1968

QUEBEC DEPOSIT AND INVESTMENT FUND

THIRD ANNUAL REPORT

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

Quebec Agricultural Marketing Board

Quebec Crop Insurance Board

Quebec Deposit Insurance Board

Quebec Pension Board

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Claude Prieur, *Chairman*
General Manager,
Quebec Deposit and Investment Fund

Robert De Coster, *Vice-Chairman*
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Quebec Pension Board

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Montreal Stock Exchange and
Canadian Stock Exchange

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General Director,
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Vice-President,
Quebec Municipal Commission

**Associate member*

Management

General Manager
Claude Prieur

Investment Department

Bonds
Gérard H. Cloutier
Jean-Michel Paris
Jean C. Lavoie

Stocks
Pierre Arbour
Etienne de Kosko, C.F.A.

Real Estate and Mortgages
Patrick O. Wells

Treasury Department
Jean-Marie Côté, C.A.

Secretariat
Gérard J. Blondeau

Law Department
Paul Martel, LL.L.

Quebec Deposit and Investment Fund

CLAUDE PRIEUR
CHAIRMAN OF THE BOARD
AND GENERAL MANAGER

Quebec City, March 14, 1969.

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, I am transmitting herewith our third annual report for the year ended December 31, 1968.

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

Report of management

During the year ended on 31st December 1968, the assets of the Quebec Deposit and Investment Fund increased from \$418,565,282 to \$683,932,828 and the income for this third year of operation reached \$35,306,683 compared with \$18,733,899 for the preceding year.

Brief financial review of 1968

The investment activities of the Fund were carried on during the year in a tense economic climate and under unsettled market conditions. A summary of the major events of the year will provide a background against which these operations may be assessed.

Much of the uncertainty which clouded the economic outlook at the close of 1967 persisted during 1968 and is still with us. Nevertheless, the rate of growth of the Canadian economy was greater in 1968 than during the previous year and the economy marked a seventh year of uninterrupted expansion. The growth since 1967 was aided markedly by expansionary fiscal and monetary policies in Canada and the United States. These policies intensified the inflationary tendencies present in our economy since 1965. In Canada, the economic expansion did not prevent a rise in unemployment. At the close of the year investors became acutely concerned with the effects of inflation on the bond market.

During the first five months of 1968, the Canadian financial markets were under almost continuous pressure. The rise in interest rates recorded in that period was, to a considerable extent, the result of speculation in the Canadian dollar in the wake of the gold crisis. Canadian monetary authorities took corrective measures and, on the 8th of March, arranged international credits to the extent of \$900 million and obtained exemption for Canada from certain United States controls of its foreign investments. These measures sparked a renewal of confidence in the Canadian dollar and led to an improvement in the bond market. The Stockholm meeting on March 29th, the announcement by President Johnson on the 31st of March of the cessation of bombing of North Vietnam and the adoption by the U.S. Senate on April 2nd of the 10% surtax, tied to a $6 billion budget reduction, brought about a rally in both the stock and the bond markets. Long-term bonds gained approximately 4 points in three days, a rise which proved to be short-lived, while stock prices began a rise which pushed the Dow Jones index from 825 to 925 over the following nine months. The ground gained in April by the North American bond market was lost, however, in the following months due to delays in the adoption of the American fiscal program and the fading hopes for a negotiated settlement in Vietnam. Nevertheless, the approval of the U.S. fiscal program by Congress on June 20th sparked a rise in the bond markets which reached a peak at the end of August.

From the beginning of September, the bond markets started to deteriorate as a result of renewed concern over inflationary tendencies. Towards the end of the month the news of an unexpected Canadian budget deficit and the necessity for adopting expansionary measures to deal with it, removed any hope of preventing a further decline. Furthermore, the budget finally tabled by the Federal Government not only showed a deficit well in excess of that forecast but also proposed basic changes in the tax status of life insurance companies, prompting them to withdraw from the long-term bond market. In spite of subsequent measures to restrict credit, the long-term bond market continued to deteriorate until the end of the year when the yield on long-term Government of Canada bonds touched 7.27%, a level never before reached in this century.

