Annual Report **2004**

The mission of the Caisse is to receive moneys on deposit as provided by law and manage them with a view to achieving optimal return on capital within the framework of depositors' investment policies while at the same time contributing to Québec's economic development.

Caisse de dépôt et placement du Québec

40 years of investing

Table of contents

Annual Report 2004

1 Profile
2 Highlights
6 40 years of investing for our depositors
10 Message from the Chairman and Chief Executive Officer
18 The Caisse of the future
20 The performance plan levers
28 Management of depositors' holdings
35 Economic context 2004
37 Performance summary
44 Investment operations and analysis of returns
75 Analysis of combined financial statements and financing activities
79 Combined financial statements
107 Corporate governance
114 Board of Directors and management
115 Glossary
120 Tables and figures

Annual Report 2004 – Additional Information
(separate document)

Composite performance summary
Financial statistics and review
Code of Ethics and Professional Conduct

General notes

1. The Caisse's operations comply with the requirements of the *Act respecting the Caisse de dépôt et placement du Québec*[1] and with industry practices. Its financial statements are prepared in accordance with generally accepted accounting principles in Canada. The Auditor General of Québec, to the extent that he deems it appropriate, conducts the financial audit and ensures that the Caisse's operations comply with laws, regulations, policies and guidelines, and with the systems and procedures set up to control and protect its assets.
2. The *Annual Report 2004 – Additional Information* is an integral part of the Annual Report 2004 and presents the tables of composites and calculations of returns as at December 31, 2004, relating to the composites depositors accounts of the Caisse. These tables have been audited as at December 31, 2004, by Deloitte & Touche LLP for compliance with the AIMR-PPS®, the version of the Global Investment Performance Standards (GIPS®) that applies in Canada and the United States.
3. The *Act to amend* the *Act respecting the Caisse de dépôt et placement du Québec*, which came into force on January 15, 2005, significantly changes the Caisse's governance, notably by giving specific responsibilities to certain committees of the Board of Directors which will have to provide a report each year for inclusion in the Annual Report. These provisions take effect starting in fiscal 2005.
4. The terms "depositors' holdings" and "depositors' net assets" are equivalent.
5. Unless otherwise indicated, returns are presented before operating expenses. They include the return on cash and cash equivalents and they take into account a foreign exchange hedging position.
6. Unless otherwise indicated, all figures are given in Canadian dollars.
7. The returns on the specialized portfolios represent the time-weighted rate of return.
8. Certain returns are expressed in basis points (b.p.). One hundred basis points equal 1.0% and one basis point equals 0.01%.
9. Totals may vary because of the rounding of figures.
10. Many of the financial terms in this annual report are defined in the *Glossary* section.
11. Unless otherwise indicated, all data in the tables and figures are from studies made by the Caisse.
12. The terms "specialized Commodity Financial Instruments portfolio" and "specialized Commodities portfolio" are equivalent.

[1] The *Act respecting the Caisse de dépôt et placement du Québec* can be consulted on the Caisse's Web site at: www.lacaisse.com

Profile

The Caisse de dépôt et placement du Québec was created in 1965 by an Act of National Assembly of Québec to manage the funds contributed to a newly created universal pension plan, the Québec Pension Plan. In the decades that followed, many other public bodies also became depositors, increasing the pool of capital that the Caisse represents.

The Caisse is recognized as one of Québec's leading financial institutions and is now the largest institutional fund manager in Canada. It conducts its operations from its business office in Montréal and its head office in Québec City.

Organizational structure

The Caisse has six investment groups: Equity Markets; Fixed Income; Absolute Return; Real Estate; Private Equity; and Investment Analysis and Optimization. These groups are supported by five general services teams: Risk Management and Depositors' Accounts Management; Finance, Treasury and Strategic Initiatives; Human Resources and Organizational Development; Institutional Affairs; and Information Technology and Investment Administration.

The investment groups and general services units are represented on the Caisse's Executive Committee. The Corporate Secretariat, Legal Affairs and Internal Audit also report to the Chairman and Chief Executive Officer of the Caisse.

Organization chart of the Caisse as at December 31, 2004

figure 1

As at December 31, 2004, the Caisse had 717 employees. The real estate management and administration subsidiaries, CDP Capital – Real Estate Advisory, Ivanhoe Cambridge and SITQ, had a total of 1,524 employees.

Highlights

Summary of the outstanding events of 2004

January	→ Creation of the specialized Real Return Bond portfolio.
March	→ Adoption of a Policy on Socially Responsible Investment to take effect on January 1, 2005.
April	→ Integration of the underwriting operations of CDP Capital - Mortgages and MCAP. → Addition of a new depositor: the Regime de retraite de l'Université du Québec.
May	→ Launch by CDP Capital – Real Estate Advisory and Group LSR of the Villas-sur-Rive project in Laval, one of Québec's largest residential projects.
June	→ Caisse-OECD presentation on the future of pension plans, at the 10th Conference of Montréal. → Inauguration of the Caisse's business office in Montréal. → Public exhibition "The Caisse: An Investment Story" in The Parquet of the Centre CDP Capital. → Acquisition, with five other institutional investors, of a 50.4% interest in Noverco.
July	→ Issuance of $750 million of term notes by CDP Financial.
August	→ Creation of the specialized Commodities Financial Instruments portfolio.
September	→ Inauguration of the Journées Claude-Prieur, a seminar held to discuss the challenges facing the Caisse, with the participation of the institution's stakeholders.
October	→ Deployment of the technology venture capital strategy as part of the Caisse's new approach to private equity. → Launch of Park Square Capital Partners LP, Europe's largest independent mezzanine fund, in partnership with the Ontario Teachers' Pension Plan Board.
November	→ Inauguration of Vaughan Mills (Ontario), owned by Ivanhoe Cambridge and The Mills Corporation, the first regional shopping centre to open in Canada in 14 years.
December	→ Adoption of the *Act to amend the Act respecting the Caisse de dépôt et placement du Québec* by the National Assembly of Québec. → For the first time since its creation, the Caisse's mission is enshrined in its constituting statute. → Abolition of the soft-dollar commission program paid to its securities dealers as of January 1, 2005.

Composition of total assets under management

The Caisse's total assets under management consist of depositors' total assets, namely their net assets and liabilities (assets financed by borrowing), and assets that the Caisse manages or administers for clients, especially real estate.

figure 2

Depositors			Clients				
Depositors' net assets	$102.4 billion						
Liabilities *(assets financed by borrowing)*	$44.8 billion						
Depositors' total assets	$147.2 billion	+	Assets under managment Assets under administration	$10.7 billion $16.9 billion	=	**Total assets under management**	**$174.7 billion**

Assets under management: Assets that belong to partners or clients of certain Caisse subsidiaries and are managed by one of the Caisse's subsidiaries or affiliated companies. The teams that manage these assets are involved in investment and divestment decisions and receive fees in consideration for services rendered.

Assets under administration: Assets for which the Caisse's subsidiaries provide administrative services on behalf of the clients who own them. The subsidiaries that administer these assets are not involved in investment and divestment decisions and receive payment in the form of fees in consideration for services rendered.

Liabilities (assets financed by borrowing): Liabilites related mainly to investments, such as mortgage loans, repurchase agreements and shorted securities.

Results and changes in total assets under management

table 3

(in millions of dollars)	**2004**	2003[1]
Investment activities		
Investment revenues	**3,850**	3,662
less: operating expenses	**212**	205
Net investment revenues	**3,638**	3,457
Net gains from sales	**4,169**	2,324
Total realized revenues	**7,807**	5,781
Net unrealized value	**3,011**	5,743
Total investment activities	**10,818**	11,524
Deposit surplus above depositors' withdraws	**2,217**	192
Net asset growth	**13,035**	11,716
Net depositors' assets (depositors' holdings)	**102,433**	89,398
Liabilities (assets financed by borrowing)	**44,767**	28,315
Depositors' total assets	**147,200**	117,713
Assets under management	**10,664**	7,660
Assets under administration	**16,857**	13,836
Total assets under management	**174,721**	139,209

1 The presentation of certain elements of the 2003 balance sheet has been restated in accordance with the format used for 2004 in order to reflect the character of certain financial instruments.

Returns for the Caisse and its depositors

table 4

(as at December 31)	**2004**	2003
Weighted average return on depositors' funds (return on the Caisse's overall portfolio):	**12.2%**	15.2%
Global Index	**11.2%**	15.2%
Value added	**100 b.p.**	8 b.p.
Individual returns for depositors' funds were between:	**5.0% and 14.6%**	5.5% and 16.0%

Performance of the investment groups in relation to market or recognized indexes

table 5

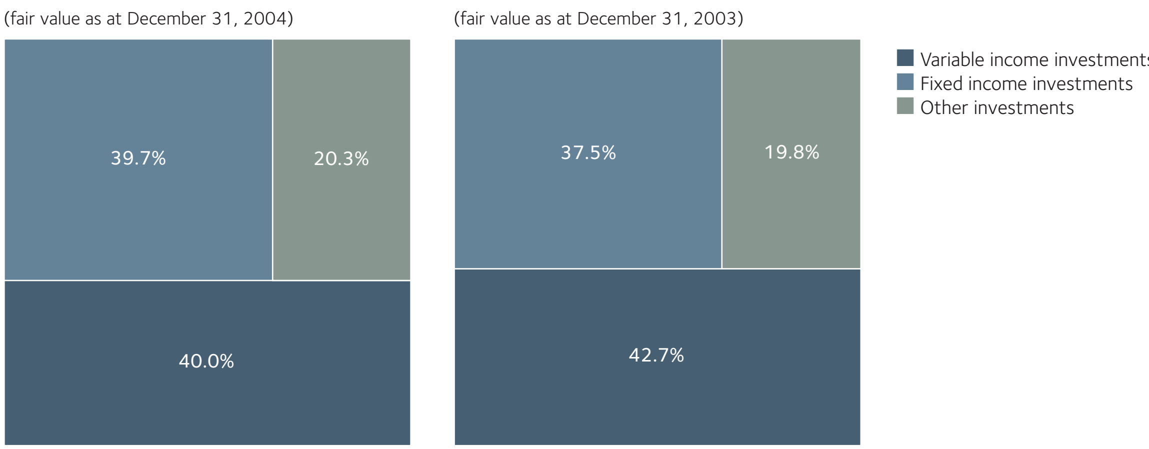
(as at December 31, 2004)

Investment groups	Return %	Contribution $ billion	Value added basis points
Equity Markets	12.6	4.6	(7)
Fixed Income	7.1	2.3	13
Absolute Return	7.8	0.1	784
Real Estate	22.7	2.2	758
Private Equity	20.5	1.6	271
Total	**12.2**	**10.8**	**100**

N.B.: The investment operations of the Investment Analysis and Optimization group began in the second half of 2004 and had no significant impact on the Caisse's overall return. In the above table, they have been included in the performance of the Absolute Return group.

Breakdown of depositors' net assets by investment type

figure 6



Detailed breakdown of depositors' net assets by investment type

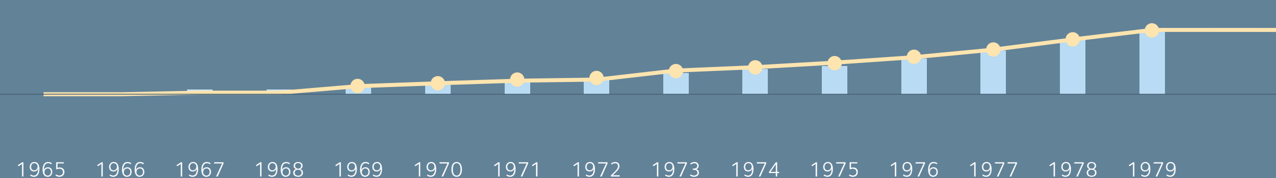
table 7

(fair value as at December 31)	**2004**	2003
	%	%
Specialized portfolios		
Fixed income investments		
Short-term Investments	**2.3**	2.7
Real Return Bonds	**1.1**	–
Bonds	**32.1**	31.2
Mortgages	**4.2**	3.6
	39.7	37.5
Variable income investments		
Canadian Equity	**15.0**	17.5
U.S. Equity	**8.3**	8.3
Foreign Equity	**7.8**	9.1
Emerging Markets Equity	**0.9**	1.0
Québec International	**8.0**	6.8
	40.0	42.7
Other investments		
Hedge Funds	**2.7**	1.1
Investments and Infrastructures	**3.8**	3.0
Private Equity	**5.0**	6.8
Real Estate	**7.6**	8.7
Commodities	**1.0**	–
Asset Allocation	**0.2**	0.2
	20.3	19.8
Total	**100.0**	100.0

40 years of investing for our depositors

(as at December 31 – in dollars)

The Caisse's investment approach has constantly evolved since it made its first investments in bonds, back in 1966. As a result of its size, its determination to achieve superior returns for depositors and its efforts to limit the overall risk of its portfolio, it has adopted various strategies and diversified its investments across an increasingly broad range of asset classes.



1965
Adoption of the law to create the Caisse de dépôt et placement du Québec

1966
First depositor: Régie des rentes du Québec

The Caisse's very first transaction: purchase of bonds from the International Bank for Reconstruction and Development

1966 (cont.)
Purchase of Asbestos Corporation debentures

1967
First commercial and industrial mortgage loans

First equity purchases: Alcan and Banque Canadienne Nationale

First private loans to small and mid-sized businesses

1968
Legislative amendment limiting equities to 30% of the portfolio

Private purchase of $60 million of Québec government bonds

1969
First construction financing in the form of mortgage loans

First private purchase of Hydro-Québec bonds

1970
First purchase of corporate bonds: SIDBEC

The Caisse's assets exceed $1 billion

1971
First private equity investments

1974
The Caisse manages the country's largest Canadian equity portfolio

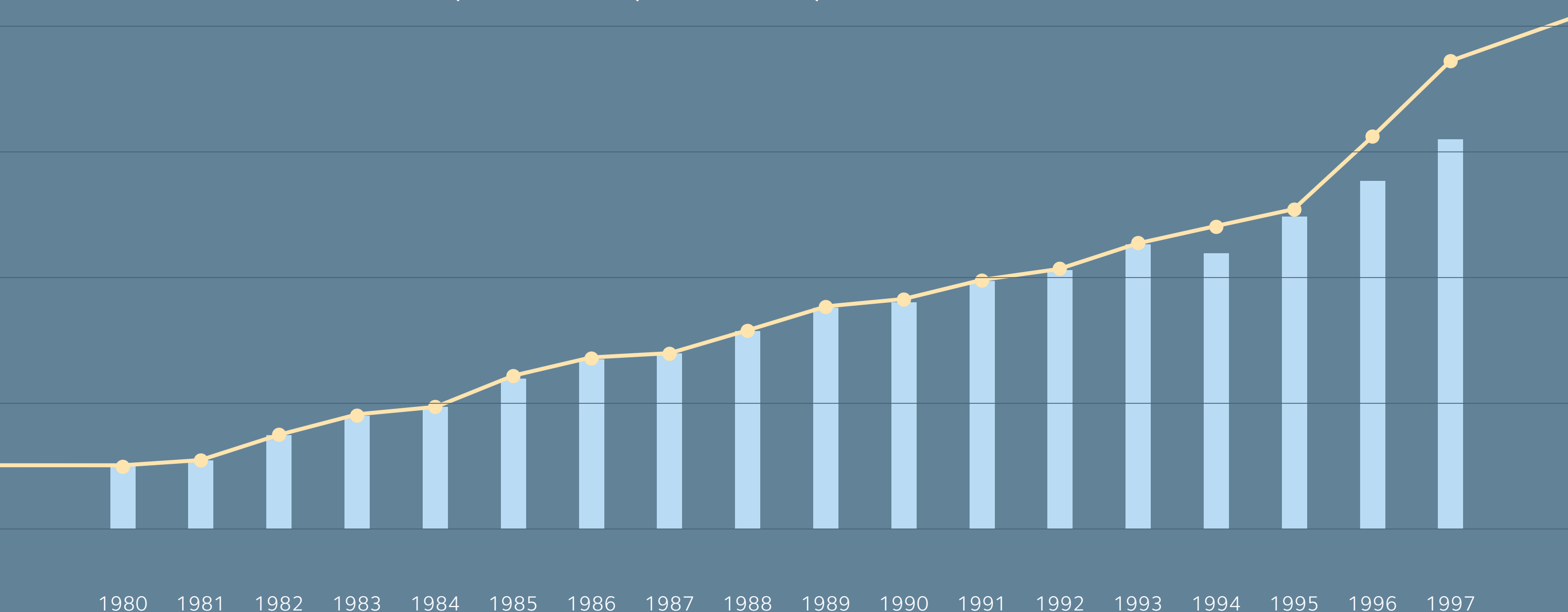
1979
Caisse involvement in the Québec Stock Savings Plan (QSSP)

Total assets under management

$174,720,999,405

Depositors' net assets

$102,432,711,441



1980
First acquisition of an office building: Complexe Delta in Sainte-Foy, Québec

Investment in a City of Montréal project to provide 10,000 housing units: 150 mortgage loans totalling $15 million

1983
First international equity transaction

1984
Creation of Société immobilière Trans-Québec (SITQ)

First private equity investment outside Canada

1989
Acquisition of Ivanhoe: the Caisse purchases the Steinberg empire in partnership and becomes the owner of its real estate portfolio

1991
Creation of a fund to finance Québec small caps

1992
Creation of the Caisse's Real Estate group

1993
First investment in commercial real estate outside Canada

1994
In co-operation with the Montréal Exchange, launch of new derivatives traded only in Montréal

1995
Creation of the Caisse's Private Equity group and the specialized private equity subsidiaries

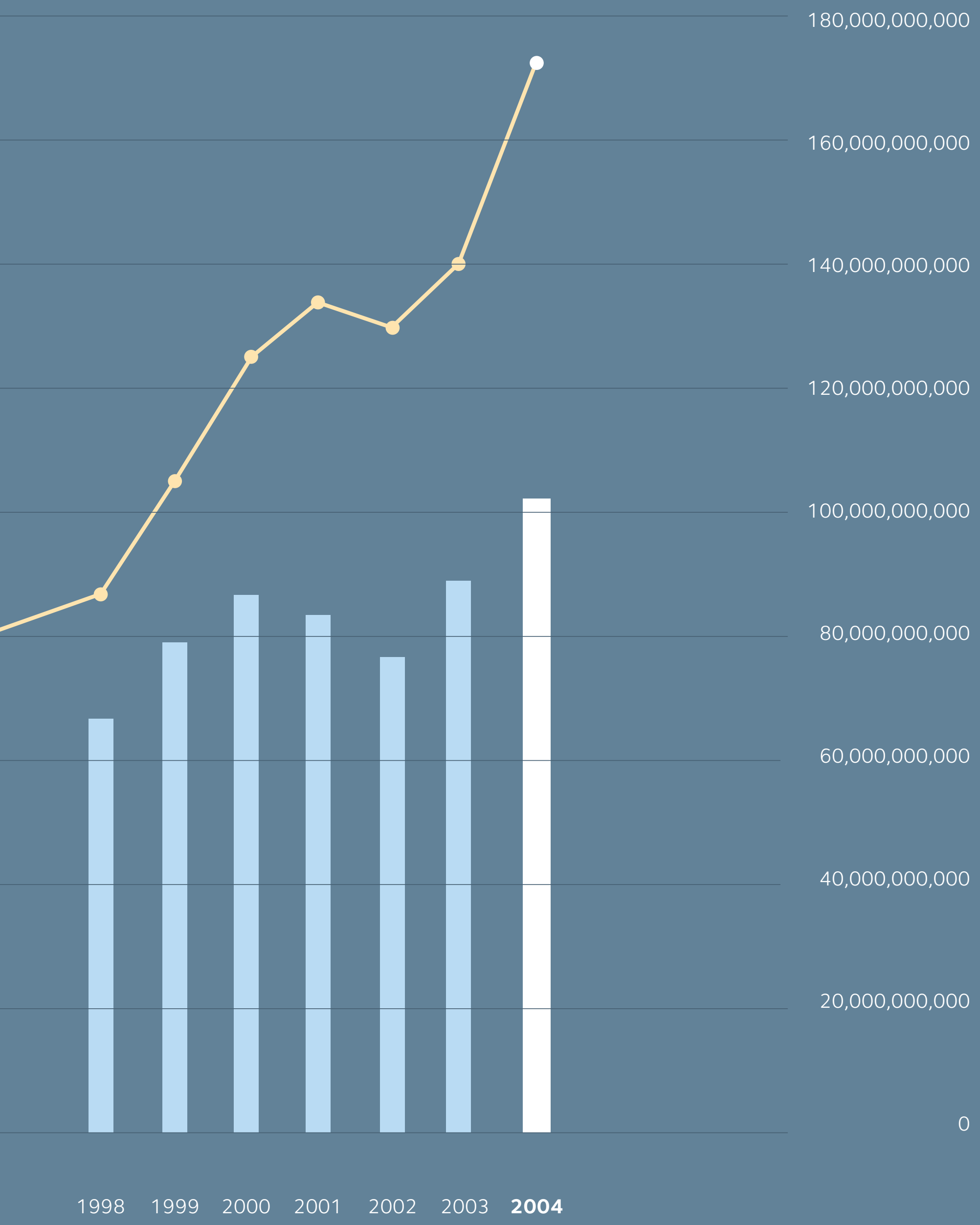
1996
Acquisition of shopping centres and industrial buildings outside Canada

1997
The Caisse Real Estate group owns the largest portfolio of properties in Québec and the second-largest in Canada

Amendment to the Caisse's constituting statute allows it to hold as much as 70% of its total portfolio in equities

1998
Foreign consulting mandates obtained

New business objectives involving development of new clientele's



1999
First issue of commercial mortgage-backed securities on the Canadian market

2000
The Caisse is ranked the best fund management group in Canada in the *Reuters Survey 2000*

SITQ acquires five major Montréal buildings, including Place Ville Marie

2001
Merger of Ivanhoe and Cambridge to form Ivanhoe Cambridge

The Caisse provides the largest mortgage in its history: $379 million

2001 (cont.)
The technology bubble bursts, pushing investment values down

2002
Adoption of a new Code of Ethics and Professional Conduct for managers and employees

Announcement of a strategic refocusing and an internal reorganization geared to depositors

2003
Adoption of a performance plan

Move to the Centre CDP Capital

2003 (cont.)
Reorganization of the Caisse's operations around a new management structure: six investment groups and five general services groups

Board of Director's Report on Corporate Governance

Adoption of the Integrated Risk Management Policy

First issue of commercial paper

Signature of service agreements with the main depositors

2004
Adoption of the Policy on Socially Responsible Investment

Completion of the reorganization of the Private Equity group and adoption of a new strategy for technology venture capital

Important amendments to the Act respecting the Caisse (clarified mission and improved governance)

Adoption of an investment policy for each specialized portfolio

The Caisse now has 19 depositors

The Caisse's Depositors

(fair value as at December 31 – in millions of dollars)

	Symbol	First deposit	Number of participants[1]	Depositors' net assets 2003 $	2003 %	2004 $	2004 %
Pension plans							
Régie des rentes du Québec	RRQ						
Fonds du Régime de rentes du Québec		1966	3,649,000	19,161	21.4	22,854	22.3
Commission de la construction du Québec	CCQ						
Supplemental Pension Plan for Employees of the Québec Construction Industry		1970	119,144	7,497	8.4	8,405	8.2
Commission administrative des régimes de retraite et d'assurances	CARRA						
Government and Public Employees Retirement Plan	RREGOP	1973	480,000	30,997	34.7	34,362	33.6
Pension Plan for Managment	RRPE	1973	24,700	4,939	5.5	5,529	5.4
Individual Plans		1977	285	183	0.2	201	0.2
Pension Plan for Elected Municipal Officials	RREM	1989	1,700	109	0.1	126	0.1
Régime complémentaire de rentes des techniciens ambulanciers œuvrant au Québec	RRTAQ	1990	4,102	152	0.2	176	0.2
Fonds d'amortissement des régimes de retraite		1994	1	11,753	13.1	14,985	14.6
Régime de retraite de l'Université du Québec[2]	RRUQ	2004	10,000	–	–	86	0.1
Insurance plans							
Régie des marchés agricoles et alimentaires du Québec	RMAAQ						
Fonds d'assurance-garantie		1967	79	5	–	5	–
La Financière agricole du Québec		1968	*	135	0.2	173	0.2
Autorité des marchés financiers**	AMF	**	**	315	0.3	343	0.3
Commission de la santé et de la sécurité du travail	CSST						
Health and Work Safety Fund		1973	185,427	7,237	8.1	7,928	7.7
Société de l'assurance automobile du Québec	SAAQ						
Fonds d'assurance automobile du Québec		1978	4,964,100	6,575	7.4	6,890	6.7
La Fédération des producteurs de bovins du Québec		1989	21,779	3	–	4	–
Régime de rentes de survivants		1997	1	333	0.4	362	0.4
Office des producteurs de tabac jaune du Québec[3]							
Fonds de garantie des producteurs de tabac jaune du Québec		2001	56	–	–	–	–
Other depositors							
Office de la protection du consommateur	OPC	1992	950	4	–	4	–
Société des alcools du Québec[3]	SAQ	1994	–	–	–	–	–
TOTAL				**89,398**	**100.0**	**102,433**	**100.0**

* Fonds d'assurance-prêts agricoles et forestiers		16,916
Fonds d'assurance-stabilisation des revenus agricoles		18,246
Fonds d'assurance-récolte		13,318
** Formerly the Commission des valeurs mobilières du Québec; including the Fonds d'assurance-dépôts		
Fonds d'assurance-dépôts (formerly the Régie de l'assurance-dépôts du Québec)	1969	612
Fonds des valeurs mobilières	1998	-
Fund used for a specific purpose under the *Securities Act*	2004	-

1 Estimate
2 New depositor in 2004
3 These depositors use only the Caisse's treasury management services

Message from the Chairman and Chief Executive Officer

Guided by fundamental values of excellence, boldness, ethics and transparency, the Caisse de dépôt et placement du Québec undertakes to do its utmost to continue to meet depositors' expectations. In so doing, it will achieve its ambition: to become a constant source of collective pride, to deserve the renewed confidence of Quebecers and to inspire respect on the part of its peers.

A first-quartile performance

The Caisse de dépôt et placement du Québec turned in a strong performance in 2004, with a 12.2% weighted average return on its depositors' funds. This return exceeds the first-quartile threshold by 90 basis points (0.90%) and the median for Canadian pension fund managers by 200 basis points (2.00%). In comparison, the Caisse earned a return of 15.2% in 2003, a performance that was superior to the median for Canadian managers and just below the first-quartile threshold.

The weighted average return on depositors' funds exceeds the long-term benchmark indexes specified in the depositors' investment policies by 100 basis points (1.00%). The return represents $847 million of value added in relation to the benchmark indexes used by the Caisse and its depositors and $1.8 billion in relation to the median returns of Canadian pension fund managers. In addition, the Caisse's managers exceeded the overall short-term return threshold by 247 basis points (2.47%).

The depositors' individual returns ranged from 5.0% to 14.6%, a spread that reflects their different investment policies. All benefited from the positive value added generated by the Caisse's investment groups.

Depositors' net assets reached a historic high of $102.4 billion in 2004, a substantial increase from the $89.4 billion recorded in 2003, as a result of $10.8 billion of investment gains and $2.2 billion of net deposits during the year.

Returns earned by the investment groups

The Caisse's excellent results in 2004 are due to the record return earned by its Real Estate group, the solid performance by its Private Equity group, the strength of the equity markets around the world, the appreciation of its fixed income portfolios and the contribution of its absolute return operations.

The Real Estate group generated a return of 22.7%, for a contribution of $2.2 billion, which represents value added of 758 basis points (7.58%) in relation to its benchmark index. The Private Equity group earned a return of 20.5%, for a contribution of $1.6 billion, or value added of 271 basis points (2.71%) in relation to its benchmark index.

The Equity Markets group earned a return of 12.6%, for a contribution of $4.6 billion, or seven basis points (0.07%) less than its benchmark index. The group's relative return was up 64 basis points (0.64%) in relation to 2003. Although this is a distinct improvement, value creation in this area, especially on international equity markets, remains a major challenge that will require investments in human resources, research and risk management.

The Fixed Income group earned a return of 7.1%, for a contribution of $2.3 billion, or value added that exceeds its benchmark index by 13 basis points (0.13%). Lastly, the Absolute Return group produced a return of 7.8%, for a contribution of $100 million.

Amendments to the Act respecting the Caisse

A clarified mission

The year ended with an event of historic import for the Caisse de dépôt et placement du Québec. In December, the National Assembly of Québec passed a bill that amends its constituting statute considerably.

The new text of the Act includes a section that, for the first time since the Caisse was created 40 years ago, formally states the institution's mission. The section states that the Caisse's mission is "to receive moneys on deposit as provided by law and manage them with a view to achieving optimal return on capital within the framework of depositors' investment policies while at the same time contributing to Québec's economic development."

The mission statement does not represent a break with the past, but rather a clarification of the Caisse's fundamental role, in a spirit of continuity that reflects the institution's performance over the past four decades. It also emphasizes that, far from being mutually exclusive, investment returns and economic development are closely and positively correlated.

It is important to bear in mind that the Caisse's returns have a direct impact on the contributions required to finance its depositors' plans. For example, when the long-term return on deposits made by the Government and Public Employees Retirement Plan (known by its French acronym, RREGOP), exceeds the actuarial assumptions, the participants' contributions to the plan can be reduced or maintained. Conversely, RREGOP's December 2004 actuarial analysis shows that a constant 1% decrease in the Caisse's returns could permanently increase employee contributions by 4% a year, which would deprive the plan's contributors of substantial amounts.

When the members of a plan are deprived of returns on their capital, the resulting increase in contributions has the effect of an income tax hike without any offsetting benefit. In other words, they must spend less or save less. In both cases, their standard of living drops, and Québec's economic development and job creation are affected adversely.

Furthermore, since the Caisse is an important player in the private equity sector, it is expected to contribute directly to Québec's economic development by investing in dynamic companies with the potential for strong growth and returns. From its mission, it is clear that the Caisse must invest above all where the returns offset the risks assumed, in other words according to the appropriate investment horizon, when there is no tradeoff between financial return and economic development.

New governance rules

In addition to clarifying the Caisse's mission, the text of the Act that took effect on January 15, 2005, contains various changes to the governance rules the Caisse has been subject to since its creation in 1965. These new provisions essentially concern the responsibility and independence of its Board of Directors.

Separation of the positions of Chairman and Chief Executive Officer tops the list of changes made by the Act. The Chairman, whose position is part-time, will have a renewable mandate of up to five years and will be responsible mainly for implementation of the Board of Director's governance rules. The President and Chief Executive Officer will be the organization's most senior officer and its spokesman. He will be responsible for direction and management of the Caisse in accordance with its regulations and policies. He will also assume any other responsibility assigned by the Board of Directors.

Other changes involve the way the members of the Board of Directors are appointed. The law provides a mechanism for consultation of the Board before the Government makes an appointment. The law also provides that the Board of Directors must establish an expertise and experience profile, to guide the Government in making its choices. This is the first time such mechanisms have been included in a law governing a public corporation created by the National Assembly of Québec.

As for the members of the Board, at least two-thirds, including the Chairman, must be independent. Only independent members may sit on the audit committee, the human resources committee, and the governance and ethics committee of the Board of Directors. Lastly, the Act specifies that the audit committee must include members with accounting and financial expertise.

The Caisse's role

The new provisions of the *Act respecting the Caisse de dépôt et placement du Québec* also cover the institution's role as adviser and fund manager for its depositors.

Advisory services

Section 22.1 of the Act stipulates that the Caisse "shall advise its depositors on investment matters." As an adviser, the Caisse plays a crucial role in the development and review of the depositors' investment polices. It prepares economic analysis and forecasts, and provides return, risk and correlation forecasts for its specialized portfolios. It also simulates various asset allocation scenarios to enable the depositors, with whom the final decision rests, to set the parameters for their benchmark portfolios.

Apart from the performance of the financial markets, a large portion of the depositors' returns depends on the composition of the benchmark portfolio included in their individual investment policies, and this portion of the return is the result of a joint effort by the Caisse and its depositors.

Since the Caisse regards its advisory role from a long-term perspective, it performs research whose outcome includes development of new investment products that reflect depositors' changing needs. The specialized Real Return Bond and Commodities portfolios, created in 2004, are the result of such work. Like the specialized Québec International portfolio, created in 1999, these are truly "Caisse" products that are customized for depositors and cannot be duplicated with index products, although their returns are measured against benchmark indexes.

Fund management

Fund management is the other aspect of the Caisse's contribution to its depositors' return. As defined in the Caisse's mission statement, the objective is to add value over the long term in relation to the return on the market indexes for the specialized portfolios in which the depositors invest their holdings. The Act also requires that the Caisse adopt an investment policy for each of its specialized portfolios, so as to assign them a target return, a benchmark index, risk limits and a specific investment universe. Within the framework of these policies, the value added objectives of the Caisse's portfolio managers are aligned with the return objectives set by the depositors in their investment policies.

Our vision: recognition as a benchmark for institutional fund managers

Above all, a clear mission statement in a text with the force of law ensures continuity between our institution's past and future. We will use this renewed mission to create our vision of a Caisse de dépôt et placement du Québec that, in doing its utmost to meet depositors' long-term needs, achieves recognition as a benchmark organization for institutional fund managers.

This vision calls for constant evaluation and improvement of the Caisse's advisory services and portfolio management expertise. Although we have every reason to be satisfied with the Caisse's 2004 first-quartile return, we must bear in mind that only sustained high results will enable the Caisse to achieve its depositors' long-term return objectives.

Moreover, to be recognized by its peers as a benchmark organization, the Caisse cannot merely strive for excellence in all facets of its business model; it must set itself apart with the clarity of its investment philosophy, the expertise of its professional teams, the rigour of its processes and risk management, and the quality of its client services. For example, the calibre of its reporting to depositors as well as the publications and stature of the experts who provide investment counsel to the depositors will be important indicators of the Caisse's progress toward that objective.

The challenges facing the Caisse

While pursuing the objective of becoming a benchmark organization, the Caisse will have to rise to many challenges in the years to come, as an investor, shareholder, public organization and employer.

Return outlook
The economic and financial universe in which the Caisse operates has changed dramatically since the mid-1960s. Today, in its role as an investor, the Caisse must cope with the expectation that returns will be significantly lower than in the past, especially on liquid markets. Bond yields are now at historically low levels, and the equity risk premium in relation to bonds will be much lower than the excess returns of the past decade. Other factors are the diminished effect of equity portfolio diversification as a result of market globalization and a greater correlation between fixed income and equities.

Another phenomenon that weighs on the outlook for future returns is the massive flows of capital into liquid asset classes, such as real estate and private equity. The Caisse has a considerable head start on many newcomers to these markets, but it must compete with large investors for a limited number of investment opportunities. Lastly, although absolute return operations are an important source of value that is less correlated with the stock and bond markets, investor enthusiasm for hedge funds could also lead to a scarcity of investment opportunities in overexploited markets, at least over the medium term.

In short, the expectation of lower returns on liquid markets and more intense competition for new sources of value will make it increasingly difficult to obtain returns that meet depositors' long-term needs. Faced with the same problems as other institutional fund managers, the Caisse will have no choice but to assume greater relative and absolute risk in seeking returns similar to those it obtained in the past, in an environment where absolute risk is especially high.

Higher absolute risk

The very accommodative polices adopted by central banks after the technology meltdown and the events of September 2001 caused a massive injection of liquidity into the global economy and markets. Rather than causing inflation in goods and services, the excess liquidity has caused the prices of financial assets and residential real estate to spiral. In 2005 and 2006, the central banks may try to revert to less stimulative policies, while keeping the economy on track and avoiding a destabilizing price correction affecting financial assets and real estate.

This delicate adjustment will have to be made in a context of significant imbalances that are fuelling investor uncertainty. Accelerated integration of large countries, such as China, into the emerging economy has done a great deal to curb global inflation in manufactured goods by making a previously inaccessible pool of manpower available. Still, the rapid shift of production capacity to these countries is creating large trade imbalances that will in all likelihood be corrected by means of exchange rates. As for the United States' chronic trade deficit, it is constantly increasing, creating concerns about the scope of the exchange rate adjustment needed to correct the situation, particularly with regard to the speed at which the adjustment will occur.

In short, all these factors have created a context of high absolute risk.

Ethics, corporate governance and regulatory framework

In addition to coping with the difficulties and disruptions occurring in its business environment, the Caisse must deal with new qualitative constraints related to ethics and corporate governance, as a major shareholder and investor, and as a public institution. This will especially be the case starting in 2005, when it will have to adapt to the new provisions of its constituting statute as well as the new North American regulatory context for financial governance and reporting.

In addition, a new page of the Caisse's history began when its Policy on Socially Responsible Investment took effect on January 1, 2005. Under this new policy, the Caisse's managers must consider governance criteria as well as social, ethical and environmental factors in their analysis of the risk inherent in any investment. This is another field of endeavour where the Caisse intends to make a name for itself and join the ranks of the best institutional fund managers over the medium term. All these factors represent a new facet of performance measurement.

Talent hunt

The rapid changes occurring in the financial sector have created another major challenge for the Caisse. Fund management requires increasingly specialized resources to address the technical and quantitative aspects of investing and to perform rigorous risk management. As managers compete for returns, they are also competing fiercely to attract the best talent, and at the moment hedge funds have the greatest appeal.

Changes in the business model and performance levers

The exhaustive analysis done in 2003 of the risks and opportunities presented by the various features of the Caisse's environment prompted it to adopt a business model that is focused, open and geared to performance. The model has been put into effect over the past two years under a performance plan that is based on four levers: excellent human resources, rigorous and disciplined risk management, leading-edge financial research capability, and operational and technological efficiency.

Our priorities in 2005 will be to continue to deploy our business model in each investment group.

We will maintain our efforts to recruit talented specialists, we will rely on continual training and development of our employees and we will help our leaders hone their management skills. To ensure an ongoing performance capability, we will continue to invest in advanced risk management systems, quantitative and analytical tools as well as risk optimization and simulation methods.

We will build world-class research teams to ensure depositors receive the best advisory services and our portfolio managers receive superior-quality information that gives them a competitive edge. Lastly, we will put in place a project management office to accelerate the orderly improvement of our processes and technologies. Implementation of a robust technology architecture and compliance with a responsible budgetary framework will be instrumental in enhancing the operating efficiency of the entire organization.

Outlook 2005-2008

To achieve our vision, we must look ahead and work to ensure our institution's sustainability. The Caisse's 40 years of investing show that talent and expertise are the cornerstone of success when it comes to serving depositors' interests. It is clear that this situation is not about to change.

