Quebec Deposit and Investment Fund

FIRST ANNUAL REPORT

1966

BOARD OF DIRECTORS

CLAUDE PRIEUR, *Chairman*	General Manager, Quebec Deposit and Investment Fund
ROBERT DE COSTER, *Vice-Chairman*	President, Quebec Pension Board
A. HAMILTON BOLTON	President, Bolton, Tremblay & Company
MARCEL CAZAVAN *	Deputy Minister of Finance, Government of Quebec
RAYMOND LAVOIE	Associate General Manager, Crédit Foncier Franco-Canadien
E. A. LEMIEUX *	General Manager, Finance and Accounting, Hydro-Quebec
ROLAND PARENTEAU	General Director, Quebec Economic Advisory Council
JACQUES PARIZEAU	Economic and Financial Advisor to the Cabinet, Government of Quebec
MARCEL PEPIN	National President, Confederation of National Trade Unions
MAURICE TURGEON *	Vice-President, Quebec Municipal Commission

* *Associate member*

MANAGEMENT

General Manager,	CLAUDE PRIEUR
Investment Department,	PIERRE ARBOUR
	JEAN-MICHEL PARIS
Accounting Department,	JEAN-M. CÔTÉ, C.A.
Secretariat,	GÉRARD J. BLONDEAU
Law Department,	SERGE BOURQUE

Quebec Deposit and Investment Fund

CLAUDE PRIEUR
CHAIRMAN OF THE BOARD
AND GENERAL MANAGER

Quebec City, March 13, 1967.

The Honourable Paul Dozois,
Minister of Finance,
Government of Quebec.

Dear Sir:

In accordance with the provisions of the charter of the Quebec Deposit and Investment Fund, 13-14 Elizabeth II, ch. 23, I am transmitting herewith our first annual report for the year ended December 31, 1966.

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 the required related statistical data.

Yours very truly,

Claude Prieur

REPORT OF MANAGEMENT

The Board of Directors and the General Manager of the Quebec Deposit and Investment Fund took office on January 20, 1966. A first deposit by the Quebec Pension Board, on February 16, officially marked the beginning of operations.

A corporation within the meaning of the Civil Code and an agent of the Crown in right of the Province, the Quebec Deposit and Investment Fund was created by a provincial law sanctioned July 15, 1965. It was the advent of the Quebec Pension Plan which made possible the creation of the Fund or as it is more commonly known, the "Caisse". Although the law states that the Fund shall "receive on deposit all moneys whereof such deposit is provided for by law", the initial purpose was to receive the deposits of the Quebec Pension Board.

The Board of Directors of the Fund is comprised of seven members and three associate members. The members are the General Manager of the Fund and the President of the Quebec Pension Board, respectively the Chairman and Vice-Chairman, two senior civil servants, one representative of labour and two representatives of the financial community. The associate members are the Deputy Minister of Finance, the General Manager-Finance and Accounting of Hydro-Quebec and the Vice-President of the Quebec Municipal Commission.

During this first year, much effort was devoted to the planning of the organization, the recruiting of personnel, the establishment of offices, and the development of operating procedures. The Board, which held eighteen meetings during the course of the year, established investment policy and formulated the regulations (including the by-laws) of the Fund. This first year of the Fund was therefore one of intensive organization.

The heavy administrative burden, inherent in the launching of the Fund, did not in any way hinder its early investment operations. Doubtless, the first operations were somewhat restricted in nature but very quickly these expanded and the Fund became an important factor both in the money market and the bond market.

INVESTMENT POLICY

The first task to which the Board of Directors had to address itself, was the formulation of an investment policy. The rational process of investing funds requires a general investment policy and a specific investment programme, the latter being complementary to the former.

The development of this general investment policy was the result of considerations of the very nature of the Fund and the needs of the depositors. It is fundamental that the Fund has no assets in its own right and that its main function is to administer assets belonging to others. With this concept in mind, it is evident that the needs and objectives of the depositors must be the prime consideration in the determination of a general investment policy. The Quebec Pension Board being to date the only depositor and likely to remain the largest in the future, it follows that for all practical purposes the needs and objectives of this Board are those which the Fund will have to meet. For this reason, two major considerations guided the Board of Directors: first, the necessity of ensuring the protection of the capital and secondly the long term aspect of the deposits. These are the bases for the general investment policy which is to administer deposits as a trustee in a long term investment programme.