Investment policy

The Quebec Deposit and Investment Fund is a corporation charged with the management of funds deposited by various provincial public bodies. The most important among these is the Quebec Pension Board to which the citizens of the Province are called upon to entrust part of their savings to provide for their retirement. The sums thus entrusted to the Fund will eventually be returned to the depositors; an actuarial analysis establishes that in approximately 15 years the benefits then payable by the Quebec Pension Board will exceed the annual contributions received. It follows, therefore, that the investment policy of the Fund must give primary consideration to the security and growth of capital.

Without compromising the foregoing principles, the Fund must also use its best endeavors to promote the economic development of Quebec. However, it is incumbent on the Fund to avoid granting any form of preferential terms and conditions in its investments and to refrain from assuming unwarranted entrepreneurial risks. Any financially sound project measuring up to the requirements of the market, with or without government assistance, must and will receive the full support of the Fund within its available resources. With the further economic development of Quebec, the Fund anticipates that it will have more such investment opportunities.

Bonds — Because of the long-term nature of its liabilities, the Fund has pursued a policy of investing in the long-term bond market. However, in view of the state of the market, the Fund saw fit, from the beginning of the year, to increase its short-term holdings substantially. This proved to be a judicious move which greatly assisted in subsequent operations. These holdings of short-term investments, coupled with a very substantial cash flow, enabled the Fund to play a still greater part in the market for Quebec and Hydro-Quebec bonds.

The issuing of new long-term municipal and school bonds, difficult as it proved to be during the first three quarters, became even more difficult towards the end of the year. The

Fund stepped up its purchases of these issues to help strengthen the demand. In point of fact, without the intervention of the Fund certain issues could not have been marketed at all.

It is in the sector of corporate financing that the Fund realizes it can make the most direct contribution towards the economic development of Quebec. It must appraise the contribution that these enterprises bring to the economic life of Quebec regardless of their place of incorporation. The Fund was a buyer of almost every public issue offered to it of companies active in Quebec. Purchases were limited by the scarcity of new issues, many borrowers deferring their long-term financing due to abnormally high interest rates. In a few instances the Fund acquired bonds of other Canadian corporations to realize short-term profits or to secure conversion rights or warrants.

Real estate and mortgages—The Real Estate and Mortgage Department first established at the close of 1967, started to operate in the course of the year. The Fund was appointed an "approved lender" by the Central Mortgage and Housing Corporation in May and more than half of the mortgage investments approved during the year was guaranteed by the Corporation. Mortgage investments were channeled into commercial, industrial and residential developments and in this last category, lending operations were confined to multiple dwellings. As a general rule, in its mortgage and property investments, the Fund gave preference to new construction projects with a view to helping to ease the housing shortage while at the same time providing a stimulus to the building industry.

Direct placements — The Fund continued to expand its activities in the field of direct placements. In this type of transaction, recourse was had to every type of investment vehicle: mortgages, bonds, debentures, preferred shares, common shares, rights, purchase and leasebacks, etc. Private financing is particularly well suited to the requirements of a large number of Quebec enterprises. The Fund is confident that the still limited but growing number of companies seeking financing in this form will permit it to play a larger role in the future.

Stocks — In the equity field, the Fund actively pursued its programme of acquiring shares of Canadian companies. In selecting these investments, priority was given to shares of companies whose activities bear favourably on the economy of Quebec.

The Fund has sought to build up its stock portfolio as quickly as possible. This policy is not only considered sound investment practice by investors but is consistent with the aims of the Legislators who provided for such investments up to 30% of total assets. However, it was not without a certain amount of difficulty that the Fund managed to acquire an equity portfolio amounting to only 14.5% of its assets. In considering the aims of such a portfolio, the Fund sees primarily the need to protect its depositors against erosion in the purchasing power of the dollar, especially when a depositor has commitments tied to the cost of living index. Stock purchases by the Fund contribute directly to the development of a company only in the case of new issues. Such issues are unfortunately relatively scarce. Although it is possible to forecast an increase in the number of such new issues, given current market conditions, the Fund will inevitably continue to have recourse to the secondary market for the bulk of its equity investments.