But the Caisse has other attributes to ensure it ranks among the best institutional fund managers. In the next few years, our institution will take its cue from its renewed mission and the new governance provisions of its constituting statute in order to fulfill its roles as an adviser and a fund manager for its depositors. On the strength of its adapted business model, it will continue to take advantage of the size of its depositors' holdings and the fact that it has patient capital to invest in its quest for high returns over the long term.

Guided by fundamental values of excellence, boldness, ethics and transparency, the Caisse de dépôt et placement du Québec undertakes to do its utmost to continue to meet depositors' expectations. In so doing, it will achieve its ambition: to become a source of collective pride, to deserve the confidence of Quebecers and to inspire respect on the part of its peers.

Impact on Québec's economic development

The excellent returns earned in 2004 represent only a portion of the Caisse's contribution to Québec's economic development. The institution's investments in Québec amount to tens of billions of dollars and include the main asset classes in its overall portfolio. For example, the Caisse holds Québec government bonds, shares of large corporations, office buildings and shopping centres as well as direct and indirect private investments in companies of all sizes.

The Caisse is also involved in initiatives that will continue to have a positive impact on the development of Québec companies. For example, the Caisse stepped up its efforts to meet the needs of mid-sized businesses whose projects have strong value-creation potential. It developed a financing program that facilitates ownership transfers to family members or management as well as the sustainability of such businesses. In addition, it did a complete review of its approach to venture capital for the technology sector and adopted a strategy of using investment funds to stimulate Québec's venture capital industry.

Lastly, the presence of a large institution such as the Caisse also has a significant impact on Québec's economy, considering the number of people it employs and the goods and services it purchases from local suppliers.

Acknowledgments

Our business is so complex that it is difficult to convey accurately in a few lines the energy and commitment required to produce results that fully satisfy all the organizations that entrust their funds to our institution. The pages that follow will give you an idea of the tremendous efforts made by the Caisse in 2004.

I believe it is important to underline one last time the extraordinary work accomplished in 2004 by all the Caisse's employees. I should like to convey my unreserved admiration and gratitude for those who contributed to our success during a memorable year.

In conclusion, I should like to thank the members of the Board of Directors as well as the members of the depositors' investment committees and boards of directors for their hard work and constructive support, as well as their complete confidence in the Caisse's management team and personnel, during what proved to be a year of consolidation and success for the Caisse de dépôt et placement du Québec.

Henri-Paul Rousseau

Chairman and Chief Executive Officer

The Caisse of the future

Fulfillment of the Caisse's mission depends to a large extent on a clear vision, respect for fundamental values, an understanding of its business model and development of priority levers.

MISSION

The mission of the Caisse is to receive moneys on deposit as provided by law and manage them with a view to achieving optimal return on capital within the framework of depositors' investment policies while contributing to Québec's economic development.

(Section 4.1 of the *Act respecting the Caisse de dépôt et placement du Québec*)

VISION

Become recognized as a benchmark organization for institutional fund managers

VALUES

- Excellence
- Boldness
- Ethics
- Transparency

BUSINESS MODEL

Focused
- Clear priorities
- Judicious choices
- Unifying strategic orientations

Open
- To the industry's best practices
- To judicious outsourcing
- To targeted third-party services

Effective
- Measure itself against and compare with the best
- Enhance and reward performance

LEVERS

Human resources
- Best practices
- Continuous improvement plan
- Recruit / Integrate / Retain / Train / Compensate / Recognize / Motivate

Risk management
- Measure / Control / Manage / Optimize / Decentralize

Leading-edge research
- Financial research centre of excellence for depositors and managers

Operational and technological efficiency
- Benchmark organization for management of resources and technology

AMBITION

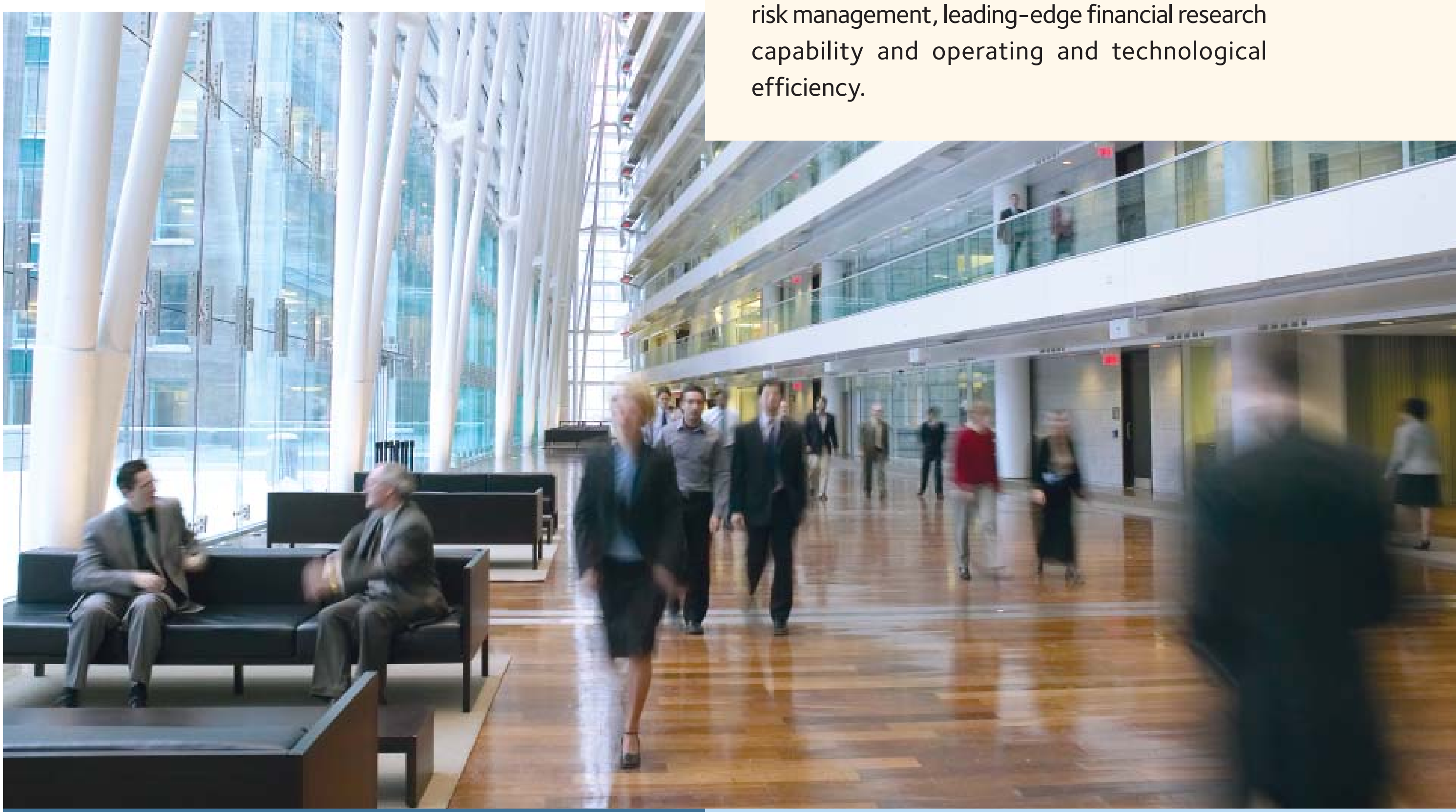
The Caisse de dépôt et placement du Québec
- Become a source of collective pride for its employees and depositors
- Deserve Quebecers' confidence
- Inspire respect on the part of its peers

Senior management

From left: Michel Malo, Richard Guay, Normand Provost, Christian Pestre, Fernand Perreault, V.P. Pham, Robert W. Desnoyers, Suzanne Masson, Henri-Paul Rousseau, Ghislain Parent, François Grenier and Denis Senécal.

The performance plan levers

To make orderly progress toward a superior performance, the Caisse has adopted a performance plan that will guide its operations in the years to come. The plan has four levers: human resources excellence, rigorous and disciplined risk management, leading-edge financial research capability and operating and technological efficiency.



Human resources

The Caisse relies on the diversified expertise of highly qualified employees to carry out the mandates received from its depositors. Its investment professionals, who are recruited from among the top talent at home and abroad, are backed up by solid multidisciplinary teams.

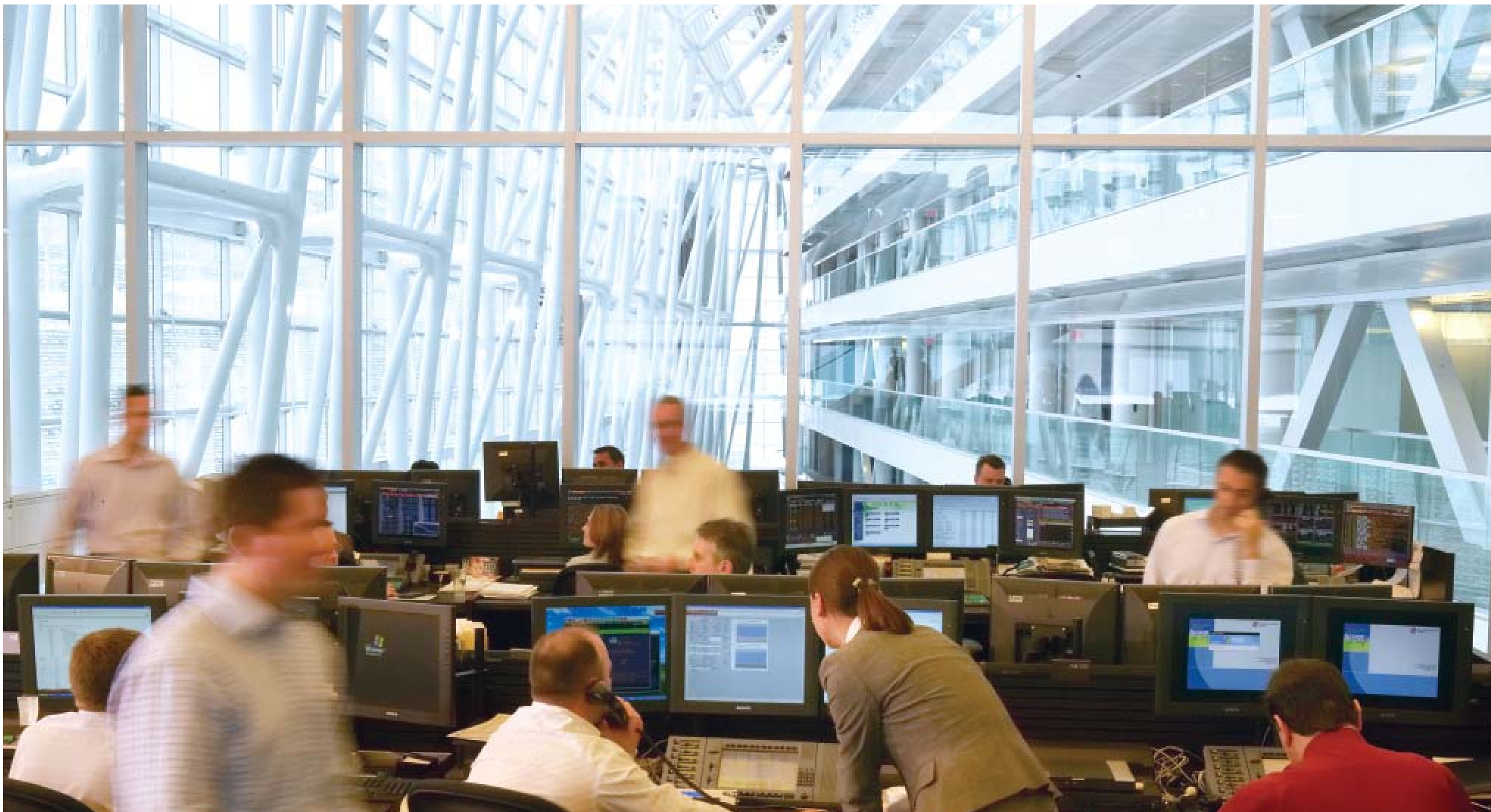
- 65% of the Caisse's employees have a university degree, 29% a master's degree and 3% a doctorate.
- Many of the Caisse's employees are members of professional orders (lawyers, accountants, notaries, etc.) or hold designations conferred by recognized organizations.
- 95 employees hold the Chartered Financial Analyst (CFA) designation.
- 9 employees have Financial Risk Manager (FRM) certification.

The success of any organization is based on the calibre of its personnel. The Caisse is essentially a knowledge-based institution that relies on the expertise and dedication of its employees. But it must cope with a scarcity of talent, mainly because of the increasing specialization and mobility that go hand in hand with globalization of the investment industry.

To stand out as a first-rate employer, the Caisse has made proactive management of human resources a strategic priority and has adopted practices that ensure effective recruiting, selection, retention and development as well as incentives to earn superior returns.

The Caisse strives to offer its highly talented employees a stimulating environment that meets their expectations, as well as competitive working conditions conducive to their professional development.

	Highlights 2004	**Outlook 2005**
Proactive management of human resources	• In-depth review of the role of each unit and its function within the organization • Revision of certain human resources policies • Deployment of the program to recognize years of service • Revision of the compensation programs • Revision of the performance management program • Creation of 72 new positions	• Give team leaders the tools and training they need to meet the challenge of active management of human resources • Deploy a number of human resources policies with priority on continuation of recruiting, succession, recognition and performance management programs
Organizational stability and sustainability	• Exhaustive inventory of employee experience and training • Development of a succession plan for critical positions in the Real Estate and Private Equity groups	• Continue to develop the succession plan and the development plan for the Caisse’s other investment groups and general services teams • Foster constant development of employee competencies with further training and more effective follow-up on skills-development programs

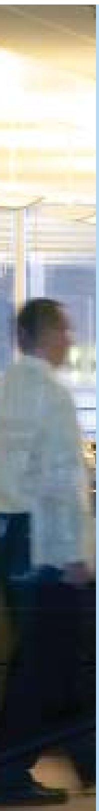


Risk management

Risk management has taken on unprecedented importance in an increasingly demanding financial environment in which fund managers must assume greater risk to achieve expected returns.

At the Caisse, risk-related decisions are based on specific directives set out in the depositors' investment policies and the investment policies of the specialized portfolios. It is then up to each portfolio manager to obtain the best possible return by taking risks that respect the limits specified in the policies.

	Highlights 2004	Outlook 2005
Effective risk allocation and measurement to generate a constant performance	• Refinement of risk measurement methods • Acquisition of software package to estimate market risk	• Complete implementation of software package to estimate market risk • Continue revising methods used to estimate market risk for real estate, private equity and hedge funds • Continue developing methods to estimate credit risk and monitor operational risks
Ongoing improvement of integrated risk management	• Establishment of investment policies for all specialized portfolios	• Revise and complete: – Integrated Risk Management Policy – Outsourcing Policy – Crisis Management Policy – Policy on the Use of Financial Products – Investment policies for the specialized portfolios



Research expertise

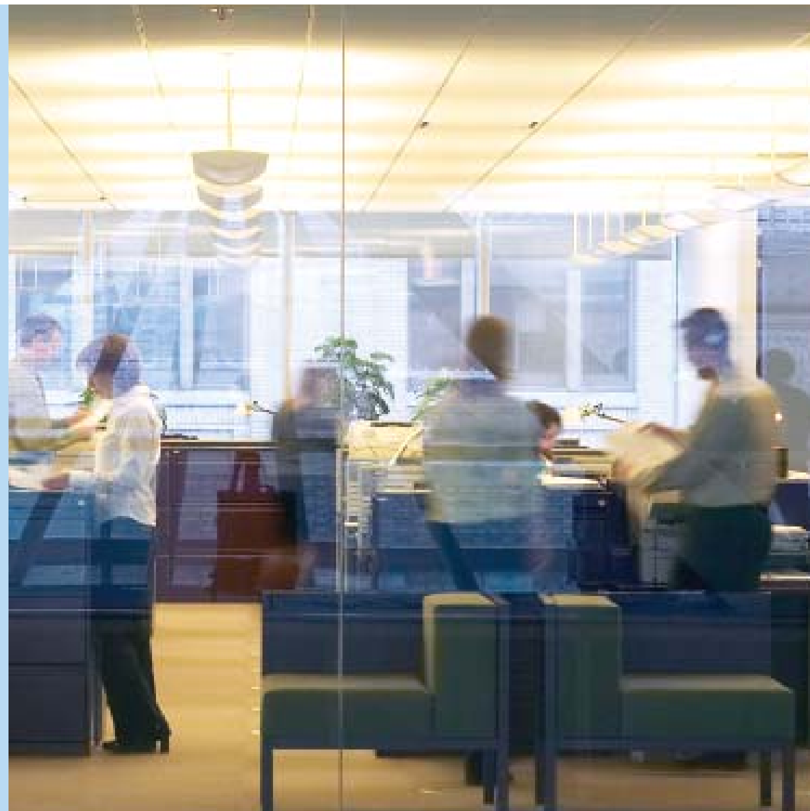
The research carried out at the Caisse covers four complementary fields:

1) **Creation of benchmark portfolios**
Since depositors are faced with an increasingly complex economic and financial environment, the Caisse constantly strives to define solutions that are suited to their needs and comply with their investment policies. A team of researchers is responsible for developing forecasts of the risk and returns of the benchmark portfolios established in the investment policies. This portfolio sets the asset allocation, the expected returns and the absolute risk for each depositor.

2) **Management of asset allocation and investment optimization**
Dynamic management of the specialized portfolios requires research that constantly relates depositors' constraints to the risks inherent in the financial markets. This research covers analysis of the macroeconomic outlook, as well as modelling and simulation required to optimize the active risk of the specialized portfolios and the absolute risk of the overall portfolio.

3) **Management of specialized portfolios**
Each asset class requires specific research adapted to the strategies of the various management styles used by the portfolio managers. Highly skilled teams of analysts within each investment group specialize in bottom-up and top-down analysis as well as technical and quantitative analysis (by region, industry or company).

4) **Strategic and competitive analysis**
The Caisse strives to constantly improve its research methods. It has all the resources required to monitor trends and conduct benchmarking of best practices for all sectors of the fund management industry.



Research

The Caisse devotes substantial resources to financial research, since it constitutes a performance lever that contributes significantly to active management of depositors' holdings. In the years to come, the Caisse intends to take advantage of its size to become a true centre of research excellence for depositors and portfolio managers alike. It intends to offer its depositors unsurpassed expertise and advisory services, and to achieve a genuine competitive advantage with its leading-edge research on market trends.

	Highlights 2004	**Outlook 2005**
Ensure the research model reflects the changing portfolio management environment and requirements	• Completion of analysis and consideration of proprietary research • Alignment with best practices in research, e.g. abolition of the soft-dollar commission program in 2005	• Place greater emphasis on proprietary research while making selective use of external research
Become a benchmark organization by publishing articles in the most prestigious academic and professional portfolio management journals	• Publication of articles in *Financial Management* and *Financial Analysts Journal*, among others, on research related to management of depositors' holdings	• Continue to publish articles in the most highly regarded academic and professional journals, in Canada and elsewhere

Operating and technological efficiency

Operating and technological efficiency is a strategic priority for the Caisse. In addition to striving to respect a responsible budgetary framework and keep operating expenses at a reasonable level, the Caisse believes that effective technology tools and platforms are vital for successful decision making and investment management.

In 2004, the Caisse completed an evaluation of its computer systems and a study of the best practices in this area. This exercise resulted in the adoption of a strategic plan whose main stages will be carried out over the next three years.

	Highlights 2004	**Outlook 2005**
Ensure the technology architecture is robust and efficient	• Adoption of a three-year information technology strategic plan • More emphasis on the role played by information technology and reinforcement of in-house expertise • Complete review of technology tools and platforms to simplify methods and eliminate overlap between various applications	• Begin putting in place a better data infrastructure • Implement the components required for straight through processing • Lay the foundations of the Caisse's electronic portal, which will combine tools and data in an integrated and personalized manner

Management of depositors' holdings

The seven main depositors

The Government and Public Employee Retirement Plan is the Caisse's main depositor. This plan consists primarily of contributions by employees who work in Québec's health and social services sector, education system and public sector. The plan is administered by the Commission administrative des régimes de retraite et d'assurances (CARRA).

The Fonds du Régime de rentes du Québec contributes to Quebecers' income security by providing for payment of a retirement pension. Administered by the Régie des rentes du Québec (RRQ), the plan is mandatory and the contributions to the fund are made by all employers and employees.

The Fonds d'amortissement des régimes de retraite (FARR) provides for payment of retirement benefits that are the responsibility of the government, according to the provisions of the retirement plans for the public and parapublic sectors. The fund is financed by the Québec government and administered by the Ministère des Finances.

The Supplemental Pension Plan for the Employees of the Québec Construction Industry is administered by the Commission de la construction du Québec (CCQ). The contributions to the plan are paid by construction industry employers and employees.

The Health and Work Safety Fund compensates workers who have work-related accidents and contributes to their rehabilitation. The fund is administered by the Commission de la santé et de la sécurité du travail (CSST) and financed by contributions from Québec employers.

The Fonds d'assurance automobile du Québec provides the funds required to compensate victims of vehicular accidents and to promote traffic safety. The fund is financed mainly by fees collected by the Société de l'assurance automobile du Québec (SAAQ) for driver's licences and vehicle registration.

The Pension Plan for Management consists of contributions by management employees in the public and parapublic sectors. The plan is administered by the Commission administrative des régimes de retraite and d'assurances (CARRA).

The Caisse's depositors

Most of the Caisse's depositors are public bodies that entrust to the Caisse management of the funds they administer. All these organizations have a common objective: to earn a superior return on the monies provided by contributors in order to meet future needs, such as payment of pension benefits or accident compensation.

As at December 31, 2004, the Caisse had 19 depositors whose holdings were divided among 24 funds: pension and insurance plans as well as funds of various types. Seven of them account for 98.6% of depositors' net assets.

Responsibilities of the Caisse and its depositors

Unlike organizations that both manage their funds and administer their pension or insurance plan, the Caisse and its depositors share these responsibilities as specified under service agreements.

Responsibilities of the depositor

Each depositor, through its pension committee, investment committee or board of directors, is responsible for managing its actuarial liabilities, or the sum of its financial obligations. It also develops and updates its investment policy as a function of its needs, investment horizon and risk tolerance.

The policy, which is revised at least every three years, specifies the plan's profile and characteristics, its benchmark portfolio and the market indexes for the asset classes in it, the return expected by the depositor and the level of risk it is prepared to assume.

Responsibilities of the Caisse

Advisory services

As an adviser, the Caisse provides advisory services to its depositors for the development or review of their investment policies. For example, it prepares economic analysis and forecasts as well as risk, return and correlation forecasts for the specialized portfolios (table 12).

It also simulates various asset allocation scenarios that enable the depositors to establish their benchmark portfolio. It designs and proposes new investment products to suit their changing needs. Lastly, it prepares studies and presentations on subjects related to their investment policies.

In conjunction with its advisory services, the Caisse offers depositors training and information sessions on portfolio management as well as on its own structures, processes and operations.

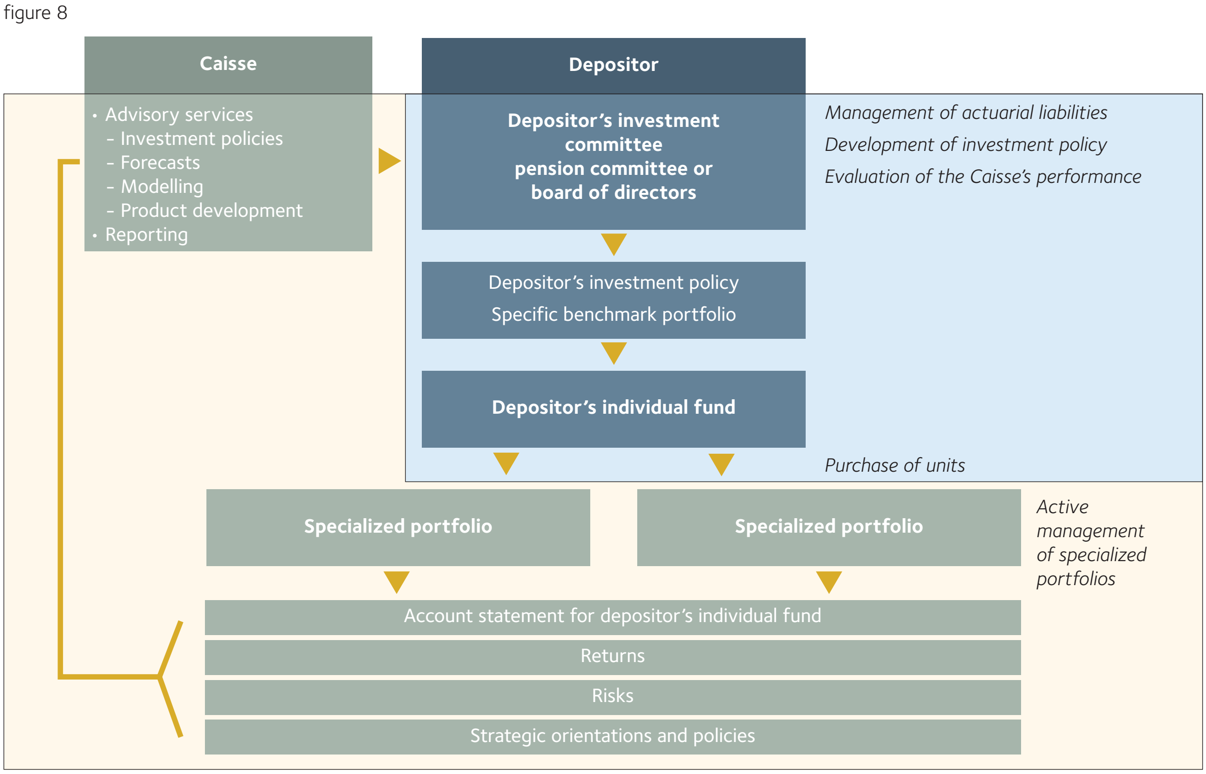
Fund management
As a manager of depositors' holdings, the Caisse undertakes to manage the funds it receives by seeking an optimal return on capital in accordance with their investment policies. This commitment includes the responsibility to report on the results of its operations. The Caisse reports periodically to each of its depositors on the return obtained, the source of the return, the value added or subtracted in relation to market or recognized indexes, the risk assumed and its performance in comparison with other institutional fund managers. It also issues compliance certificates to attest that the portfolio managers have respected the depositors' investment policies as well as the investment policies of the specialized portfolios. The Caisse must also keep depositors informed of its strategic orientations and significant changes affecting its personnel and various aspects of its management.

Highlights 2004
In 2004, the Caisse continued its efforts to consolidate its relations with depositors and to enhance the products and services it offers. It also welcomed a new depositor, the Régime de retraite de l'Université du Québec.

During the year, the Caisse advised several depositors on the optimization of their investment policies and entered into five service agreements with three of them. It also introduced a process to monitor compliance with the investment policies of its specialized portfolios.

It carried out research on inclusion of liabilities in the development of investment policies, exposure to currency fluctuations and the increase in non-traditional investments. Its research also led to the creation of two new specialized portfolios for depositors – Real Return Bonds and Commodities – as well as a change in the market index for the Hedge Funds portfolio.

Relationship between the Caisse and a depositor
figure 8



Lastly, to keep its depositors informed, the Caisse organized more meetings with portfolio managers, held seminars on the investment and financial environments and launched an electronic information bulletin.

A modern collective savings and management system

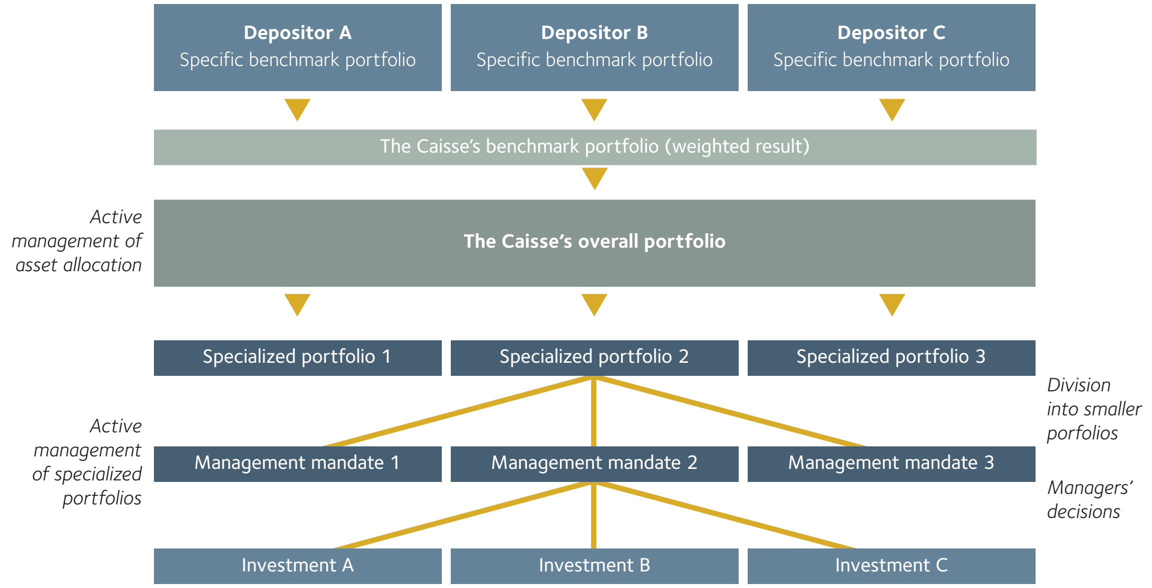
The collective savings and management system formed by the Caisse and its depositors has evolved dramatically since it was created in 1965. The substantial amounts deposited, the quest for superior returns and the need to limit overall risk have prompted the Caisse to diversify its investments across an ever-wider range of asset classes.

Over time, other asset classes have been added to bonds, which were the main holding in the Caisse's portfolio at the outset. These include mortgages, equities, private equity, real estate and hedge funds. The Caisse can offer this broader range of asset classes mainly because of the combined size of its depositors. Its large size has enabled it to develop leading-edge expertise and act on investment opportunities that are available only to major market players.

The Caisse has also encouraged well-defined investment policies that are constantly adapted to the specific needs of its depositors. The development of these policies is the outcome of a rigorous process in which the Caisse and its depositors work together.

Depositors' holdings management process

figure 9



The weighted average return on depositors' funds depends on four factors:

- Behaviour of the markets;
- Depositors' investment policies (benchmark portfolios);
- Weight of each depositor in the Caisse's overall portfolio; and
- Active management of each of the Caisse's specialized portfolios.

Developing the benchmark portfolio

Each depositor determines the long-term return objective that will enable it to meet its financial obligations. On the basis of that objective and the depositor's characteristics, the Caisse proposes various asset allocation scenarios. Each scenario reflects not only the expected return but also a level of absolute risk related to market volatility. The risk depends directly on the percentage of the assets allocated to each of the asset classes in a scenario.

The experts at the Caisse then work closely with the depositor to define the scenario that offers the best risk-return ratio. This scenario becomes the depositor's benchmark portfolio and specifies the upper and lower limits for each of the asset classes to ensure control over any future changes in their weighting. The overall benchmark portfolio, or the Caisse's benchmark portfolio, is the weighted combination of all the depositors' benchmark portfolios. Table 10 shows the composition of a fictitious depositor's benchmark portfolio.

Composition of a fictitious depositor's benchmark portfolio

table 10

Specialized portfolios	Lower limit %	Benchmark weight %	Upper limit %	Market index (in accordance with depositors)
Fixed income investments				
Short-term Investments	0.0	3.0	15.0	SC 91-Day Canadian T-Bill
Real Return Bonds	3.0	6.0	9.0	SC Real Return Bond
Mortgages	0.0	5.0	8.0	SC Universe Bond
Bonds	20.0	25.0	32.0	SC Universe Bond
Subtotal		**39.0**		
Variable income investments				
Canadian Equity	7.0	14.0	22.0	S&P/TSX capped
U.S. Equity (hedged)	2.0	5.0	10.0	S&P 500 hedged
U.S. Equity (unhedged)	2.0	4.0	8.0	S&P 500 unhedged
Foreign Equity (hedged)	2.0	5.0	10.0	MSCI EAFE hedged
Foreign Equity (unhedged)	2.0	4.0	10.0	MSCI EAFE unhedged
Emerging Markets Equity	0.0	2.0	5.0	MSCI EM
Québec International	0.0	5.0	10.0	Québec International
Subtotal		**39.0**		
Other investments				
Investments and Infrastructures	0.0	4.0	7.0	S&P/TSX adjusted
Private Equity	3.0	7.0	9.0	S&P 600 adjusted
Real Estate	5.0	8.0	12.0	Aon – Real Estate
Commodities	0.0	1.8	3.0	Commodity Financial Intruments
Hedge Funds	0.0	1.0	2.0	SC 91-Day Canadian T-Bill
Asset Allocation	0.0	0.2	1.0	n.a.
Subtotal		**22.0**		
Total		**100.0**		

Active management of the specialized portfolios
The depositors that invest in the Caisse's specialized portfolios expect them to outperform their benchmark portfolios, hence the need for active management.

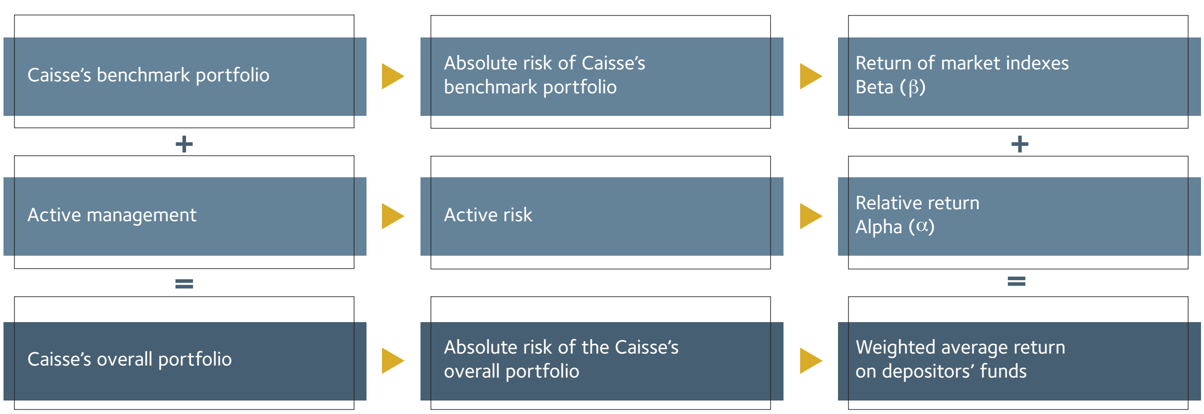
The managers responsible for asset allocation can change the weighting of each of the specialized portfolios that make up the overall portfolio, provided they respect the upper and lower limits of the Caisse's benchmark portfolio. Their decisions are based on an analysis of macroeconomic trends as well as efforts to optimize the active and absolute risks of the overall portfolio and its components. The decisions are then approved by the Asset Allocation Management Committee. Within the investment groups, each specialized portfolio is divided into management mandates that are assigned to internal or external managers. These portfolio managers select securities and currencies to achieve the value added objectives of the management mandates they are responsible for.

All these investment decisions lead to the taking of "active" risk, which creates the opportunity to outperform the benchmark indexes, while also implying the possibility that the return will underperform. This active risk is managed rigorously by means of checks and balances on all levels of the Caisse's management structure.

Figure 11 shows the components of risk and return arising from the Caisse's active management.

Long-term return outlook for the Caisse and its depositors
The Caisse and its depositors must cope with the fact that returns on traditional asset classes, namely fixed income and equities, are expected to be lower than in the past. Bond yields are currently at historically low levels, and it is expected that the premium that stocks offer over bonds will be far lower than the excess return observed in the past, namely about 3.0% in the years to come.

Active management and active risk
figure 11



The absolute risk of the Caisse's benchmark portfolio is determined by the market risk of the asset classes in the portfolio. For example, if the depositors generally decide to increase the proportion of equities in their individual benchmark portfolios, this risk will automatically increase.

Active risk represents the possibility that the Caisse will generate a return that is below the return on its benchmark portfolio in actively managing its overall portfolio.

The combination of the absolute risk of the Caisse's benchmark portfolio and the active risk assumed by the Caisse gives the absolute risk of the Caisse's overall portfolio. Each of these three risks is measured periodically.

It will therefore be difficult for the Caisse to rely solely on a traditional portfolio consisting of 60% equities and 40% fixed income, if it is to achieve its depositors' return objectives. Today it is estimated that such a portfolio would generate a nominal return of 5% to 6%, whereas, given their needs, the depositors are looking for nominal returns of 7% to 8%. The depositors' need for such returns is accentuated by unfavourable demographic factors.

In addition to the prospect of lower returns on traditional asset classes, the Caisse must cope with greater risk. Market globalization has considerably reduced the effect of equity portfolio diversification. Moreover, the correlation between fixed income and equities has increased a great deal (table 12 gives the characteristics of the various specialized portfolios and their correlation).

In such a context, the Caisse and its depositors have no alternative but to increase the weighting of non-traditional asset classes in their portfolios. In addition to offering a potentially higher return, these asset classes offer the advantage of greater diversification and, in the case of real estate and commodities, constitute a hedge against inflation. The two largest non-traditional categories – real estate and private equity – derive benefit from the advantage created by the Caisse's size. Still, they are characterized by limited liquidity and, in the case of private equity, a higher level of risk than that of publicly traded equities.

Absolute return operations are also an important source of returns with a lower correlation to the stock and bond indexes. Still, over the medium term, the increasing popularity of hedge fund strategies of all kinds could lead to a scarcity of investment opportunities in overexploited markets.

In short, to meet the challenge of earning superior long-term returns, the Caisse and its depositors will have to continue to make their asset allocation decisions with due regard for their long-term investment horizon, diversification of holdings and actuarial liabilities, while ensuring rigorous risk management.

Alpha (α) and Beta (β)

In the language of portfolio management, the portion of return attributable to the market is called "beta," while the return that is generated by active management – i.e. the choice of asset allocation, country, sector, security or other value added strategies – is called "alpha."

