annualized return	2.9% Return
	$13.7 B Net investment results	$2.3 B Net investment results

5 portfolios

Bonds

Real Estate Debt

Short Term Investments

Long Term Bonds

Real Return Bonds

Advantages

- Reduction of the risk level of la Caisse's overall portfolio
- Matching of clients' assets and liabilities
- Substantial source of liquidity

As at December 31, 2016, the Fixed Income portfolio represented 33% of la Caisse's overall portfolio. It consists of five specialized portfolios:

- Bonds and Real Estate Debt, which are managed actively;
- Short Term Investments, Long Term Bonds and Real Return Bonds, which are indexed.

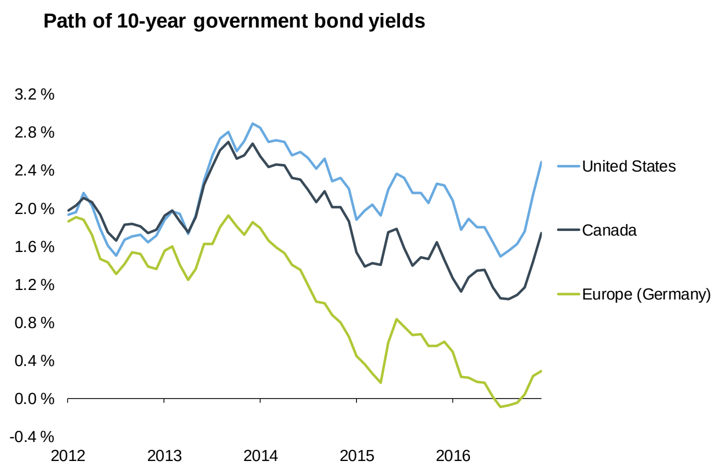
As of January 1, 2017, investments have mainly been grouped together into two specialized portfolios:

- The Rates portfolio, which includes federal and provincial bonds, is intended to manage the risk of the overall portfolio while providing liquidity;
- The Credit portfolio contains corporate debt, real estate debt, government credit, sovereign debt of growth markets and specialty finance. Its goal is to generate returns while diversifying sources of value.

Market context

In the bond markets, the past five years have been characterized by unprecedented monetary easing by major central banks. To support economic activity, they implemented significant quantitative easing programs and lowered their key interest rates to low levels. This caused some bond yields to fall to historical lows, sometimes even below zero.

The downward trend in interest rates seen from late 2013 until recently is mainly due to deflation fears in Europe and Japan, and major asset purchase programs by the European Central Bank (ECB) and the Bank of Japan (BoJ).



The widening gap between U.S. and Canadian interest rates since 2015 is mainly due to the fall in oil prices, which has weakened Canadian growth and led to two reductions in the key interest rate by the Bank of Canada.

In the first half of 2016, concerns about global growth, improved ECB and BoJ programs, the conciliatory tone of the Federal Reserve and monetary easing put in place by the Bank of England following the Brexit vote have accentuated downward pressures on bond yields.

This trend was interrupted in November with the victory of Donald J. Trump in the U.S. presidential election. His promises to boost the economy have brought upward revisions to inflation expectations and the trajectory of the Fed Funds rate. This has contributed to increasing rates in the United States, since, if delivered, fiscal stimulus would arrive at a time when the economy would likely be at full employment. Canadian rates followed the rise in U.S. interest rates, but to a lesser extent.

BONDS

This actively managed portfolio consists of government bonds (Canada, Canadian provinces and other countries) as well as public and private corporations.

$68.1 B

Net assets as at December 31, 2016

5 years		2016
3.9% Annualized return	3.3% Index	3.1% Return

$10.7 B

5-year net investment results

$1.9 billion

2016 net investment results

Five-year return

The portfolio generated net investment results of $10.7 billion over five years. Its annualized return was 3.9%, compared to 3.3% for its benchmark, resulting in $1.6 billion of value added. This performance is attributable mainly to investments in private debt and a strategy aimed at benefiting from a narrowing of credit spreads among provincial securities.

2016 return

Despite the rise in interest rates in the second half of 2016, the Bond portfolio returned 3.1%. It took advantage of continued investment in growth market debt and an overweight position in corporate securities.

REAL ESTATE DEBT

This actively managed portfolio consists of primarily senior Canadian commercial mortgages.

$11.6 B
Net assets as at December 31, 2016

$2.2 B
5-year net investment results

$282 M
2016 net investment results

5 years		2016
4.9% Annualized return	3.2% Index	2.6% Return

Five-year return

Net investment results from the Real Estate Debt portfolio totaled $2.2 billion over five years. At 4.9%, the portfolio's annualized return outperformed its benchmark by 1.7%, providing $759 million of value added. This performance is mainly due to the higher current yield on the portfolio's assets.

2016 return

In 2016, the portfolio returned 2.6%, largely due to the current yield on portfolio assets, net of the impact attributable to the increase in interest rates.

SHORT TERM INVESTMENTS

This indexed portfolio includes highly liquid short-term investments designed to meet la Caisse's liquidity requirements.

$6.2 B
Net assets as at December 31, 2016

$288 M
5-year net investment results

5 years		2016
0.9% Annualized return	0.8% Index	0.5% Return

Returns

Over five years, this portfolio has delivered an annual return of 0.9%, adding $288 million to net assets. In 2016, it generated a 0.5%. return. These results are representative of the low-interest rate environment that has prevailed over the past five years.

LONG TERM BONDS

This indexed portfolio consists primarily of long-term provincial bonds.

	5 years		2016
\$2.6 B Net assets as at December 31, 2016	4.1% Annualized return	4.2% Index	2.1% Return
\$449 M 5-year net investment results			

Returns

With a 4.1% annualized return over five years, the portfolio generated \$449 million of net investment results. In 2016, it returned 2.1%, reflecting the conservative nature of this portfolio and the low-return environment among provincial bonds.

REAL RETURN BONDS

The purpose of this indexed portfolio is to protect la Caisse's overall portfolio against rising inflation rates in Canada. The portfolio is also intended, for those clients who choose to allocate capital to it, to better match their assets with their liabilities, which are sensitive to rising inflation.

	5 years		2016
\$1.1 B Net assets as at December 31, 2016	1.3% Annualized return	1.4% Index	2.8% Return
\$48 M 5-year net investment results			

Returns

The Real Return Bond portfolio provided a 1.3% annualized return over five years and a 2.8% return in 2016.

Investment results table for Fixed Income portfolios

As at December 31, 2016		5 years			2016		
Specialized portfolio	Net assets	Net investment results	Return	Index	Net investment results	Return	Index
	\$M	\$M	%	%	\$M	%	%
Bonds	68,075	10,709	3.9	3.3	1,915	3.1	1.7
Real Estate Debt	11,553	2,237	4.9	3.2	282	2.6	1.7
Short Term Investments	6,157	288	0.9	0.8	27	0.5	0.5
Long Term Bonds	2,640	449	4.1	4.2	33	2.1	2.1
Real Return Bonds	1,087	48	1.3	1.4	30	2.8	2.9
Fixed Income	**89,512**	**13,731**	**3.7**	**3.1**	**2,287**	**2.9**	**1.8**