Investment operations

During the year, the bond portfolio increased from $331,504,500 to $577,744,000, nominal value, and the yield on these securities rose from 6.67% to 7.07%.

The major portion of this portfolio consists of bonds issued or guaranteed by the Province amounting to $413,918,000 or 71.7% of the total bond holdings and 63.4% of long-term investments. During the year, the Fund acquired securities in this category in the amount of $165.9 million compared with $123.3 million in 1967. The Province and Hydro-Quebec issued new bonds in the amount of $275 million on the Canadian market in 1968 including an issue of $60 million by the Province sold privately to the Fund on June 15th. The Fund's participation in new bond issues of the Province and Hydro-Quebec for the year amounted to $145 million or 52.7% of the total by comparison with 40% in 1967. Purchases of Quebec provincial bonds by the Fund, both of new issues and in the secondary market, helped considerably towards reducing the yield spread between Quebec bonds and those of other governments. However, in today's very thin and volatile market, yield spreads between different issues are difficult to gauge and, therefore, lose some of their significance.

The second largest category consists of municipal and school bonds which amounted to $60,849,000 at the close of the year representing 10.5% of total bond holdings, an increase of $21.3 million for the year. The yield on this class of investment rose from 7.07% to 7.47% during the year.

In third place are bonds of the Government of Canada which, due to their relatively greater marketability, constitute the defensive element of the long-term bond portfolio. At the close of the year, holdings of these bonds totalled $54,550,000 or 9.4% of total bond holdings compared with 4.2% the preceding year and the yield was 6.44% compared with 5.81% in 1967. Holdings of such bonds fluctuate considerably during the year and the somewhat larger amounts at this year-end consisted in part of relatively short-term bonds to cover various commitments.

Lastly, holdings of corporation bonds rose from $21,425,000 to $37,564,000 during the year and represented the same percentage of the total holdings as last year, i.e. 6.5%. The yield on this category increased from 6.86% in 1967 to 7.19% in 1968.

The real estate and mortgage portfolio amounted to $3,836,573 at year-end and yielded 9.30%. This does not include commitments for a total of $29.1 million undertaken during the year which will be disbursed in 1969.

Finally, the stock portfolio more than doubled during the year, rising from $47,551,487 to $99,240,295. However, this increase was not accompanied by any noticeable change in the distribution among the various categories. The six most important groupings—public utilities (24.6%), banks and financial institutions (19.1%), mines and metals (14.2%), oil and gas (14.1%), consumer goods and services (12.8%), heavy and secondary industries (6.0%) — maintained the same relative importance as last year. The market value of these securities was $18.8 million in excess of cost without taking into account $2.5 million of profit on sale of securities, of which $1.7 million was realized during 1968. An average gain in market over book value of 29.3% on stock holdings was recorded in the course of the year. This performance is about twice that recorded by the principal Canadian stock exchange indices. In addition, expected dividends will provide a return of 3.57% on book value.

The year's results

The gross income of the Fund expressed in terms of a rate of return on the average amount on deposit during the year increased from 6.23% in 1967 to 6.45% in 1968. The depressed state of the bond market which permitted this improvement in yield also involved book losses of $172,646 on bonds sold in the course of the Fund's trading operations.

However, the proceeds of sales were reinvested at higher yields and these transactions will, in fact, prove to be profitable. The net profit on sales of securities in the amount of $1,408,710 which appears in the balance sheet is the net result of profits on sales of stock less losses on sales of bonds.

The rate of net income improved more than that of gross income, rising from 6.08% in 1967 to 6.34% in 1968. This greater improvement is the result of a relative reduction in administrative costs which dropped from 0.15% to 0.12%.

The Fund accepts, according to the needs of its depositors, both demand and notice deposits. The average amount of demand deposits was $29.1 million during 1968. On these deposits, interest was paid in the amount of $1,862,555 at a rate which fluctuated between 5.59% and 7.18% through the year, while the average was 6.39% by comparison with 4.71% the preceding year. Notice deposits averaged $517.9 million in 1968 and the net income of $32,804,437 was credited to the accounts, an amount equivalent to a rate of 6.33% compared to 6.21% the preceding year. The Fund has therefore paid interest on all deposits at an average rate of 6.34% compared with 6.08% the previous year.