Characteristics of the specialized portfolios and their correlation

table 12

Specialized portfolios	Expected return	Absolute Risk		Protection against inflation	Liquidity	Correlation between specialized portfolios: Correlation	Correlation between specialized portfolios: Specialized portfolio
Short-term Investments	Very low	None		Yes	High	± –	• Majority of specialized portfolios • Real Return Bonds
Real Return Bonds	Low	Low		Yes	Low	+ ± –	• Majority of specialized portfolios • U.S. Equity, Foreign Equity, Emerging Markets Equity, Private Equity, Real Estate • Short-term Investments
Bonds	Low to medium	Low: Govern-ment bonds	Medium: Corporate bonds	No	High	+ ± –	• Real Return Bonds, Québec International, Investments and Infrastructures, Hedge Funds • Short-term Investments, Equities, Private Equity, Commodities • Real Estate
Canadian Equity, U.S. Equity, Foreign Equity, Emerging Markets Equity	Medium to high	High		Yes (long term)	High	+ ±	• Equities, Québec International, Private Equity, Hedge Funds • Short-term Investments, Real Return Bonds, Bonds, Real Estate, Commodities
Québec International	High	High		Yes (long term)	Medium	+ ±	• Majority of specialized portfolios • Short-term Investments, Real Estate, Commodities
Investments and Infrastructures	High (long term)	High		Yes (long term)	Low	+ ±	• Majority of specialized portfolios • Short-term Investments, Emerging Markets Equity, Real Estate
Private Equity	High (long term)	High to very high		Yes (long term)	Low	+ ±	• Majority of specialized portfolios • Short-term Investments, Real Return Bonds, Bonds, Real Estate, Commodities
Real Estate	High (long term)	Medium to high		Yes	Low	± –	• Majority of specialized portfolios • Bonds, Emerging Markets Equity, Hedge Funds
Mortgages	Medium to high	Medium		No	Low	+ ± –	• Real Return Bonds, Bonds, Hedge Funds • Short-term Investments, Canadian Equities, Investments and Infrastructures, Private Equity, Real Estate, Commodities • U.S. Equity, Foreign Equity, Emerging Markets Equity, Québec International
Commodities	Medium to high	Medium to high		Yes	Medium	+ ±	• Short-term Investments, Canadian Equity, Investments and Infrastructures, Hedge Funds • Majority of specialized portfolios
Hedge Funds	Medium to high	Medium to high		Yes (long term)	Low	+ ± –	• Low for the majority of specialized portfolios • Short-term Investments • Real Estate

\+ Positive
± Neutral
\- Negative

Economic context 2004

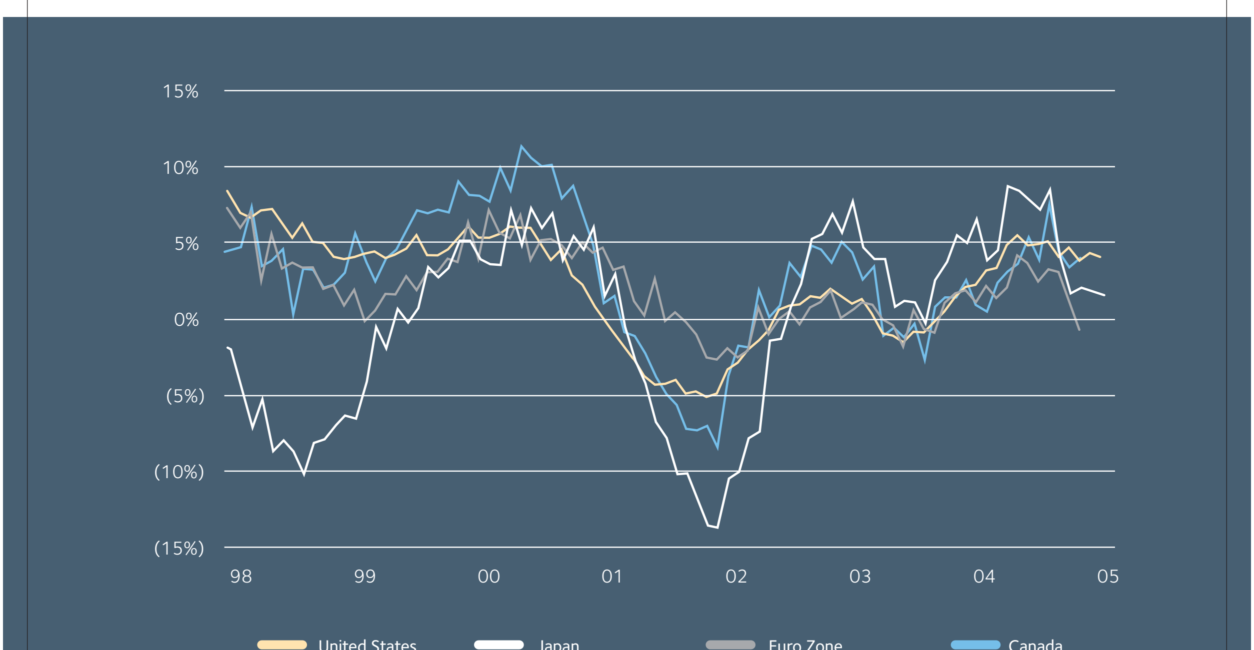
Consumer spending, oil and China
North American households seemed to have an insatiable appetite for consumer goods and housing in 2004. Income tax cuts in the United States, the long-awaited upturn in employment and massive use of credit sustained this demand and largely offset the dampening effect of the oil price spiral.

China was also one of the main themes in 2004. Its competitive edge vis-à-vis the mature economies grew sharper. As commodity prices rose around the world, Western manufacturers were unable to pass the price increases on to their customers and turned to China to contain their production costs. China therefore continued to take advantage of this shift of production capacity and the sustained demand from Western consumers. It also made a significant contribution to containing world inflation by imposing rigorous price discipline. Lastly, the acceleration of China's domestic demand was one of the important structural factors behind the rising price of crude oil. It is quite likely that this sustained demand will keep the price of oil high for several years to come.

Worldwide economic conditions
As shown by figure 13, global economic growth accelerated sharply in 2004. With impetus from North America and Asia, global GDP expanded by more than 4.0% for the first time since 2000. In China, as in 2003, industrial production was up more than 15%. This sustained growth benefited the entire region, so that manufacturing output increased throughout Asia. The European economy turned in a disappointing performance, however, with the exception of the United Kingdom, whose business cycle is more in line with North America's.

In the second half, signs of a slowdown appeared around the world but did not deter central bankers, who had begun tightening monetary conditions to prevent inflation. The U.S. Federal Reserve, the Bank of Canada, the Bank of England and the Bank of New Zealand all raised their key rates in the second half.

Industrial production: United States, Japan, Euro Zone, Canada
figure 13
(annual variation)



Sources: Macroeconomic Analysis, Datastream

North America

In the United States, after a three-year downturn employment finally began rising in 2004. Combined with income tax cuts and very low interest rates, the large employment gains recorded at the beginning of the year revived consumer confidence. Despite record household debt levels and the surging oil price, consumer spending remained the main engine of economic growth. As for production, the U.S. manufacturing sector shook off three years of sluggishness, mainly because of technology-based output gains. This upturn stemmed the hemorrhaging of jobs in the manufacturing sector, which had been going on for six years.

Expanding by more than 4.0%, the U.S. economy continued to be the main driver of global growth. In this context, its trade deficit deteriorated further in 2004, rising to more than 5.0% of GDP. The pressure created by this deficit finally got the better of the U.S. dollar. As figure 14 shows, after falling 8.5% in 2003, the greenback lost another 5.0% last year (trade-weighted exchange rate).

In Canada too, household demand remained very strong in 2004. Consumer spending and residential investment sustained growth, while external demand suffered because of the surging Canadian dollar. The results for 2004 are rather modest: GDP was up only 2.7%, after adding a lacklustre 2.0% in 2003. Still, the job market held up fairly well: about 225,000 jobs were created in 2004 and the employment rate remained at a historic high. Only manufacturing employment continued to suffer as Canadian manufacturers saw their competitive edge blunted by the rising currency.

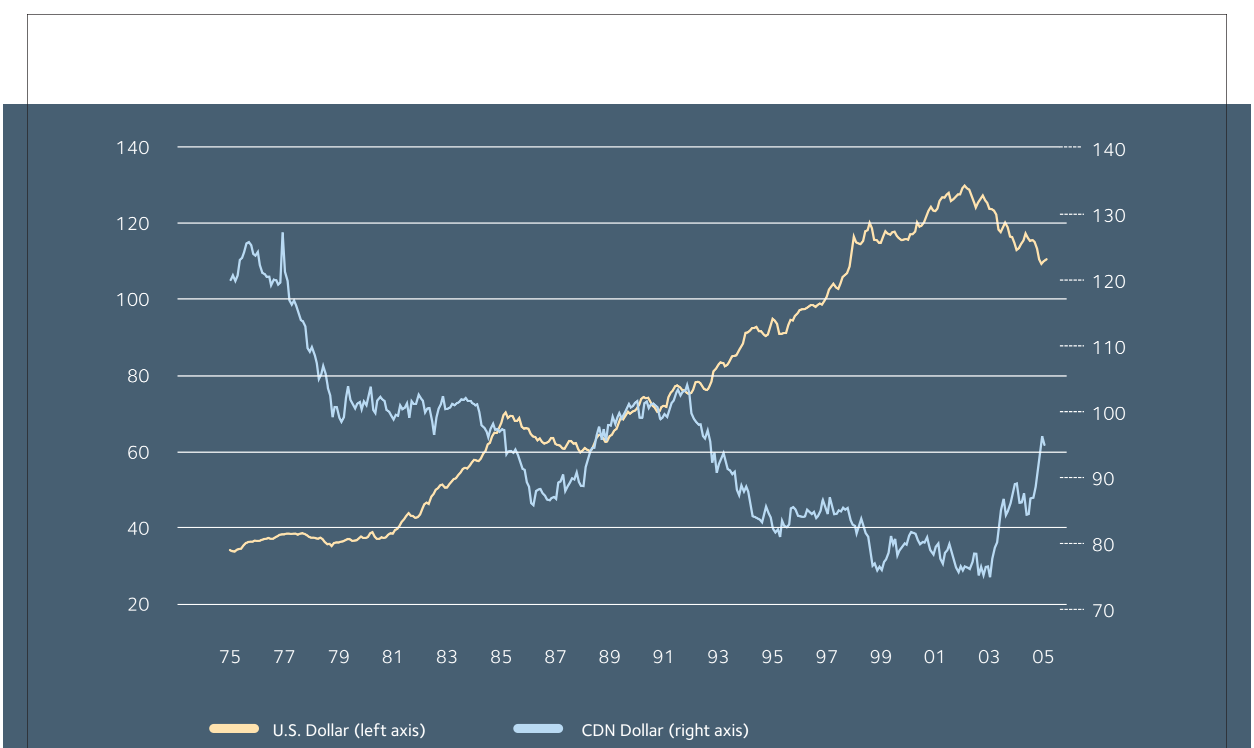
Europe

The rebound that began in late 2003 continued in the first half of 2004, fuelled by the export sector. Still, toward year-end the global slowdown and the strong euro began to take a toll on the export sector, and anemic domestic demand could not pick up the slack. Despite a stimulative monetary policy, consumer spending and business investment failed to revive. As businesses continued to restructure to improve their profitability, employment fell and household spending flagged. With little leeway to stimulate the economy, the governments of the main countries in the Euro Zone maintained austere budgetary policies.

Exchange rate of the U.S. and Canadian dollars

figure 14

(trade – weighted)



Sources: Macroeconomic analysis, Federal Reserve, Datastream

The United Kingdom stood apart from the Continent, however. The country is experiencing its longest expansion of the post-war period. The unemployment rate is the lowest it has been in a generation. As in the United States, the central bank had to raise its key rate several times to forestall inflationary pressures, at the risk of causing the overheated English real estate market to implode.

Asia

Although China's economy cooled somewhat, it remained overheated. Inflation accelerated in 2004 as the rapid erosion of qualified labour placed upward pressure on wages. The government is using administrative measures with a view to a soft landing, but the risks of a hard landing are very real. China remains an emerging country in full transition, and its ability to fine-tune economic activity is still rudimentary.

The entire region has benefited from the booming Chinese economy, including Japan, which is increasingly dependent on the economic health of its close neighbour. Still, the record volume of exports to China was unable to overcome the chronic weakness in domestic demand. In 2004 Japan fell back into recession.

Performance summary

Overall results

The Caisse's overall return is determined by the depositors' returns and the relative weight of each; it is therefore the weighted average return on depositors' funds. The weighted average return on depositors' funds was 12.2% in 2004 versus 15.2% in 2003. It exceeded by 100 b.p. (1.0%) the overall index represented by the Caisse's benchmark portfolio, versus 8 b.p. (0.08%) in 2003. Combined with the returns for 2002 and 2003, the 2004 return brings the weighted average return on depositors' funds over three years to 5.3% and over five years to 3.4%, versus 6.5% and 4.7% for the return on the benchmark portfolio.

Depositors' individual returns

The 12.2% return consists of the individual returns on 24 depositors' funds, which range from 5.0% to 14.6%. This spread reflects the varying needs and objectives of the public bodies for which the Caisse manages funds. In developing their investment policies, the depositors determine the weighting of the asset classes in which they invest as a function of the nature and horizon of their financial obligations as well as their need for liquidity.

Changes in depositors' net assets

The returns earned by the Caisse in 2004 generated a total contribution of $10.8 billion, versus $11.5 billion in 2003. Combined with the net deposits made by the depositors during the year, these gains brought depositors' net assets to $102.4 billion as at December 31, 2004, up $13.0 billion from December 31, 2003.

Since December 31, 2002, depositors' net assets have increased from $77.7 billion to $102.4 billion, for an increase of $24.7 billion or 31.8%. This increase is due mainly to investment activities, which generated $22.3 billion, while the net deposits made by the Caisse's depositors amounted to $2.4 billion.

Figures 17 and 18 give the changes in depositors' net assets as well as the total contribution by investment activities since 2000.

Changes in total assets under management

Depositors' total assets rose by $29.5 billion in 2004, to $147.2 billion as at December 31, 2004. It includes liabilities (assets financed by borrowing) contracted by the Caisse to optimize the depositors' return. At year-end, liabilities amounted to $44.8 billion. If assets under management and assets under administration for third parties are included, the Caisse's total assets under management amounted to $174.7 billion as at December 31, 2004.

Weighted average returns on depositors' funds

Table 15 shows the weighted average return for the depositors' funds over one, three and five years compared with the overall weighted index. The returns on the specialized portfolios for the same periods are shown in the *Financial statistics and review* section of *Annual Report 2004 – Additional Information.*

Weighted average returns on depositors' funds

table 15

	Return %	Index %	Spread b.p.
1 year	12.2	11.2	**100**
3 years	5.3	6.5	**(114)**
5 years	3.4	4.7	**(130)**

Contribution of the investment groups

Table 16 gives the results for each investment group as follows: the contribution in billions of dollars and as a percentage in relation to the total contribution, the return and the value added for each group in relation to the long-term return indexes.

Breakdown of contribution in dollars by investment group

table 16

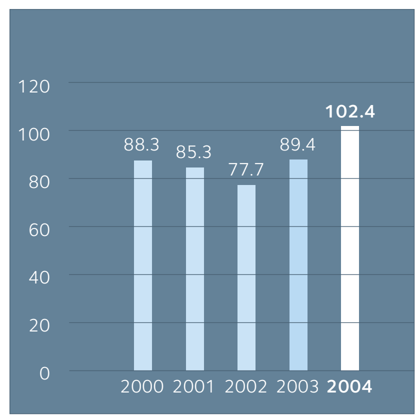
	Contribution		Return	Spread
	billions of $	%	%	b.p.
Equity Markets	4.6	42.6	12.6	(7)
Fixed Income	2.3	21.3	7.1	13
Absolute Return	0.1	0.9	7.8	784
Real Estate	2.2	20.4	22.7	758
Private Equity	1.6	14.8	20.5	271

Table 19 gives the returns for each investment group. It shows clearly that the record return earned by the Real Estate group and the excellent returns of the Private Equity group made significant contributions to the Caisse's 2004 results, which also reflect the strength of the equity markets around the world, the appreciation of the fixed income portfolios and the contribution of absolute return operations.

Depositors' net assets 2000 – 2004

figure 17

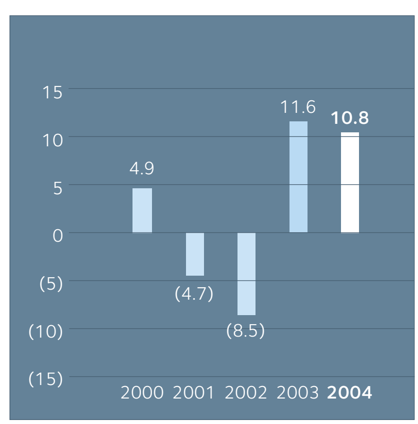
(as at December 31 – in billions of dollars)



Total contribution of investment activities 2000 – 2004

figure 18

(as at December 31 – in billions of dollars)



Returns earned by the investment groups – long term

table 19

(as at December 31, 2004 – in percentage unless otherwise indicated)

Investment groups	Return	Index	Spread b.p.	Market Index
Equity Markets				
Canadian Equity	15.2	14.5	72	S&P/TSX capped
U.S. Equity (hedged)	10.7	11.7	(105)	S&P 500 hedged
U.S. Equity (unhedged)	1.7	2.8	(108)	S&P 500 unhedged
Foreign Equity (hedged)	11.6	13.0	(139)	MSCI – EAFE hedged
Foreign Equity (unhedged)	9.9	11.5	(158)	MSCI – EAFE unhedged
Emerging Markets Equity	14.5	16.4	(191)	MSCI – EM
Québec International	16.4	16.3	15	Québec International
	12.6	**12.7**	**(7)**	
Fixed Income				
Short-term Investments	2.5	2.3	20	SC 91-Day Canadian T-Bill
Real Return Bonds	18.0	17.5	49	SC Real Return Bond
Bonds	7.3[1]	7.1	12	SC Universe Bond
	7.1	**6.9**	**13**	
Absolute Return				
Hedge Funds	10.7[1]	2.3	842	SC 91-Day Canadian T-Bill
Commodities (portfolio created August 1, 2004)	(7.1)	(7.6)	53	Commodity Financial Instruments
	7.8	**(0.1)**	**784**	
Real Estate				
Real Estate	29.3	19.3	1,001	Aon – Real Estate
Mortgages	12.0	7.1	482	SC Universe Bond
	22.7	**15.1**	**758**	
Private Equity				
Investments and Infrastructures	17.2	12.4	476	S&P/TSX adjusted
Private Equity	22.4	20.9	141	S&P 600 adjusted
	20.5	**17.8**	**271**	
Asset Allocation ($M)	(107)[2]	–	(107)	n.a.
Weighted average return on depositors' funds	**12.2**	**11.2**	**100**	

1 The value added in 2004 relative to specialized Bonds portfolio has been allocated between the teams that generated it, namely Fixed Income and Absolute Return.

2 As a function of market indexes for evaluation of cash decisions.

The predetermined return thresholds for the other investments

The predetermined return thresholds are established on the basis of three components:

1) **Expected long-term rate of return on Government bonds**
This component is generally measured by the yield to maturity of 10-year Government of Canada bonds.

2) **Equity risk premium**
This component, which is widely discussed in the financial literature, corresponds to the additional return expected from the equity markets, given the added risk assumed compared with holding long-term government bonds.

3) **Risk premium related to other investments**
The comparison parameters for other investments, i.e. databases providing the distribution of returns earned by other managers, are used to calculate the third component. The average return drawn from these distributions provides information on the historical excess return from these operations in comparison with the equity markets. This historical excess return provides a point of reference for determining the short-term return expected on other investments, namely the return on equity markets plus a risk premium reflecting the additional systematic risks associated with these operations (lower liquidity, less diversification, additional leverage, manager risk and additional operational risks).

For example, the predetermined short-term return threshold of the specialized Private Equity portfolio, after operating expenses, was 12.0% in 2004:

→ Expected return on long-term government bonds: 4.5%;
→ Plus the equity risk premium: 2.5%;
→ Plus the risk premium related to other investments: 5.0%.

Short-term results of the investment groups
The objective of the managers of the liquid portfolios, in particular the equity and fixed income portfolios, is to generate value added over the short and long terms in relation to market indexes or recognized indexes.

The value added objective of the managers of the less liquid portfolios, such as Real Estate and Private Equity, differs over the short and long terms, however. Over the short term, the managers' objective is to produce value added that exceeds predetermined return thresholds, independent of the market's yearly fluctuations. These thresholds are established to produce the level of value added expected over five years in relation to the market indexes and reflect the higher risk premium that the depositors expect of these less liquid investments. Thus, over the long term, the value added of the managers of these portfolios is measured in relation to market indexes or recognized indexes.

In 2004, the Caisse managers as a group outperformed the overall short-term return threshold by 247 b.p. (2.47%), versus 147 b.p. (1.47%) in 2003. Table 20 gives the returns on liquid investments in relation to market indexes as well as the returns on other investments in comparison with the predetermined return thresholds.

Impact of currency hedging on the results
The strength of the Canadian dollar against the U.S. dollar, the pound sterling and the yen, also affected the Caisse's overall return. The U.S. Equity portfolio hedged against currency risk returned 10.7%, versus 1.7% for the unhedged portfolio. The return spread between these two portfolios reflects mainly the strength of the Canadian dollar against the U.S. dollar in 2004. Similarly, the return on the hedged Foreign Equity portfolio was 11.6%, versus 9.9% for the unhedged portfolio. The return spread between these two portfolios is due mainly to the strength of the Canadian dollar against the yen and the pound sterling. The specialized Private Equity, Investments and Infrastructures, Real Estate and Mortgages portfolios are fully hedged against foreign exchange risks.

Returns earned by the investment groups – short term
table 20
(as at December 31, 2004 – in percentage unless otherwise indicated)

Investment groups	Return	Index or threshold	Spread b.p.	Market Index or predetermined return threshold
Equity Markets				
Canadian Equity	15.2	14.5	72	S&P/TSX capped
U.S. Equity (hedged)	10.7	11.7	(105)	S&P 500 hedged
U.S. Equity (unhedged)	1.7	2.8	(108)	S&P 500 unhedged
Foreign Equity (hedged)	11.6	13.0	(139)	MSCI – EAFE hedged
Foreign Equity (unhedged)	9.9	11.5	(158)	MSCI – EAFE unhedged
Emerging Markets Equity	14.5	16.4	(191)	MSCI – EM
Québec International	16.4	16.3	15	Québec International
	12.6	**12.7**	**(7)**	
Fixed Income				
Short-term Investments	2.5	2.3	20	SC 91-Day Canadian T-Bill
Real Return Bonds	18.0	17.5	49	SC Real Return Bond
Bonds	7.3[1]	7.1	12	SC Universe Bond
	7.1	**6.9**	**13**	
Absolute Return				
Hedge Funds	10.7[1]	6.3	442	SC 91-Day Canadian T-Bill + 4%
Commodities (portfolio created August 1, 2004)	(7.1)	(7.6)	53	Commodity Financial Instruments
	7.8	**3.6**	**419**	
Real Estate				
Real Estate	29.3	9.0	2,034	9%
Mortgages	12.0	7.1	482	SC Universe Bond
	22.7	**8.5**	**1,416**	
Private Equity				
Investments and Infrastructures	17.2	9.0	820	9%
Private Equity	22.4	12.0	1,035	12%
	20.5	**11.0**	**951**	
Asset Allocation ($ million)	137[2]		137	n.a.
Weighted average return on depositors' funds	**12.2**	**9.7**	**247**	

1 The value added in 2004 relative to the specialized Bond portfolio has been allocated between the teams that generated it, namely Fixed Income and Absolute Return.
2 As a function of predetermined thresholds for evaluation of cash decisions.

Other investments (less liquid)

Predetermined return thresholds associated with other investments

Changes in the benchmark portfolio
The Caisse endeavoured to increase its sources of return in 2004 by improving its existing specialized portfolios and by creating new ones. It created a Commodities portfolio and restructured the Hedge Funds portfolio, including in it the operations of the in-house hedge funds: Fixed Income Relative Value, Currencies, Commodities and Global Macro. It also created a Real Return Bond portfolio for depositors seeking protection against unexpected changes in the inflation rate.

Changes in the Caisse's overall portfolio
The weighting of real estate in the Caisse's overall portfolio fell during the year despite surging property values, as a result of the sale of a number of assets. At the same time, the Mortgages portfolio saw the value of its assets rise with the drop in interest rates and stronger demand for real estate financing. Lastly, the restructuring of the Private Equity group and the sale of assets caused a slight drop in the weightings of the Investments and Infrastructures and Private Equity portfolios in relation to 2003.

Table 22 gives the composition of the Caisse's benchmark portfolio as at December 31, 2004, as well as the effective allocation of the Caisse's overall portfolio as at December 31, for 2003 and 2004.

Risk of the Caisse's overall portfolio
The Caisse uses sophisticated risk-analysis and -measurement systems to monitor changes in the composition of the active risk and absolute risk of its overall portfolio.

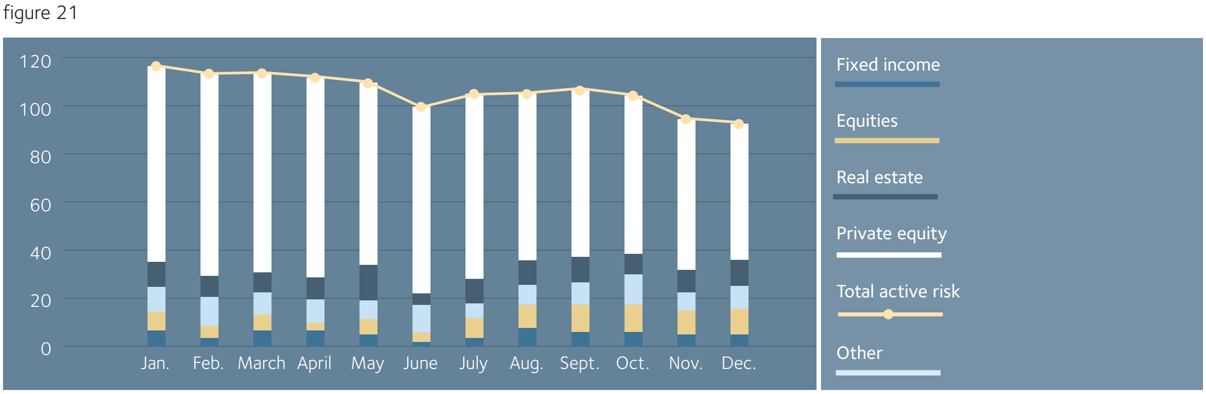
Active risk
To achieve the depositors' value added objectives, the Caisse must assume risks, within the allowed limits, in those asset classes that offer high potential returns, while avoiding undue losses. Effective allocation of active risk is therefore essential to value creation (figure 21).

In 2004, the allocation of risk between the specialized portfolios proved relevant, since it was geared to those portfolios that produced the best results. The Caisse managed a high level of risk in the Real Estate and Private Equity sectors. It also allocated the risk in its equity portfolios more effectively by increasing the risk level of Canadian equities and decreasing that of foreign equities.

Absolute risk
Measurement of absolute risk is used to control the size of the return deficit in relation to the return expected by the depositors. Owing to their size and volatility, the equity portfolios account for more than 70% of the absolute risk of the Caisse's overall portfolio. Thus absolute risk is concentrated in the asset class that has the greatest absolute return potential.

In 2004, the equity markets were characterized by a pronounced decrease in their absolute risk and an increase in their correlation. This phenomenon affected the risk of the Caisse's equity portfolios, causing a 0.80% decrease in the level of absolute risk for the overall portfolio.

Change in active risk per asset class in 2004
figure 21



Composition of the benchmark portfolio and changes in the Caisse's overall portfolio

table 22

Caisse's overall portfolio as at December 31, 2004		Benchmark portfolio as at December 31, 2004			Caisse's overall portfolio as at December 31, 2003	
		Lower limit	Benchmark portfolio	Upper limit		
	%	%	%	%	%	
Fixed income investments						**Fixed income investments**
Short-term Investments	2.3	0.4	2.0	10.5	2.7	Short-term Investments
Real Return Bonds	1.1	0.6	1.1	2.4	–	–
Bonds and Mortgages	36.3	31.2	36.3	43.1	34.8	Bonds and Mortgages
Subtotal	**39.7**		**39.4**		**37.5**	Subtotal
Variable income investments						**Variable income investments**
Canadian Equity	15.0	9.8	15.0	20.2	17.5	Canadian Equity
U.S. Equity	8.2	2.5	6.7	11.1	8.3	U.S. Equity
Foreign Equity and Emerging Markets Equity	8.8	4.3	8.6	13.1	10.1	Foreign Equity and Emerging Markets Equity
Québec International	8.0	5.5	8.0	10.0	6.8	Québec International
Subtotal	**40.0**		**38.3**		**42.7**	Subtotal
Other investments						**Other investments**
Investments and Infrastructures	3.8	1.9	3.7	6.0	3.0	Investments and Infrastructures
Private Equity	5.0	3.4	7.2	8.8	6.8	Private Equity
Real Estate	7.6	4.7	7.7	11.1	8.7	Real Estate
Commodities	1.0	–	1.1	2.1	–	–
Hedge Funds	2.7	–	2.6	4.6	1.1	Hedge Funds Partnership Units
Asset Allocation	0.2	–	–	–	0.2	Asset Allocation and Currencies
Subtotal	**20.3**		**22.3**		**19.8**	Subtotal
Total	**100.0**		**100.0**		**100.0**	**Total**

N.B.: The benchmark and its upper and lower limits are the result of the weighted average of the depositors' benchmark portfolios.

Investment operations and analysis of returns

In 2004, the Caisse managed its depositors' net assets with six investment groups: Equity Markets; Fixed Income; Absolute Return; Real Estate; Private Equity; and Investment Analysis and Optimization. Table 23 lists the investment groups as well as the specialized portfolios they manage. The investment operations and the returns are discussed in the sections that follow.

Specialized portfolios by investment group
table 23

Investment group	Specialized portfolio
Equity Markets	Canadian Equity U.S. Equity (hedged and unhedged) Foreign Equity (hedged and unhedged) Emerging Markets Equity Québec International
Fixed Income	Short-term Investments Real Return Bonds Bonds
Absolute Return	Hedge Funds Commodities
Real Estate	Real Estate Mortgages
Private Equity	Private Equity Investments and Infrastructures
Investment Analysis and Optimization	Asset Allocation

Equity Markets

The Caisse began investing in equities in the late 1960s to diversify its holdings and to obtain higher long-term returns for its depositors. It gradually increased their weight in its portfolio in relation to that of bonds, since the long-term investment horizons of a number of depositors allowed for a greater degree of risk. Equity investments also offer considerable liquidity as well as a hedge against inflation over the long term. Today, the Caisse's equity portfolios cover the main equity markets around the world and represent about 40% of depositors' net assets.

Investment philosophy

To achieve their value added objectives in relation to the benchmark indexes, the group's teams of managers emphasize a fundamental approach that focuses on the intrinsic value of companies and their earnings outlook over the medium and long terms. The portfolio managers rely on in-depth research as well as rigorous bottom-up analysis to establish their convictions and to select securities. By optimizing active risk while respecting the limits specified in the investment policies, the managers construct coherent, targeted portfolios with the potential for excellent returns.

Highlights

The Equity Markets group continued to revise its practices in 2004 to optimize the talent and expertise of its management teams. It enhanced the strength of the Canadian equity team by merging the sector-management and specialized-management groups, and by consolidating their management mandates. The group also adopted a development plan whereby the Canadian equity managers concentrate their expertise in those market segments that offer the best potential returns for a given degree of risk.

The group reallocated the active risk of the international equity teams, by rebalancing the relative weight of the internal and external management mandates within the portfolios, and by allocating additional funds to the best-performing managers. It also gave mandates to new external managers to ensure more extensive coverage of promising market segments. A new in-house team selects and monitors the external managers.

The group reorganized the management of the U.S. Equity portfolio according to four complementary approaches: traditional management, index management, long/short management and external active management. In addition, the allocation of capital among the managers was adjusted and optimized as a function of the returns earned and expected during the year.

External management of the specialized Foreign Equity portfolio was also reorganized at year-end, and a new management structure will be put in place in the first half of 2005. Lastly, the Equity Markets group expanded its absolute return operations, notably by developing a management operation that takes advantage of market volatility and by extending securities lending and borrowing to international equities.

In 2005, the group will continue to focus on development of proprietary research, further consolidation of management mandates around a more limited number of securities and an increase in the active risk assumed by the managers to generate superior returns. The group also intends to reinforce its technology platform by implementing information systems that will ensure optimal portfolio management.

Security selection will continue to be the key to successful management of Canadian equities. As for international equities, the group intends to enhance the U.S. Equity portfolio with new management methods. It will also strive to diversify its sources of value added for the foreign equity portfolios and increase research related to this asset class. The emerging markets equity team will be strengthened to take advantage of the substantial growth potential of Asia and Eastern Europe. International absolute return operations will also be stepped up in 2005.

Lastly, the strategies used for Québec International will be consolidated and diversified in anticipation of growth of the portfolio's net assets.

Expertise of the Equity Markets group

Obtaining superior returns on the equity markets on a sustained basis requires talent, in-depth analytical ability, intuition and unmatched trading skills.

Managers and analysts: The managers hold in their portfolios the securities they believe offer the best potential returns. They base their security selection on studies by in-house analysts as well as information from various external sources.

To gain a full understanding of publicly traded companies, the analysts visit the firms, hold meetings with their management teams, and study their products and services, their financial results and the industry in which they operate. The results of this research are complemented by macroeconomic analyses and forecasts.

Traders: The traders buy and sell securities on the world's exchanges at the best possible prices and in a timely fashion, taking care to avoid causing sudden price swings.

Market review

In 2004, the decision by central banks to raise interest rates to reduce excess liquidity in the financial systems as well as the impact of China's economic growth on commodity and oil prices placed pressure on the equity markets until the U.S. presidential election in November. On the whole, after the election, the markets had a good year, driven mainly by strong corporate earnings.

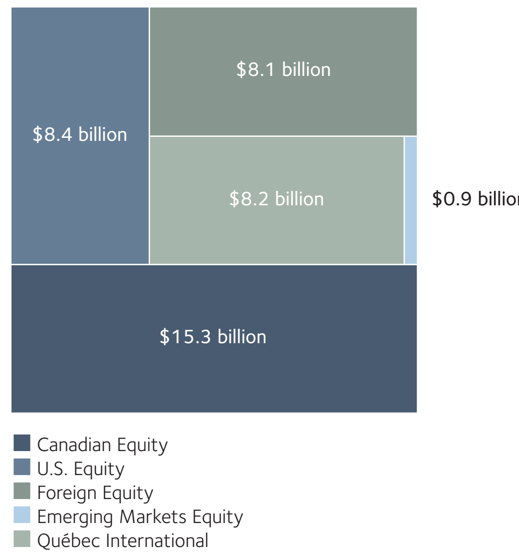
Generally speaking, value securities, or securities whose current price does not fully reflect their true value, as well as small caps performed well in markets characterized by low volatility. Within the various sectors, however, the securities themselves showed greater volatility, mainly because of activity by a larger number of specialized investors such as hedge funds.

Market growth in 2005 should go hand in hand with earnings growth, which will be lower than the levels seen in 2003 and in 2004 because of higher interest rates and slimmer profit margins. If the rate hikes come more quickly than expected, however, corporate earnings, and therefore the stock market, could see weaker growth.

Depositors' net assets by specialized portfolio

figure 24

(as at December 31, 2004)



Overall return and specialized portfolio analysis

The assets managed by the Equity Markets group are held in seven specialized portfolios: Canadian Equity, U.S. Equity (hedged and unhedged), Foreign Equity (hedged and unhedged), Emerging Markets Equity and Québec International. The depositors' net assets in these portfolios totalled $40.9 billion as at December 31, 2004 (figure 24), up $2.6 billion from 2003. The overall return earned by the Equity Markets group in 2004 was 12.6%, or 7 b.p. (0.07%) less than its index.

<u>Specialized Canadian Equity portfolio</u>

Description

The specialized Canadian Equity portfolio is managed actively by an in-house team, according to a fundamental approach that ensures complete coverage of the Canadian market. Security selection is based mainly on bottom-up analysis, complemented by top-down analysis. The portfolio consists of sector management mandates (e.g. financial services, energy, consumer discretionary) and generalist mandates (e.g. large caps, cyclical or non-cyclical securities). Absolute return operations round out the management of this portfolio.

Return on Canadian Equity

table 25

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	15.2	14.5	**72**	n.a.
3 years[2]	8.9	8.3	**63**	0.6
5 years[2]	4.7	3.6	**112**	0.8

1 S&P/TSX capped since January 1, 2003, S&P/TSX since May 1, 2002, TSE 300 before.
2 Excluding private equity investments.

Analysis of return

Canadian Equity returned 15.2% in 2004, or 72 b.p. (0.72%) more than the S&P/TSX Capped Index, which returned 14.5%. Over five years, the portfolio has outperformed the index by 112 b.p. (1.12%).

The portfolio's value added came mainly from judicious stock selection. The investments in the financial services, industrials and materials sectors were especially profitable. The securities selected in the information technology and energy sectors contributed little to the return, however.

Sector selection did not contribute to value added, since energy and financial services, the two sectors that outperformed the S&P/TSX Index in 2004, were underweighted in the portfolio. For their part, absolute return operations again made a significant contribution to the portfolio's value added.

In addition, the information ratio of the Canadian equity managers remains high, at 0.8 over a period of five years and 0.6 over three years.

Specialized U.S. Equity portfolios

Description

U.S. equities are held in two specialized portfolios: the one is hedged against currency risk and the other is unhedged. This structure allows for currency risk exposure specific to each depositor, according to its investment policy. The portfolios are managed actively, by internal and external managers, according to four complementary approaches that ensure complete coverage of the U.S. market: traditional portfolio management, index management, external active management and long/short management for non-capitalized mandates. Research is done internally according to a bottom-up approach, which is also used for security selection. Absolute return operations round out the management of these portfolios.

Analysis of return

U.S. Equity (hedged) returned 10.7% in 2004, or 105 b.p. (1.05%) less than the return on the S&P 500 hedged, which was 11.7%. Still, over a period of five years, the return on the hedged portfolio outperformed its market index. U.S. Equity (unhedged) returned 1.7% owing to the strength of the Canadian dollar, or 108 b.p. (1.08%) less than the return on the index.

Return on U.S. Equity (hedged)

table 26

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	10.7	11.7	**(105)**	n.a.
3 years[2]	2.8	4.4	**(162)**	(1.7)
5 years[2]	(1.5)	(2.2)	**65**	0.3

[1] S&P 500 capped.
[2] Excluding private equity investments.

The portion of the portfolio managed internally was affected by the scandals in the insurance sector as well as the difficulties experienced by the pharmaceutical sector after Merck took Vioxx off the market. External management had a positive return as a result of effective security selection.

Specialized Foreign Equity portfolios

Description

EAFE (Europe, Australasia and Far East) foreign equities are held in two specialized portfolios: the one is hedged against currency risk and the other is unhedged. This structure allows for currency risk exposure specific to each depositor, according to its investment policy.