One discovers, while probing the very origins of the Fund, the manifest intention on the part of the legislators to create an institution to which a role would be given in the financing of the economic development of Quebec. This objective is much in evidence in the specific investment programme. It is, in fact, at the level of the individual investment that one appreciates the working of what can be called the ancillary objective of the Fund.

The influence of this objective is evident in some of the Fund's current practices. Thus, when choosing between two investments of equal quality and price, preference will be given to that which seems more likely to favor the economic development of the Province even if it should entail some relative reduction in the diversification of the portfolio. At fair market prices, the Fund participates in every long term new issue of municipal and school bonds in the Province. Finally, by an active policy of market operations, the Fund attempts, not to maintain "the" market but "a" market for all current bond issues of the Province and Hydro-Quebec.

MARKET OPERATIONS

During the first year of operation, the adoption of an investment policy founded on the general principles outlined above has resulted in the acquisition of a portfolio composed primarily of long term bonds. Of the many factors which led to the acquisition of such a portfolio a major one was the market outlook which prevailed for most of the period under review. Faced with a bearish stock market and a relatively attractive bond market, the Fund directed its attention entirely to the latter.

When it became evident last June that the bond market was moving towards higher interest rates, the Fund allowed its short term investments to rise — and this policy was pursued until the end of the third quarter. It must be recognized that it is impossible for a large institution to remain entirely out of the market for more than a relatively brief period. Pressed by a constant increase in short term holdings, as a result of a substantial cash flow, such an institution must continue to invest in the long term high grade bond market although at a reduced pace. It was, therefore, as a result of this policy that beginning in mid-September, when interest rates were approaching their highest levels, the Fund was in a position to invest a considerable sum of money at exceptionnally favorable rates of interest. The magnitude of this market operation is illustrated by a purchase, on September 19, of \$25 million of a new Quebec issue on a 6.75% yield basis. These transactions considerably reduced short term holdings so that by the close of the year the Fund held but \$27.6 million in short term notes while commitments totalling \$23 million could be anticipated in the course of the first weeks of the new year.

THE PORTFOLIO

At year end, the bond portfolio of the Fund amounted to \$159.9 million with a yield of 6.44% on the average.

It is obvious, of course, that the relatively large holdings of Quebec bonds in the Fund's portfolio can be traced in large measure to the effects of tight credit on the borrowings of governments. This concentration of investments, the result of an active participation in both the new issue market and the secondary market for Quebec Government and Hydro-Quebec bonds was the result of a particular set of circumstances. Government bonds usually satisfy two of the three requirements of the Fund's current investment policy, that is to say, they are of relatively high quality and are of long term, well protected against early call. As for the rate of interest usually associated with such bonds, it is often at a level too low to justify the investment of more than a small fraction of a portfolio. If, in the portfolio of the Fund, this fraction appears large it is because the high rates prevailing in the market for most of the year rendered possible the acquisition of a substantial amount of such bonds at very attractive yields. At year end, the Fund held an amount of $119.3 million of Quebec Government and Hydro-Quebec bonds and the average yield on this category of investments was 6.44%, the same as for the overall bond portfolio. Without doubt, in participating as actively as it did in the market for Quebec Government and Hydro-Quebec bonds, the Fund was able to demonstrate tangibly its solidarity with the Province, all the while serving its own immediate interests.

