1970

QUÉBEC DEPOSIT AND INVESTMENT FUND

FIFTH ANNUAL REPORT

Bodies authorized by an act of
the provincial legislature
to deposit moneys with the
Québec Deposit and
Investment Fund

Québec Agricultural Marketing Board
Québec Crop Insurance Board
Québec Deposit Insurance Board
Québec Health Insurance Board
Québec Pension Board

Other bodies availing themselves
of the services of the Québec
Deposit and Investment Fund

Supplemental pension plans established by
collective agreement decrees

Legal Deposit — 1st quarter 1971
Québec National Library

QUÉBEC DEPOSIT AND INVESTMENT FUND

FIFTH ANNUAL REPORT 1970

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General Manager,
Québec Deposit and Investment Fund

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Québec Pension Board

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General Management

Claude Prieur, *General Manager*

Investment

Investment Management

Gérard H. Cloutier, *Assistant General Manager*

Bond Department

Roland Lefebvre, *Associate Manager*
Jean Laflamme, *Assistant Manager*
Pierre Mayer, *Assistant Manager*

Stock Department

Pierre Arbour, *Manager*
Etienne J. de Kosko, *Associate Manager*
Pierre Dufresne, *Assistant Manager*

Private Placement Department

Jean-Michel Paris, *Associate Manager*
Jean C. Lavoie, *Assistant Manager*

Real Estate and Mortgage Department

Patrick O. Wells, *Manager*
Gilles Doré, *Associate Manager*

Treasury Department

Jean-Marie Côté, *Treasurer*
Guy Rhéaume, *Assistant Treasurer*

Secretariat

Marcel Camu, *Assistant Secretary*

Law Department

Paul Martel, *Legal Counsel*

Québec Deposit and Investment Fund

CLAUDE PRIEUR
CHAIRMAN OF THE BOARD
AND GENERAL MANAGER

Québec City, March 8, 1971

The Honourable Raymond Garneau
Minister of Finance
Government of Québec.

Dear Sir:

In accordance with the provisions of the charter of the Québec Deposit and Investment Fund, I am transmitting herewith our fifth annual report for the year ended December 31, 1970.

As required under Section 41 of the charter, this report comprises an outline of investment policy, a summary of our activities and statements of accounts duly verified by the Provincial Auditor, along with related statistical data.

Yours very truly,

Claude Prieur

During the year ended 31st December 1970, the assets of the Québec Deposit and Investment Fund rose by some $335.5 million increasing from $990,383,601 to $1,325,853,644. The income for this fifth year of operation reached $80,975,993 compared with $55,825,222 the previous year and the net return on deposits moved up from 6.631% to 6.997%.

Brief economic review — 1970

The Canadian economy in 1970 was marked by a slowing down of the rate of growth of the main economic indicators, by a slackening of inflationary pressures accompanied by a resurgence of unemployment, and a recovery in financial and security markets.

The Canadian economy underwent a sharp setback in 1970 as a result of fiscal and monetary measures adopted throughout 1969 aimed at controlling inflation. The rate of growth of industrial production, consumer demand and imports all weakened during 1970 while company profits and capital investments declined. The only two factors on the demand side which really remained buoyant were exports and government expenditures for goods and services. With this background the rate of inflation was gradually slowed down but conversely the rate of unemployment rose steadily.

To these internal problems was added a growing demand from abroad for Canadian funds. With pressures building up the Federal Government was forced to act and on 31st May, opted for a floating exchange rate. The subsequent rise in the Canadian dollar was caused primarily by an unusually favourable balance of trade, arising from growing exports with no change in imports, and a continuing flow of capital from abroad.

To solve these internal and external problems which conflicted with a policy of long-term growth, the Canadian fiscal and monetary authorities resorted to a gradual easing of the restrictive measures adopted a year earlier which now at last appear to have achieved their desired effect. In addition, a number of programs were initiated by the Federal Government aimed at easing regional unemployment which still remains a major obstacle to Canadian economic stability. For its part, the Québec Government sought to direct its economic policy towards the creation of employment. These concerted efforts should bear fruit but their full impact remains inevitably dependent on the political, social and economic climate. Furthermore, it is only in the long run that such measures can produce all of the effect desired.