The portfolios are managed actively, by internal and external managers, according to a fundamental approach by niche and specialization by region that ensure complete coverage of foreign markets. The managers and analysts on the in-house team do most of the research related to their mandates. Security selection is based mainly on bottom-up analysis, completed by top-down analysis based on economic scenarios as well as financial and quantitative valuations.

Analysis of return
Foreign Equity (hedged) returned 11.6% in 2004, underperforming the index by 139 b.p. (1.39%).

Return on Foreign Equity (hedged)
table 27

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	11.6	13.0	**(139)**	n.a.
3 years[2]	(1.7)	0.0	**(169)**	(1.9)
5 years[2]	(6.1)	(4.6)	**(154)**	(0.9)

1 MSCI EAFE hedged. The provisional index was used from October 2001 to May 2002.
2 Excluding private equity investments.

Owing to the strength of the Canadian dollar, the Foreign Equity portfolio (unhedged) had a return of 9.9%, underperforming the index by 158 b.p. (1.58%). Although the allocation of internal and external management mandates changed very little from 2003 to 2004, the underperformance vis-à-vis the index is due mainly to the weak results of external management, which favoured large caps and overweighted the pharmaceutical sector in particular. Internal management also experienced difficulty, mainly because of its defensive positions in Continental Europe, but obtained fairly good returns in the United Kingdom.

Specialized Emerging Markets Equity portfolio
Description
The specialized Emerging Markets Equity portfolio is managed actively, by internal and external managers, according to a targeted approach that ensures complete coverage of emerging markets. It is not hedged against currency risk owing to the illiquidity of emerging countries' currencies on the foreign exchange markets.

Top-down analysis takes precedence over bottom-up analysis in the management of this portfolio. The managers use each country's weighting in the index as a starting point and then determine the most promising countries and sectors by analyzing the economic aspects of monetary and fiscal policies. Finally, the team does a rigorous analysis of individual companies to determine those that are most attractive in terms of valuation, quality and growth outlook.

Analysis of return
Emerging Markets Equity returned 14.5% in 2004, underperforming the market index by 191 b. p. (1.91%). Over a period of five years, the portfolio returned 18 b.p. (0.18%) less than its index.

Return on Emerging Markets Equity
table 28

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	14.5	16.4	**(191)**	n.a.
3 years[2]	10.8	11.3	**(44)**	(0.2)
5 years[2]	0.3	0.5	**(18)**	(0.1)

1 MSCI EM unhedged since July 1, 2000.
2 Excluding private equity investments.

The internal management team recorded a positive return with careful security selection in the materials sector and an overweighted position in three countries with a strong growth outlook: Turkey (anticipation of the positive outcome of negotiations on its forthcoming membership in the European Union), Brazil (spinoffs from China's growth) and Mexico (higher oil prices). The team also avoided Russia's Yukos debacle. These positive results were offset by the underperformance of external management, which significantly underweighted Taiwanese and South Korean technology issues throughout 2004.

Specialized Québec International portfolio
Description
The specialized Québec International portfolio has a hybrid structure. It consists of fixed income securities denominated in Canadian dollars, which implicitly protect it against currency risk,

as well as a basket of futures contracts based on world stock markets. The futures contracts produce a stock-index return rather than a return on short-term investments. The portfolio's objective is to increase the exposure of the Caisse's overall portfolio to foreign equity markets so as to increase diversification and obtain superior returns.

Analysis of return

The Québec International portfolio returned 16.4% in 2004, or 15 b.p. (0.15%) more than its market index. Over a five-year period, the portfolio has outperformed the index by 11 b.p. (0.11%).

Return on Québec International

table 29

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	16.4	16.3	**15**	n.a.
3 years	7.1	7.2	**(3)**	(0.1)
5 years	0.4	0.3	**11**	0.2

[1] Index created by the Caisse and based 80 % on the SC Provincial Québec Subindex and 20 % on the SC 91-Day T-Bill Index plus a predetermined basket of futures based on global equity indexes.

The value added in 2004 came mainly from active management of fixed income securities. Since inception, the Québec International portfolio has outperformed the MSCI World Index, mainly because of the positive performance of Québec bonds, which account for 80% of its underlying assets.

Fixed Income

In a diversified portfolio such as the Caisse's, each asset class plays a specific role. Fixed income investments are the core holdings in the depositors' benchmark portfolio. Owing to their low volatility in relation to equities, they contribute to preservation of capital and, like equities, they are highly liquid.

In addition, they can be matched to depositors' actuarial liabilities. To enhance asset-liability matching, the Caisse has introduced a portfolio of real return bonds to provide an inflation hedge. Finally, over the years, in a context of fierce competition and increased market efficiency, the Caisse has emphasized non-traditional management of its fixed income investments to continue to generate returns that meet depositors' expectations.

Investment philosophy

The group's investment philosophy is to:

- Act on opportunities on all fixed income markets;
- Diversify its management styles and invest in flexible, liquid products that allow quick, precise use of a large number of strategies;
- Control losses with a rigorous risk management structure.

To create value, the group's management teams develop and apply strategies based on three main investment themes: interest rates, credit risk and volatility.

Expertise of the Fixed Income group

With the knowledge and expertise of its teams of managers and analysts, the Fixed Income group can operate in the international arena, invest in specialized products with high potential returns, use leverage, carry out short selling and take part in large structured operations. Moreover, it shares its expertise with the Caisse's other groups.

Quantitative tools and derivatives play an increasingly important role in the group's operations. Given the high degree of specialization involved, the analysts on the portfolio management teams play a vital role. The quantitative nature of the operations requires specialists with degrees in finance, mathematics, applied science, engineering, accounting, actuarial science and econometrics.

Highlights

In 2004, the Fixed Income group began managing the new specialized Real Return Bond portfolio, a product adapted to the needs of certain depositors that want to protect a portion of their portfolios against unforeseen changes in the inflation rate. It also continued to diversify its operations by strengthening its in-house teams of managers and analysts with new hires, as well as by assigning certain mandates to external managers.

At the same time, the group improved its management tools to enhance portfolio monitoring and analysis. It also rationalized its sources of market information by emphasizing independent research firms as well as exchanges of information with a specialized network of partners.

During the year, the group also monitored industry best practices, an exercise that pointed out the immense challenge of adding value in an increasingly competitive environment.

In 2005, to diversify its sources of value added, the Fixed Income group intends to continue to broaden its range of in-house management styles and strategies, while obtaining complementary expertise from carefully selected external managers. It will also complete the integration of its new automated systems to monitor risks and the results of the various management mandates.

Market review

Three main trends prevailed on the bond markets during the year. In the first quarter, yields fell, followed by a widespread increase in the second quarter, when more vigorous economic growth and job creation were creating concerns that inflation would spike. As these fears abated, bond yields began a long downward slide that lasted until year-end.

The spreads between Canadian and U.S. yields narrowed early in the year when the Bank of Canada lowered its official interest rate. The spreads then widened over the summer and finally narrowed again when the Bank voiced concerns about the impact of the surging dollar on Canada's economy.

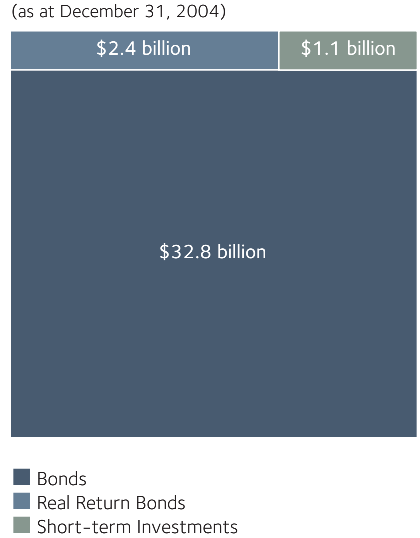
As for provincial government bonds, a slight widening of yield spreads offset the additional return expected from this sector, owing to its higher coupon rates. Lastly, buoyed by the demand for higher returns and the considerable liquidity present in the capital markets, corporate bond spreads narrowed, enabling this sector to contribute positively to the benchmark index's overall return.

Overall return and specialized portfolio analysis

The investment operations of the Fixed Income group involve three specialized portfolios: Short-term Investments, Bonds and Real Return Bonds.

The depositors' net assets in these portfolios totalled $36.3 billion as at December 31, 2004 (figure 30), up $6.1 billion from 2003. In 2004, excluding Fixed Income Relative Value operations, the group's overall return was 7.1%, or 0.13% more than its index.

Depositors' net assets by specialized portfolio in the Fixed Income group
figure 30
(as at December 31, 2004)



Specialized Short-term Investments portfolio

Description

The specialized Short-term Investments portfolio preserves invested capital and maintains a high degree of liquidity, while generating a current return. It is managed actively according to a fundamental approach with emphasis on top-down analysis.

The portfolio managers analyze money market trends and invest in a wide range of quality securities maturing in less than two years. To add value, they focus on management of the portfolio's duration, its positioning on the yield curve, exploitation of credit spreads, tactical use of securities borrowing and lending, and relative value strategies.

Analysis of return

The Short-term Investments portfolio outperformed its index by 20 b.p.(0.2%) in 2004 with a return of 2.5%. Over five years, the return is 3.9%, versus 3.6% for the market index.

Return on Short-term Investments

table 31

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	2.5	2.3	**20**	n.a.
3 years	2.8	2.6	**20**	1.0
5 years	3.9	3.6	**30**	1.2

[1] SC 91-Day Canadian T-Bill.

During the year, massive purchases of Canadian bonds by foreign investors attracted by the surging Canadian dollar caused the rate spreads between Canada and the United States to narrow. The managers took this value added opportunity to purchase Canadian securities and sell U.S. securities short.

Specialized Real Return Bond portfolio

Description

The objective of the specialized Real Return Bond portfolio, for which index management is used, is to provide a long-term hedge against inflation by earning a return related to the Canadian consumer price index. The capital under management is invested mainly in real return bonds issued by the governments of Canada and Québec.

Analysis of return

This new portfolio outperformed its index by 49 b.p. (0.49%) in 2004 with a return of 18.0%.

Return on Real Return Bonds

table 32

(for the period ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	18.0	17.5	**49**	n.a.

[1] SC Real Return Bond.

The excellent return on this portfolio is due to the widespread drop in real long-term interest rates in Canada, combined with a bond supply-demand imbalance.

Specialized Bond portfolio

Description

The specialized Bond portfolio is managed actively and its benchmark index is the SC Universe Bond Index. The management strategies use cash securities and derivatives to take advantage of interest rate fluctuations, market volatility and credit spreads.

The team's organizational structure reflects the various market sectors included in the benchmark index. The Caisse has a specialized team for each sector: federal bonds, provincial bonds and corporate bonds. Bond management includes two additional mandates: investments in international markets and absolute return operations.

Analysis of return

The return on the Bond portfolio outperformed its index by 35 b.p. (0.35%) in 2004 with a return of 7.5%. Over three and five years, the return outperformed the indexes by 69 b.p. (0.69%) and 68 b.p. (0.68%) respectively.

Return on Bonds

table 33

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	7.5	7.1	**35**	n.a.
3 years[2]	8.2	7.5	**69**	1.7
5 years[2]	8.9	8.2	**68**	1.3

1 SC Universe Bond.
2 Excluding private equity investments.

The strategies used by the portfolio managers generated $92 million of added value in 2004. They took advantage of interest rate trends, the widening of provincial bond spreads, judicious selection of corporate notes and, above all, the favourable performance of the Canadian bond market in relation to the U.S. market. Like the team that manages the specialized Short-term Investments portfolio, the managers of the Bond portfolio took advantage of the narrowing of Canada-U.S. spreads to purchase Canadian notes and sell U.S. bonds short.

Absolute Return

In recent years, in addition to continuing to invest in non-traditional asset classes, such as real estate and private equity, the Caisse has sought new sources of return that are less correlated with the equity and bond markets. From 1997 to 2002, a team specializing in tactical alternative investments used directional strategies and invested more broadly in hedge funds. In January 2003, the Caisse created a specialized team to develop a rigorous process to manage external hedge funds of funds. In November of that year, the Absolute Return group was created to consolidate, institutionalize and enhance the Caisse's expertise in management of internal and external hedge funds.

Investment philosophy

The objective of the Absolute Return group is to earn for depositors a renewed, sustainable, positive absolute return that is independent of the markets' fluctuations. Its investment philosophy is based on the assumption that it is possible to take advantage of anomalies created by the constant inefficiency of the financial markets.

The group's approach is based essentially on talent and the use of flexible methods to find and exploit sources of value with leading-edge technological and analytical support. Its managers are distinguished by their methodical risk management and use of investment strategies based on a discretionary approach.

Highlights

During its first complete year of operations, the Absolute Return group developed its management and support teams in accordance with the best practices of the hedge fund industry. It first created two teams to consolidate investment support. The first team is responsible for planning, structuring and implementing the group's organizational operations, portfolios and systems, while the second ensures the managers have the customized analytical tools and databases they require.

The group also made various portfolio management changes. It completed the restructuring of the Hedge Funds portfolio, whose net assets almost tripled during the year, rising from $954 million to $2.8 billion. It reorganized certain operations of the internal hedge funds, namely Fixed Income Relative Value, Currencies, Commodities and Global Macro. It also formed a team that specializes in commodities arbitrage and it reoriented its currency management team.

Several new funds were added to the external hedge funds of funds in the portfolio to diversify the management styles and geographic allocation and to ensure access to superior-quality funds.

During the year, the Absolute Return group was given responsibility for management of the new Commodities portfolio, whose net assets totalled $1.0 billion as at December 31, 2004.

In 2005, the group intends to continue building its management teams, particularly those responsible for currencies and commodities, by recruiting new talent that will expand its range of styles and strategies. It will also develop a systematic approach, specifically a long/short style for the international equity markets to complement its discretionary approach. The group will also focus on the application of new strategies.

In investment support, the group will finish documenting its procedures to ensure better reporting and optimal risk management. Lastly, under its three-year business plan it will begin an overhaul of its analytical and technological platforms to ensure it can monitor markets, generate ideas and carry out arbitrage operations more effectively.

Market review

During the year, many observers concluded that the erosion of hedge funds' returns was due to intense competition caused by the massive flows of capital into this asset class and a scarcity of value-creation opportunities. The managers in the Absolute Return group believe, however, that the sub-par performance by hedge funds in the first half of the year was due to contradictory signals from the markets. Since many hedge funds were unable to determine clear signals from the global macroeconomic environment, they decided to reduce their risk and leverage.

Investor uncertainty was caused mainly by the following macroeconomic factors:

- Interest rate hikes by the U.S. Federal Reserve starting in the second quarter;
- The increasing risk of inflation;
- Uncertainty surrounding the direction of the U.S. dollar and the prices of oil and other commodities;
- The extent of China's economic slowdown and its impact on the global economy.

Satisfactory results were recorded in the second half, however, as a result of the improved job market in the United States, the expected outcome of the U.S. presidential election and the greenback's better-defined trend.

Overall return and specialized portfolio analysis

The Absolute Return group is responsible for two specialized portfolios: Hedge Funds and Commodities. The depositors' net assets in these portfolios totalled $3.8 billion as at December 31, 2004 (figure 34), up $2.9 billion in relation to 2003. The Absolute Return group's overall return was 7.8% in 2004, or 784 b.p. (7.84%) more than its index.

Expertise in management of external funds of hedge funds

The Caisse has created a team that specializes in development and management of external funds of hedge funds. The purpose of this approach to investing in the universe of hedge funds is to diversify styles and strategies and to decrease the risk specific to each fund. It also facilitates access to the most highly regarded and best-performing external managers, who tend to close their doors to new investors once their funds have reached the size they consider ideal.

The expertise of the external hedge funds of funds team is based on a rigorous investment management process that essentially comprises five stages:

1) **Portfolio construction**
This stage involves determining the allocation of assets among the various styles and strategies to achieve the portfolio's risk and return objectives. This approach offers the advantage of effectively grouping funds with similar return profiles (average return, volatility, correlation between market factors and other strategies). Portfolio construction weights the strategies to take advantage of complementary features in the distribution of their returns.

2) **Preselection of managers**
Preselection of managers involves finding quality funds in the global universe of 7,000 hedge funds through an international network of contacts that includes advisers, managers of funds of funds (strategic alliances) and brokers, as well as the use of databases combined with search engines that use quantitative and qualitative criteria.

3) **Meetings with managers and benchmarking of funds**
During the initial meeting with the manager of an external hedge fund, all aspects of its strategy (concept, execution and risk monitoring) are evaluated. They are then written up in a report recommending whether or not to proceed to the due diligence stage.

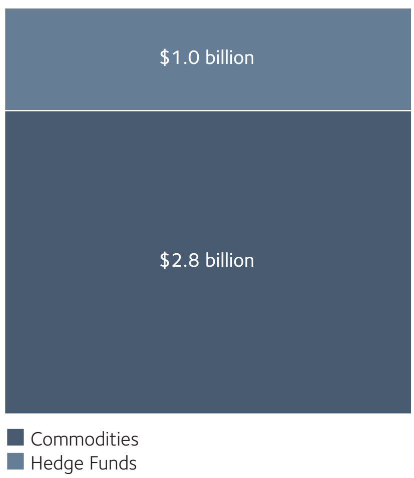
4) **Due diligence and evaluation**
At this stage, an in-depth analysis of the managers is done to evaluate organizational, strategic and operational considerations as well as risk management and past results. Verification of the fund's legal pedigree and a review of the offering memorandum and the underwriting agreement are done by specialized independent advisers. The selected funds are then reviewed by a committee.

5) **Monitoring and control**
A follow-up on the investments is done on a monthly basis to ensure that all requirements pertaining to the fund and its manager are respected at all times.

Other internal teams follow a similar process in managing external fund managers.

Depositors' net assets by specialized portfolio
figure 34

(as at December 31, 2004)



Depositors' net assets by specialized portfolio

Description

The purpose of the specialized Hedge Funds portfolio is to generate a stable, high absolute return that has little correlation with the returns of traditional asset classes. The portfolio is managed actively by four internal hedge fund teams and an external hedge funds of funds team (figure 35).

Internal hedge funds

The internal hedge fund teams have the following mandates: Fixed Income Relative Value, Currencies, Commodities and Global Macro.

- **Fixed Income Relative Value:** Arbitrage operations to exploit fixed income pricing anomalies and trends.
- **Currencies:** Operations involving directional strategies or options to take advantage of short-, medium- and long-term trends on the foreign exchange market.
- **Commodities:** Arbitrage operations involving the price of commodities, such as energy (coal, crude oil and natural gas), foodstuffs (grains and oilseeds, livestock and fish) and industrial commodities (metals, minerals and forestry products).
- **Global Macro:** Long/short strategies using financial instruments to take advantage of micro- and macroeconomic trends.

The managers of these mandates mainly base their decisions on analysis and exploitation of macroeconomic trends and relative price anomalies in the structure of the financial markets, while limiting portfolio risk.

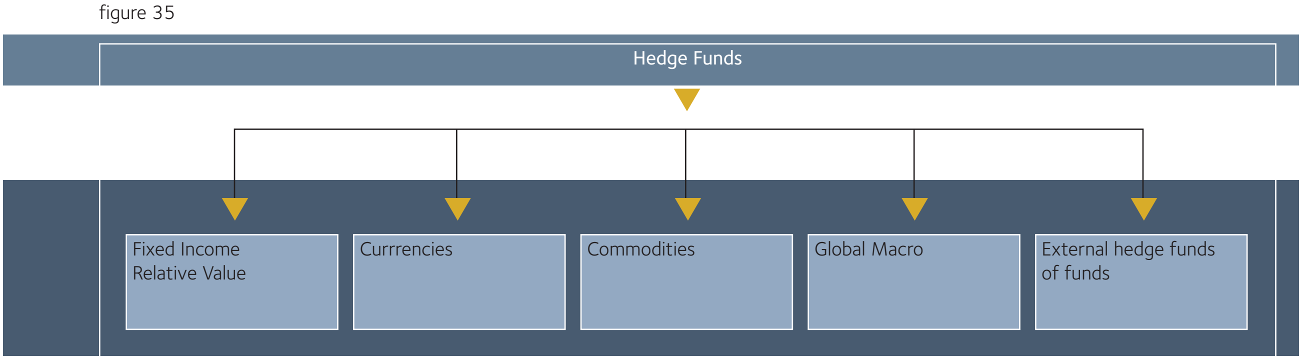
External hedge funds of funds

The external hedge funds of funds team manages and administers about 90 hedge funds selected on the basis of rigorous criteria and classified according to their strategies within four funds of funds: Global Macro, Multi-strategy, Opportunity and Strategic.

Analysis of return

The specialized Hedge Funds portfolio returned 4.7% in 2004, or 237 b.p. (2.37%) more than its index. The external hedge funds of funds returned 6.6%, or 426 b.p. (4.26%) more than the index.

Hedge fund management teams
figure 35



Return on Hedge Funds
table 36

(for the period ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	4.7	2.3	**237**	n.a.

[1] SC 91-Day Canadian T-Bill.

Not all the strategies generated a comparable return in 2004. The most effective were arbitrage strategies involving corporate bonds and distressed securities, which benefited from the sustained narrowing of credit spreads that began in 2003. In addition, several factors reduced the return on strategies not involving credit. The reduced volatility and the increased correlation that are generally associated with a lack of trends are the reasons for the weak results that directional strategies generated in the second and third quarters. Moreover, the convertible securities arbitrage strategy, although favoured by the prevailing credit conditions, was affected by the decreased volatility and generated a return that fell short of expectations.

The four internal hedge funds, which were incorporated into the specialized portfolio on June 1, subtracted 154 b.p. (1.54%) from the specialized portfolio's total return.

The results of the Fixed Income Relative Value operations were recorded in the specialized Bond portfolio in the first half. Taking these results into account, the total return earned by the hedge funds team (internal and external) was 10.7%, or 842 b.p. (8.42%) more than its benchmark index. The managers obtained this result by exploiting market inefficiencies in an environment characterized by low interest rates and volatility. The impact of the three other categories (Currencies, Commodities and Global Macro) on the portfolio's return was negligible.

Specialized Commodities portfolio

Description

The Commodities portfolio meets depositors' needs by ensuring diversification, especially by providing protection against unforeseen spikes in inflation caused by higher commodity prices. The managers use fundamental and analytical approaches based on quantitative and qualitative analysis. They are partial to a relative value strategy, complemented by directional, seasonal and volatility strategies.

Management of the portfolio involves three types of activity:
- **Management of the underlying assets,** with a target allocation of 80% in U.S. real return bonds and 20% in the U.S. money market (treasury bills);
- **Index management,** using futures contracts to reproduce the composition of the Dow Jones-AIG Commodity Excess Return Index (unhedged);
- **Active management of value added,** using derivatives on energy and agricultural commodities as well as industrial and precious metals.

Analysis of return

Expressed in U.S. dollars, the currency used for the operations, the portfolio returned 3.1%, or 58 b.p. (0.58%) more than the index. Management of the underlying assets saw a positive return on both of its components, U.S. money market and real return bonds. Index management had a slightly negative return. Finally, active management of value added contributed to the portfolio's return mainly with arbitrage gains on the aluminum market.

Return on Commodities
table 37

(for the period ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**	Information ratio
5 months	(7.1)	(7.6)	**53**	n.a.

[1] Commodity Financial Instruments.

The increase in the Canadian dollar since August 1, 2004, subtracted 10.1% from the absolute return and 5 b.p. (0.05%) from the value added.

Since its inception on August 1, 2004, the portfolio has returned -7.1%, or 53 b.p. (0.53%) less than its index[1]. This result is due to the performance of the three management activities as well as currency conversion of the portfolio's return.[2]

[1] Return on the index = (20%* return on U.S. treasury bills) + (80%* return on real return bonds) + return on the DJ-AIG Commodity Excess Return Index.
[2] The portfolio is denominated in U.S. dollars and the return objectives are also expressed in that currency.

Real Estate

The Caisse began to invest in real estate in the 1960s, making its first investments in mortgages. In the 1980s, it began investing in equity with the purchase of properties, later doubling its real estate assets with the acquisition of Ivanhoe. The growth of this asset class and the specialized investment operations it requires eventually prompted the Caisse to create specialized portfolios and to reorganize its subsidiaries. The result was the creation of the Caisse Real Estate group in 1992, followed by sustained acquisition of real estate assets in the international arena. Today, the Caisse manages one of the world's 10 largest real estate portfolios.

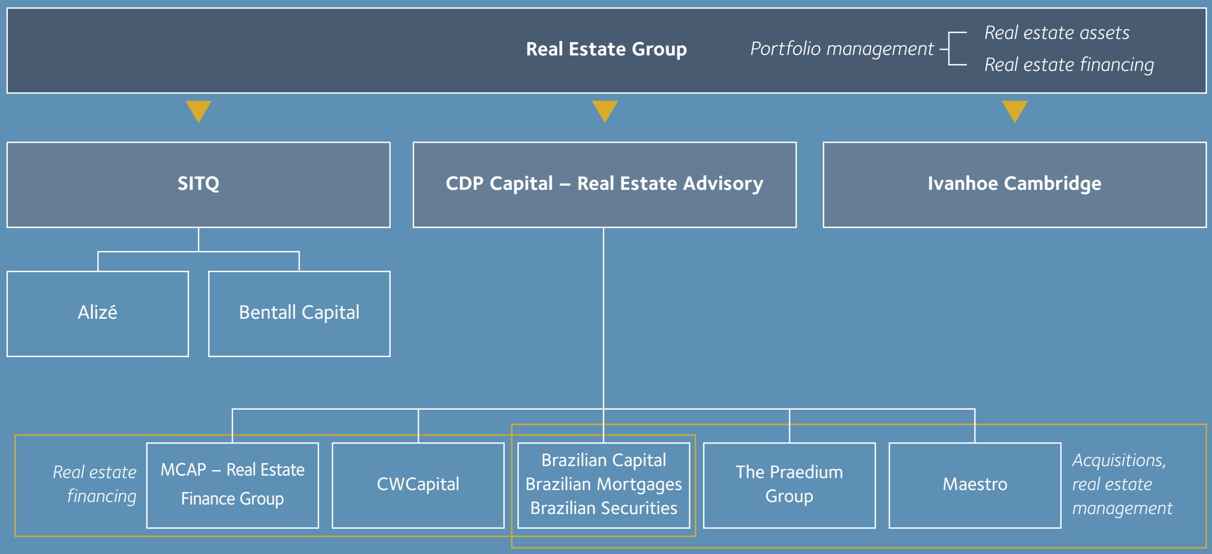
Investment philosophy
The Real Estate group makes diversified investments, from the standpoint of regions and products alike. It invests in debt and equity products on public and private markets, office buildings and business parks, retail properties, hotels and residential buildings, including seniors residences. The group coordinates the operations of its three member companies: Ivanhoe Cambridge, SITQ and CDP Capital - Real Estate Advisory.

The overall management strategy of the Real Estate group is based on three main parameters:

- Active management to create value through asset turnover and arbitrage between markets, type of holdings and products in a timely fashion. This management approach relies on:
  - Timing based on real estate cycles and capital flows that affect the real estate investment cycle around the world;
  - Geographic, sector and product diversification to take advantage of specific risk profiles and arbitrage opportunities created by asynchronous real estate cycles.

- A partnership strategy to add a local perspective, mainly for investments outside Canada, and to develop a global network so that the group can act on business opportunities more effectively while reducing risk;
- Rigorous management of leverage risks and concentration risks as a function of the needs of depositors and other clients, to ensure the best possible return on investments.

Organization chart of Real Estate Group
figure 38



Real estate subsidiaries

SITQ is a real estate leader in North America and Western Europe. It develops, invests in and manages office buildings in downtown locations in Canada, the United States and Europe. The company owns its properties outright or in partnership with other investors for which it may perform asset management, mainly in Europe.

CDP Capital - Real Estate Advisory is involved in merchant banking and investment management around the world. The company has teams in North America, Europe and Asia and a large network of platform or affiliated companies in Canada, the United States and Brazil. CDP Capital - Real Estate Advisory invests in debt and equity on public and private markets, mainly in Canada, the United States, Europe and Asia. Its investments include opportunistic products that are usually held for less than three years. It also offers advisory and structured finance services.

Ivanhoe Cambridge owns, manages, develops and invests in regional and super-regional shopping centres in urban areas of Canada and is one of the largest players in its sector. The Company owns its properties outright or in partnership, and provides asset management services for syndicated properties in Canada. It is also active in the United States and Europe, in partnership with major real estate companies.

Platform or affiliated companies

The platform or affiliated companies are firms owned in partnership with other real estate managers. They serve the subsidiaries in the group as well as Canadian and international investors. They enable the group to maintain a permanent presence in the various real estate markets and to remain on the lookout for investment opportunities.

Canada

Bentall Capital is one of Canada's foremost real estate consulting and services companies. With its subsidiaries, the Company offers more than 100 institutional and private investors a broad range of asset management and real estate services, as well as leasing and development services. It also has significant operations in the United States.

Alizé specializes in multiservice technical management in Québec, especially building technologies.

Maestro specializes in management of real estate capital and creates investment vehicles adapted to the needs of the pension funds and other institutional and private investors that it partners with. It is a leading manager of assets and investments in Québec's seniors housing industry.

MCAP - Real Estate Finance Group is a Canadian mortgage company that originates, underwrites and services mortgage and leasing loans to meet the varied needs of borrowers and investors. Through its subsidiaries, it offers services for residential, commercial and construction mortgages as well as equipment leasing.

United States

The Praedium Group is a real estate investment and fund management company that specializes in unproductive and undervalued assets. It originates, underwrites, negotiates, finances and manages equity real estate investments in North America.

CWCapital is a U.S. financing company that specializes in the multiple-unit residential sector, seniors residences and commercial properties. It originates, underwrites, negotiates and services loans of all kinds for institutional investors and also acts as an intermediary for government finance programs as well as conduits for securitization and acquisition of subordinated tranches.

Brazil and Latin America

Brazilian Capital, Brazilian Mortgages and **Brazilian Securities** specialize respectively in management of real estate funds and assets, real estate financing and loan securitization.

The Real Estate group's expertise

The expertise of the Caisse's Real Estate group constitutes a chain of strategic competencies in specialized areas.

1) Real estate operators

The functions of a real estate operator include leasing, maintenance and management of properties. In addition to performing routine management to reduce operating costs, real estate operators have a mandate to ensure satisfaction of tenant needs, to position proprieties vis-à-vis the competition and to manage property maintenance effectively by identifying required renovations or improvements.

2) Investment managers

The role of Investment manager includes the occupations of investment analyst, transaction specialist and construction project manager.

These specialists evaluate the potential returns on prospective purchases or sales using various market-forecast scenarios that take into account rents, leasehold improvements and capital expenditures. This evaluation determines the price they believe a property will fetch. They carry out a transaction if it meets certain profitability criteria in line with a strategy of growth, value creation or strategic (re)positioning.

3) Asset and portfolio managers and financial engineers

Borrowed from the world of finance, the occupations of asset manager, portfolio manager and financial engineer are recent additions to the real estate sector.

These specialists devise strategies to optimize investments, develop innovative leasing policies and reposition properties that no longer reflect market trends. They actively manage portfolios and carry out strategic planning and research. They also strive to minimize the cost of capital and to protect investments from the risks of fluctuations on the capital market by ensuring optimal debt management and a flexible, effective capital structure that reflects the risks created by global markets.

4) Real estate financing managers

The real estate financing sector has two occupations whose responsibilities are complementary. Underwriters establish relationships with borrowers and ensure internal financing policies are respected. Chartered appraisers assess the market value of properties, according to the rules of their profession, taking quantitative and qualitative factors into account.

Highlights

The Real Estate group earned an outstanding return in 2004 by making the most of an advantageous position based on the cycles of the various markets where it invests. The group continued to sell mature properties that no longer fit in with its strategy, in a context of high prices, and it completed the restructuring of its Mortgages portfolio to include a broader range of real estate financing products. At mid-year, the group refinanced its debt in anticipation of rising interest rates.

In terms of investments, the subsidiaries in the group were very active. Two long-term partnerships were formed: the one, between SITQ and a large Canadian institutional investor, involved the sale of an interest in Place Ville Marie, in Montréal; the other was between Ivanhoe Cambridge and a major German investor that acquired an interest in six Canadian shopping centres. For its part, CDP Capital - Real Estate Advisory committed an additional US$900 million to Lone Star's new distressed debt funds. In Québec, SITQ partnered with Group LSR to launch Villas-sur-Rive, one of the largest residential projects in Québec, with a total of 1,000 housing units to be built in three phases. The opening of Vaughan Mills, in suburban Toronto, was the event of the year in the Canadian shopping centre industry. It is the first regional shopping centre to open in Canada in 14 years. The result of a partnership between Ivanhoe Cambridge and The Mills Corporation, Vaughan Mills sets itself apart from the competition with an innovative mix of stores, restaurants and entertainment venues.

In the real estate financing sector, integration of the underwriting operations of the Caisse and MCAP was one of the important developments of 2004 in Canada. The new entity, MCAP - Real Estate Finance Group, has branches in all the large urban centres and manages commercial assets. It is now one of the foremost commercial mortgage players.

The growth of real estate financing continued in 2004 with investments in subordinated debt on public and private markets in Canada and the United States. Growth and diversification of the Mortgages portfolio will continue to be priorities for the Real Estate group. The group will pay special attention to segmentation of financing products, which should improve the portfolio's return while limiting risk.

Market review

Generally speaking, the real estate market saw an influx of capital during the year from increasing numbers of foreign institutional investors seeking higher current returns than those offered by traditional asset classes. This phenomenon pushed property values up and gave investors already active in the industry returns that exceeded those of 2003, owing to the substantial drop in capitalization rates.

The office building sector saw improvements in its underlying economic fundamentals, such as employment growth, which indicates a gradual upturn in leasing activity over the next few years. As for the shopping centre industry, it generated unprecedented returns in 2004. Interest rates are forecast to rise, however, as are the returns required of real estate investments, so property values should stabilize over the medium term.

The real estate finance market saw fierce competition in 2004, as a result of new and very active players and investor familiarity with commercial mortgage-backed securities. The abundance of capital caused a pronounced narrowing of the rate spreads between mortgages and bonds.

Owing to the cyclical nature of real estate, as shown by figure 39, these favourable conditions will most likely give way to results that are more in line with past returns. In the near future, the industry's returns may reflect long-term market conditions to a greater degree.

Despite the pressure created by the prospect of higher interest rates and the effect that an increase in equity market returns could have on real estate, the risks of a severe correction appear relatively limited. The potential for lower asset prices is offset by the fact that most markets are not overbuilt. The risks are also mitigated by certain structural factors that have sustainable appeal for investors seeking characteristics specific to the quality real estate sector, such as a constant cash flow.

The Real Estate group intends to use its expertise in 2005 to determine the markets that are least correlated and have diversified economies or strong growth potential. It intends to act on growth opportunities created by the cyclical nature of the real estate market, while limiting risks with rigorous portfolio management.

Overall return and specialized portfolio analysis

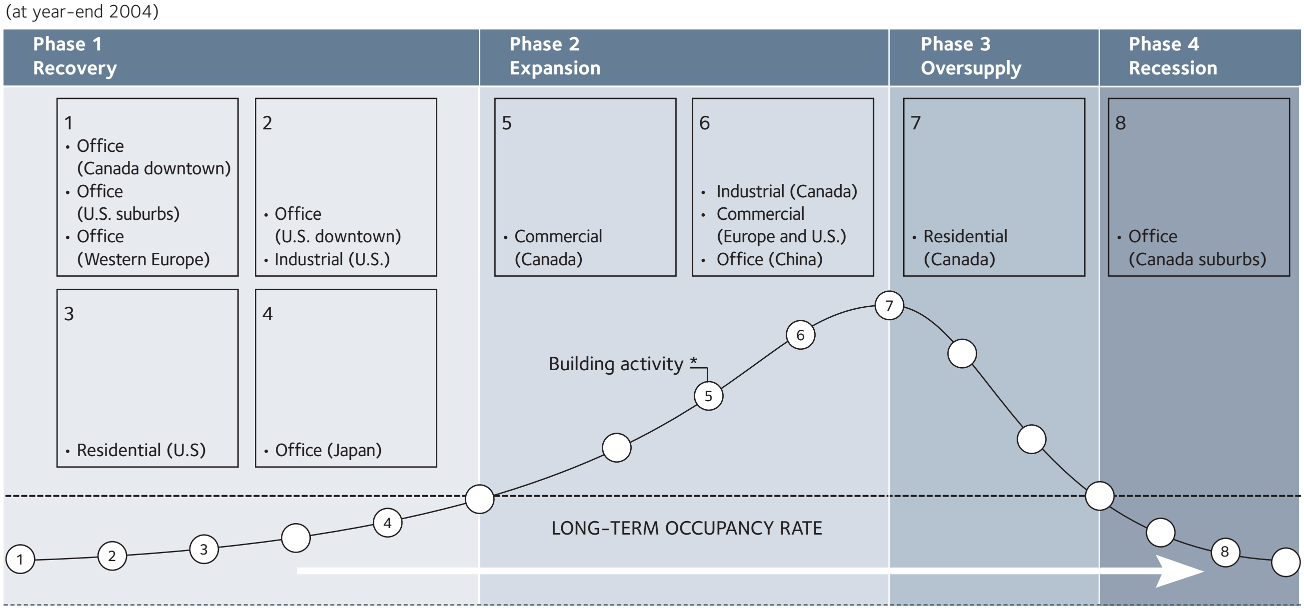
The Real Estate group manages the specialized Real Estate and Mortgages portfolios. As shown in table 40, depositors' net assets in these portfolios totalled $12.1 billion as at December 31, 2004, or $7.8 billion for the specialized Real Estate portfolio and $4.3 billion for the specialized Mortgages portfolio. Depositors' total assets amounted to $21.7 billion and assets under management or assets under administration totalled $26.4 billion, versus $22.5 billion and $20.7 billion in 2003. Lastly, the total assets under management in these portfolios amounted to $48.1 billion as at December 31, 2004, up $4.9 billion in relation to 2003.

During the year, through its member companies, the Real Estate group carried out transactions with a total value of $7.3 billion: $3.8 billion of divestitures; $2.0 billion of acquisitions, construction and renovation projects, and investments in real estate securities, companies and funds; and $1.5 billion of mortgage financings. In 2004 the overall return earned by the Real Estate group was 22.7% or 758 b.p. (7.58%) more than the return on its index.