Staff

At the close of the year, the Fund had a staff of 50 employees. The Board of Directors recognizes the important part played by the staff in achieving these excellent results and wishes to extend its grateful appreciation to them, particularly to the management which has had to assume a heavy burden during this period of organization and expansion.

On behalf of the Board of Directors,

Claude Pratte

Chairman.

Quebec City, March 4, 1969.

FINANCIAL STATEMENTS

Quebec Deposit and Investment Fund

BALANCE SHEET
As at December 31, 1968

ASSETS

	1968	1967
Portfolio (book value)		
Bonds	$549,970,455	*$317,258,056*
Preferred shares	4,745,695	*2,353,602*
Common shares	94,494,600	*45,197,885*
Mortgages	2,695,341	—
Real estate	1,141,232	—
Short-term investments	20,542,389	*47,975,000*
	$673,589,712	*$412,784,543*
Current assets		
Cash on hand and in bank	$ 77,096	*$ 41,874*
Accrued interest	10,040,725	*5,572,743*
Dividends receivable	40,520	*11,522*
	$ 10,158,341	*$ 5,626,139*
Fixed assets		
Leasehold improvements	$ 118,769	*$ 95,327*
Office furniture and equipment	99,340	*72,762*
	$ 218,109	*$ 168,089*
Less: depreciation	40,450	*17,490*
	$ 177,659	*$ 150,599*
Other assets		
Guarantee deposits	$ 2,066	*$ 2,050*
Prepaid expenses	5,050	*1,951*
	$ 7,116	*$ 4,001*
	$683,932,828	*$418,565,282*

LIABILITIES

	1968	1967
Current liabilities		
Accounts payable	$ 64,991	*$ 28,494*
Commitment guarantees	81,844	—
Accrued interest on demand deposits	445,113	*317,707*
Interest payable on notice deposits	10,010,281	*5,680,507*
	$ 10,602,229	*$ 6,026,708*
Demand deposits	$ 53,840,705	*$ 43,709,894*
Notice deposits		
Depositor's account	$618,081,184	*$368,987,183*
Profit (loss) on sale of investments	1,408,710	*(158,503)*
	$619,489,894	*$368,828,680*
	$683,932,828	*$418,565,282*

STATEMENT OF INCOME AND EXPENDITURE

for the year ended December 31, 1968

	1968	1967
Income		
Interest on bonds	$ 29,779,068	*$ 16,144,209*
Dividends	2,501,021	*688,941*
Interest on mortgages	69,110	—
Real estate revenue	53,805	—
Net interest on short-term investments	2,903,679	*1,887,845*
Sundry	—	*12,904*
	$ 35,306,683	*$ 18,733,899*
Expenditure		
Directors' fees and expenses	$ 7,090	*$ 5,033*
Salaries	383,377	*276,789*
Travelling expenses	19,525	*11,333*
Legal and professional fees	5,501	*6,636*
Rent	72,426	*48,828*
Bank charges	51,890	*31,356*
Office equipment rental	19,603	*14,193*
Electricity, telephone and insurance	16,959	*11,593*
Financial publications and services	10,082	*7,764*
Stationery and printing	15,514	*12,235*
Depreciation	22,960	*17,490*
Other expenses	14,764	*12,040*
	$ 639,691	*$ 455,290*
Net operating income	$ 34,666,992	*$ 18,278,609*
Less: Interest on demand deposits	$ 1,862,555	*$ 1,248,197*
Net income	$ 32,804,437	*$ 17,030,412*

Distribution of net operating income and amounts allocated during the year

	Interest on		
	Demand Deposits	*Notice Deposits*	*Total*
Balance of interest payable for previous year	$ 317,707	$ 5,680,507	$ 5,998,214
Add: Net operating income for the year	1,862,555	32,804,437	34,666,992
	$ 2,180,262	$ 38,484,944	$ 40,665,206
Less: Interest paid during 1968	1,735,149	28,474,663	30,209,812
Balance of interest payable on January 1, 1969	$ 445,113	$ 10,010,281	$ 10,455,394