Investment policy

There was no significant change in the investment policy of the Fund during 1970. The investment program formulated at the start of the year provided for the allocation of $330 million to various long-term investments. In this program no account was taken of the $54.2 million of short-term investments held in reserve at the start of the year for the purpose of taking advantage of possible market situations or to meet unforeseen liquidity requirements. As long-term investments made during the year were in excess of cash flow, these reserves were reduced by $25.6 million.

The Fund is well aware of the importance of the financial support it is able to bring to the Québec Government, should conditions in the capital markets become for any reason momentarily difficult. It is for this reason that the Fund usually maintains very substantial liquid and marketable assets which constitute its only effective tool. In fact, as a large part of its cash flow is usually committed in advance, the Fund, if faced with a tight market, could only increase its liquidity by disposing of that relatively small part of its long-term investments which still remained marketable.

Again this year the operations of the Fund have played a vital role both in the primary and secondary markets for Québec and Hydro-Québec bonds. Although it is expedient, at times, for the Fund to be in a position to negotiate private placements for these issues, the fact still remains that there is little or no market for private bond issues; furthermore, in such negotiations there is always a risk of overlooking the forces of supply and demand.

The Fund plays a major role in maintaining a market for Québec issues, a role which it can only play by purchasing and holding an adequate volume of bonds of all public issues. The yield spreads between the issues of the various Provincial Governments fluctuate constantly. In striving to maintain, within reasonable limits and within its own resources, an active market for Québec issues, the Fund can help to minimize the unduly wide technical swings which, from time to time, could result in broad fluctuations in yield spreads between Québec issues and those of other provinces. To the extent that its operations increase trading in the secondary market for Québec bonds the Fund paves the way for new public issues. It is obvious that if the Fund did not follow this practice between public issues of Québec and Hydro-Québec bonds, the interest of some institutional buyers would decline considerably or even disappear altogether when new issues came to the Canadian Market.

At the close of the financial year the Fund's portfolio of bonds issued or guaranteed by the Government of Québec, bonds guaranteed directly or secured by annual subsidy, and municipal and school bonds reached a book value of $838.5 million or 65.7% of the long-term portfolio. This figure is evidence of the tangible support given by the Fund to the market for issues of the public sector in Québec throughout the difficult period of the last five years.

In its program of real estate and mortgage investments, the Fund is primarily interested in new construction. This policy of favouring the construction industry contributes both directly and indirectly to the relief of unemployment. In recent periods of stagnation in the building industry, the Fund was almost alone among the lending institutions with funds available for many types of construction in Québec. At the close of the year, the investments of the Fund related to building construction, including commitments, amounted to more than $110 million. Furthermore, the Fund has under study the financing of large-scale projects totalling some $60 million, the completion of which would be spread over several years.

The long-term portfolio increased by some $355 million during 1970. Although the allocation of these new funds did not involve any radical change in the composition of the portfolio, the distribution of the year's investments was related to the resumption of activity in the financial and security markets which made it possible to conform more closely to the overall long-term investment policy of the Fund.

Investment operations

Bonds

In anticipation of a changing trend in the bond market, the Fund continued its policy of again favouring long-term investment established at the close of preceding financial year. In the belief that the fiscal and monetary authorities would, probably in the shorter term, succeed in checking the inflationary spiral and that an easing of the restrictions on bank credit would follow, the Fund invested substantial amounts at interest rates which in the circumstances could not long remain at their unusually high level. The reluctance of investors to enter the bond market during the first nine months of the year helped the Fund to some extent to achieve its investment program before the decline of the long-term rates began at the close of the year. In the course of this operation the Fund reduced its short-term holdings; the latter amounted only to $28 million at the close of the year at which time forward commitments were $23 million. Thus a net total of $269.7 million was invested long-term during the year bringing the total bond portfolio to $1,004,931,224 while the average yield rose from 7.46% to 7.95%.