Regional distribution within the global commercial real estate cycle

figure 39

(at year-end 2004)



Phase 1
- Declining vacancy
- Rental rates growth, below inflation rates
- No new building activities

Phase 2
- Strong rental rates growth in tighter markets
- Growing rental rates justify building activites
- Declining vacancy

Phase 3
- Increase in rental rates, although slower building activites
- Increasing vacancy
- Increase in development and redevelopment projects

Phase 4
- Decline in rental rates, below inflation
- Increasing vacancy
- Building activities, increased competition

* Occupancy level that justifies new construction.

Breakdown of total assets under management – Real Estate group
table 40

(fair value as at December 31 2004, in billions of dollars)	Depositors' net assets	Depositors' total assets	Property under management or under administration	Total assets under management	%
SITQ		6.2	10.6	16.8	34.9
Ivanhoe Cambridge		7.0	1.5	8.5	17.7
CDP Capital – Real Estate Advisory		3.3	14.3 *	17.6	36.6
Real Estate portfolio	**7.8**	**16.5**	**26.4**	**42.9**	**89.2**
CDPQ Mortgages inc.		4.6	–	4.6	9.6
CDP Capital – Real Estate Advisory		0.6	–	0.6	1.2
Mortgages portfolio	**4.3**	**5.2**	**–**	**5.2**	**10.8**
	12.1	**21.7**	**26.4**	**48.1**	**100.0**

* Excludes the assets of CDPQ Mortgages inc. managed by MCAP – Real Estate Finance Group and includes $12.2 billion of real estate underwriting and finance administration operations by the affiliated companies.

Specialized Real Estate portfolio

Description

The specialized Real Estate portfolio holds conventional and opportunistic investments that include buildings and land, owned outright or in partnership, securities of real estate companies, units of real estate funds and investment trusts, and interests in construction projects.

Conventional investments include quality office buildings in downtown locations and regional shopping centres in urban areas. They provide a stable income stream and are acquired for the long term.

Opportunistic investments are made to take advantage of market opportunities. They are held for shorter periods than are conventional investments and are intended to generate a high return.

The Real Estate group effectively manages geographic and sector risks through rigorous analysis of the markets, an independent annual valuation of its proprieties, exit strategies geared to real estate cycles and a high volume of purchases and sales. It reduces the risks related to construction by limiting the number of projects and setting preleasing and presale objectives. It limits credit and default risking by diversifying its tenants and lease-expiry dates. It manages the risk related to financial leverage by aiming for a maximum debt rate of 50% of the portfolio, by staggering loan-maturity dates and by balancing fixed-rate and variable-rate debt. Lastly, to limit the risk of currency fluctuations, the group fully hedges the currency risk of its foreign investments.

Total assets under management

As at December 31, 2004, depositors' total assets amounted to $16.5 billion, and assets under management or administration totalled $26.4 billion, bringing the total assets under management in the specialized Real Estate portfolio to $42.9 billion.

In 2004, the portfolio managers preferred to take advantage of high prices and the advantageous positioning of the group's assets in terms of the cycle of the various markets where they invest, carrying out $3.8 billion of divestitures versus $1.4 billion of acquisitions and investments in real estate securities, companies and funds, as well as $0.6 billion of construction, renovation and leasehold improvement projects. The overall transaction volume was down $0.3 billion from that of 2003.

In the retail sector, the total transaction volume for Ivanhoe Cambridge was $1.5 billion in 2004, with $1.1 billion of divestitures, $0.1 billion of acquisitions and $0.3 billion of construction, renovation and leasehold improvement projects.

In office buildings and business parks, $1.4 billion of divestitures, $0.1 billion of acquisitions as well as $0.2 billion of construction, renovation and leasehold improvements brought SITQ's total transaction volume to $1.7 billion.

Lastly, in opportunistic products and residential buildings, the transactions carried out by CDP Capital – Real Estate Advisory totalled $2.6 billion, with $1.3 billion of divestitures, $1.2 billion of investments and acquisitions and $0.1 billion of construction, renovation and leasehold improvement projects.

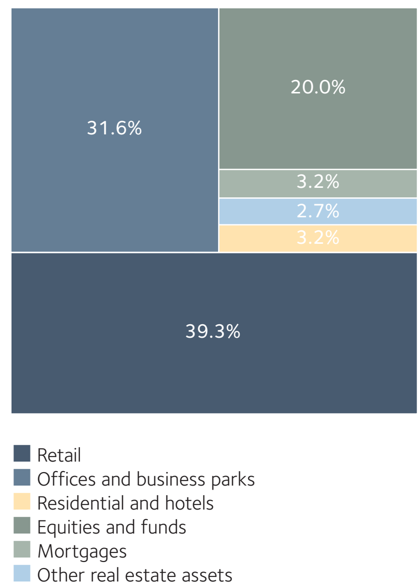
As shown by figures 41 and 42, the sector and geographic breakdown of the specialized Real Estate portfolio reflects satisfactory asset diversification, taking into account the forecast market opportunities and risks.

A portion of the capital was freed as a result of the major program of divestitures carried out in 2002, 2003 and 2004, as the demand for quality properties continued to grow. This strategy has put the Real Estate group in an excellent position to invest in construction projects in emerging markets that have strong growth potential and present significant entry barriers. The group's strategy of collaborating with a network of partners and affiliates that are well established in their geographic markets will facilitate this reinvestment objective.

Sector breakdown of the specialized Real Estate portfolio

figure 41

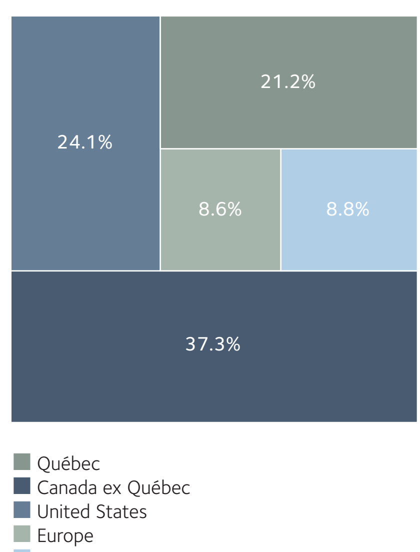
(fair value as at December 31, 2004)



Geographic breakdown of the specialized Real Estate portfolio

figure 42

(fair value as at December 31, 2004)



Analysis of return
This analysis is based on the depositors' net assets allocated to this portfolio.

For the year ended December 31, 2004, the specialized Real Estate portfolio returned 29.3%, or 1001 b.p. (10.01%) more than the Aon Index - Real Estate, which returned 19.3%. Over five years the portfolio returned 16.8%, beating the index by 436 b.p. (4.36%). The portfolio's return for 2004 stems mainly from investor preference for real estate products over other types of investment, which led to exceptional gains, especially in the shopping centre sector. These results are due to a very strong performance by opportunistic products, but above all to disciplined long-term management that has put together a portfolio of quality assets. Despite the cyclical nature of real estate, the group has obtained a high level of internally generated funds year after year, while also providing a hedge against inflation.

Return on the specialized Real Estate portfolio
table 43

(for periods ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**
1 year	29.3	19.3	**1,001**
3 years	17.3	12.2	**513**
5 years	16.8	12.4	**436**

1 Aon - Real Estate

Specialized Mortgages portfolio
Description
The specialized Mortgages portfolio constitutes a fixed income product that has a duration similar to that of its market index as a result of financial engineering operations. The limited liquidity of these assets and the expertise required to control risks related to mortgage loans make it possible to generate returns that exceed those of traditional fixed income products. The mortgage loans and subordinated debt products in the portfolio include senior, mezzanine and interim loans, subordinated tranches of CMBS, B and C notes of promissory notes and collateralized debt obligations.

The composition of the portfolio is the result of extensive experience in real estate debt underwriting, from low-risk investments, such as first mortgages, to higher-risk operations, such as subordinated debt. Its other features include a historic performance that exceeds the market average and an ongoing rigorous underwriting process. The managers limit credit and default risks associated with financing operations by diversifying in terms of borrower, region and property type.

The Real Estate group manages the portfolio and holds the securities, while the affiliated companies and the subsidiaries handle underwriting and account management operations.

Total assets under management
As at December 31, 2004, total assets under management in the specialized Mortgages portfolio amounted to $5.2 billion, up $1.1 billion in relation to the previous year-end.

A large number of mortgage loans were provided in 2004 to a broad range of clients for various types of properties. The amount of the loans ranged from $0.1 million to $142.5 million, and the total transaction volume was $1.5 billion, down $0.2 billion in relation to 2003.

Figures 45 and 46 show that the geographic and sector breakdowns of the portfolio ensure adequate diversification. In sector terms, the share of office buildings held steady in 2004 while retail was up 4.2%, business parks were down 2.3% and hotels decreased 2.8%.

Analysis of return

In 2004, the specialized Mortgages portfolio returned 12.0%, or 482 b.p. (4.82%) more than the return on its index. Over five years, the portfolio has returned 10.9%, outperforming the index by 2.74%.

The pronounced difference between the portfolio's return and that of its index is due to the narrowing of mortgage rate spreads, effective underwriting methods and strong results from subordinated debt assets.

Return on the specialized Mortgages portfolio

table 44

(for periods ended December 31, 2004)

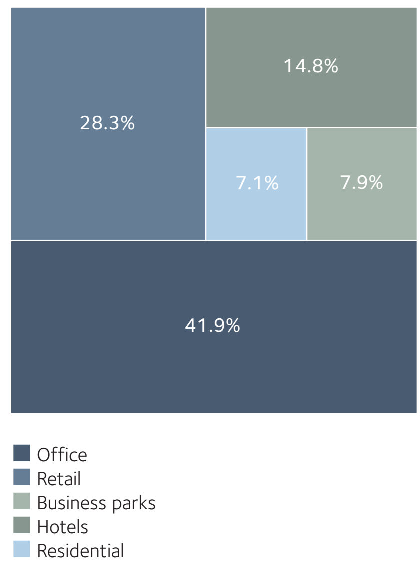
	Return %	Index[1] %	**Spread b.p.**	Information ratio
1 year	12.0	7.1	**482**	n.a.
3 years	10.9	7.5	**342**	4.3
5 years	10.9	8.2	**274**	2.9

1 SC Universe Bond.

Sector breakdown of the specialized Mortgages portfolio

figure 45

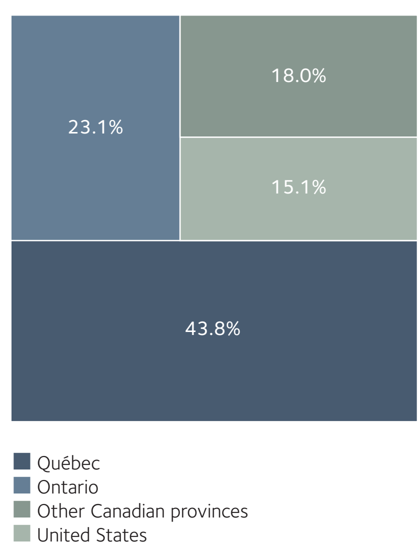
(fair value as at December 31, 2004)



Geographic breakdown of the specialized Mortgages portfolio

figure 46

(fair value as at December 31, 2004)



Private Equity

The Caisse broke new ground in Canada by developing private equity as a structured investment activity in the early 1980s. Today the institution is the leading Canadian investor in this area. Private equity offers a risk-return ratio that is complementary to that of the stock markets and allows for greater diversification of investments.

Investment philosophy

The Private Equity group has a mandate to develop a portfolio of direct investments in companies and indirect investments, mainly through investment funds. Its investment strategy is based on an assessment of a companies' potential value creation rather than solely on their market valuation.

Private equity investment requires in-depth knowledge of the markets as well as the target companies. For that reason, the investment philosophy of the Private Equity group is based on proximity to its markets. The closer the market, the more the managers are involved in negotiating and actively managing the investments. Conversely, when investing in distant markets, the Caisse joins forces with partners who are already established locally, in order to increase its chances of finding attractive opportunities.

The Private Equity group strives to invest in companies with the best management teams, according to market opportunities and economic cycles, in order to maximize long-term capital appreciation. It manages risk primarily with stringent analysis and monitoring of its investments and pays special attention to exit strategies. Lastly, it diversifies its investments according to industrial sectors, geographic areas, financial products and stage of company development.

Highlights

The Private Equity group completed the reorganization of its operations in 2004 and adopted a new strategic position to focus its human and financial resources on the investment niches it handles best. This comprehensive restructuring did not detract from its operations during the year, as the group outperformed its benchmark indexes in 2004.

In organizational terms, the group's new positioning involved the integration of three subsidiaries, CDP Capital - Communications, CDP Capital - Technology Ventures and CDP Capital - Americas, into one unit and cessation of the private equity operations of the Paris office. The group now has a simplified structure that draws on the extensive experience of its management team and the expertise of its investment professionals, while facilitating execution of its overall strategy and rapid investment decisions. As shown by table 47, the investment teams were reorganized as a function of the various investment categories.

Support for Québec companies

The Private Equity group formed an alliance with the Business Development Bank of Canada in 2003 to invest in small and mid-sized enterprises in Québec and Canada and to contribute to their growth. In 2004, the team assigned to mid-sized Québec companies was expanded and stepped up its efforts to meet the needs of business people. The team continued its business development efforts, focusing on companies with strong growth potential. It also launched *Partners*, a quarterly information bulletin, and organized a conference on strategies for doing business with China: "A China strategy: Is your business model ready?"

As a result of the analysis of its approaches to venture capital investment in biotechnology, information technology and energy technology, the group decided to adopt a strategy based on investment through funds.

Expertise of the Private Equity group

table 47

		Debt	Infrastructures and energy	Venture capital technology	Leveraged buyouts and mezzanine loans	Development capital – small and medium – sized enterprises	Development capital – large corporations and securities
Development stage of targeted businesses		Growth / mature (private or public)	Mature stage and special projects	Start-up	Growth / mature	Growth	Growth / mature
Main investment types		Senior debt	Securities	Funds	Funds	Minority equity	Equity / mezzanine loans
Investment strategy by region	Québec	Direct	Direct	Indirect or partnership	Indirect or partnership	Indirect with the Business Development Bank of Canada or direct	Direct
	Canada	Direct or syndication	Direct and partnership	Indirect or partnership	Indirect or partnership	Indirect with the Business Development Bank of Canada	Direct or partnership
	United States / Europe	Partnership or syndication (in United States only)	Direct and partnership	Indirect or partnership	Indirect or partnership		Indirect or partnership
	Emerging countries		Indirect and monitoring		Indirect and monitoring		Indirect and monitoring

The group's direct investments in companies, whether publicly traded or privately held, are negotiated by mutual agreement, whereas indirect investments are made through merchant banks, limited partnerships and Canadian and foreign investment funds. The group usually makes its major investments through a partnership to obtain the necessary capital and to share risks and returns with the other party.

The Private Equity group's new strategy for technology venture capital in Québec is founded on five principles:

1. Partner with the best venture capital funds in Québec;
2. Make joint investments with the best venture capital funds in Québec;
3. Support Québec venture capital firms and incubators that specialize in technology start-ups;
4. Integrate Québec into the international venture capital market;
5. Diversify geographically by partnering with the best fund managers, especially in the United States.

Using this strategy, the group completed the outsourcing of its portfolio of direct investments, with assistance from a consulting firm. It awarded the management of a portfolio to two Montréal firms, GeneChem and Propulsion, and the management of its international investments to three recognized firms, VantagePoint Venture Partners, SAM Private Equity and AXA Private Equity, of which two have offices in Montréal.

The Caisse's Private Equity group intends to play the role of a catalyst and leader in Québec's technology venture capital market, which explains the scope of the commitments announced in 2004. Taking into account the leverage effect of these commitments, which total $370 million, the group could contribute to the creation of Québec venture capital funds with a total value of $1.5 billion by the end of 2007.

Investment funds and partnerships

The Private Equity group reviewed its investment fund management methods to bring them in line with the industry's best practices. Its strategy is now to concentrate on relationships and partnerships with teams that rank in the first quartile in their markets. The team responsible for buyout funds therefore restructured its portfolio, reducing from 100 to 50 the number of external fund management teams it partners with.

New authorized investments

After several quiet years, the group's transaction volume increased considerably in 2004. Authorized investments totalled $4.2 billion, including $2.6 billion of direct transactions and $1.6 billion in investment funds, as shown in table 48.

In Canada, the Private Equity group and five other institutional investors acquired, at a cost of $900 million, a 50.4% interest in Noverco, a holding company with stakes in Gaz Métro and Enbridge, two energy sector leaders. A €55-million authorized investment in La Compagnie financière Edmond de Rothschild was another of the group's major commitments. In addition, a $62.5-million term loan was provided to the SFK Pulp Fund of Saint-Félicien, Québec. The team that invests in mid-sized enterprises was also active in 2004. For example, a $4-million investment was authorized for Omega Laboratories in Montréal.

Authorized investments

table 48

(as at December 31, 2004)	Number	billions of dollars
Investment category		
Debt	23	0.7
Infrastructures and energy	10	1.0
Technology venture capital	37	0.4
Leveraged buyouts and mezzanine loans	32	1.5
Development capital and accumulation	23	0.6
Total	125	4.2
Direct transactions	92	2.6
Investment funds	33	1.6
Total	125	4.2

Lastly, on the international scene, in partnership with the Ontario Teachers' Pension Plan Board, the group started up Park Square Capital Partners LP, Europe's largest independent mezzanine fund, with assets totalling a billion euros.

Market review

Like real estate, the private equity industry attracted interest from a large number of institutional investors seeking new sources of return in 2004.

The leveraged buyout and debt markets in particular were flooded with capital, which caused transaction costs to rise in a highly competitive environment. Still, for investors already present in these frothy markets, the context was conducive to exits at high prices. The venture capital industry was still in a cyclical trough but showed signs of an upturn and a slight increase in initial public offerings (IPOs).

Private equity should continue to inspire investor enthusiasm in 2005. The teams in the Private Equity group will continue to seek the best business opportunities in their markets, mainly by taking positions in specific niches where expertise is a determining factor in an increasingly competitive market.

Overall return and specialized portfolio analysis

The Private Equity group manages two specialized portfolios: Private Equity; and Investments and Infrastructures.

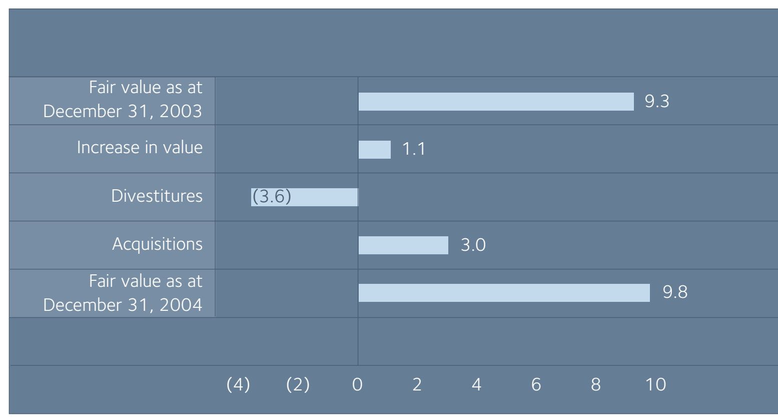
As shown by table 49, the depositors' net assets in these portfolios totalled $9.0 billion as at December 31, 2004, up $0.2 billion from 2003. Depositors' total assets amounted to $10.2 billion and assets under management and assets under administration, $0.5 billion. The group's total assets under management stood at $10.7 billion as at December 31, 2004.

As at December 31, 2004, direct investments represented 77% of the fair value of the group's investments, versus 23% for indirect investments, which clearly demonstrates the effective active management by the in-house teams.

Changes in the fair value of the investments of the Private Equity group

figure 50

(in billions of dollars)



N.B.: Before leverage and financial instruments.

As shown by figure 50, the fair value of the group's investments was $9.8 billion as at December 31, 2004, up $0.5 billion from the previous year. This increase is due to the combined effect of acquisitions totalling $3.0 billion, divestitures with a value of $3.6 billion, and a $1.1-billion increase in the value of the investments. The group carried out a high volume of purchases and sales taking advantage of market opportunities.

The group's overall return in 2004 was 20.5%, or 271 b.p. (2.71%) more than its index.

Total assets under management by the Private Equity group

table 49

(fair value as at December 31, 2004 in billions of dollars)	Depositors' net assets	Depositors' total assets	Assets under management or under administration	Total assets under management	%
Private Equity portfolio	5.1	5.2	–	5.2	48.6
Investments and Infrastructures porfolio	3.9	5.0	0.5	5.5	51.4
	9.0	10.2	0.5	10.7	100.0

Specialized Private Equity portfolio

Description

The specialized Private Equity portfolio consists of direct investments, negotiated by the in-house teams, and indirect investments made through funds, mainly in North America and Europe. It covers three investment categories: leveraged buyouts, venture capital and mezzanine debt.

Investments

As at December 31, 2004, the fair value of the investments in the specialized Private Equity portfolio was $5.1 billion, distributed among 430 companies and funds. The portfolio consists mainly of investments in leveraged buyouts and venture capital, as shown by figure 51.

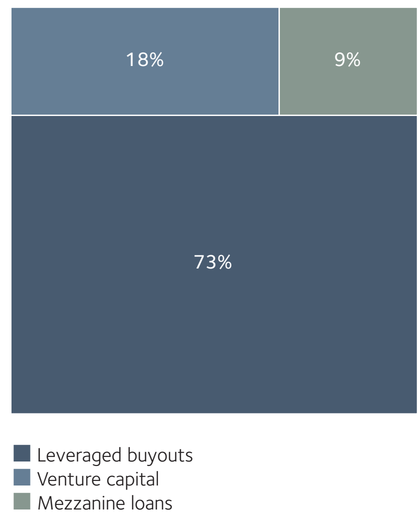
The fair value of the investments in Canada totalled almost $1.5 billion, or 30% of the portfolio, with $1.3 billion invested in Québec companies. Foreign investments represent 70% of the portfolio (figure 52).

As shown by figure 53, investments are made in various sectors of activity, with emphasis on consumer discretionary. Investments in private equity funds are not subject to sector allocation and are presented separately.

Breakdown of the specialized Private Equity portfolio by investment category

figure 51

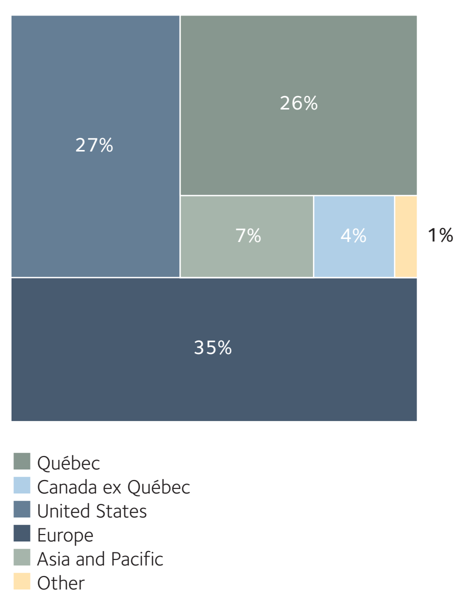
(fair value as at December 31, 2004)



Geographic breakdown of the specialized Private Equity portfolio

figure 52

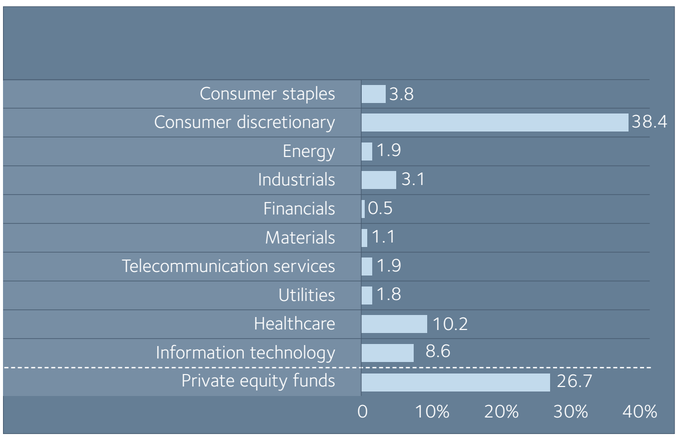
(fair value as at December 31, 2004)



Sector breakdown of the specialized Private Equity portfolio

figure 53

(fair value as at December 31, 2004)



Analysis of return

The specialized Private Equity portfolio returned 22.4% in 2004, while its benchmark index, the S&P 600 adjusted, returned 20.9%.

Return on Private Equity

table 54

(for the period ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**
1 year	22.4	20.9	**141**

[1] S&P 600 adjusted.

The 141 b.p. (1.41%) of value added resulted in a gain of $1.1 billion. Financing of leveraged buyouts made a substantial contribution to the return, as it represents 73% of the portfolio (figure 51). Geographically, all the areas covered produced positive results.

Specialized Investments and Infrastructures portfolio

Description

The specialized Investments and Infrastructures portfolio holds mainly direct investments made in Canada in the form of debt and equity underwriting to support, maintain and develop companies in traditional sectors. Since the risk of this portfolio is lower than that of the specialized Private Equity portfolio, the expected returns are also lower. The portfolio essentially focuses on three investment areas: development capital, senior debt and infrastructures.

To complement these three categories, the managers can purchase securities of publicly traded companies in traditional sectors. In their target sectors, this enables them to capitalize on outstanding market opportunities that meet the portfolio's long-term return objectives.

Investments

As at December 31, 2004, the fair value of the investments in the specialized Investments and Infrastructures portfolio was $4.8 billion distributed among 202 companies and funds.

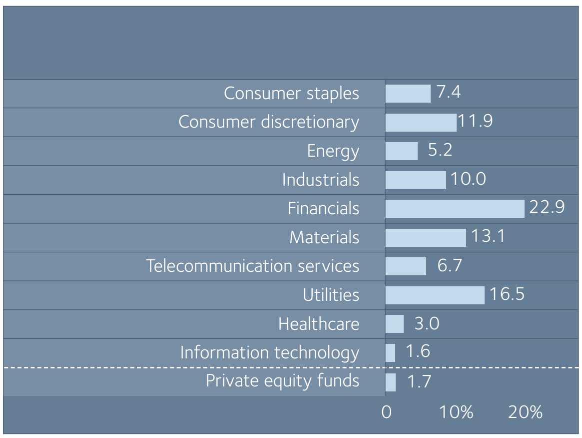
As figures 56 and 58 show, the portfolio holds mainly investments in Québec, which account for 62% of its assets, and it is geared to development capital and debt for medium-sized and large companies. The predominant sectors are financials, utilities, materials, consumer discretionary and industrials (figure 55).

In the years to come, investments in the financing of infrastructure projects, whose low risk level is generally associated with substantial current income, will represent an increasing share of the portfolio.

Sector breakdown of the specialized Investments and Infrastructures portfolio

figure 55

(fair value as at December 31, 2004)



Analysis of return

The specialized Investments and Infrastructures portfolio earned a return of 17.2% in 2004, excluding operating expenses, and outperformed its benchmark index, the S&P/TSX adjusted, by 476 b.p. (4.76%).

Return on the specialized Investments and Infrastructures portfolio

table 57

(for the period ended December 31, 2004)

	Return %	Index[1] %	**Spread b.p.**
1 year	17.2	12.4	**476**

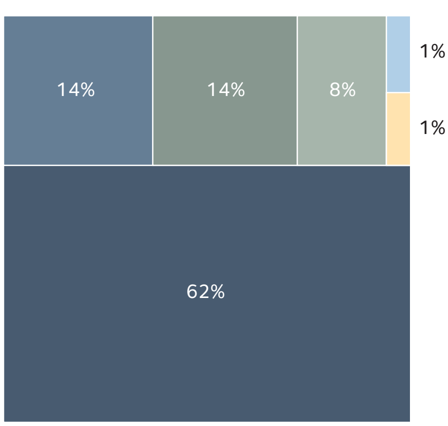
1 S&P/TSX adjusted.

Development capital, which represents 56% of the portfolio (figure 58), is the investment category that contributed the most to the portfolio's return. Geographically, Canada and the United States were the main contributors to the return.

Geographic breakdown of the specialized Investments and Infrastructures portfolio

figure 56

(fair value as at Decembrer 31, 2004)

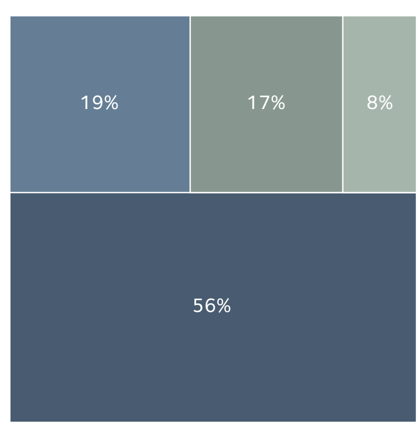


- Québec (84% Investments and 16% Infrastructures)
- Canada ex Québec
- United States
- Europe
- Asia and Pacific
- Latin America, Africa and Middle East

Breakdown of the specialized Investments and Infrastructures portfolio by investment category

figure 58

(fair value as at December 31, 2004)



- Development capital
- Debt
- Infrastructures
- Accumulation

Investment Analysis and Optimization

To respond to economic integration, which amplifies the effect of market events, the Caisse had to enhance its ability to understand and predict changes on the financial markets. It was also essential that it equips itself with tools to optimize the risk-return ratios of the various asset classes in its portfolio. It therefore created the Investment Analysis and Optimization group in late 2003.

Investment philosophy

The group has a mandate to enhance the Caisse's return and to preserve capital through dynamic management of the overall portfolio on an investment horizon of less than three years. To do so, it must constantly ensure optimal asset allocation and active management of the portfolio's risk.

The group's asset allocation and rebalancing operations are based on the following:

- Constant analysis of fundamental and financial factors likely to affect returns on the various asset classes in order to determine market inefficiencies;
- Evaluation, using quantitative analysis models, of short-term market trends as well as the effects of the economic cycle and the changing fundamentals of the financial markets;
- Development of an asset allocation program to optimize the overall portfolio's return and absolute risk;
- Optimization of active risk between the specialized portfolios.

Investment decisions are based on application of this rigorous process, which takes into account such factors as the economic cycle, national and international macrofinancial conditions, structural and cyclical changes in investor behaviour, relative valuations of financial markets, changing risk premiums, the outlook for individual sectors, short- and medium-term financial indicators, the absolute and relative risks of positions and lastly the costs and risks associated with execution of the transactions under consideration.

Highlights

In June 2004, the group assumed responsibility for the asset allocation activities of the Asset Allocation portfolio. It continued to put in place the internal infrastructure and tools needed to optimize and manage asset allocation for the Caisse's overall portfolio, and it began selecting and monitoring external managers. In the second half of the year, matching operations to reflect changes in the indexes that track illiquid classes were gradually added to the portfolio rebalancing operations that had been carried out since the beginning of the year.

As part of this organizational process, the group defined its double macroeconomic analysis mandate: support for the decision-making process of the asset allocation managers and support for senior management and the Caisse's other investment groups. It also did an exhaustive analysis of Caisse's research avenues and developed organizational models for management of the institution's proprietary research.

Expertise of the Investment Analysis and Optimization group

The group applies its expertise directly through management positions in the Asset Allocation portfolio and during monthly rebalancing of the Caisse's specialized portfolios. It also manages a portfolio of external managers who specialize in asset allocation.

The group also applies its expertise indirectly through the economic and financial advice it provides to the other investment groups as well as by providing quantitative investment information support.

The group also introduced new portfolio analysis tools, especially for managers in the Equity Markets and Fixed Income groups, and laid the foundation of a platform that will electronically manage documents for the Caisse and its subsidiaries. Finally, it revised the policy and procedures for suppliers of brokerage services, which led to the abolition of the program of soft-dollar commissions paid to its securities dealers.

The task of enhancing the Caisse's overall return is being carried out in a complex environment in which the proliferation of hedge funds is creating significant volatility on the financial markets. In this context, the portfolio optimization process has to be grounded in proven economics principles and rules. Accordingly, while developing its modelling and simulation tools further, the Investment Analysis and Optimization group will continue to advance its research in 2005 to sustain asset allocation decision making.

Specialized Asset Allocation portfolio

Description

The specialized Asset Allocation portfolio was created to enhance the weighted average return on depositors' funds, to preserve capital and to manage active risk. It includes the operations of internal and external asset allocation managers as well as rebalancing operations.

Asset allocation management is intended to position asset classes and subclasses, including the Caisse's currency exposure, as a function of risk and return forecasts.

Investments in illiquid asset classes can be adjusted only over fairly long periods. Rebalancing is therefore used to offset the monthly differences between the positions of these classes and their weight in the benchmark portfolio over the long term through short-term repositioning of liquid classes. This rebalancing may be effected with cash securities, between specialized portfolios or in a more targeted manner with derivatives.

Analysis of return

The Asset Allocation portfolio returned -$107.0 million in relation to its index. The negative portion of this result is due to the differences, in relation to the weight in the benchmark portfolio, in the illiquid private equity and real estate asset classes. As a result of timely sales in the second half of the year, these classes were significantly underweighted, although their returns far exceeded that of the other classes.

Rebalancing

In October, the group decided to make targeted investments using derivatives to offset the shortfall cause by the under-weighting of private equity. These investments generated $49.4 million of profits.

External management

Begun in August 2004 with of $115 million of investments that reached $542 million in December, external asset allocation management generated positive results. The gross return net of management fees was $13 million.

Analysis of combined financial statements and financing activities

Investment valuation process

Liquid investments
The fair value of investments is established by means of valuation methods used in capital markets, such as the discounting of future cash flows at the current interest rate, the closing prices of major stock exchanges and data provided by securities brokers or other recognized specialist organizations.

Private equity
The fair value of investments in private equity is established annually as at December 31. The valuation is based on an institutional Caisse policy and is first determined by the managers responsible for the investments concerned. It is then approved by the senior managers of the Private Equity group.

Investments for which the fair value is higher than a pre-established material threshold must be submitted to an independent valuation committee. Given the specialized nature of private equity investments, several valuation committees exist. These committees, which report to the Caisse's Audit Committee, are composed of valuation professionals. The Auditor General of Québec attends all the meetings of the independent valuation committees. The annual valuation process is supplemented internally by periodic valuations and as events occur.

Real estate investments
For the specialized Real Estate portfolio, external chartered appraisers certify the fair value of real estate assets. For other real estate investments, fair value is usually determined by external managers and, for debt associated with real estate investments, by internal managers. In both cases, the subsidiaries' external auditors participate in the review of fair values. In his audit of the Caisse's books and accounts, the Auditor General of Québec relies on the work of external auditors.

In the case of the specialized Mortgages portfolio, the fair value of mortgage loans and subordinated debt is established according to the discounted value of future contractual cash flows at the market interest rate. This is the rate that can be obtained for loans or securities with similar conditions and maturity dates. In situations where cash flow spread cannot be estimated reasonably or reliably, the fair value corresponds either to the fair value of any asset given as collateral for the security, after deducting foreseeable realization costs and any amount legally owed to the borrowers, or to the security's market price.

Analysis of combined financial statements

The financial statements of the Caisse de dépôt et placement du Québec are combined, which means they include the accounts of subsidiaries controlled by the Caisse, the General Fund, the Individual Funds and the specialized portfolios. Depositors' holdings presented in the Combined Statement of Net Assets reflect the combination of the net account value of each Caisse depositor.

The combined financial statements are prepared according to generally accepted accounting principles in Canada, as provided for by the Caisse's statute and according to current practices in the field of mutual funds, such as the presentation of these investments at fair value.

As required by law, the Auditor General of Québec audited the Caisse's books in 2004 and his report accompanies the combined financial statements. Over all, the Auditor General reports on 42 financial statements, including the Caisse's combined statements, the depositors' 24 Individual Funds and the 17 specialized portfolios. He has issued unqualified opinions for all the financial statements.

Total assets under management
As at December 31, 2004, the net assets belonging to the Caisse's various depositors totalled $102.4 billion. If liabilities (assets financed by borrowing) of $44.8 billion contracted mainly to optimize depositors' returns are added, depositors' total assets rise to $147.2 billion. Total assets are up 25% from last year and 37% from 2002.

In addition to the assets entrusted to it by depositors, the Caisse manages and administers assets for third parties, mainly through its Real Estate group. The total amount of assets under management and assets under administration rose to $27.5 billion in 2004, up 28% from 2003.

The sum of depositors' total assets and assets under management or administration for third parties gives the Caisse's total assets under management, namely $174.7 billion, up $45 billion since December 31, 2002.

The $13.0-billion increase in depositors' net assets in 2004 comes from $10.8 billion of investment activities and $2.2 billion of depositors' net contributions. In 2003, the increase was $11.7 billion, with $11.5 billion from to investment activities and $0.2 billion from depositors.

Fair value of investments

Investments are recorded in the financial statements at fair value. In the case of liquid investments, or almost 82% of the total, the Caisse uses quoted market prices or methods recognized by organized financial markets to determine fair value. In the case of private equity and real estate, or about 18% of investments, fair value is determined according to a valuation process that corresponds to good practices used by these industries.

This process is repeated annually and requires the participation of internal managers as well as valuators and independent professionals. The work and findings of the latter are reviewed by the Caisse's Audit Committee in the case of private equity and, for real estate investments, by the Audit Committee of each subsidiary. Lastly, the Auditor General of Québec does a detailed review of the fair value of the Caisse's investments in his audit work.

Combined earnings

Combined earnings for 2004 totalled $10.8 billion compared with $11.5 billion in 2003. This performance is due to three sources: investment income net of operating expenses (mainly interest income, dividends, fees and rents), net gains from the sale of investments (gains or losses realized on the sale of investments) and net unrealized increases in the value of investments (appreciation or depreciation relative to changes in the fair value of the investments that the Caisse held as at December 31, 2004).

Investment income totalled $3.9 billion in 2004 versus $3.7 billion in 2003. If operating expenses are excluded, this income totalled $3.6 billion in 2004 and $3.5 billion in 2003. Investment income came from fixed income securities ($2.4 billion in 2004 versus $2.1 billion in 2003) and variable income securities ($1.5 billion in 2004 and $1.5 billion in 2003). The differences between 2004 and 2003 are mainly due to the variation in average investment volume.

Net gains from the sale of investments totalled $4.2 billion, $4.1 billion for variable income securities and $0.1 billion for fixed income securities. Net gains totalled $2.3 billion in 2003, $1.6 billion for variable income securities and $0.7 billion for fixed income securities.

The net unrealized increase in the value of investments was $3.0 billion, including $1.1 billion for fixed income securities and $1.9 billion for variable income securities, including liabilities related to investments. In 2003, the net unrealized increase in the value of investments was $5.7 billion, consisting of a decrease of $0.9 billion for fixed income securities combined with an increase of $6.6 billion for variable income securities, including liabilities related to investments.

The Caisse's total operating expenses were $212 million in 2004, up $7 million, or 3.4%, in relation to $205 million in 2003. The operating expenses for 2004 are, however, 4% less than the $221 million of recurring operating expenses recorded in 2002.