Deposit accounts – summary of transactions

	Demand Deposits	*Notice Deposits*	*Total*
Balance at beginning of year	$ 43,709,894	$368,987,183	$412,697,077
1968: Deposits	229,015,000	—	229,015,000
Transfers	(220,619,338)	220,619,338	—
Interest paid	1,735,149	28,474,663	30,209,812
Balance at end of year	$ 53,840,705	$618,081,184	$671,921,889

Auditor's report

In accordance with Section 43 of the Quebec Deposit and Investment Fund's act, I have examined the balance sheet of the Fund as at December 31, 1968 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 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, 1968 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.

Quebec City, March 3, 1969.

Yield on deposits

	Amount	Yield equivalence on average deposits*
Gross Income	$ 35,306,683	6.453%
Expenditures	639,691	0.116%
Net Operating Income	$ 34,666,992	6.337%

*Average deposits were $547,088,503.

Average interest rate paid on deposits

	Average Deposits	Interest paid or due	Average yield
Demand Deposits	$ 29,153,271	$ 1,862,555	6.388%
Term Deposits*	—	—	—
Notice Deposits	517,935,232	32,804,437	6.333%
Total	$547,088,503	$ 34,666,992	6.337%

*No Term Deposits received during the year.

Bond portfolio summary as at December 31, 1968

	Nominal Value	Percentage
Government of Canada	$ 54,550,000	9.4%
Government of Quebec and Guarantees	413,918,000	71.7%
Guaranteed by Provincial Grants	10,863,000	1.9%
Municipal and School	60,849,000	10.5%
Corporate	37,564,000	6.5%
	$577,744,000	100%

(1) Investments in bonds are taken at amortized cost.

(2) Weighted average of yields as at December 31, 1968.

(3) Where no active market exists, bonds are valued on a yield basis.

(4) The deficiency of market under book value, in the amount of $49,869,091, does not take into account a net cumulative deficit of $1,071,747 on sale of bonds.

Real estate and mortgage portfolio summary as at December 31, 1968

	Price of acquisition
Mortgages	$ 2,706,745
Real Estate[3]	1,150,000
	$ 3,856,745

(1) Investment in mortgages are taken at amortized cost.

(2) Cost price less depreciation of buildings over term of leases.

(3) Description: Town of Laval, Lot (616-3), Parish of St. Martin: land and building $900,000; under lease for 35 years. Town of Boucherville, Lot (48-10), Parish St. Famille de Boucherville: land and building $250,000; under lease for 25 years.

Book Value[1]	Yield[2]	Market Value[3]
$ 51,368,926	6.44%	$ 47,553,224
394,719,721	7.08%	358,707,242
10,610,699	7.01%	9,421,767
56,532,081	7.47%	50,968,401
36,739,028	7.19%	33,450,730
$549,970,455	7.07%	$500,101,364 [4]

Book Value	Yield
$ 2,695,341 [1]	9.33%
1,141,232 [2]	9.25%
$ 3,836,573	9.30%

Stock portfolio summary as at December 31, 1968

	Book Value[1]
Preferred Shares	$ 4,745,695
Common Shares	
Public Utilities	24,383,015
Banks and Financial	18,979,620
Consumer Goods and Services	12,717,421
Heavy and Secondary Industries	5,908,380
Oil and Gas	14,010,952
Mines and Metals	14,061,068
Forest Products	1,897,455
Science and Technology	2,536,689
	$ 99,240,295

[1] Investment in stocks are taken at cost.

[2] The excess of market value over book value, in the amount of $18,833,356, does not take into account a net cumulative profit of $2,480,186 on sale of such securities.

Percentage	Yield on Book Value	Market Value
4.7%	5.77%	$ 6,285,075
24.6%	3.40%	27,934,581
19.1%	4.85%	26,012,012
12.8%	2.85%	14,652,091
6.0%	3.83%	6,201,479
14.1%	1.67%	17,847,851
14.2%	4.00%	14,825,407
2.0%	5.04%	1,824,825
2.5%	1.59%	2,490,330
100%	3.57%	$118,073,651 (2)