Within the framework of its operations the Fund lent considerable support to the borrowing programs of the Québec Government and Hydro-Québec. It participated in the public issues of these two borrowers on the Canadian Market acquiring a total of $77.5 million of bonds.

Furthermore, in March, the Fund negotiated a private deal for $50 million with the Province and in June another private deal of $30 million with Hydro-Québec. These investments in the primary market amounted in all to $157.5 million or 45% of all issues by the Province and Hydro-Québec on the Canadian Market during 1970. If to this are added the net purchases made in the course of trading activities in the secondary market, the portfolio of Government of Québec and Hydro-Québec bonds increased by $178.8 million during the financial year and the net yield on this category of investments was 7.97% at year-end compared with 7.44% the preceding year. The Fund also invested, during the year, $7.1 million in bonds secured by government subsidies, issued by hospitals, universities and CEGEPs.

In the field of municipal and school financing the Fund subscribed an amount slightly in excess of $15 million. The keen competition with which brokers bid for issues during the second half of the year, induced the Fund to consider the relative merits of alternative investment in other sections of the market. The total amount of investment in this category held by the Fund at the close of the year was $98.6 million on which the yield had increased from 8.00% to 8.27% during the period.

During this year, a greater number of new corporate bond issues were offered on the market at attractive rates which permitted the Fund to become more active in this field, in this way contributing to projects which help develop the Québec economy. Some $47.5 million were channelled to this type of investment during 1970 bringing the total of the corporate bond account to $93.1 million at the close of the year, on which the yield had increased from 7.38% to 8.31%.

Depending on its assessment of the market outlook the Fund invests its available funds either in the money market or in easily negotiable bonds. To take advantage of improvements that the Fund anticipated in the bond market, short-term holdings were reduced and holdings in Government of Canada bonds were increased by $26.5 million. For a brief period which coincided with the year-end, holdings in this category stood at $73.3 million. The subsequent reversal of part of these transactions resulted in substantial profits.

Stocks

Following a fairly stable first quarter in 1970, North American stock markets slumped during the second quarter and gradually recovered the lost ground during the rest of the year. In May the Dow Jones hit its lowest level since 1963, i.e. 631.16, which amounted to a drop of 21% from the level at the start of the year and a loss of 37% over eighteen months from the all time high of December 1968.

The market collapse during 1970 was essentially an extension of the trend started at the close of 1968. This decline if viewed as the effect of steps taken to slow down an overheated economy, leaves room for optimism in the near future but the possibility of technical corrections should not be overlooked.

Taking advantage of the depressed market, the Fund substantially increased its holdings of certain stocks. The book value of the stock portfolio increased from $156.6 million to $212.4 million, an increase of 35.6%. The percentage of funds invested in gas, oil, consumer goods, service and heavy industries increased while relatively, holdings in mines, metals, utilities and financial institutions declined. At the close of the financial period, the stock portfolio represented 16.6% of the book value of long-term investments and its indicated dividend return was 3.27% compared with 3.53% at the close of the previous year.

Real Estate and Mortgages

Mortgage interest rates stood at a very high level during the first half of 1970 but declined slightly with a lower demand for funds and an increase in supply together with the improvement in the bond market.

As in the past the Fund directed its mortgage investments almost exclusively to new construction while seeking to give preference to medium priced rental projects. The bulk of mortgage loans granted during the financial year was insured by the Central Mortgage and Housing Corporation.

An analysis of mortgage loan applications shows a disturbing decline in attractiveness of new housing developments. The contributing factors to this situation were the high mortgage interest rates, steadily increasing material and labour costs and an ever growing burden of taxation on real estate. As regards interest rates, the recent market tendency should bring some relief; it is interesting to note that a reduction of 1% in the mortgage rate can have an equivalent effect on the monthly mortgage instalments of a single family dwelling as a drop of 10% in construction costs.

It is difficult to forecast a drop in building costs without a wholesale review of antiquated building codes, the acceptance by the construction trades of more rational work methods and the development and use of new techniques and materials by building contractors. As for the tax load carried by real estate, profitability studies for many projects presented to the Fund reveal in a striking manner the crushing burden of taxation on housing. A change of attitude on the part of the competent authorities regarding the taxation of real estate appears to us to be of the greatest urgency. Radical changes are essential to check the rise in the cost of housing and to prevent investors shying away from the real estate market altogether.