Analysis of operating expenses

The Caisse's operating expenses comprise management and administrative expenses related to portfolio management.

These expenses totalled $212 million in 2004, up $7 million from the operating expenses in 2003 and down $9 million from the recurring expenses of 2002. The increase in 2004 in relation to 2003 is due mainly to the increase in the cost of external management mandates and securities custody. Operating expenses pertaining to professional services were down, however.

Operating efficiency

It is essential that the Caisse ensure efficient operations by periodically reviewing its procedures and maintaining strict control over operating expenses. The goal of the Caisse's management team is to keep operating expenses at a level comparable with those of fund managers that are the same size and conduct similar operations, making due allowance for the composition of investments.

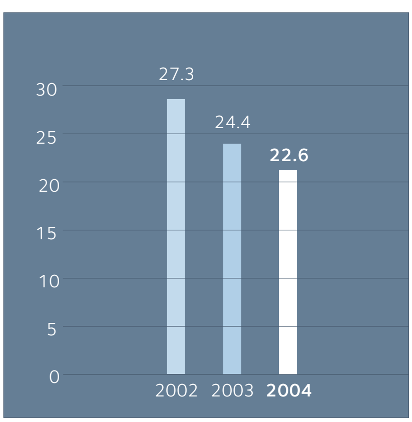
It is common practice for fund managers to express operating expenses in basis points, or the cost in cents to manage $100 of average net assets.

Figure 59 shows operating expenses expressed in cents per $100 of depositors' average net assets for 2002, 2003 and 2004.

Recurring operating expenses expressed in cents per $100 of depositors' average net assets

figure 59

(as at December 31)



Expressed per $100 of depositors' average net assets, the Caisse's operating expenses fell from 27.3 cents in 2002 to 22.6 cents in 2004. This favourable difference reflects the combined effect of the increase in depositors' average net assets and the decrease in operating expenses since 2002.

Still, this measure is not ideally suited to the Caisse because the institution differs from other managers in that it assumes the cost of active management of a major program of investment-related liabilities as well as management and administration, for clients, of portfolios of properties totalling $27.5 billion. Thus to monitor operating expenses related to its overall operations, the Caisse expresses its total operating expenses as a function of average total assets under management.

Figure 60 shows recurring operating expenses expressed in cents per $100 of average total assets under management for 2002, 2003 and 2004.

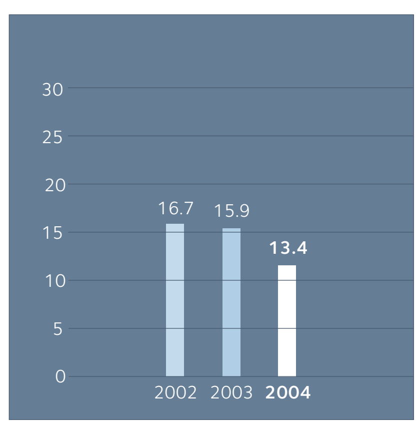
Expressed per $100 of average total assets under management, the Caisse's operating expenses fell from 16.7 cents in 2002 to 13.4 cents in 2004. This favourable difference is due to the combined effect of the increase in average total assets under management and the decrease in operating expenses since 2002.

For many years, the Caisse has taken part in exercises to benchmark costs per asset class. Generally speaking, its costs are comparable to those of its Canadian and international peers.

Recurring operating expenses expressed in cents per $100 of depositors' average total assets under management

figure 60

(as at December 31)



CDP Financial's operations

The role of CDP Financial, a wholly owned subsidiary of the Caisse, is to develop financing programs that respond to the needs of the institution's investment groups and to continually issue various types of debt securities. It is also responsible for maintaining relations with rating agencies and providing them with any information necessary to obtain or maintain credit ratings.

The financing operations of CDP Financial have enabled the Caisse to diversify its sources of liquidities and optimize the financing cost for a portion of its operations by replacing some of the existing debt contracted by its investment groups. The positive impact of this refinancing on the Caisse's borrowing costs has resulted in substantial savings for depositors.

During the year, CDP Financial pursued its mandate to optimize the cost of the funds borrowed by the Caisse's subsidiaries and investment portfolios, in order to meet their financing needs effectively. As at December 31, 2004, its liabilities totalled $3.7 billion, a level below the limit set by the Caisse's Board of Directors. This level may not at any time exceed 7.5% of depositors' net assets ($7.7 billion as at December 31, 2004). CDP Financial's financing programs are guaranteed by the Caisse.

Short-term borrowing

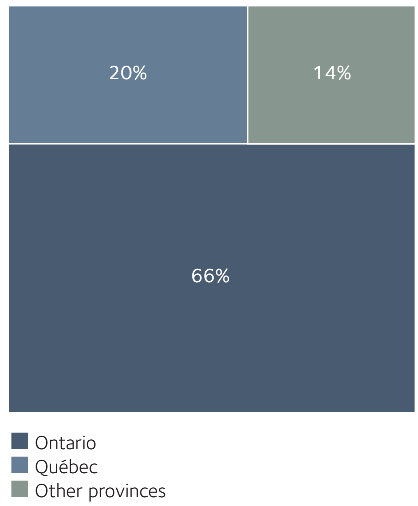
There was sustained activity in the commercial paper program, with a relatively stable outstanding amount totalling $2.2 billion versus $2.4 billion in 2003. Annual transaction volume was $23.3 billion, for a turnover rate of 10.1 times the average amount outstanding and an average maturity of 36 days. CDP Financial took advantage of historically low interest rates to decrease the average effective interest rate on its borrowings from 2.8% to 2.6% between December 31, 2003 and 2004.

Medium-term borrowing

CDP Financial was active in medium-term borrowing with an issue of $750 million of notes consisting of three tranches with terms of three, four and five years (figure 61).

Geographic allocation of the fixed-rate notes maturing in 3, 4 and 5 years

figure 61



New operations

In 2004, the Caisse gave CDP Financial a mandate to co-ordinate issues of letters of guarantee, which provide interim support for certain foreign investment operations. The outstanding amount of letters of guarantee was $231 million as at December 31, 2004.

Credit ratings

Dominion Bond Rating Service (DBRS), Moody's Investors Service (Moody's) and Standard & Poor's (S&P) have assigned CDP Financial, and its garantor, the Caisse, the highest issuer credit ratings.

CDP Financial's credit ratings

table 62

	Short-term	Long-term
DBRS	R-1 high	AAA
Moody's	Prime-1 (Aaa)	Aaa
S&P	A-1 + A-1 high	AAA

Combined financial statements

Management's responsibility for combined financial reporting

The combined financial statements of the Caisse de dépôt et placement du Québec were prepared by management, which is responsible for the integrity and accuracy of such data. This responsibility includes selecting the appropriate accounting policies in accordance with generally accepted accounting principles in Canada. The combined financial statements may contain information based on management's best estimates and judgment and reflecting their relative importance.

Management is also responsible for the information and declarations disclosed in other sections of the Operations report, and ensures that the financial information presented elsewhere in this annual report is consistent with that shown in the financial statements.

Management maintains internal accounting control systems which are designed to provide reasonable assurance that assets are safeguarded and that transactions are recorded in an appropriate and timely manner, that they are duly authorized and allow for the preparation of reliable financial statements. The internal audit team reviews the internal controls on a regular basis to ensure that they are adequate and applied consistently by the Caisse.

The Caisse is aware of its responsibility to manage its operations in accordance with the rules and regulations that govern the institution.

The Board of Directors supervises the manner in which management assumes its responsibility regarding financial information, and it has approved the combined financial statements. The Board of Directors is assisted by the Audit Committee, of which all members are outside directors. The Audit Committee meets with management and the auditor, examines the financial statements and recommends their approval by the Board of Directors.

The combined financial statements of the Caisse are audited by the Auditor General of Québec, who conducted his audit in accordance with generally accepted auditing standards in Canada. The auditor's report covers the nature and scope of the audit and expresses the auditor's opinion on the financial statements. The Auditor General has unrestricted access to the Audit Committee to discuss any matter relating to his audit.

Henri-Paul Rousseau
Chairman and Chief Executive Officer

Ghislain Parent
Executive Vice-President
Finance, Treasury and Strategic Initiatives

Montréal, February 10, 2005

Auditor's report

To the National Assembly

I have audited the combined statement of net assets of the Funds of the Caisse de dépôt et placement du Québec as at December 31, 2004, along with the combined statement of income and the combined statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Caisse's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in Canada. These standards require that I plan and perform an audit in such a way as to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the financial statements.

In my opinion, these combined financial statements present fairly, in all material respects, the financial position of these Funds as at December 31, 2004, as well as the results of their operations and the changes in their net assets for the year then ended, in accordance with accounting principles generally accepted in Canada. As required by the *Auditor General Act* (R.S.Q., chapter V-5.01), I report that in my opinion, these principles have been applied on a consistent basis in comparison with that of the preceding year.

Renaud Lachance, CA
Auditor General of Québec

Québec City, February 10, 2005

Combined financial statements

Combined statement of net assets

As at December 31, 2004

(in millions of dollars)	**2004**	2003
Assets		
Investments at fair value *(note 3a)*	**144,317**	115,098
Advances to depositors	**884**	987
Investment income, accrued and receivable	**873**	802
Transactions being settled	**338**	110
Other assets	**788**	716
	147,200	117,713
Liabilities		
Liabilities related to investments *(note 3b)*	**42,069**	24,866
Transactions being settled	**1,047**	1,604
Other liabilities	**1,033**	930
Non-controlling interest *(note 3c)*	**618**	915
	44,767	28,315
Depositors' holdings *(note 4)*	**102,433**	89,398

Derivative financial instruments *(note 7)*

Commitments and contingencies *(note 9)*

The accompanying notes are an integral part of the combined financial statements.

For the Board of Directors,

Henri-Paul Rousseau

Jean-Claude Bachand

Combined statement of income and changes in net assets

For the year ended December 31, 2004

(in millions of dollars)	**2004**	2003
Investment income *(note 5a)*	**3,850**	3,662
Less:		
Operating expenses *(note 6)*	**212**	205
Net investment income	**3,638**	3,457
Gains (losses) on sale of investments *(note 5c)*	**4,169**	2,324
Total realized income	**7,807**	5,781
Unrealized increase (decrease) in the value of investments and liabilities related to investments *(note 5d)*	**3,011**	5,743
Total investment operations	**10,818**	11,524
Excess depositors' deposits over withdrawals	**2,217**	192
Increase in combined net assets	**13,035**	11,716
Combined net assets, beginning of year	**89,398**	77,682
Combined net assets, end of year	**102,433**	89,398

The accompanying notes are an integral part of the combined financial statements.

Combined funds – Notes to financial statements

As at December 31, 2004

1 Constitution and operations

The Caisse de dépôt et placement du Québec is a legal person within the meaning of the Civil Code, created by a special act (R.S.Q., chapter C-2). It receives funds, the deposit of which is provided under the act. Pursuant to both the federal and provincial income tax acts, the Caisse is not subject to income taxes.

General Fund (consolidated statements)
The General Fund's depositor is the Fonds du régime des rentes du Québec administered by the Régie des rentes du Québec. The General Fund is comprised of diversified investments, and represents a pooled fund for demand, term, and participation deposits.

Individual Funds
The individual funds are comprised of diversified investments, and each fund has only one depositor that exclusively makes participation deposits therein. The various individual funds are:

Fund 301: For the Government and Public Employees Retirement Plan, administered by the Commission administrative des régimes de retraite et d'assurances;

Fund 302: For the Pension Plan for Management, administered by the Commission administrative des régimes de retraite et d'assurances;

Fund 303: For individual plans administered by the Commission administrative des régimes de retraite et d'assurances;

Fund 305: For the Pension Plan for Elected Municipal Officers, administered by the Commission administrative des régimes de retraite et d'assurances;

Fund 306: For the Régime complémentaire de rentes des techniciens ambulanciers oeuvrant au Québec;

Fund 307: For the Fonds d'assurance automobile du Québec administered by the Société de l'assurance automobile du Québec;

Fund 311: For the Supplemental Pension Plan for employees of the Québec construction industry – general account, administered by the Commission de la construction du Québec;

Fund 312: For the Supplemental Pension Plan for employees of the Québec construction industry – retirees account – administered by the Commission de la construction du Québec;

Fund 313: For the Supplemental Pension Plan for employees of the Québec construction industry – supplementary account, administered by the Commission de la construction du Québec;

Fund 314: For the Fonds d'assurance-dépôts administered by the Autorité des marchés financiers;

Fund 315: For the Fonds d'assurance-prêts agricoles et forestiers administered by La Financière agricole du Québec;

Fund 316: For the Fonds d'amortissement du régime de retraite – RREGOP administered by the ministère des Finances, Government of Québec;

Fund 317: For the Fonds d'amortissement du régime de retraite – RRPE administered by the ministère des Finances, Government of Québec;

Constitution and operations (cont.)

Fund 318: For the Fonds d'amortissement des autres régimes de retraite administered by the ministère des Finances, Government of Québec;

Fund 326: For the Fonds d'assurance-récolte administered by La Financière agricole du Québec;

Fund 327: For the Fédération des producteurs de bovins du Québec;

Fund 328: For the Régime de rentes de survivants administered by the Conseil du trésor, Government of Québec;

Fund 329: For the Fonds d'assurance-garantie administered by the Régie des marchés agricoles et alimentaires du Québec;

Fund 330: For the Fonds de la santé et de la sécurité au travail administered by the Commission de la santé et de la sécurité du travail;

Fund 332: For the Fonds des cautionnements des agents de voyages – cautionnements individuels administered by the Office de la protection du consommateur;

Fund 333: For the Fonds des cautionnements des agents de voyages – cautionnements collectifs : détaillants administered by the Office de la protection du consommateur;

Fund 341: For the Fonds affecté à une fin particulière en vertu de la loi sur les valeurs mobilières administered by the Autorité des marchés financiers;

Fund 342: For the Régime de retraite de l'Université du Québec.

Specialized Portfolios
The specialized portfolios are pooled funds for participation deposits of the various funds. The specialized portfolios are the following:

- Bonds
- Quebec International
- Real Return Bonds (created January 1, 2004)
- Commodity Financial Instruments (created August 1, 2004)
- Canadian Equity
- Hedge Fund (previously the Hedge Fund Partnership Units) (consolidated statements)
- U.S. Equity – hedged
- U.S. Equity – unhedged
- Foreign Equity – hedged
- Foreign Equity – unhedged
- Emerging Markets Equity
- Mortgages (consolidated statements)
- Real Estate (consolidated statements)
- Short-Term Investments
- Asset Allocation and Currencies
- Private Equity (consolidated statements)
- Investments and Infrastructures (consolidated statements)

2 Accounting policies

The combined financial statements of the Caisse have been prepared by management, in accordance with generally accepted accounting principles in Canada. These statements include amounts based on best judgement and estimates.

a) Combined financial statements

The combined financial statements comprise the accounts of the Caisse's subsidiaries, along with those of the General Fund, the individual funds, and the specialized portfolios. The accounts of each fund and each portfolio are presented in financial statements audited by the Auditor General of Québec.

b) Investments and joint operations

Investments and related assets and liabilities are accounted for at fair value, which is the estimated exchange value that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act, established at year-end.

Fixed-income securities

Fixed-income securities comprise short-term investments, bonds, and mortgages. These securities are recorded as at the commitment date, except mortgages, which are recorded as at the date of agreement.

i) Valuation method

The fair value of fixed-income securities is determined by means of valuation methods used in capital markets, such as the annualization of future cash flows at the current interest rate and the closing prices of the major stock exchanges as well as those provided by recognized financial institutions. In addition, certain valuations are made according to commonly used valuation methods, or on the basis of similar arm's-length transactions.

ii) Investment income and gains and losses on the sale of investments

Investment income from fixed-income securities includes amortization of the premium and the discount, which makes it possible to maintain a constant real return until maturity.

Gains and losses on the sale of investments represent the difference between the unamortized cost and the net realizable fair value on the sale of investments. The unamortized cost corresponds to the acquisition cost and the costs inherent to the acquisition of investments, and is restated in order to take into account amortization of the premium or the discount.

Variable-income securities

Variable-income securities comprise equities and convertible securities as well as real estate holdings. Equities and convertible securities are recorded as at the commitment date whereas real estate holdings are recorded as at the date of agreement.

i) Valuation method

The fair value of equities traded on a stock exchange is determined from the closing prices on major stock exchanges as well as those provided by recognized financial institutions. For equities not traded on a stock exchange and real estate holdings, valuations are made by independent valuators, while others are made according to commonly used valuation methods or on the basis of similar arm's-length transactions. The valuations of equities and convertible securities that are not publicly traded are reviewed annually by an independent valuation committee.

ii) Investment income and gains and losses on the sale of investments

Dividend income is recognized on the ex-dividend date. Income from real estate holdings is reduced by operating expenses related to real estate holdings, operation expenses and loan financial expenses and is recorded under the item Investment income – Variable-income securities.

Gains and losses on the sale of investments represent the difference between the cost and the net realizable value on the sale of investments. The cost corresponds to the acquisition cost and the costs inherent to the acquisition of investments.

Accounting policies (cont.)

Derivative financial instruments

Pursuant to its investment operations management, the Caisse conducts transactions involving various derivative financial instruments in order to manage the risks associated with exchange rate, interest rate, and market fluctuations.

Derivative financial instruments whose fair value is favourable are recorded under the item Investments, while those whose fair value is unfavourable are recorded under Liabilities related to investments.

i) Valuation method
Derivative financial instruments are recorded at their fair value at year-end. These values are established from closing prices on the major stock exchanges as well as those provided by recognized financial institutions. In the case of unlisted instruments, certain valuations are made on the basis of similar arm's-length transactions, or according to recognized, commonly used models.

ii) Investment income and gains and losses on the sale of investments
Investment income from derivative financial instruments is included in income from fixed-income and variable-income securities, whereas gains and losses from derative financial instruments are included in gains (losses) on the sale of investments as a function of the underlying investments. As of December 31, 2001, the balance of deferred gains and losses on derivative financial instruments used to hedge foreign exchange risks is recorded in gains and losses on the sale of investments based on disposal of foreign investment.

Securities acquired under reverse repurchase agreements

The Caisse conducts security borrowing operations involving short-term investments and bonds in order to cover short sales or to generate additional income from security borrowing operations. These security borrowing operations are recorded under Securities acquired under reverse repurchase agreements. Interest earned on reverse repurchase agreements is recorded as interest income under the item Investment income – Fixed-income securities.

Securities sold under repurchase agreements

The Caisse conducts security lending operations involving short-term investments and bonds in order to generate cash flow liquidity or to generate additional income from security lending operations. These security lending operations are recorded under Securities sold under repurchase agreements. Interest paid on repurchase agreements is applied against Investment income – Fixed-income securities.

Short selling of securities

Short selling of securities represents the commitment by the Caisse to purchase securities from third parties in order to cover such transactions. Interest related to commitments involving short selling of short-term investments and bonds is recorded under Investment income – Fixed-income securities, while costs related to commitments involving short selling of equities are recorded under Investment income – Variable-income securities.

Gains and losses on commitments related to short selling of short-term investments and bonds are recorded in Gains and losses on the sale of investments – Fixed-income securities, while those related to short selling of equities are recorded in Gains and losses on the sale investments – Variable-income securities.

c) Administered property and property under management

Some subsidiaries of the Caisse administer and manage property entrusted to them by clients and on their behalf. This property is not included in the combined statement of net assets of the Caisse. Some subsidiaries of the Caisse receive fees in return for the portfolio management services and administrative services provided, which include administration of real estate properties and management of securitized loans.

Accounting policies (cont.)

d) Foreign currency translation

The fair value of investments and any other assets and liabilities denominated in foreign currencies is translated into Canadian dollars at the rate of exchange prevailing at year-end.

The cost of investments in equities and that of real estate holdings from integrated foreign operations and the unamortized costs of investments in bonds, mortgages, and short-term investments are translated at the rate prevailing on the acquisition date. The cost of investments from self-sustaining foreign operations is translated at the rate prevailing at year-end.

Income is translated at the rate of exchange prevailing on the transaction date, with the exception of income from the specialized real estate portfolio, which is translated at the average rate for the year-end.

e) Loan securitization

The Caisse periodically securitizes loans by selling loans to a collateralized security entity, which then issues securities to investors. Such transactions are recorded as sales where the Caisse is deemed to have abandoned control over such assets and to have received compensation other than the beneficial rights attached to the assets disposed of, in accordance with Accounting Guideline No.12. At time of securitization, no beneficial right attached to the securitized loans is retained. Any gains and losses deriving from such transactions are recorded under Gains (losses) on sale of investments – Mortgages.

Companies under common control usually continue to manage loans after disposition. Since management fees are established based on the market for such services, no assets or liabilities under management have been recorded as of the date of disposition.

f) Operating expenses

Operating expenses cover all expenses related to investment operations, including expenses paid to external financial institutions, and are presented under a specific item, with the exception of those related to real-estate management and operation expenses, which are deducted from real-estate holdings investment income.

3 Investments and liabilities related to investments

a) Investments

(in millions of dollars)		**2004**		2003
	Fair value	**Cost**	Fair value	Cost
Fixed-income securities				
Short-term investments				
Canadian	**15,358**	**15,362**	10,429	10,448
Foreign	**1,709**	**1,777**	912	929
	17,067	**17,139**	11,341	11,377
Bonds				
Issued or guaranteed by:				
Canadian government	**21,523**	**21,006**	14,137	13,993
Province of Quebec	**10,826**	**9,710**	12,835	11,714
Other Canadian provinces	**1,452**	**1,418**	253	244
Municipalities and other Canadian bodies	**1,129**	**1,052**	1,201	1,085
Canadian government corporations	**7,818**	**6,866**	5,576	4,739
U.S. government	**3,675**	**3,839**	1,518	1,570
Other foreign government	**1,971**	**1,950**	931	935
Mortgage securities	**793**	**801**	532	529
Canadian corporations	**7,072**	**6,908**	5,138	5,092
Foreign corporations	**2,215**	**2,227**	852	1,400
Canadian inflation-indexed securities	**1,090**	**1,024**	179	174
Foreign inflation-indexed securities	**865**	**912**	–	–
Hedge funds	**476**	**487**	14	14
	60,905	**58,200**	43,166	41,489
Mortgages				
Canadian	**3,998**	**3,832**	3,248	3,166
Foreign	**554**	**584**	376	380
	4,552	**4,416**	3,624	3,546
Total fixed-income securities	**82,524**	**79,755**	58,131	56,412
Variable-income securities				
Equities and convertible securities				
Canadian	**15,427**	**14,935**	15,453	15,542
U.S	**14,030**	**14,986**	10,462	12,026
Foreign and emerging markets	**13,130**	**12,875**	11,842	12,027
Hedge funds	**2,335**	**2,463**	864	869
Other	**119**	**119**	1,729	1,602
	45,041	**45,378**	40,350	42,066
Real estate holdings				
Canadian	**8,543**	**7,827**	8,869	8,873
Foreign	**3,205**	**3,609**	5,155	5,270
	11,748	**11,436**	14,024	14,143
Total variable-income securities	**56,789**	**56,814**	54,374	56,209
Amounts to be received in respect of investments				
Securities acquired under reverse repurchase agreements				
Canadian	**734**	**734**	413	413
Foreign	**2,613**	**2,664**	806	816
Amount pertaining to derivative products				
Canadian	**225**	**8**	191	10
Foreign	**1,432**	**309**	1,183	356
	5,004	**3,715**	2,593	1,595
Total investments	**144,317**	**140,284**	115,098	114,216

Investments and liabilities related to investments (cont.)

b) Liabilities related to investments

(in millions of dollars)		**2004**		2003
	Fair value	**Cost**	Fair value	Cost
Securities sold under repurchase agreements				
Canadian	**17,793**	**17,793**	9,567	9,566
Foreign	**5,496**	**5,590**	2,258	2,290
Commercial paper payable	**2,167**	**2,167**	2,376	2,376
Medium-term notes	**1,338**	**1,309**	752	750
Loans payables				
Canadian	**162**	**169**	420	419
Foreign	**169**	**169**	34	34
Canadian commercial mortgage-backed securities	**598**	**543**	628	599
Short selling of securities				
Canadian	**7,333**	**6,963**	2,869	2,647
Foreign	**2,688**	**2,646**	357	331
Mortgage loans payable				
Canadian	**1,683**	**1,532**	2,026	1,893
Foreign	**1,500**	**1,482**	2,569	2,546
Amount pertaining to derivative instruments				
Canadian	**237**	**89**	103	24
Foreign	**905**	**277**	907	319
	42,069	**40,729**	24,866	23,794

c) Non-controlling interest

(in millions of dollars)		**2004**		2003
	Fair value	**Cost**	Fair value	Cost
Canadian	**481**	**462**	400	434
Foreign	**137**	**157**	515	340
	618	**619**	915	774

d) Summary geographic breakdown at market value of investments and liabilities related to investments

(in millions of dollars)			**2004**			2003
	Canadian	**Foreign**	**Total**	Canadian	Foreign	Total
Investments						
Fixed-income securities	**70,217**	**12,307**	**82,524**	52,751	5,380	58,131
Equities and convertibles securities	**15,427**	**29,614**	**45,041**	15,453	24,897	40,350
Real estate holdings	**8,543**	**3,205**	**11,748**	8,869	5,155	14,024
Amount to be received in respect of investments	**959**	**4,045**	**5,004**	604	1,989	2,593
	95,146	**49,171**	**144,317**	77,677	37,421	115,098
Liabilities related to investments	**31,311**	**10,758**	**42,069**	18,741	6,125	24,866
Non-controlling interests	**481**	**137**	**618**	400	515	915

Investments and liabilities related to investments (cont.)

e) Summary of maturities of investments and liabilities related to investments at par value

(in millions of dollars)

	2004					2003	
	Less than 2 years	**2 to 5 years**	**More than 5 years**	**Total**	**Effective interest rate**	Total par value	Effective interest rate
Fixed-income securities							
Short-term investments							
Canadian	**15,233**	**851**	**92**	**16,176**	**2.7%**	10,494	3.0%
Foreign	**600**	**582**	**394**	**1,576**	**4.4%**	912	4.2%
	15,833	**1,433**	**486**	**17,752**	**2.9%**	11,406	3.1%
Bonds							
Issued or guaranteed by:							
Canadian government	**2,476**	**6,149**	**11,306**	**19,931**	**4.3%**	13,445	4.1%
Province of Québec	**1,516**	**1,911**	**5,966**	**9,393**	**5.7%**	11,371	6.3%
Other Canadian provinces	**146**	**319**	**907**	**1,372**	**4.7%**	243	5.5%
Municipalities and other Canadian bodies	**402**	**487**	**138**	**1,027**	**6.2%**	1,046	7.1%
Canadian government corporations	**422**	**2,963**	**3,368**	**6,753**	**5.4%**	4,700	6.5%
U.S. government	**485**	**490**	**2,894**	**3,869**	**4.3%**	1,739	4.6%
Other foreign governments	**327**	**480**	**1,107**	**1,914**	**2.5%**	1,004	3.5%
Mortgage securities	**23**	**13**	**1,020**	**1,056**	**12.1%**	529	8.6%
Canadian corporations	**2,354**	**2,045**	**2,441**	**6,840**	**4.7%**	4,851	5.6%
Foreign corporations	**310**	**188**	**1,825**	**2,323**	**4.9%**	1,491	4.9%
Canadian inflation-indexed securities	**–**	**–**	**710**	**710**	**2.4%**	158	2.9%
Foreign inflation-indexed securities	**–**	**201**	**535**	**736**	**1.2%**	–	–
	8,461	**15,246**	**32,217**	**55,924**	**4.8%**	40,577	5.4%
Mortgages							
Canadian	**954**	**1,153**	**1,725**	**3,832**	**6.6%**	3,166	7.0%
Foreign	**396**	**50**	**138**	**584**	**8.0%**	380	8.6%
	1,350	**1,203**	**1,863**	**4,416**	**6.8%**	3,546	7.2%
	25,644	**17,882**	**34,566**	**78,092**	**4.5%**	55,529	5.0%
Amounts to be received in respect of investments							
Securities acquired under reverse repurchase agreements							
Canadian	**735**	**–**	**–**	**735**	**2.4%**	465	2.8%
Foreign	**2,640**	**–**	**–**	**2,640**	**1.6%**	807	0.9%
	3,375	**–**	**–**	**3,375**	**1.8%**	1,272	1.6%
Liabilities related to investments							
Securities sold under repurchase agreements	**23,335**	**–**	**–**	**23,335**	**2.4%**	11,552	2.5%
Commercial paper payable	**2,176**	**–**	**–**	**2,176**	**2.6%**	2,388	2.7%
Medium-term notes	**–**	**1,312**	**–**	**1,312**	**4.2%**	750	4.1%
Loans payable	**330**	**–**	**–**	**330**	**3.6%**	466	3.1%
Canadian commercial mortgage-backed securities	**17**	**53**	**480**	**550**	**6.9%**	599	6.4%
Short selling of securities	**1,237**	**2,043**	**3,935**	**7,215**	**4.3%**	2,020	4.8%
Mortgage loans payable	**723**	**1,093**	**1,198**	**3,014**	**6.9%**	4,511	6.5%
	27,818	**4,501**	**5,613**	**37,932**	**3.3%**	22,286	3.7%

Investments and liabilities related to investments (cont.)

The balance of losses on derivative financial foreign exchange risk hedging instruments reported in the cost of investments as of December 31, 2001, was $127 million as at December 31, 2004 ($263 million in 2003).

The fair value of investments in short-term investments, bonds, equities and convertible securities includes investments in private companies, in the amount of $1,125 million, $1,316 million and $5,121 million respectively as at December 31, 2004 ($1,061 million in short-term investments, $478 million in bonds, and $5,710 million in equities and convertible securities in 2003), for which market prices are not available.

In addition, the $4,169 million ($2,324 million in 2003) of gains on the sale of investments presented in the combined statement of changes in net assets includes $103 million in foreign exchange gains ($1,024 million in 2003).

4 Depositors' holdings

Demand and term deposits bear interest, and constitute indebtedness on the part of the Caisse toward the depositors.

Participation deposits are expressed in units, and each unit gives its holder a proportionate share in the net equity and net income of a particular fund. At the end of each monthly period for the General Fund and the individual funds, the net investment income and gains and losses on the sale of investments are distributed to participation deposit holders. At the beginning of the following period, the amounts distributed are paid out to (recovered from) the depositors' demand deposit accounts.

(in millions of dollars)	**2004**	2003
Caisse's indebtedness toward depositors		
Demand deposits	**41**	36
Term deposits	**–**	18
Interest on demand and term deposits	**(1)**	(1)
Net income to be paid out to participation deposit holders	**471**	184
	511	237
Participation deposit holders' holdings		
Participation deposits		
Balance, beginning of year	**87,206**	84,702
Units issued	**6,897**	3,983
Units cancelled	**(786)**	(1,479)
Balance, end of year	**93,317**	87,206
Amount not allocated with respect to real estate holdings *	**33**	47
Unrealized increase (decrease) in value allocated following interfund transactions	**182**	73
Amount not allocated following gains and losses on the sale of investments in the specialized portfolios **	**5,696**	2,166
Unrealized increase (decrease) in value of investments and other related assets and liabilities	**2,694**	(331)
	101,922	89,161
Depositors' holdings	**102,433**	89,398

* Represents the restated amount of accumulated amortization of real estate properties resulting from the recording of investments at fair value. This amount will be allocated upon the sale of the properties.

** Represents the gains and losses on the sale of investments in the specialized portfolios that are not distributed at year-end. This amount will be allocated upon the sale of the participation units in portfolios.

5 Investment income, gains (losses) on the sale of investments, and unrealized increase (decrease) in the value of investments and liabilities related to investments

a) Investment income

(in millions of dollars)	**2004**	2003
Fixed-income securities		
Short-term investments	**245**	249
Bonds	**1,839**	1,629
Mortgages	**269**	267
	2,353	2,145
Variable-income securities		
Equities and convertible securities	**999**	869
Real estate holdings *(note 5b)*	**531**	678
	1,530	1,547
Other income	**22**	33
Non-controlling interests	**(55)**	(63)
	3,850	3,662

b) Net income from real estate holdings

(in millions of dollars)	**2004**	2003
Income from real estate holdings	**1,844**	2,163
Less:		
Expenses related to real estate subsidiaries		
Operating expenses related to real estate holdings	**967**	1,085
Operation expenses	**53**	51
Loan financial expenses	**308**	356
	1,328	1,492
Other income	**15**	7
	531	678

c) Gains (losses) on sale of investments

(in millions of dollars)	**2004**	2003
Fixed-income securities		
Short-term investments	**(190)**	(101)
Bonds	**295**	740
Mortgages	**2**	97
	107	736
Variable-income securities		
Equities and convertible securities	**4,122**	1,135
Real estate holdings	**(76)**	458
	4,046	1,593
Non-controlling interests	**16**	(5)
	4,169	2,324

Investment income, gains (losses) on the sale of investments, and unrealized increase (decrease) in the value of investments and liabilities related to investments (cont.)

d) Unrealized increase (decrease) in the value of investments and liabilities related to investments

(in millions of dollars)	**2004**	2003
Fixed-income securities		
Short-term investments	**(17)**	(108)
Bonds	**1,103**	(632)
Mortgages	**59**	(93)
Securities acquired under reverse repurchase agreements	**(53)**	(25)
	1,092	(858)
Variable-income securities		
Equities and convertible securities	**1,543**	6,171
Real estate holdings	**502**	(136)
	2,045	6,035
Total investments	**3,137**	5,177
Less:		
Liabilities related to investments		
Securities acquired under reverse repurchase agreements	**(63)**	(51)
Medium-term notes	**27**	2
Loans payable	**(8)**	13
Commercial mortgage-backed securities	**26**	(9)
Short sellinging securities	**164**	312
Mortgage loans payable	**13**	(13)
Derivative financial instruments	**109**	(872)
Non-controlling interests	**(142)**	52
	126	(566)
	3,011	5,743

6 Operating expenses

(in millions of dollars)	**2004**	2003
Salaries and employee benefits	**106**	101
Professional services	**38**	42
Premises and equipment	**15**	13
Depreciation of fixed assets	**18**	20
External – management and safekeeping of securities	**21**	16
Other	**14**	13
	212	205

7 Derivative financial instruments

Derivative financial instruments are financial contracts whose value fluctuates as a function of the underlying security, and which do not require holding or delivery of the underlying good itself. This underlying good may be of a financial nature (interest rate, foreign currency, stock market security or index) or a commodity (precious metal, foodstuff, oil).

The notional amount of a derivative financial instrument represents the value of the theoretical capital to which a rate or a price applies in order to determine the exchange of future financial returns, and does not reflect the credit risk pertaining to the instrument.

The Caisse uses derivative financial instruments that include those described below:

Forward contracts and futures contracts are undertakings that enable the purchase or sale of an underlying good, the quantity and price of which are determined in the contract by a predetermined delivery date. A forward contract involves customized conditions negotiated directly between the parties on the over-the-counter market. A futures contract has terms and conditions determined by an organized market.

A swap is a transaction whereby two parties agree to exchange financial returns on predetermined conditions that include a notional amount and a term.

An option is a contract negotiated by mutual agreement or traded on an organized market that gives the purchaser the right, but not the obligation, to buy or sell a given amount of an underlying security, index, or commodity, at a strike price stipulated in advance, either at a determined date or at any time before a specified maturity.

Foreign exchange risk arises from investments and liabilities related to investments denominated in foreign currencies, as well as related derivative financial instruments. In order to manage the exchange risk, the Caisse uses instruments negotiated with banks; maturities generally range from one to twelve months in the case of forward contracts and options, and from one to two years for foreign currency swaps. Upon maturity, new derivative financial instruments are negotiated in order to maintain effective long-term management of foreign exchange risks associated with investments and liabilities related to investments in foreign currencies.

Derivative instruments that are traded on exchanges or with banks and securities dealers are used to manage the interest rate and market risks of the total investment portfolio, as well as to generate income from transactions, which is included in investment income from fixed-income and variable-income securities.

These transactions are negotiated with financial institutions whose credit rating is established by a recognized credit rating agency and operational limits are duly approved by management, which supports signing compensation agreements in order to limit credit risks.

Derivative financial instruments (cont.)

a) Summary of derivative financial instruments

(in millions of dollars)

	2004				2003
		Fair value			
	Notional amount	**Assets**	**Liabilities**	**Net amount**	Net amount
Foreign exchange risk management					
Foreign currency swaps	432	–	81	(81)	(103)
Forward contracts	23,044	694	221	473	301
Over-the-counter foreign currency options					
Purchases	155	16	–	16	60
Sales	157	–	2	(2)	(47)
	23,788	710	304	406	211
Interest rate and market risk management					
Interest rate and foreign currency swaps	53,791	311	480	(169)	(184)
Equity swaps	6,973	154	73	81	167
Forward contracts	19,287	224	116	108	43
Futures contracts	73,023	–	–	–	–
Exchange-traded options					
Purchases	7,039	21	–	21	5
Sales	7,975	–	15	(15)	(5)
Over-the-counter options					
Purchases	30,018	237	–	237	357
Sales	22,911	–	154	(154)	(230)
	221,017	947	838	109	153
Total derivative financial instrument contracts	244,805	1,657	1,142	515	364

Derivative financial instruments (cont.)

b) Summary of derivative financial instrument maturities

(in millions of dollars)

				2004	2003
				Notional amount – Maturity	Notional amount
	Less than 2 years	**2 to 5 years**	**More than 5 years**	**Total**	
Foreign exchange risk management					
Foreign currency swaps	**–**	**174**	**258**	**432**	465
Forward contracts	**23,044**	**–**	**–**	**23,044**	14,681
Over-the-counter foreign currency options					
Purchases	**155**	**–**	**–**	**155**	1,026
Sales	**157**	**–**	**–**	**157**	420
	23,356	**174**	**258**	**23,788**	16,592
Interest rate and market risk management					
Interest rate and foreign currency swaps	**12,260**	**15,855**	**25,676**	**53,791**	44,006
Equity swaps	**6,131**	**777**	**65**	**6,973**	5,462
Forward contracts	**18,937**	**150**	**200**	**19,287**	18,170
Futures contracts	**58,756**	**13,272**	**995**	**73,023**	12,331
Exchange-traded options					
Purchases	**7,018**	**21**	**–**	**7,039**	2,746
Sales	**7,957**	**18**	**–**	**7,975**	5,373
Over-the-counter options					
Purchases	**26,189**	**2,682**	**1,147**	**30,018**	50,540
Sales	**18,728**	**3,714**	**469**	**22,911**	36,563
	155,976	**36,489**	**28,552**	**221,017**	175,191
Total derivative financial instruments contracts	**179,332**	**36,663**	**28,810**	**244,805**	191,783

8 Securitization

During the year, the Caisse securitized no commercial mortgage loans ($1,392.8 million in 2003), and issued no commercial mortgage-backed securities ($1,512.2 million in 2003).