Municipal and school bonds represent the second largest category in the portfolio. In conformity with its stated investment policy, the Fund concentrated its purchases in longer term issues. One of the features of this market is the wide diversity of rates and therefore prices that investors demand for loans to different municipalities and school commissions. Daily, the Fund has had to evaluate offers of such bonds, and therefore has developed a rational and uniform method of evaluating relative credits. The charter of the Fund effectively prevents the direct purchase of bonds from a borrowing municipality or school commission. These bonds are generally sold by tender to investment houses and because of keen competition, the borrowers usually obtain the best possible price in the market. On the other hand, overly keen competition occasionally results in an investment house, accidentally or otherwise, paying a price which makes resale in the institutional market either very difficult or impossible without losses. The Fund must therefore be very objective in evaluating the many offers made to it, and the protection of its own interests requires it at times to purchase only a token amount or even refuse outright to participate in a new issue. Although the Fund would gladly have purchased more of these issues, a number of municipalities and school commissions, because of market conditions, postponed borrowings or in some instances managed to obtain short or medium term money. Nevertheless, by the year end, the Fund held a total of $16.6 million of bonds issued by 63 municipalities and school commissions. The average term of these holdings was slightly in excess of 17 years and the yield on that portion of the portfolio was 6.91%.

Although the Fund is not subject to wide fluctuations in its cash flow, it remains nevertheless essential, for efficiency in operations, to preserve a minimum degree of liquidity and therefore of flexibility. At first sight, it would appear that holdings of short term investments could be a satisfactory cushion to assure liquidity. This is not entirely the case, because not only are these short term investments subject to some fluctuation, a number of them already cover existing forward commitments. Holdings of different issues of Canadian Government bonds provide a secondary cushion of liquidity and negotiability. Such bonds also offer some very real advantages in that they are frequently an instrument of exchange at the time new issues come to the market. It must be remembered that often these are the only securities which may be dealt with in size to take advantage of short term movements in the market. These transactions can result in real and immediate profits. At the year end, the Fund held $12.5 million of Canadian Government bonds. This amount cannot be taken as a typical or average holding of the Fund, because the position has varied widely during the year to meet the needs of the moment.

The amount of $345,000 invested in corporate bonds indicates the late involvement of the Fund in this particular market. It should be noted that, as of the year end, the Fund had made commitments totalling $2,750,000 in this category. It was, in fact, only in the last months of the year that the Fund became active in this market. This type of investment is bound to play a constantly increasing role in the activities of the Fund both in the public market and in privately negotiated issues.

During its second year of operations, the Fund will pursue a policy of diversification of the portfolio and will initiate a programme to acquire common stocks. Furthermore, 1967 could see the beginning of operations in the field of mortgage lending.

During the year, trading operations were carried out with a view to improving the yield on the portfolio. Some of these transactions resulted in book losses but the securities sold were at all times replaced by more advantageous investments. The net loss of $145,436 appearing on the balance sheet has been carried forward as this amount will be subject to fluctuations in the periods ahead.

DEPOSITS

The deposits received in 1966 amounted to $178.5 million and were all in the category of notice deposits. The first deposit having been received in mid-February, the operations of the Fund for 1966 cover a period of slightly more than ten months. Unlike demand deposits which are a debt of the Fund, notice deposits are in the nature of a participation in profits. While the interest payable on demand deposits is determined daily, the interest payable on notice deposits corresponds to the net revenue of our operations. The amount of $4,916,788 earned on notice deposits represents a return of 5.99% on the average of these deposits in 1966. This return on deposits, which exceeds the 5% rate used in the actuarial studies for the Quebec Pension Plan, was made possible in large measure by the exceptional market conditions which prevailed during 1966.

THE STAFF

Although the buying and selling of securities is the more obvious activity of the complex investment process, it is in fact, but the end result of the total investment operation. The many facets of the investment process require a personnel that is highly qualified in many disciplines such as economics, accounting, finance, statistics, etc. The importance of the competence of the specialists employed cannot be overestimated and the Fund has undertaken to endow itself with a staff competent in all phases of investments. The Fund had 23 employees at year end, including six officers. It is expected that, by next year end, staff will have nearly doubled.

The Board of Directors acknowledges with gratitude the contribution of an enthusiastic and dedicated staff whose initiative was of particular value to the rapidly growing institution which is the Fund.

ON BEHALF OF THE BOARD OF DIRECTORS,

Claude Prieur

Chairman.

Quebec City, March 13, 1967.