The total value of the real estate and mortgage portfolio doubled during the year, reaching $59.5 million at the close, the earned rate of the portfolio having reached 9.95% compared with 9.10% at the close of 1969. These figures do not take into account construction financed by mortgage bonds.

The year's results

The gross income of the Fund, expressed as a rate of return on average deposits during the year, increased from 6.733% in 1969 to 7.083% in 1970, while the net income reached 6.997% compared with 6.631%

during the previous year. The increase in net income exceeded that of gross income because of a further reduction in the incidence of administrative expenses which dropped from 0.102% to 0.086% during the year.

Due to high yield rates, particularly during the first three quarters of the year, the average yields on the fixed-interest portfolios increased substantially again this year. However, low company dividends caused a drop in the indicated earnings of the stock portfolio. The average return on the aggregate of the long-term investments reached 7.26% at the close of the period compared with 6.84% the previous year.

The market recovery at the close of the year had the effect of increasing considerably the market value of the bond portfolio while the poor performance of the stock market over the year had a slightly unfavourable effect on that of the stock portfolio. The long-term portfolios of the Fund show an increase of some \$61.9 million, the spread between the market value and book value having been reduced from \$124.2 million to \$62.3 million.

The average of demand deposits during the year amounted to \$32,616,849; interest amounting to \$2,061,985 was paid on these deposits at rates which ranged from 7.92% to 4.88% following the decline in short-term rates and the average rate was 6.32% compared with 7.32% the preceding year. On term deposits, the average of which was \$456,139 during the year, interest in the amount of \$31,598 was paid, equivalent to a rate of 6.93%. The average balance of notice deposits was \$1,110,117,367; the distributed income amounted to \$77,896,440, a return of 7.02% compared with 6.61% in 1969. The average rate paid by the Fund on the aggregate of all deposits was 6.997% in 1970, compared with 6.631% the preceding year.

New legislation

A law assented to 10th December 1970 amended the charter of the Fund. The amendments were made at the request of the Fund to clarify certain articles particularly those concerning real estate operations. Another amendment extended the powers of the Fund to accept securities pledged as collateral.

Supplemental pension plans

In the application of an Act respecting supplemental pension plans established by collective agreement decrees, the Fund was, on 14th February 1970, entrusted with a portion of the assets of these supplemental plans to administer them by virtue of articles 18a and 18b of its charter. The remainder of these assets did not come under the control of the Fund until June as a consequence of judicial action over which the Fund had no control.

The existing investments of the supplemental pension plans at the time of the coming into force of the Act are administered in separate portfolios for each plan and are designated by the Fund as the "portfolios under management". The cash assets of the plans at the coming into force of the Act, the revenues and proceeds of sales of assets of the portfolios under management together with other new monies becoming available to the Administrator of the plans, principally through contributions, are deposited on demand with the Fund. From time to time, the amounts so accumulated are used to purchase for each plan units of participation in the segregated portfolios of the Fund. These portfolios, four in all, constitute pooled funds to acquire stocks, bonds, mortgages and real estate within the meaning of the regulation made under the supplemental pension plans Act.

The distribution of investments of each supplemental plan in these four portfolios is made according to the general investment policy directives of the Administrator of the plans as notified to the Fund pursuant to the agreement entered into between the Administrator and the Fund which agreement has received the approval of the Lieutenant-Governor in Council.

The book value of the portfolios under management was $50,952,887 at 31st December 1970. The book value of the segregated portfolios amounted to $8,642,975 of which $3,030,292 were for bonds, $2,503,510 for stocks, $2,778,798 for mortgages and $330,375 for real estate. The demand and term deposits of the supplemental plans at the same date stood at $2,248,099 the bulk of which was earmarked for the purchase of units of participation in the segregated portfolios on the first day of business of the following financial period.

The board of directors

During the year, Judge Gill Fortier succeeded Mr. Robert De Coster as President of the Québec Pension Board and holds, ex-officio, the post of Vice-Chairman of the Board of the Québec Deposit and Investment Fund.