Commercial mortgage-backed securities acquired by the Caisse are recorded in the combined statement of net assets under Mortgages. As at December 31, 2004, these securities amounted to $251.0 million ($261.0 million in 2003). Securitization allowed companies under common control to generate $1.5 million in management fees in 2004 ($0.8 million in 2003). No losses are expected due to the nature and quality of the loans.

9 Commitments and contingencies

Given the nature of its operations, the Caisse has a number of commitments.

Commitments to buy investments mean the Caisse is committed to buying investments which will be settled over the coming financial years, in accordance with the terms and conditions in each agreement.

For the Caisse, collaterals and loan guarantees consist in securing future income deriving from the sale of investments and transactions on derivatives as well as the reimbursement of loans made by investee companies to financial institutions and corporations. In general, the Caisse has no recourse with third parties regarding these collaterals.

(in millions of dollars)	**2004**	2003
Commitments to buy investments	**7,262**	5,025
Collaterals and loan guarantees	**448**	403
	7,710	5,428

10 Collaterals

In the normal course of business, the Caisse conducts transactions involving the lending and borrowing of securities in exchange for collaterals or assets, with various counterparties with which clearing agreements have been signed in order to limit credit risk. In its securities-lending operations, the Caisse received assets as collateral. As at December 31, the Caisse pledged and received as collateral securities and other assets for amounts of $25,210 million ($12,315 million in 2003) and $6,709 million ($3,468 million in 2003) respectively. The amount of the assets pledged as collateral consists of assets with a value of $631 million ($513 million in 2003), which were pledged with depositors to participate in clearing and payment systems.

11 Comparative figures

During the year, the presentation of certain items in the 2003 report was reviewed in order to better reflect the nature of some financial instruments. This change resulted in an increase (decrease) in the following items of the financial statements:

(in millions of dollars)		2003
	Fair value	Cost
Assets		
Investments	(987)	(758)
Other assets	(138)	(138)
Liabilities		
Liabilities related to investments	(1,259)	(1,030)
Other liabilities	134	134

Supplementary information – Summary financial statements for the funds

(in millions of dollars)	General fund		Individual funds							
			301		302		303		305	
CONSOLIDATED NET ASSETS AS AT DECEMBER 31	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
ASSETS										
Investments at fair value										
Bonds	**10,172.3**	7,834.9	**14,906.6**	12,665.8	**2,580.6**	2,159.2	**71.0**	61.5	**44.4**	36.4
Equities and convertible securities	**9,276.6**	8,081.4	**15,172.7**	13,774.7	**2,152.9**	2,035.0	**100.4**	94.3	**62.5**	55.0
Mortgage loans	**762.3**	578.8	**1,575.0**	1,264.1	**265.3**	196.8	**8.1**	6.5	**5.2**	3.8
Real estate investments	**1,876.7**	1,905.6	**2,021.2**	2,468.9	**463.1**	441.9	**15.5**	16.3	**9.2**	9.9
Short-term investments	**1,728.9**	1,544.2	**1,836.7**	1,754.5	**250.5**	256.8	**13.0**	10.6	**8.3**	7.1
Demand deposits in the General Fund	**—**	—	**0.2**	7.0	**0.4**	0.2	**—**	—	**—**	0.2
	23,816.8	19,944.9	**35,512.4**	31,935.0	**5,712.8**	5,089.9	**208.0**	189.2	**129.6**	112.4
Other assets	**7,714.8**	3,022.1	**100.3**	133.1	**18.6**	22.2	**0.6**	0.7	**0.4**	0.5
	31,531.6	22,967.0	**35,612.7**	32,068.1	**5,731.4**	5,112.1	**208.6**	189.9	**130.0**	112.9
LIABILITIES										
Demand and term deposits	**6,759.7**	2,944.9	**—**	—	**—**	—	**—**	—	**—**	—
Loans and notes payable	**1,590.1**	669.4	**1,251.2**	1,087.2	**201.9**	173.4	**7.3**	6.4	**4.5**	3.8
Derivative financial instruments	**0.2**	0.4	**0.2**	0.6	**—**	0.1	**—**	—	**—**	—
Other liabilities	**437.5**	255.8	**171.6**	44.5	**32.7**	13.2	**1.4**	0.3	**0.6**	0.2
	8,787.5	3,870.5	**1,423.0**	1,132.3	**234.6**	186.7	**8.7**	6.7	**5.1**	4.0
PARTICIPATION DEPOSIT HOLDERS' NET HOLDINGS	**22,744.1**	19,096.5	**34,189.7**	30,935.8	**5,496.8**	4,925.4	**199.9**	183.2	**124.9**	108.9
STATEMENT OF CONSOLIDATED INCOME FOR THE YEAR ENDED DECEMBER 31										
INCOME										
Investment income										
Bonds	**419.9**	366.0	**664.8**	618.7	**109.6**	101.2	**3.2**	3.1	**1.9**	1.9
Equities and convertible securities	**194.3**	173.0	**330.4**	305.1	**46.6**	43.6	**2.3**	2.1	**1.4**	1.2
Mortgage loans	**52.5**	51.9	**110.9**	114.2	**18.1**	17.4	**0.6**	0.5	**0.3**	0.3
Real estate investments	**113.2**	147.0	**123.2**	190.5	**28.2**	34.1	**0.9**	1.3	**0.6**	0.7
Short-term investments	**21.1**	28.7	**19.7**	15.6	**2.0**	1.9	**0.1**	0.1	**0.1**	0.1
Demand deposits (Advances from) in the General Fund	**—**	—	**—**	(0.2)	**—**	—	**—**	—	**—**	—
	801.0	766.6	**1,249.0**	1,243.9	**204.5**	198.2	**7.1**	7.1	**4.3**	4.2
Other income	**6.8**	3.3	**—**	—	**—**	—	**—**	—	**—**	—
Total income	**807.8**	769.9	**1,249.0**	1,243.9	**204.5**	198.2	**7.1**	7.1	**4.3**	4.2
Operating costs	**3.9**	3.0	**—**	—	**—**	—	**—**	—	**—**	—
INCOME BEFORE THE FOLLOWING ITEM	**803.9**	766.9	**1,249.0**	1,243.9	**204.5**	198.2	**7.1**	7.1	**4.3**	4.2
Interest on demand and term deposits	**(1.2)**	(15.7)	**—**	—	**—**	—	**—**	—	**—**	—
NET INVESTMENT INCOME	**802.7**	751.2	**1,249.0**	1,243.9	**204.5**	198.2	**7.1**	7.1	**4.3**	4.2
CHANGES IN CONSOLIDATED NET ASSETS FOR THE YEAR ENDED DECEMBER 31										
INVESTMENT OPERATIONS										
Net investment income	**802.7**	751.2	**1,249.0**	1,243.9	**204.5**	198.2	**7.1**	7.1	**4.3**	4.2
Gains (losses) on sale of investments	**44.9**	(268.0)	**345.1**	(283.5)	**44.8**	(100.4)	**1.6**	(2.0)	**0.4**	(0.8)
Unrealized increase (decrease) in value of investments and liabilities	**1,657.6**	2,119.1	**1,915.9**	3,012.8	**328.5**	541.7	**12.8**	18.9	**8.6**	10.9
Total investment operations	**2,505.2**	2,602.3	**3,510.0**	3,973.2	**577.8**	639.5	**21.5**	24.0	**13.3**	14.3
Participation deposits	**1,990.0**	373.8	**1,338.0**	851.1	**242.9**	182.0	**3.9**	1.0	**7.4**	(1.1)
Net income allocated to participation deposit holders	**(847.6)**	(483.2)	**(1,594.1)**	(960.4)	**(249.3)**	(97.8)	**(8.7)**	(5.1)	**(4.7)**	(3.4)
INCREASE (DECREASE) IN CONSOLIDATED NET ASSETS	**3,647.6**	2,492.9	**3,253.9**	3,863.9	**571.4**	723.7	**16.7**	19.9	**16.0**	9.8
CONSOLIDATED NET ASSETS, BEGINNING OF YEAR	**19,096.5**	16,603.6	**30,935.8**	27,071.9	**4,925.4**	4,201.7	**183.2**	163.3	**108.9**	99.1
CONSOLIDATED NET ASSETS, END OF YEAR	**22,744.1**	19,096.5	**34,189.7**	30,935.8	**5,496.8**	4,925.4	**199.9**	183.2	**124.9**	108.9
INVESTMENTS AND CERTAIN LIABILITIES AT COST AS AT DECEMBER 31										
ASSETS										
Investments										
Bonds	**9,650.7**	7,833.0	**13,959.9**	12,076.8	**2,426.3**	2,082.2	**65.3**	57.3	**40.9**	34.0
Equities and convertible securities	**8,125.3**	7,753.0	**13,422.3**	13,288.0	**1,868.9**	1,924.0	**92.9**	95.8	**56.5**	55.1
Mortgage loans	**725.6**	560.5	**1,498.4**	1,225.4	**253.3**	191.2	**7.7**	6.2	**5.0**	3.7
Real estate investments	**1,410.5**	1,727.1	**1,470.3**	2,158.9	**342.7**	390.6	**11.1**	14.0	**6.7**	8.7
Short-term investments	**1,711.9**	1,542.3	**1,808.5**	1,751.2	**245.8**	256.2	**12.8**	10.5	**8.2**	7.1
Demand deposits in the General Fund	**—**	—	**0.2**	7.0	**0.4**	0.2	**—**	—	**—**	0.2
	21,624.0	19,415.9	**32,159.6**	30,507.3	**5,137.4**	4,844.4	**189.8**	183.8	**117.3**	108.8
LIABILITIES										
Term deposits	**—**	18.2	**—**	—	**—**	—	**—**	—	**—**	—
Loans and notes payable	**1,583.3**	668.9	**1,240.9**	1,086.4	**200.2**	173.3	**7.3**	6.4	**4.5**	3.8
Derivative financial instruments	**—**	—	**—**	—	**—**	—	**—**	—	—	—

Supplementary information – Summary financial statements for the funds (cont.)

Individual funds

306		307		311		312		313		314		315		316	
2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
86.1	80.6	**2,750.5**	1,838.9	**1,324.1**	903.4	**1,289.2**	1,000.3	**555.2**	377.9	**158.8**	143.7	**56.3**	49.8	**3,167.9**	2,176.3
68.1	59.9	**2,644.7**	3,779.2	**1,630.2**	1,652.4	**1,608.0**	1,817.3	**678.8**	688.8	**—**	—	**15.9**	28.9	**3,125.5**	2,325.3
10.3	—	**259.4**	217.8	**167.5**	104.7	**165.0**	114.5	**70.0**	43.6	**—**	—	**12.0**	10.6	**328.6**	215.6
8.2	7.2	**995.9**	569.5	**280.2**	243.1	**304.0**	255.5	**116.5**	96.0	**—**	—	**23.7**	5.5	**342.9**	379.3
8.8	8.3	**462.5**	376.0	**205.5**	175.2	**191.7**	182.4	**87.6**	74.5	**169.1**	152.7	**20.3**	16.6	**430.8**	346.3
—	—	**—**	—	**0.1**	0.1	**—**	0.1	**—**	0.1	**—**	—	**—**	—	**0.2**	0.2
181.5	156.0	**7,113.0**	6,781.4	**3,607.6**	3,078.9	**3,557.9**	3,370.1	**1,508.1**	1,280.9	**327.9**	296.4	**128.2**	111.4	**7,395.9**	5,443.0
0.5	0.5	**28.7**	26.0	**10.8**	11.7	**11.0**	12.7	**4.5**	4.8	**0.9**	0.8	**0.7**	0.5	**19.9**	21.9
182.0	156.5	**7,141.7**	6,807.4	**3,618.4**	3,090.6	**3,568.9**	3,382.8	**1,512.6**	1,285.7	**328.8**	297.2	**128.9**	111.9	**7,415.8**	5,464.9
—	—	**2.2**	1.9	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
6.4	5.3	**249.1**	230.4	**126.3**	103.7	**125.5**	115.3	**52.6**	42.8	**11.8**	10.3	**4.5**	3.8	**257.1**	185.2
—	—	**—**	0.1	**—**	0.1	**—**	—	**—**	—	**—**	—	**—**	—	**—**	0.1
1.0	0.2	**37.3**	8.9	**17.6**	2.9	**18.8**	6.8	**7.8**	1.3	**0.8**	0.8	**0.7**	0.4	**19.8**	6.7
7.4	5.5	**288.6**	241.3	**143.9**	106.7	**144.3**	122.1	**60.4**	44.1	**12.6**	11.1	**5.2**	4.2	**276.9**	192.0
174.6	151.0	**6,853.1**	6,566.1	**3,474.5**	2,983.9	**3,424.6**	3,260.7	**1,452.2**	1,241.6	**316.2**	286.1	**123.7**	107.7	**7,138.9**	5,272.9
4.1	4.1	**102.1**	93.4	**55.0**	44.8	**57.1**	53.7	**23.1**	18.6	**7.2**	7.6	**2.5**	2.5	**127.9**	97.6
1.5	1.3	**71.5**	82.5	**37.4**	35.1	**38.8**	41.1	**15.6**	14.6	**—**	—	**0.5**	0.6	**62.4**	47.6
0.4	—	**17.4**	19.9	**11.0**	8.1	**11.3**	9.5	**4.6**	3.4	**—**	—	**0.9**	0.7	**21.4**	17.9
0.5	0.5	**51.2**	44.0	**17.1**	18.7	**18.5**	19.7	**7.1**	7.4	**—**	—	**0.9**	0.4	**20.9**	29.3
0.1	0.1	**6.1**	3.4	**2.2**	1.5	**2.2**	1.7	**1.1**	0.6	**4.8**	4.6	**0.5**	0.5	**6.0**	2.9
—	—	**(0.1)**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
6.6	6.0	**248.2**	243.2	**122.7**	108.2	**127.9**	125.7	**51.5**	44.6	**12.0**	12.2	**5.3**	4.7	**238.6**	195.3
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
6.6	6.0	**248.2**	243.2	**122.7**	108.2	**127.9**	125.7	**51.5**	44.6	**12.0**	12.2	**5.3**	4.7	**238.6**	195.3
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
6.6	6.0	**248.2**	243.2	**122.7**	108.2	**127.9**	125.7	**51.5**	44.6	**12.0**	12.2	**5.3**	4.7	**238.6**	195.3
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
6.6	6.0	**248.2**	243.2	**122.7**	108.2	**127.9**	125.7	**51.5**	44.6	**12.0**	12.2	**5.3**	4.7	**238.6**	195.3
6.6	6.0	**248.2**	243.2	**122.7**	108.2	**127.9**	125.7	**51.5**	44.6	**12.0**	12.2	**5.3**	4.7	**238.6**	195.3
1.5	(1.2)	**135.8**	(56.6)	**17.7**	(26.8)	**51.6**	(58.4)	**1.4**	(17.2)	**0.2**	(1.4)	**(0.1)**	(1.8)	**(57.0)**	(105.6)
9.4	12.2	**496.9**	662.6	**224.0**	285.9	**197.3**	359.6	**98.3**	127.2	**2.5**	3.2	**8.3**	7.1	**479.2**	545.8
17.5	17.0	**880.9**	849.2	**364.4**	367.3	**376.8**	426.9	**151.2**	154.6	**14.7**	14.0	**13.5**	10.0	**660.8**	635.5
14.2	12.6	**(209.9)**	—	**266.6**	(58.4)	**(33.4)**	115.3	**112.3**	67.4	**27.6**	25.0	**7.7**	10.2	**1,386.8**	634.5
(8.1)	(4.8)	**(384.0)**	(186.6)	**(140.4)**	(81.4)	**(179.5)**	(67.3)	**(52.9)**	(27.4)	**(12.2)**	(10.8)	**(5.2)**	(2.9)	**(181.6)**	(89.7)
23.6	24.8	**287.0**	662.6	**490.6**	227.5	**163.9**	474.9	**210.6**	194.6	**30.1**	28.2	**16.0**	17.3	**1,866.0**	1,180.3
151.0	126.2	**6,566.1**	5,903.5	**2,983.9**	2,756.4	**3,260.7**	2,785.8	**1,241.6**	1,047.0	**286.1**	257.9	**107.7**	90.4	**5,272.9**	4,092.6
174.6	151.0	**6,853.1**	6,566.1	**3,474.5**	2,983.9	**3,424.6**	3,260.7	**1,452.2**	1,241.6	**316.2**	286.1	**123.7**	107.7	**7,138.9**	5,272.9
78.2	73.9	**2,507.2**	1,671.1	**1,228.8**	834.1	**1,187.1**	919.0	**514.5**	348.2	**145.7**	133.9	**52.5**	47.2	**3,018.0**	2,108.3
61.9	60.4	**2,308.1**	3,682.6	**1,472.8**	1,645.3	**1,478.7**	1,814.6	**644.4**	722.1	**—**	—	**14.1**	29.8	**3,171.4**	2,707.4
10.1	—	**247.1**	210.8	**160.3**	101.6	**157.4**	110.9	**67.0**	42.2	**—**	—	**11.4**	10.3	**314.2**	209.0
6.0	6.2	**757.4**	504.5	**208.1**	213.0	**222.0**	218.1	**86.2**	83.1	**—**	—	**19.1**	5.0	**259.4**	346.2
8.6	8.3	**457.3**	375.3	**202.7**	174.9	**189.0**	182.0	**86.4**	74.3	**168.5**	151.3	**20.3**	16.6	**425.4**	345.8
—	—	**—**	—	**0.1**	0.1	**—**	0.1	**—**	0.1	**—**	—	**—**	—	**0.2**	0.2
164.8	148.8	**6,277.1**	6,444.3	**3,272.8**	2,969.0	**3,234.2**	3,244.7	**1,398.5**	1,270.0	**314.2**	285.2	**117.4**	108.9	**7,188.6**	5,716.9
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
6.3	5.3	**247.0**	230.3	**125.2**	103.7	**124.5**	115.2	**52.2**	42.8	**11.7**	10.3	**4.5**	3.8	**255.0**	185.1
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—

Supplementary information – Summary financial statements for the funds (cont.)

(in millions of dollars)

	Individual funds							
	317		318		325 (inactive since Jan. 1st, 03)		326	
CONSOLIDATED NET ASSETS AS AT DECEMBER 31	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
ASSETS								
Investments at fair value								
Bonds	**449.3**	320.4	**2,977.4**	2,351.9	—	—	**22.6**	11.5
Equities and convertible securities	**445.3**	342.2	**2,992.8**	2,525.2	—	—	**8.7**	6.6
Mortgage loans	**46.7**	31.7	**312.3**	232.6	—	—	**2.7**	1.1
Real estate investments	**50.4**	55.9	**370.7**	424.5	—	—	**10.7**	1.7
Short-term investments	**60.3**	49.5	**382.8**	339.6	—	—	**4.0**	1.6
Demand deposits in the General Fund	—	—	**0.2**	0.2	—	0.1	—	0.1
	1,052.0	799.7	**7,036.2**	5,874.0	—	0.1	**48.7**	22.6
Other assets	**2.9**	3.2	**19.5**	24.0	—	—	**0.3**	0.6
	1,054.9	802.9	**7,055.7**	5,898.0	—	0.1	**49.0**	23.2
LIABILITIES								
Demand and term deposits	—	—	—	—	—	—	—	—
Loans and notes payable	**36.7**	27.2	**247.1**	199.9	—	—	**1.7**	0.7
Derivative financial instruments	—	—	—	0.1	—	—	—	—
Other liabilities	**2.6**	1.0	**13.1**	6.4	—	0.1	**0.2**	—
	39.3	28.2	**260.2**	206.4	—	0.1	**1.9**	0.7
PARTICIPATION DEPOSIT HOLDERS' NET HOLDINGS	**1,015.6**	774.7	**6,795.5**	5,691.6	—	—	**47.1**	22.5
STATEMENT OF CONSOLIDATED INCOME FOR THE YEAR ENDED DECEMBER 31								
INCOME								
Investment income								
Bonds	**18.4**	14.6	**127.6**	111.5	—	—	**0.9**	0.4
Equities and convertible securities	**9.0**	7.1	**63.0**	54.3	—	—	**0.2**	0.2
Mortgage loans	**3.1**	2.7	**21.3**	20.4	—	—	**0.2**	0.1
Real estate investments	**3.1**	4.3	**22.6**	32.8	—	—	**0.4**	0.1
Short-term investments	**0.8**	0.4	**4.6**	3.0	—	—	**0.1**	—
Demand deposits (Advances from) in the General Fund	—	—	—	—	—	—	—	—
	34.4	29.1	**239.1**	222.0	—	—	**1.8**	0.8
Other income	—	—	—	—	—	—	—	—
Total income	**34.4**	29.1	**239.1**	222.0	—	—	**1.8**	0.8
Operating costs	—	—	—	—	—	—	—	—
INCOME BEFORE THE FOLLOWING ITEM	**34.4**	29.1	**239.1**	222.0	—	—	**1.8**	0.8
Interest on demand and term deposits	—	—	—	—	—	—	—	—
NET INVESTMENT INCOME	**34.4**	29.1	**239.1**	222.0	—	—	**1.8**	0.8
CHANGES IN CONSOLIDATED NET ASSETS FOR THE YEAR ENDED DECEMBER 31								
INVESTMENT OPERATIONS								
Net investment income	**34.4**	29.1	**239.1**	222.0	—	—	**1.8**	0.8
Gains (losses) on sale of investments	**(9.3)**	(17.0)	**(86.6)**	(166.6)	—	(0.4)	**(1.3)**	(2.1)
Unrealized increase (decrease) in value of investments and liabilities	**70.4**	82.3	**516.4**	658.1	—	0.4	**4.6**	3.8
Total investment operations	**95.5**	94.4	**668.9**	713.5	—	—	**5.1**	2.5
Participation deposits	**170.5**	78.0	**587.5**	258.4	—	(2.6)	**20.0**	—
Net income allocated to participation deposit holders	**(25.1)**	(12.1)	**(152.5)**	(55.4)	—	0.4	**(0.5)**	1.3
INCREASE (DECREASE) IN CONSOLIDATED NET ASSETS	**240.9**	160.3	**1,103.9**	916.5	—	(2.2)	**24.6**	3.8
CONSOLIDATED NET ASSETS, BEGINNING OF YEAR	**774.7**	614.4	**5,691.6**	4,775.1	—	2.2	**22.5**	18.7
CONSOLIDATED NET ASSETS, END OF YEAR	**1,015.6**	774.7	**6,795.5**	5,691.6	—	—	**47.1**	22.5
INVESTMENTS AND CERTAIN LIABILITIES AT COST AS AT DECEMBER 31								
ASSETS								
Investments								
Bonds	**428.0**	310.8	**2,838.8**	2,291.8	—	—	**21.4**	11.5
Equities and convertible securities	**460.0**	406.8	**3,225.1**	3,135.2	—	—	**8.0**	7.4
Mortgage loans	**44.6**	30.7	**296.7**	224.6	—	—	**2.6**	1.0
Real estate investments	**37.9**	50.5	**273.8**	377.5	—	—	**8.8**	1.6
Short-term investments	**59.5**	49.4	**377.5**	338.9	—	—	**3.9**	1.6
Demand deposits in the General Fund	—	—	**0.2**	0.2	—	0.1	—	0.1
	1,030.0	848.2	**7,012.1**	6,368.2	—	0.1	**44.7**	23.2
LIABILITIES								
Term deposits	—	—	—	—	—	—	—	—
Loans and notes payable	**36.4**	27.2	**245.0**	199.8	—	—	**1.7**	0.8
Derivative financial instruments	—	—	—	—	—	—	—	—

Supplementary information – Summary financial statements for the funds (cont.)

Individual funds

327		328		329		330		332		333		341		342	
	(created on Jan. 1st, 03)		(created on Jan. 1st, 03)		(created on Jan. 1st, 03)				(created on Jan. 1st, 03)		(created on Jan. 1st, 03)		(created on Jan. 1st, 04)		(created on Apr. 1st, 04)
2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
1.8	1.6	**158.2**	145.7	**2.9**	3.1	**2,214.7**	1,614.3	**0.6**	0.6	**1.6**	1.6	**—**	—	**—**	—
0.9	0.6	**147.3**	136.5	**0.4**	0.4	**4,588.6**	4,581.9	**0.2**	0.2	**0.7**	0.7	**—**	—	**—**	—
0.2	0.2	**13.2**	10.3	**0.4**	0.3	**254.9**	191.4	**0.1**	-	**0.2**	0.2	**—**	—	**15.4**	—
0.2	0.2	**27.1**	25.4	**0.5**	0.5	**706.6**	663.6	**0.1**	0.1	**0.2**	0.2	**—**	—	**55.9**	—
0.4	0.2	**24.6**	22.3	**0.7**	0.6	**426.5**	429.7	**0.1**	0.1	**0.3**	0.2	**15.2**	—	**—**	—
—	—	**—**	—	**—**	—	**5.0**	—	**—**	—	**—**	—	**—**	—	**—**	—
3.5	2.8	**370.4**	340.2	**4.9**	4.9	**8,196.3**	7,480.9	**1.1**	1.0	**3.0**	2.9	**15.2**	—	**71.3**	—
—	—	**1.1**	1.4	**—**	—	**23.5**	27.5	**—**	0.1	**—**	—	**—**	—	**1.0**	—
3.5	2.8	**371.5**	341.6	**4.9**	4.9	**8,219.8**	7,508.4	**1.1**	1.1	**3.0**	2.9	**15.2**	—	**72.3**	—
—	—	**—**	0.2	**—**	—	**—**	13.0	**—**	—	**—**	—	**—**	—	**—**	—
0.1	0.1	**13.1**	11.6	**0.2**	0.2	**291.3**	257.5	**0.1**	0.1	**0.1**	0.1	**0.6**	—	**—**	—
—	—	**—**	—	**—**	—	**0.1**	0.2	**—**	—	**—**	—	**—**	—	**—**	—
—	—	**0.3**	0.7	**—**	—	**34.3**	25.7	**—**	—	**—**	—	**—**	—	**0.4**	—
0.1	0.1	**13.4**	12.5	**0.2**	0.2	**325.7**	296.4	**0.1**	0.1	**0.1**	0.1	**0.6**	—	**0.4**	—
3.4	2.7	**358.1**	329.1	**4.7**	4.7	**7,894.1**	7,212.0	**1.0**	1.0	**2.9**	2.8	**14.6**	—	**71.9**	—
0.1	0.1	**7.1**	7.2	**0.2**	0.1	**90.2**	79.7	**—**	—	**0.1**	0.1	**—**	—	**—**	—
—	—	**3.2**	3.0	**—**	0.1	**109.6**	98.9	**—**	—	**—**	—	**—**	—	**—**	—
—	—	**0.9**	0.9	**—**	—	**17.6**	17.1	**—**	—	**—**	—	**—**	—	**0.4**	—
—	—	**1.6**	1.8	**—**	—	**43.1**	51.2	**—**	—	**—**	—	**—**	—	**2.0**	—
—	—	**0.4**	0.3	**—**	—	**4.9**	4.0	**—**	—	**—**	—	**0.1**	—	**—**	—
—	—	**—**	—	**—**	—	**(0.1)**	—	**—**	—	**—**	—	**—**	—	**—**	—
0.1	0.1	**13.2**	13.2	**0.2**	0.2	**265.3**	250.9	**—**	—	**0.1**	0.1	**0.1**	—	**2.4**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
0.1	0.1	**13.2**	13.2	**0.2**	0.2	**265.3**	250.9	**—**	—	**0.1**	0.1	**0.1**	—	**2.4**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
0.1	0.1	**13.2**	13.2	**0.2**	0.2	**265.3**	250.9	**—**	—	**0.1**	0.1	**0.1**	—	**2.4**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
0.1	0.1	**13.2**	13.2	**0.2**	0.2	**265.3**	250.9	**—**	—	**0.1**	0.1	**0.1**	—	**2.4**	—
0.1	0.1	**13.2**	13.2	**0.2**	0.2	**265.3**	250.9	**—**	—	**0.1**	0.1	**0.1**	—	**2.4**	—
(0.1)	(0.1)	**(4.7)**	(17.2)	**0.1**	(0.7)	**44.4**	(151.7)	**—**	(0.2)	**—**	(0.3)	**—**	—	**—**	—
0.2	0.3	**31.1**	49.1	**0.2**	1.0	**578.2**	844.3	**—**	0.3	**0.1**	0.5	**—**	—	**9.9**	—
0.2	0.3	**39.6**	45.1	**0.5**	0.5	**887.9**	943.5	**—**	0.1	**0.2**	0.3	**0.1**	—	**12.3**	—
0.5	2.4	**(2.1)**	280.0	**(0.2)**	3.7	**103.9**	(332.0)	**—**	0.7	**—**	2.3	**14.6**	—	**62.0**	—
—	—	**(8.5)**	4.0	**(0.3)**	0.5	**(309.7)**	(99.2)	**—**	0.2	**(0.1)**	0.2	**(0.1)**	—	**(2.4)**	—
0.7	2.7	**29.0**	329.1	**—**	4.7	**682.1**	512.3	**—**	1.0	**0.1**	2.8	**14.6**	—	**71.9**	—
2.7	—	**329.1**	—	**4.7**	—	**7,212.0**	6,699.7	**1.0**	—	**2.8**	—	**—**	—	**—**	—
3.4	2.7	**358.1**	329.1	**4.7**	4.7	**7,894.1**	7,212.0	**1.0**	1.0	**2.9**	2.8	**14.6**	—	**71.9**	—
1.7	1.7	**166.0**	164.6	**2.7**	2.9	**2,046.4**	1,489.4	**0.5**	0.5	**1.5**	1.5	**—**	—	**—**	—
0.9	0.7	**141.9**	146.6	**0.3**	0.3	**4,392.6**	4,805.4	**0.2**	0.3	**0.6**	0.7	**—**	—	**—**	—
0.2	0.1	**12.2**	9.6	**0.4**	0.3	**242.3**	184.7	**0.1**	-	**0.2**	0.2	**—**	—	**15.2**	—
0.2	0.2	**19.4**	21.7	**0.4**	0.4	**524.9**	587.9	**0.1**	0.1	**0.2**	0.2	**—**	—	**46.2**	—
0.4	0.2	**24.3**	22.3	**0.6**	0.7	**420.2**	429.0	**0.1**	0.1	**0.3**	0.2	**15.1**	—	**—**	—
—	—	**—**	—	**—**	—	**5.0**	—	**—**	—	**—**	—	**—**	—	**—**	—
3.4	2.9	**363.8**	364.8	**4.4**	4.6	**7,631.4**	7,496.4	**1.0**	1.0	**2.8**	2.8	**15.1**	—	**61.4**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
0.1	0.1	**13.0**	11.6	**0.2**	0.2	**288.9**	257.3	**0.1**	0.1	**0.1**	0.1	**0.5**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—

Supplementary information – Summary financial statements for the specialized portfolios

(in millions of dollars)

	Bonds		Real Return Bonds (created on Jan. 1st, 04)		Commodity Financial Instruments (created on August 1st, 04)		Quebec International	
CONSOLIDATED NET ASSETS AS AT DECEMBER 31	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
ASSETS								
Investments at fair value								
Bonds	**47,657.5**	37,739.4	**1,089.8**	—	**847.7**	—	**6,462.1**	5,054.2
Equities and convertible securities	**—**	—	**—**	—	**11.1**	—	**509.6**	811.5
Mortgage loans	**—**	—	**—**	—	**—**	—	**—**	—
Mortgage securities	**—**	—	**—**	—	**—**	—	**—**	—
Real estate holdings	**—**	—	**—**	—	**—**	—	**—**	—
Short-term investments	**14,790.2**	1,747.3	**—**	—	**211.3**	—	**1,658.8**	1,200.2
Demand deposits in the General Fund	**—**	1,515.9	**16.6**	—	**—**	—	**—**	—
Securities acquired under reverse repurchase agreements	**3,271.7**	2,507.7	**—**	—	**—**	—	**636.2**	1,015.0
	65,719.4	43,510.3	**1,106.4**	—	**1,070.1**	—	**9,266.7**	8,080.9
Other assets	**774.5**	603.5	**2.9**	—	**18.3**	—	**87.1**	66.6
	66,493.9	44,113.8	**1,109.3**	—	**1,088.4**	—	**9,353.8**	8,147.5
LIABILITIES								
Advances from the General Fund	**1,413.0**	—	**—**	—	**11.5**	—	**571.2**	1,108.5
Deposits on loans of securities	**20,862.8**	12,012.5	**—**	—	**—**	—	**497.5**	771.2
Commitments related to short selling of securities	**10,093.3**	2,109.2	**—**	—	**—**	—	**—**	1.4
Loans and notes payable	**—**	—	**—**	—	**—**	—	**—**	—
Mortgage loans payable	**—**	—	**—**	—	**—**	—	**—**	—
Commercial mortgage-backed securities	**—**	—	**—**	—	**—**	—	**—**	—
Derivative financial instruments	**353.0**	634.0	**—**	—	**64.7**	—	**10.1**	1.0
Other liabilities	**1,039.8**	1,634.5	**23.4**	—	**5.5**	—	**107.3**	209.6
Non-controlling interests	**—**	—	**—**	—	**—**	—	**—**	—
	33,761.9	16,390.2	**23.4**	—	**81.7**	—	**1,186.1**	2,091.7
NET HOLDINGS OF FUNDS	**32,732.0**	27,723.6	**1,085.9**	—	**1,006.7**	—	**8,167.7**	6,055.8
STATEMENT OF CONSOLIDATED INCOME FOR THE YEAR ENDED DECEMBER 31								
INCOME								
Investment income								
Bonds	**1,436.2**	1,323.9	**31.2**	—	**8.7**	—	**270.8**	220.9
Equities and convertible securities	**—**	—	**—**	—	**—**	—	**11.1**	18.7
Mortgage loans	**—**	—	**—**	—	**—**	—	**—**	—
Real estate holdings	**—**	—	**—**	—	**—**	—	**—**	—
Short-term investments	**99.9**	64.6	**—**	—	**1.1**	—	**33.0**	31.9
Demand deposits (advances from) in the General Fund	**(35.4)**	23.4	**1.4**	—	**—**	—	**(3.1)**	(13.5)
	1,500.7	1,411.9	**32.6**	—	**9.8**	—	**311.8**	258.0
Other income	**—**	0.8	**—**	—	**—**	—	**—**	—
Total income	**1,500.7**	1,412.7	**32.6**	—	**9.8**	—	**311.8**	258.0
Operation costs	**26.8**	32.7	**0.5**	—	**0.7**	—	**4.3**	2.0
INCOME BEFORE THE FOLLOWING ITEMS	**1,473.9**	1,380.0	**32.1**	—	**9.1**	—	**307.5**	256.0
Interests on notes payable	**—**	9.2	**—**	—	**—**	—	**—**	—
Non-controlling interests	**—**	—	**—**	—	**—**	—	**—**	—
NET INVESTMENT INCOME (LOSS)	**1,473.9**	1,370.8	**32.1**	—	**9.1**	—	**307.5**	256.0
CHANGES IN CONSOLIDATED NET ASSETS FOR THE YEAR ENDED DECEMBER 31								
INVESTMENT OPERATIONS								
Net investment income (loss)	**1,473.9**	1,370.8	**32.1**	—	**9.1**	—	**307.5**	256.0
Gains (losses) on sale of investments	**366.6**	559.0	**17.9**	—	**12.6**	—	**712.7**	1,103.1
Unrealized increase (decrease) in value of investments and liabilities	**369.8**	(126.5)	**62.6**	—	**(100.6)**	—	**101.6**	130.2
Total investment operations	**2,210.3**	1,803.3	**112.6**	—	**(78.9)**	—	**1,121.8**	1,489.3
Participation units issued (cancelled)	**4,272.0**	5,128.1	**1,005.4**	—	**1,094.7**	—	**1,297.6**	(241.7)
Transfer from portfolios	**—**	(551.6)	**—**	—	**—**	—	**—**	—
Net income allocated to participation unit holders	**(1,473.9)**	(1,370.8)	**(32.1)**	—	**(9.1)**	—	**(307.5)**	(256.0)
INCREASE (DECREASE) IN CONSOLIDATED NET ASSETS	**5,008.4**	5,009.0	**1,085.9**	—	**1,006.7**	—	**2,111.9**	991.6
CONSOLIDATED NET ASSETS, BEGINNING OF YEAR	**27,723.6**	22,714.6	**—**	—	**—**	—	**6,055.8**	5,064.2
CONSOLIDATED NET ASSETS, END OF YEAR	**32,732.0**	27,723.6	**1,085.9**	—	**1,006.7**	—	**8,167.7**	6,055.8
INVESTMENTS AND LIABILITIES AT COST AS AT DECEMBER 31								
ASSETS								
Investments								
Bonds	**45,089.6**	35,548.2	**1,027.2**	—	**895.1**	—	**6,128.1**	4,802.9
Equities and convertible securities	**—**	—	**—**	—	**3.1**	—	**512.8**	839.7
Mortgage loans	**—**	—	**—**	—	**—**	—	**—**	—
Mortgage securities	**—**	—	**—**	—	**—**	—	**—**	—
Real estate holdings	**—**	—	**—**	—	**—**	—	**—**	—
Short-term investments	**14,758.2**	1,759.1	**16.6**	—	**211.3**	—	**1,646.8**	1,197.0
Demand deposits in the General Fund	**—**	1,515.9	**—**	—	**—**	—	**—**	—
Securities acquired under reverse repurchase agreements	**3,302.5**	2,516.7	**—**	—	**—**	—	**634.6**	1,007.3
	63,150.3	41,339.9	**1,043.8**	—	**1,109.5**	—	**8,922.3**	7,846.9
LIABILITIES								
Deposits on loans of securities	**20,914.5**	12,042.7	**—**	—	**—**	—	**497.6**	771.0
Commitments related to short selling of securities	**9,914.5**	2,098.3	**—**	—	**—**	—	**—**	1.3
Loans and notes payable	**—**	—	**—**	—	**—**	—	**—**	—
Mortgage loans payable	**—**	—	**—**	—	**—**	—	**—**	—
Commercial mortgage-backed securities	**—**	—	**—**	—	**—**	—	**—**	—
Derivative financial instruments	**147.6**	311.0	**—**	—	**3.5**	—	**—**	—
Non-controlling interests	**—**	—	**—**	—	**—**	—	**—**	—

Supplementary information – Summary financial statements for the specialized portfolios (cont.)