QUEBEC DEPOSIT AND INVESTMENT FUND

ASSETS AND LIABILITIES

as at December 31, 1966

ASSETS

PORTFOLIO		
Bonds - (amortized cost)	$153,253,884	
Short term investments	27,583,250	$180,837,134
CURRENT ASSETS		
Cash on hand and bank deposits	$ 8,691	
Accrued interest	2,329,675	
Accounts receivable	2,932	$ 2,341,298
FIXED ASSETS		
Rented Space Improvements	$ 74,386	
Office furnitures and equipment	46,068	
Deposit of guarantee	2,000	$ 122,454
		$183,300,886

LIABILITIES

CURRENT LIABILITIES		
Interest payable on notice deposits	$ 4,916,788	
Accounts payable	14,534	$ 4,931,322
NOTICE DEPOSITS	$178,515,000	
Profit (loss) on sale of investments	(145,436)	$178,369,564
		$183,300,886

QUEBEC DEPOSIT AND INVESTMENT FUND

STATEMENT OF INCOME AND EXPENDITURE

From January 20 (beginning of operations) to December 31, 1966

INCOME		
Interest on Bonds		$4,064,734
Interest on short term investments		1,039,481
Sundry		2,931
		$5,107,146
EXPENDITURE		
Directors' fees and expenses	$ 7,626	
Salaries	116,685	
Travel expenses	2,896	
Bank charges	10,366	
Legal and consultation fees	18,122	
Rent	17,083	
Stationery and printing	5,239	
All other operating expenses	12,341	$ 190,358
NET INCOME		$4,916,788

NET INCOME DISTRIBUTION

Net income of the year		$4,916,788
Interest on demand and/or term deposits (*Note 1*)	—	
Interest on notice deposits (*Note 2*)	$4,916,788	$4,916,788

Note 1: No demand and/or term deposit was received in 1966.

 Note 2: To be credited to the sole depositor: the Quebec Pension Board.

BUREAU DE L'AUDITION

HÔTEL DU GOUVERNEMENT

QUÉBEC

AUDITOR'S REPORT

In accordance with section 43, 13-14 Elizabeth II, chapter 23, I have examined the balance sheet of the Quebec Deposit and Investment Fund as at December 31, 1966 and the statement of income and expenditure for the period 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 the circumstances.

In my opinion, the operations of the Fund during the year have been carried out in conformity with the law, and the accompanying balance sheet and statement of income and expenditure present fairly the financial position of the Quebec Deposit and Investment Fund as at December 31, 1966 and the results of its operations for the period ended on that date, in accordance with generally accepted accounting principles.

Gustave-E. Tremblay, C.A.,
Provincial Auditor.

Quebec City, March 3, 1967

STATISTICAL INFORMATION

YIELD ON DEPOSITS

	Amounts	Yield equivalence on average deposits (1)
Gross Income	$5,107,146	6.22%
Expenses	190,358	0.23%
Net Income	$4,916,788	5.99%

(1) Average deposits were $82,128,534 (365 days basis).

AVERAGE INTEREST RATE PAID ON DEPOSITS

	Average Deposits	Interests Paid	Average Rate
Demand Deposits	—	—	—
Term Deposits	—	—	—
Notice Deposits	$82,128,534	$4,916,788	5.99%

BOND PORTOFOLIO SUMMARY, as at December 31, 1966

	Face Value Amount	%	Book Value	Market Value (1)	Yield (2)
BONDS					
Government of Canada	$ 12,475,000	7.8%	$ 11,912,000	$ 12,042,749	5.812%
Government of Quebec and Guarantees	123,520,000	77.3%	119,188,750	115,664,221	6.436%
Guaranteed by Provincial Grants	4,410,000	2.8%	4,316,126	4,278,762	6.803%
Municipal and School	16,630,500	10.4%	15,060,495	14,062,465	6.907%
Corporate	345,000	0.2%	344,525	340,775	7.153%
Others	2,500,000	1.5%	2,431,988	2,309,125	5.924%
	$159,880,500	100%	$153,253,884	$148,698,097	6.438%

(1) *Where no active market exists, bonds are valued on a yield basis.*
(2) *Weighted average of yields as at December 31, 1966.*