The Board of Directors expresses its thanks to Mr. De Coster for his effective participation in the deliberations of the Board and the invaluable assistance he brought to the Management of the Fund since its inception.

Staff

At the close of the year the Fund had a staff of 66 employees. The Board recognizes that these highly satisfactory results could not have been achieved without the complete co-operation of the officers and staff and extends to them its deep appreciation and gratitude.

On behalf of the Board of Directors,

Claude Prieur

Chairman.

Québec City, March 8, 1971.

FINANCIAL STATEMENTS

Québec Deposit and Investment Fund

BALANCE SHEET
As at December 31, 1970

ASSETS

	1970	1969
Portfolio (book value)		
Bonds	$1 004 931 224	*$735 250 469*
Preferred shares	8 717 045	*6 004 185*
Common shares	203 703 980	*150 631 320*
Mortgages	44 737 522	*25 499 045*
Real estate	14 814 092	*4 411 761*
Short-term investments	28 646 778	*54 220 472*
	$1 305 550 641	*$976 017 252*
Current assets		
Cash on hand and in bank	$ 81 717	*$ 52 271*
Accrued interest	19 499 750	*14 086 011*
Dividends receivable	127 699	*7 575*
Accounts receivable	372 474	*1 220*
	$ 20 081 640	*$ 14 147 077*
Other assets		
Fixed assets (less depreciation)	$ 204 557	*$ 217 027*
Guarantee deposits and prepaid expenses	16 806	*2 245*
	$ 221 363	*$ 219 272*
	$1 325 853 644	*$990 383 601*

(Note) Book value: Short-term investments, shares and land are taken at cost while other investments are taken at amortized cost.

On behalf of the Board of Directors
Claude Prieur Gill Fortier

LIABILITIES

	1970	1969
Current liabilities		
Accounts payable	$ 353 212	*$ 66 969*
Commitment guarantees	72 230	*99 971*
Accrued interest on demand deposits	276 881	*410 516*
Interest payable on notice deposits	22 486 872	*15 785 490*
	$ 23 189 195	*$ 16 362 946*
Demand deposits	$ 50 019 165	*$ 43 354 405*
Notice deposits		
Depositor's account	$1 245 224 399	*$924 712 714*
Profit on sale of investments	7 420 885	*5 953 536*
	$1 252 645 284	*$930 666 250*
	$1 325 853 644	*$990 383 601*

AUDITOR'S REPORT

In accordance with Section 43 of the Québec Deposit and Investment Fund's act, I have examined the balance sheet of the Fund as at December 31, 1970 and the related statement of income and expenditure for the year ended on that date. My examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as I considered necessary.

In my opinion, the investments and the operations of the Fund were made in accordance with the act; the accompanying balance sheet and statement of income and expenditure present fairly the financial position of the Québec Deposit and Investment Fund as at December 31, 1970 and the results of its operations for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Gustave-E. Tremblay, c.a.,
Provincial Auditor.

Québec City, March 8, 1971.

STATEMENT OF INCOME AND EXPENDITURE

for the year ended December 31, 1970

	1970	1969
Income		
Interest on bonds	$ 67 447 647	*$ 45 255 337*
Dividends	6 288 839	*4 410 257*
Interest on mortgages	3 151 192	*1 270 749*
Real estate revenue	697 407	*180 842*
Net interest on short-term investments	3 353 834	*4 666 375*
Sundry	37 074	*41 662*
	$ 80 975 993	*$ 55 825 222*
Expenditure		
Directors' fees and expenses	$ 7 999	*$ 6 941*
Salaries	630 170	*536 857*
Travelling expenses	42 955	*30 760*
Legal and professional fees	18 399	*8 872*
Rent	103 205	*98 749*
Bank charges	47 983	*30 951*
Office equipment rental	21 718	*21 263*
Electricity, telephone and insurance	29 620	*24 051*
Financial publications and services	11 306	*11 138*
Stationery and printing	22 626	*19 879*
Depreciation	40 513	*34 820*
Other expenses	27 476	*23 495*
Less: reimbursement*	(18 000)	—
	$ 985 970	*$ 847 776*
Net operating income	$ 79 990 023	*$ 54 977 446*
Less: Interest on demand and term deposits	2 093 583	*2 101 208*
Net income	$ 77 896 440	*$ 52 876 238*

**Reimbursement of some administrative direct costs from supplemental pension plans.*

Distribution of net operating income and amounts allocated during the year

	Interest on		
	Demand and Term Deposits	Notice Deposits	Total
Balance of interest payable for previous year	$ 410 516	$ 15 785 490	$ 16 196 006
Add: Net operating income for the year	2 093 583	77 896 440	79 990 023
	$ 2 504 099	$ 93 681 930	$ 96 186 029
Less: Interest paid during 1970	2 227 218	71 195 058	73 422 276
Balance of interest payable on January 1, 1971	$ 276 881	$ 22 486 872	$ 22 763 753

Deposit accounts — summary of transactions

	Demand and Term Deposits	Notice Deposits	Total
Balance at beginning of year	$ 43 354 405	$ 924 712 714	$ 968 067 119
1970: Deposits	253 754 169	—	253 754 169
Transfers	(249 316 627)	249 316 627	—
Interest paid	2 227 218	71 195 058	73 422 276
Balance at end of year	$ 50 019 165	$1 245 224 399	$1 295 243 564

STATISTICAL INFORMATION

Yield on deposits

	Amount	Yield equivalence on average deposits*
Gross Income	$ 80 975 993	7.083%
Expenditures	985 970	0.086%
Net Operating Income	$ 79 990 023	6.997%

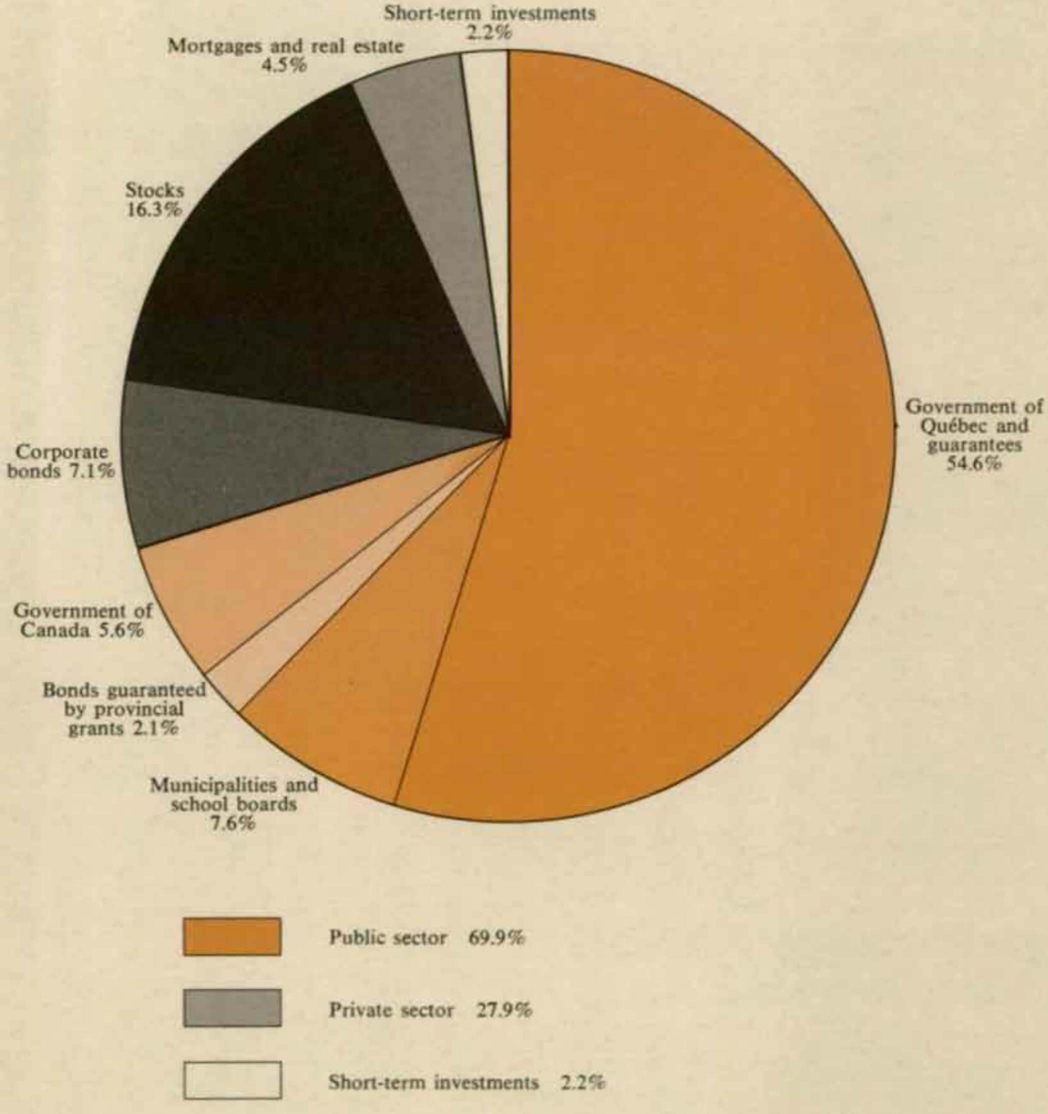
*Average balance of deposits amounted to $1 143 190 355 in 1970.

Average interest rate paid on deposits

	Average Deposits	Interest paid or due	Average yield
Demand Deposits	$ 32 616 849	$ 2 061 985	6.321%
Term Deposits	456 139	31 598	6.927%
Notice Deposits	1 110 117 367	77 896 440	7.016%
Total	$1 143 190 355	$ 79 990 023	6.997%

PORTFOLIO DISTRIBUTION

AS AT DECEMBER 31, 1970



Portfolio summary as at December 31, 1970

% Book Value		Nominal Value	Book Value
77.0%	Bonds		
	Government of Canada	$ 76 195 000	$ 73 317 262
	Government of Québec and Guarantees	738 301 000	711 740 582
	Guaranteed by Provincial Grants	29 110 000	28 095 528
	Municipal and School	104 931 000	98 643 806
	Corporate	94 451 500	93 134 046
		$1 042 988 500	$1 004 931 224
16.3%	Stock		
	Public Utilities		$ 42 162 403
	Banks and Financial		37 334 411
	Consumer Goods and Services		34 169 625
	Heavy and Secondary Industries		40 131 600
	Oil and Gas		24 637 689
	Mines and Metals		21 240 705
	Forest Products		12 744 592
			$ 212 421 025
3.4%	Mortgages		$ 44 737 522
1.1%	Real Estate		14 814 092
			$ 59 551 614
2.2%	Short-Term Investments		$ 28 646 778
100.0%	Total Portfolio		$1 305 550 641

1) Weighted average of yields as at December 31, 1970.

2) The deficiency of market under book value, in the amount of $53 699 998, does not take into account a net cumulative deficit of $1 334 728 on sale of bonds.

3) The deficiency of market under book value, in the amount of $8 571 713, does not take into account a net cumulative profit of $8 755 613 on sale of such securities.

Percentage	Yield[1]	Market Value
7.3%	6.76%	$ 72 632 019
70.8%	7.97%	670 044 714
2.8%	8.56%	27 269 760
9.8%	8.27%	91 430 113
9.3%	8.31%	89 854 620
100.0%	7.95%	$ 951 231 226[2]
19.8%	3.31%	$ 43 419 417
17.6%	4.60%	41 329 100
16.1%	2.57%	27 918 932
18.9%	4.10%	34 181 831
11.6%	1.32%	27 045 856
10.0%	4.03%	19 921 439
6.0%	3.59%	10 032 737
100.0%	3.27%	$ 203 849 312[3]
75.1%	9.74%	$ 44 737 522
24.9%	11.06%	14 814 092
100.0%	9.95%	59 551 614
	8.02%	$ 28 646 778
		$1 243 278 930