Canadian Equity		Hedge Fund (1)		U.S. Equity Hedged		U.S. Equity Unhedged		Emerging Markets Equity		Foreign Equity Hedged		Foreign Equity Unhedged		Mortgages	
2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
1,834.9	—	**3,839.7**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
12,543.8	11,890.8	**2,406.5**	891.0	**7,339.0**	7,532.2	**—**	—	**953.3**	962.2	**8,433.4**	8,608.3	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**4,390.0**	3,665.4
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**692.7**	394.9
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**7.4**	10.7
3,402.1	4,849.2	**482.8**	667.6	**—**	—	**4,950.8**	4,904.4	**25.8**	16.9	**14.1**	—	**5,149.9**	5,400.4	**—**	—
—	336.3	**—**	27.4	**1,218.3**	31.6	**99.3**	62.7	**—**	—	**—**	—	**276.8**	268.6	**—**	—
—	—	**1,000.1**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
17,780.8	17,076.3	**7,729.1**	1,586.0	**8,557.3**	7,563.8	**5,050.1**	4,967.1	**979.1**	979.1	**8,447.5**	8,608.3	**5,426.7**	5,669.0	**5,090.1**	4,071.0
69.5	68.3	**51.2**	1.1	**31.9**	17.6	**7.4**	7.5	**1.8**	5.2	**26.2**	16.9	**3.2**	3.9	**107.4**	64.9
17,850.3	17,144.6	**7,780.3**	1,587.1	**8,589.2**	7,581.4	**5,057.5**	4,974.6	**980.9**	984.3	**8,473.7**	8,625.2	**5,429.9**	5,672.9	**5,197.5**	4,135.9
130.8	—	**766.5**	—	**—**	—	**—**	—	**7.4**	5.7	**567.4**	132.5	**—**	—	**79.5**	22.1
—	—	**2,907.0**	—	**—**	—	**—**	—	**—**	—	**—**	341.2	**—**	—	**—**	—
1,988.5	1,322.9	**501.1**	—	**178.6**	14.7	**—**	—	**33.8**	20.1	**41.1**	50.8	**—**	—	**—**	—
—	—	**—**	—	**4,950.1**	4,902.7	**—**	—	**—**	—	**5,134.2**	5,319.8	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**730.1**	794.9
15.2	2.3	**485.6**	631.4	**7.6**	3.2	**54.2**	137.8	**—**	—	**25.6**	129.2	**60.4**	153.9	**16.9**	21.3
408.1	230.2	**114.7**	1.7	**27.9**	17.5	**6.3**	6.2	**1.3**	1.9	**20.3**	53.0	**1.7**	0.8	**96.4**	73.0
—	—	**200.4**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
2,542.6	1,555.4	**4,975.3**	633.1	**5,164.2**	4,938.1	**60.5**	144.0	**42.5**	27.7	**5,788.6**	6,026.5	**62.1**	154.7	**922.9**	911.3
15,307.7	15,589.2	**2,805.0**	954.0	**3,425.0**	2,643.3	**4,997.0**	4,830.6	**938.4**	956.6	**2,685.1**	2,598.7	**5,367.8**	5,518.2	**4,274.6**	3,224.6
7.9	11.2	**(0.3)**	—	**—**	5.1	**—**	—	**—**	—	**—**	4.1	**—**	—	**—**	—
288.5	314.1	**—**	—	**150.5**	114.9	**—**	—	**18.8**	25.5	**335.2**	268.8	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**302.0**	285.1
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
96.3	134.1	**(3.1)**	0.9	**—**	—	**95.9**	80.3	**0.4**	0.4	**—**	0.1	**215.0**	191.3	**—**	—
(2.9)	2.2	**(0.4)**	(0.7)	**1.1**	2.1	**—**	(0.1)	**(0.1)**	0.1	**(7.0)**	7.0	**0.4**	0.1	**1.2**	4.1
389.8	461.6	**(3.8)**	0.2	**151.6**	122.1	**95.9**	80.2	**19.1**	26.0	**328.2**	280.0	**215.4**	191.4	**303.2**	289.2
1.4	2.2	**—**	—	**—**	0.3	**—**	—	**—**	—	**—**	5.3	**—**	—	**4.8**	8.0
391.2	463.8	**(3.8)**	0.2	**151.6**	122.4	**95.9**	80.2	**19.1**	26.0	**328.2**	285.3	**215.4**	191.4	**308.0**	297.2
29.6	50.8	**26.7**	3.5	**6.3**	6.8	**11.6**	13.0	**7.2**	7.4	**6.8**	9.3	**13.1**	18.7	**15.3**	12.1
361.6	413.0	**(30.5)**	(3.3)	**145.3**	115.6	**84.3**	67.2	**11.9**	18.6	**321.4**	276.0	**202.3**	172.7	**292.7**	285.1
—	—	**—**	—	**95.9**	80.3	**—**	—	**—**	—	**215.0**	191.3	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
361.6	413.0	**(30.5)**	(3.3)	**49.4**	35.3	**84.3**	67.2	**11.9**	18.6	**106.4**	84.7	**202.3**	172.7	**292.7**	285.1
361.6	413.0	**(30.5)**	(3.3)	**49.4**	35.3	**84.3**	67.2	**11.9**	18.6	**106.4**	84.7	**202.3**	172.7	**292.7**	285.1
1,565.6	1,129.6	**114.1**	205.7	**348.3**	165.1	**(6.1)**	(377.0)	**65.3**	(21.6)	**258.8**	(702.1)	**270.2**	(128.1)	**37.3**	75.0
228.5	2,249.0	**(40.1)**	(96.1)	**(59.5)**	367.8	**3.4**	373.7	**43.7**	257.6	**(76.2)**	1,028.0	**25.4**	472.7	**78.1**	(32.5)
2,155.7	3,791.6	**43.5**	106.3	**338.2**	568.2	**81.6**	63.9	**120.9**	254.6	**289.0**	410.6	**497.9**	517.3	**408.1**	327.6
(2,075.6)	(1,033.6)	**1,777.0**	591.0	**492.9**	35.1	**169.1**	512.6	**(127.2)**	(96.5)	**(96.2)**	(53.5)	**(446.0)**	171.5	**934.6**	(308.5)
—	(6,282.8)	**—**	—	**—**	(305.5)	**—**	(607.9)	**—**	(310.5)	**—**	(331.1)	**—**	(687.8)	**—**	—
(361.6)	(413.0)	**30.5**	3.3	**(49.4)**	(35.3)	**(84.3)**	(67.2)	**(11.9)**	(18.6)	**(106.4)**	(84.7)	**(202.3)**	(172.7)	**(292.7)**	(285.1)
(281.5)	(3,937.8)	**1,851.0**	700.6	**781.7**	262.5	**166.4**	(98.6)	**(18.2)**	(171.0)	**86.4**	(58.7)	**(150.4)**	(171.7)	**1,050.0**	(266.0)
15,589.2	19,527.0	**954.0**	253.4	**2,643.3**	2,380.8	**4,830.6**	4,929.2	**956.6**	1,127.6	**2,598.7**	2,657.4	**5,518.2**	5,689.9	**3,224.6**	3,490.6
15,307.7	15,589.2	**2,805.0**	954.0	**3,425.0**	2,643.3	**4,997.0**	4,830.6	**938.4**	956.6	**2,685.1**	2,598.7	**5,367.8**	5,518.2	**4,274.6**	3,224.6
1,832.0	—	**3,824.1**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
10,166.2	9,853.4	**2,555.6**	961.2	**7,176.6**	7,234.7	**—**	—	**741.7**	794.8	**7,793.3**	7,777.4	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**4,201.9**	3,556.5
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**671.2**	389.4
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**10.9**	16.5
3,402.1	4,849.2	**469.4**	36.2	**—**	—	**4,781.8**	4,655.2	**26.3**	17.2	**—**	—	**4,961.8**	5,144.2	**—**	—
—	336.3	**—**	27.4	**1,218.3**	31.6	**99.3**	62.7	**—**	—	**—**	—	**276.8**	268.6	**—**	—
—	—	**1,012.2**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
15,400.3	15,038.9	**7,861.3**	1,024.8	**8,394.9**	7,266.3	**4,881.1**	4,717.9	**768.0**	812.0	**7,793.3**	7,777.4	**5,238.6**	5,412.8	**4,884.0**	3,962.4
—	—	**2,923.5**	—	**—**	—	**—**	—	**—**	—	**—**	346.9	**—**	—	**—**	—
1,666.7	1,107.2	**514.9**	—	**171.8**	14.4	**—**	—	**32.0**	18.7	**39.8**	47.2	**—**	—	**—**	—
—	—	**—**	—	**4,781.8**	4,655.2	**—**	—	**—**	—	**4,961.8**	5,144.2	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
—	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**674.2**	755.7
8,402.0	4.0	**485.9**	—	**7.3**	—	**—**	—	**—**	—	**—**	3.0	**—**	—	**14.3**	21.3
—	—	**191.7**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—

(1) Previously called Hedge fund partnership units.

Supplementary information – Summary financial statements for the specialized portfolios (cont.)

(in millions of dollars)

	Real Estate		Short-Term Investments		Asset Allocation and Currencies (created on May 1st, 03)		Private Equity (created on July 1st, 03)		Investments and Infrastructures (created on July 1st, 03)	
CONSOLIDATED NET ASSETS AS AT DECEMBER 31	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
ASSETS										
Investments at fair value										
Bonds	**—**	16.4	**—**	—	**364.9**	1.2	**565.2**	384.4	**740.4**	230.0
Equities and convertible securities	**3,163.6**	2,653.4	**—**	—	**3,054.2**	33.4	**4,316.3**	5,366.8	**3,276.1**	2,477.7
Mortgage loans	**355.0**	307.0	**—**	—	**—**	—	**—**	—	**—**	—
Mortgage securities	**131.1**	140.5	**—**	—	**—**	—	**—**	—	**—**	—
Real estate holdings	**12,017.0**	14,225.7	**—**	—	**—**	—	**—**	—	**—**	—
Short-term investments	**112.6**	107.0	**11,148.1**	9,700.6	**202.6**	154.1	**287.6**	275.7	**828.3**	785.1
Demand deposits in the General Fund	**—**	207.3	**4,982.5**	—	**—**	129.7	**—**	118.2	**119.5**	152.5
Securities acquired under reverse repurchase agreements	**—**	—	**14,798.0**	1,003.5	**—**	—	**—**	—	**—**	—
	15,779.3	17,657.3	**30,928.6**	10,704.1	**3,621.7**	318.4	**5,169.1**	6,145.1	**4,964.3**	3,645.3
Other assets	**673.4**	711.2	**504.1**	269.0	**4.6**	1.8	**29.9**	33.6	**26.6**	27.1
	16,452.7	18,368.5	**31,432.7**	10,973.1	**3,626.3**	320.2	**5,199.0**	6,178.7	**4,990.9**	3,672.4
LIABILITIES										
Advances from the General Fund	**24.4**	—	**—**	468.4	**2,911.3**	—	**68.9**	—	**—**	—
Deposits on loans of securities	**—**	—	**14,689.5**	1,996.0	**—**	—	**—**	—	**—**	—
Commitments related to short selling of securities	**58.6**	18.7	**—**	29.8	**—**	35.4	**8.0**	15.9	**55.5**	44.7
Loans and notes payable	**3,744.2**	3,888.6	**14,254.3**	6,046.1	**299.6**	—	**—**	0.8	**1,029.3**	949.8
Mortgage loans payable	**3,358.6**	4,938.8	**—**	—	**—**	—	**—**	—	**—**	—
Commercial mortgage-backed securities	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
Derivative financial instruments	**230.5**	214.5	**18.0**	4.8	**160.6**	143.8	**17.8**	46.8	**12.6**	11.4
Other liabilities	**739.1**	822.5	**120.1**	20.1	**30.1**	0.6	**6.8**	20.4	**20.5**	6.0
Non-controlling interests	**617.8**	914.7	**—**	—	**—**	—	**—**	—	**—**	—
	8,773.2	10,797.8	**29,081.9**	8,565.2	**3,401.6**	179.8	**101.5**	83.9	**1,117.9**	1,011.9
NET HOLDINGS OF FUNDS	**7,679.5**	7,570.7	**2,350.8**	2,407.9	**224.7**	140.4	**5,097.5**	6,094.8	**3,873.0**	2,660.5
STATEMENT OF CONSOLIDATED INCOME FOR THE YEAR ENDED DECEMBER 31										
INCOME										
Investment income										
Bonds	**5.0**	1.6	**—**	—	**2.3**	2.6	**36.3**	16.3	**30.1**	16.6
Equities and convertible securities	**37.7**	30.0	**—**	—	**4.3**	(0.1)	**90.8**	76.8	**61.6**	20.3
Mortgage loans	**37.9**	54.6	**—**	—	**—**	—	**—**	—	**—**	—
Real estate holdings	**419.0**	547.2	**—**	—	**—**	—	**—**	—	**—**	—
Short-term investments	**18.4**	22.8	**216.6**	204.6	**—**	—	**29.7**	12.6	**38.5**	24.2
Demand deposits (advances from) in the General Fund	**(1.0)**	(1.1)	**46.7**	(6.0)	**(2.1)**	2.5	**2.3**	0.8	**(0.9)**	0.7
	517.0	655.1	**263.3**	198.6	**4.5**	5.0	**159.1**	106.5	**129.3**	61.8
Other income	**—**	—	**—**	—	**—**	—	**4.8**	9.2	**6.5**	2.7
Total income	**517.0**	655.1	**263.3**	198.6	**4.5**	5.0	**163.9**	115.7	**135.8**	64.5
Operation costs	**6.9**	7.8	**1.1**	1.5	**6.5**	2.8	**50.0**	33.5	**20.9**	8.7
INCOME BEFORE THE FOLLOWING ITEMS	**510.1**	647.3	**262.2**	197.1	**(2.0)**	2.2	**113.9**	82.2	**114.9**	55.8
Interests on notes payable	**—**	—	**203.5**	149.3	**0.1**	—	**—**	—	**24.5**	16.9
Non-controlling interests	**54.9**	63.3	**—**	—	**—**	—	**—**	—	**—**	—
NET INVESTMENT INCOME (LOSS)	**455.2**	584.0	**58.7**	47.8	**(2.1)**	2.2	**113.9**	82.2	**90.4**	38.9
CHANGES IN CONSOLIDATED NET ASSETS FOR THE YEAR ENDED DECEMBER 31										
INVESTMENT OPERATIONS										
Net investment income (loss)	**455.2**	584.0	**58.7**	47.8	**(2.1)**	2.2	**113.9**	82.2	**90.4**	38.9
Gains (losses) on sale of investments	**373.0**	481.2	**4.5**	(2.8)	**(36.1)**	51.3	**(61.2)**	(230.9)	**0.2**	165.2
Unrealized increase (decrease) in value of investments and liabilities	**1,001.2**	9.9	**(14.9)**	(0.6)	**90.3**	(16.6)	**1,066.3**	778.7	**362.6**	226.0
Total investment operations	**1,829.4**	1,075.1	**48.3**	44.4	**52.1**	36.9	**1,119.0**	630.0	**453.2**	430.1
Participation units issued (cancelled)	**(1,265.4)**	(759.7)	**(46.7)**	791.6	**30.1**	105.7	**(1,496.1)**	(359.4)	**343.4**	(901.5)
Transfer from portfolios	**—**	—	**—**	—	**—**	—	**(506.3)**	5,906.4	**506.3**	3,170.8
Net income allocated to participation unit holders	**(455.2)**	(584.0)	**(58.7)**	(47.8)	**2.1**	(2.2)	**(113.9)**	(82.2)	**(90.4)**	(38.9)
INCREASE (DECREASE) IN CONSOLIDATED NET ASSETS	**108.8**	(268.6)	**(57.1)**	788.2	**84.3**	140.4	**(997.3)**	6,094.8	**1,212.5**	2,660.5
CONSOLIDATED NET ASSETS, BEGINNING OF YEAR	**7,570.7**	7,839.3	**2,407.9**	1,619.7	**140.4**	—	**6,094.8**	—	**2,660.5**	—
CONSOLIDATED NET ASSETS, END OF YEAR	**7,679.5**	7,570.7	**2,350.8**	2,407.9	**224.7**	140.4	**5,097.5**	6,094.8	**3,873.0**	2,660.5
INVESTMENTS AND LIABILITIES AT COST AS AT DECEMBER 31										
ASSETS										
Investments										
Bonds	**—**	13.3	**—**	—	**364.9**	0.2	**558.5**	857.2	**759.0**	374.5
Equities and convertible securities	**2,257.7**	2,199.7	**—**	—	**2,979.2**	27.2	**8,730.0**	10,634.2	**2,681.0**	1,827.2
Mortgage loans	**372.4**	307.0	**—**	—	**—**	—	**—**	—	**—**	—
Mortgage securities	**129.3**	140.9	**—**	—	**—**	—	**—**	—	**—**	—
Real estate holdings	**11,264.9**	13,975.8	**—**	—	**—**	—	**—**	—	**—**	—
Short-term investments	**112.6**	107.0	**11,159.7**	9,693.3	**43.1**	55.6	**287.8**	281.8	**837.8**	796.2
Demand deposits in the General Fund	**—**	207.3	**4,982.5**	—	**—**	129.7	**—**	118.1	**119.5**	152.6
Securities acquired under reverse repurchase agreements	**—**	—	**14,798.0**	1,003.4	**—**	—	**—**	—	**—**	—
	14,136.9	16,951.0	**30,940.2**	10,696.7	**3,387.2**	212.7	**9,576.3**	11,891.3	**4,397.3**	3,150.5
LIABILITIES										
Deposits on loans of securities	**—**	—	**14,704.9**	1,994.5	**—**	—	**—**	—	**—**	—
Commitments related to short selling of securities	**54.4**	16.8	**—**	29.7	**—**	28.5	**8.0**	15.3	**40.2**	36.1
Loans and notes payable	**3,732.9**	3,885.1	**14,254.3**	6,046.1	**299.5**	—	**—**	0.8	**1,024.8**	949.7
Mortgage loans payable	**3,172.2**	4,756.3	**—**	—	**—**	—	**—**	—	**—**	—
Commercial mortgage-backed securities	**—**	—	**—**	—	**—**	—	**—**	—	**—**	—
Derivative financial instruments	**10.5**	43.7	**3.5**	3.0	**—**	28.4	**—**	—	**1.1**	0.6
Non-controlling interests	**618.6**	773.9	**—**	—	**—**	—	**—**	—	**—**	—

Corporate governance

Risk management, internal audit and financial governance

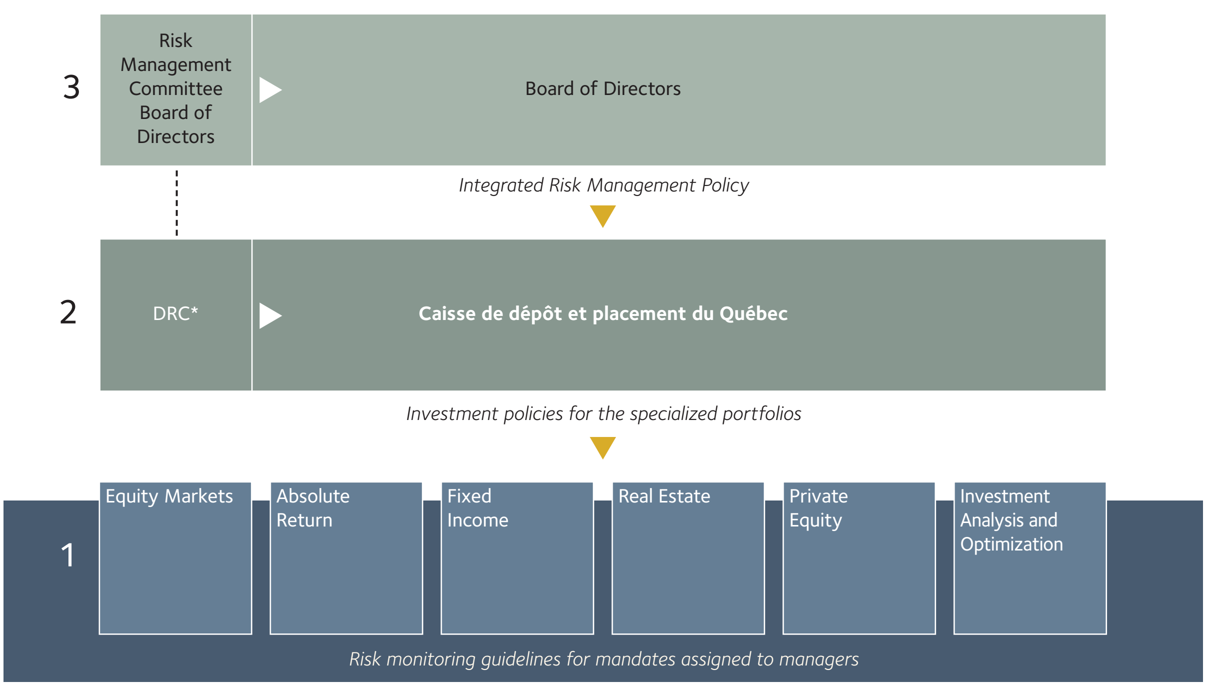
Risk management
The Integrated Risk Management Policy and the investment policies of the specialized portfolios are the cornerstone of risk management at the Caisse.

The fundamental objective of the Integrated Risk Management Policy is to implement a culture of risk management with rigorous practices that ensure the Caisse can fulfill its mission on behalf of its depositors. More specifically, the policy serves to define governance of risk management within the organization, to avoid excessive losses by determining the acceptable level of risk, to relate this level of risk to value added objectives and to promote effective risk allocation.

In addition to establishing risk limits for the various portfolios, the policy specifies the maximum size of real estate and private equity transactions that the following decision-making levels can authorize, according to each subsidiary: the Executive Committee of the subsidiary, its Board of Directors, the Chairman and Chief Executive Officer of the Caisse and the Board of Directors of the Caisse.

The risk limits for the specialized portfolios are defined in investment policies that specify their investment philosophy and management style, structure, investment universe, short- and long-term return thresholds, allocation criteria and hedging of currency risk.

Risk management
figure 63



** Depositor-Client Account Management and Integrated Risk Management Committee*

To ensure objectivity and rigour in risk management, independent teams of portfolio managers are responsible for defining and monitoring the Integrated Risk Management Policy as well as the investment policies of the specialized portfolios.

Levels of authority and responsibility

The levels of authority and responsibility for integrated risk management have been structured on the basis of how investment recommendations flow within the organization, namely from the bottom to the top of the hierarchy. There are three such levels (figure 63).

1. Heads of investment groups
   These managers develop monitoring guidelines and set risk limits for each management mandate under their responsibility. They may authorize overruns of these risk limits, in which case they must inform the DRC.

2. Depositor-Client Account Management and Integrated Risk Management Committee (DRC)
   (see *Governance, Ethics and Socially Responsible Investing* on page 111).

3. The Board of Directors and its Risk Management Committee
   (see *Governance, Ethics and Socially Responsible Investing* on page 111).

Guiding principles

The Integrated Risk Management Policy is based on four principles.

Definition of risk

Risk is defined as active risk, namely the risk associated with active portfolio management, in other words the risk that a manager's return may fall short of the portfolio's market index. This risk is expressed in basis points and is standard information in the industry.

Measured or monitored risks

With assistance from independent teams of portfolio managers, the DRC monitors and measures the following risks: market risk, credit risk, liquidity risk, operational risk and legal risk. Furthermore, the DRC monitors changes in strategic risk and reputation risk.

Integration of risks

Although each of the risks is distinctive, the DRC aims to integrate them into a single analytical process.

Best practices

To ensure that the monitoring and practice of the Caisse's integrated risk management comply with the industry's best practices, the risk management policies are reviewed regularly, with a view to their continual improvement. The DRC and the portfolio managers also receive support from internal and external experts whose role is to improve the risk evaluation methods.

Risk categories

The Caisse manages seven types of risk.

Strategic risk
Strategic risk is related to the inadequacy of business strategies or deficiencies in the implementation of strategic orientations. The Caisse manages this risk with bottom-up, structured strategic planning that involves all units of the organization. Its strategic orientations are proposed by the Executive Committee, approved by the Board of Directors and communicated to all employees. The members of the Board and the Executive Committee receive a monthly summary of the Caisse's activities. The Chairman and Chief Executive Officer reviews the business plans of all units on a quarterly basis.

Reputation risk
Reputation risk is the risk that an event related to the business practices or relations of the Caisse, its subsidiaries or its employees will cause a loss of confidence in the institution's integrity and affect its ability to achieve its objectives. All directors, members of management and employees are responsible for carrying out their activities in a way that minimizes this risk.

The Caisse manages and controls this risk by such means as its Code of Ethics and Professional Conduct, training programs, effective internal governance practices, and various policies and procedures. The Caisse also ensures that the information it provides internally and externally is truthful and has been confirmed. It strives to improve the understanding of its operations by the public and the media. The Caisse rigorously monitors communications concerning it and responds by taking public positions as required.

Market risk
Marker risk represents the risk of financial loss resulting from fluctuations in the price of financial instruments. The value of a financial instrument may be affected by interest rate and currency fluctuations as well as by variations in the prices of shares and commodities.

The market risk to which the portfolios are exposed is assessed periodically. It is measured according to the value at risk (VaR) method, which is based on a statistical evaluation of the volatility of individual market positions and their correlation. The Caisse uses risk assessment methods associated with cash securities and derivatives.

Credit risk
Credit risk is the risk of financial loss resulting from the inability of a counterparty or an issuer of securities to honour its obligations. The Caisse constantly monitors investments that are sensitive to credit risk by regularly undertaking four types of analysis.

- The analysis of concentration risk measures the fair value of all financial products related to a single issuer or a group of issuers with common characteristics (regions, sectors, credit categories).
- The analysis of default risk measures the probability of default and the recovery rate on debt products held by the Caisse, taking into account the credit quality of each security.
- In the case of derivatives, the analysis of counterparty risk measures the current credit exposure of the Caisse's counterparties for over-the-counter derivatives. This analysis takes creditworthiness into account to establish reasonable limits for each counterparty.
- The analysis of delivery risk measures the risk of default and liquidity in the settlement of transactions. This risk arises mainly from foreign exchange forward contracts.

Liquidity risk
Liquidity risk is related to the Caisse's ability to ensure that the invested funds are available and to discharge its financial obligations.

Compliance with established rules is monitored on a daily basis and the liquidity status is submitted to the DRC on a monthly basis. Risk management evaluates the liquidity situation in scenarios involving unfavourable movements in financial markets and recommends an acceptable level of liquidity.

Operational risk
Operational risk corresponds to the risk of direct or indirect financial loss arising from the deficiency of processes, human resources or systems, or from external events.

Operational risk is managed and measured through self-analysis of risks, a listing of incidents, the use of indicators and maintenance of rigorous processes. The Caisse is currently undertaking the implementation of operational risk management and evaluation methods.

Legal risk
Legal risk is related to the rights and obligations associated with the Caisse's operations and the legislative framework in which they are carried out. Important aspects of legal risk are related to compliance with the laws and regulations governing the Caisse and its management teams, and assurance that the agreements concluded by the institution properly reflect the planned operations and contain the appropriate provisions. A team of experts is responsible for providing managers with routine legal advice and support. As part of its legal risk program, Legal Affairs, with support from external consultants, identifies the risk in each sector of activity, suggests ways of making employees more aware of these risks and proposes methods based on the needs of the decision-making centres.

Internal audit

Internal Audit provides independent and objective assurance and consultation services to increase the effectiveness and efficiency of the Caisse's operations. Using a systematic, methodical approach, it evaluates the procedures and systems used by the Caisse for risk management, control and corporate governance, and proposes ways to make them more effective. Internal Audit also assists in the development of special projects by lending its expertise in internal control and risk management. Lastly, it supports the institution by identifying industry trends and best practices.

Internal Audit's annual planning process is approved by the Audit Committee of the Board of Directors, which can contact it directly regarding any matter of concern. The planning process takes into account the major risks facing the Caisse. To that end, and to improve the understanding of risk it has gained through its auditing work, Internal Audit works closely with the risk managers and has regular meetings with the Executive Committee. Internal Audit representatives also regularly attend meetings of the committees that report to senior management.

The work of Internal Audit focuses primarily on mandates identified during the annual planning process, including:

- Compliance mandates to ensure adherence to policies, guidelines, laws, regulations, bylaws and contracts;
- Optimization mandates to ensure that human, information, physical and financial resources are acquired economically and used effectively and efficiently;
- Computer audit mandates to ensure adequate control of the risk associated with technology use;
- Follow-up on recommendations to ensure that the action plans proposed by the managers on the basis of Internal Audit's findings and recommendations are implemented on schedule.

A variety of mandates not provided for in the annual planning process may arise from special requests from the Board of Directors, the Board's Audit Committee or the Executive Committee. Internal Audit personnel comply with the Institute of Internal Auditors' standards for professional practice.

Financial governance

For a number of years, the Canadian Securities Administrators have published rules on corporate governance and reporting. The Caisse is not a publicly traded company, so it is not governed by such standards. Still, since the principles set out in these rules serve as best practices, the Caisse's statute has been amended to include certain elements of corporate governance, and management has initiated a project to ensure reporting requirements are fulfilled.

The Caisse is mindful that rigorous oversight of the reporting process will enable all its stakeholders, especially its depositors, to receive reliable information that reflects reality.

Governance, ethics and socially responsible investing

Highlights
In March 2004, the Caisse adopted a Policy on Socially Responsible Investment, which took effect on January 1, 2005. Under this policy, portfolio managers must consider corporate governance criteria as well as social, ethical and environmental criteria in their analysis of the risk inherent in any investment. The Caisse held in-house training sessions on this new policy.

The Caisse issued to its depositors the first compliance certificates for transactions made under the investment policies of the specialized portfolios. Henceforth, each depositor will receive a certificate every six months attesting to compliance with or deviation from the policies.

Governance practices and the Caisse's new statute
The *Act to amend the Act respecting the Caisse de dépôt et placement du Québec* was passed by the National Assembly in December 2004 and came into force on January 15, 2005. The Act sets forth the Caisse's mission and specifies its governance rules with respect to the composition and mandate of the Board of Directors and its committees.

Ethics and professional conduct
The Caisse reviews the compliance of its operations with respect to depositors' investment policies and the investment policies of all the specialized portfolios. It ensures that all transactions are reported properly to the various securities authorities and that employees' personal transactions respect the standards and policies established by the Caisse.

The institution also applies other internal policies, such as those governing harassment at the workplace, air quality and smoking at the workplace, and language. Lastly, the Caisse has introduced a pay-equity program.

Policy on socially responsible investment

March 2003
- **Creation of working group**

The working group was given a mandate to examine the social responsibility of businesses and responsible investment, taking into account the best practices adopted by the industry, issues facing the Caisse in this area and depositors' wishes.

March 26, 2004
- **Adoption of policy by the Board of Directors**

The policy takes into account the Caisse's mission, depositors' wishes, the institution's position vis-à-vis large pension funds and its ability to implement an effective policy. It also takes into account impacts on return and investment opportunities.

October - November 2004
- **Training program**

The Caisse set up a training program for portfolio managers to make them aware of the policy's impact on their work.

January 1, 2005
- **Coming into force of policy**

The new policy specifies the approach to be taken by portfolio managers as well as the systematic use of voting rights to express the Caisse's concerns in this area. The idea is not to prompt the managers to invest more in any given sector, but to encourage them to look at all facets of risk before investing.

The Caisse will continue to invest in all sectors of the economy. Still, the managers will have to ensure they invest in companies that respect the legal standards governing them, have clear governance rules, adopt the best governance practices and behave responsibly in the conduct of their business.

Exercise of shareholder voting rights

The Caisse systematically exercises its right to vote on all proposals tabled at shareholder meetings according to the principles in its Corporate Governance Policy. Each vote is documented and archived. It has also set up an internal consultation procedure to develop a position on any proposal that requires special consideration.

Internal governance

Board of Directors

In 2004, the Chairman of the Caisse was also the Chairman of its Board of Directors. The Board consisted of depositors' representatives - as at December 31, 2004, the President and General Manager of the Régie des rentes du Québec, who is the Vice-Chairman of the Board, and the President of the Commission administrative des régimes de retraite et d'assurances - as well as members of the business community, the credit union movement and labour union leaders.

During the year, the Board of Directors met 15 times. It dealt with such matters as the strategic and operational repositioning of the Private Equity group, including the new technology venture capital strategy and the strategy for SMEs and traditional sectors, the Policy on Socially Responsible Investment, the review of each unit in the investment and general services groups, the business plans of the Caisse and each of its Executive Vice-Presidencies, the budget and human resources policies. The Board also considered certain potential investments and followed up on strategic matters. Lastly, it analyzed and approved several investment policies for the specialized portfolios.

The Board of Directors included three committees in 2004:

Audit Committee

The Audit Committee, composed solely of external members, has a mandate to review the financial statements and management's analysis of the financial situation and to recommend their approval to the Board of Directors as well as to follow up on recommendations by external auditors and the Auditor General of Québec. It also approves the internal audit plan and performs follow-up on the findings of internal audit projects. The Audit Committee met five times during the year.

Human Resources, Ethics and Corporate Governance Committee

The Human Resources, Ethics and Corporate Governance Committee consists solely of external members. It met nine times in 2004.

The Committee's human resources responsibilities include reviewing and recommending the Caisse's senior management appointments, ensuring adequate senior management succession planning and recommending compensation policies to the Board.

With regard to ethics, the Committee is responsible for developing and applying controls that govern the restricted use of confidential information and the resolution of complaints and conflicts of interest. It also reviews the Code of Ethics and Professional Conduct on a regular basis and recommends its approval to the Board.

Lastly, the Committee is responsible for reviewing all matters concerning corporate governance and compliance with related rules and guidelines.

Risk Management Committee

This Committee oversees the supervision and application of policies and systems designed to maintain an acceptable level of market, credit, liquidity, operational and legal risk. It also examines any transaction, investment or investment-related matter submitted to it, particularly in terms of its impact on the portfolio or asset allocation. Lastly, it approves the Caisse's risk policies and risk budgets referred to it by the Depositor-Client Account Management and Integrated Risk Management Committee (DRC).

The Risk Management Committee met 15 times during the year.

Management committees
The Caisse relies on four committees to ensure its day-to-day management.

Executive Committee
This Committee's main mandate is to advise the Chairman and Chief Executive Officer regarding major decisions concerning the overall management of the organization. In this capacity, the Committee has a mandate to oversee and monitor all operations and, if necessary, implement appropriate action plans to ensure the organization meets transparency and performance requirements.

Asset Allocation Management Committee
This Committee's mandate is to review and approve the Caisse's main policies on asset allocation among the various investment sectors within the minimum and maximum limits of the Caisse's benchmark portfolio and the foreign exchange hedge ratio, and the impact of such decisions on management of liquid assets and financial leverage.

Depositor-Client Account Management and Integrated Risk Management Committee (DRC)
This Committee oversees and implements policies and systems designed to maintain an acceptable level of market, credit, liquidity, operational and legal risk for the Caisse. The DRC's responsibilities include interpreting depositors' investment policies, particularly in terms of market, liquidity and credit risk. It monitors and controls the risks and reports regularly to the Executive Committee and the Board's Risk Management Committee.

The DRC also examines measures to be taken to manage risks adequately. It approves risk policies and limits to maintain the best possible risk-return balance. Any transaction that exceeds a manager's risk budget is submitted to the DRC for approval. If such transactions exceed its level of authority, the DRC requests the approval of the Board's Risk Management Committee.

Information Technology and Capital Budget Committee
This Committee has a mandate to ensure the Caisse's technological environment is appropriate for its operations, to approve major technology management policies and to ensure that projects are in keeping with the Caisse's strategic orientations. The Committee approves the annual plan for information technology projects and the related capital budget and recommends its approval to the Executive Committee. It also regularly monitors progress on various computer-related projects.

Complaint management

The Caisse de dépôt et placement du Québec has designated its Vice-President and Corporate Secretary as the person responsible for receiving and examining complaints from clients and members of the public with all due attention.

Tel.: (514) 847-5901
Fax: (514) 847-5445
E-mail: gestiondesplaintes@lacaisse.com

Board of Directors and management

Board of Directors

Henri-Paul Rousseau[3]
Chairman and Chief Executive Officer
Caisse de dépôt et placement du Québec

Jean-Claude Bachand[2]
President
Audit Committee
Counsel
Fraser Milner Casgrain

Bernard Bonin[3]
President
Risk Management Committee
Economist-Adviser
Former Senior Deputy Governor
Bank of Canada

Claudette Carbonneau[2]
President
Confédération des syndicats nationaux

Steven M. Cummings
President and Chief Executive Officer
Maxwell Cummings & Sons Holdings Limited

Alban D'Amours[3]
President and Chief Executive Officer
Desjardins Group

Sylvie Dillard[1]
President
Human Ressources, Ethics and
Corporate Governance Committee
President and Chief Executive officer
Fonds québécois de la recherche
sur la nature et les technologies

Yves Filion[2]
President
Hydro-Québec TransÉnergie

Gilles Godbout[1]
Deputy Minister of Finance

Henri Massé[3]
President
Fédération des travailleurs
et travailleuses du Québec

Pierre Prémont[1]
President and General Manager
Régie des rentes du Québec

Nicole Trudeau[3]
Vice-President
Commission municipale du Québec

Duc Vu[2]
President
Commission administrative
des régimes de retraite
et d'assurances

John T. Wall[1]
Chairman of the Board
Capital Markets Advisors, Inc.

Senior management

Henri-Paul Rousseau
Chairman and Chief Executive Officer

Robert W. Desnoyers
Executive Vice-President
Human Resources and
Organizational Development

François Grenier
Executive Vice-President
Equity Markets

Richard Guay
Executive Vice-President
Risk Management and Depositors'
Accounts Management

Michel Malo
Executive Vice-President
Investment Analysis and Optimization

Suzanne Masson
Executive Vice-President
Institutional Affairs

Ghislain Parent
Executive Vice-President
Finance, Treasury and Strategic Initiatives
President
CDP Financial

Fernand Perreault
Executive Vice-President
Real Estate

Christian Pestre
Executive Vice-President
Absolute Return

V.P. Pham
Executive Vice-President
Information Technology and
Investment Administration

Normand Provost
Executive Vice-President
Private Equity

Denis Senécal
Executive Vice-President
Fixed Income

Other managers reporting to the Chairman and Chief Executive Officer

Claude Bergeron
Vice-President
Legal Affairs

Ginette Depelteau
Vice-President and Corporate Secretary

Karen Laflamme[4]
Vice-President
Internal Audit

Real Estate Group

Paul D. Campbell
President and Chief Executive Officer
SITQ

Richard Dansereau
President and Chief Operating Officer
CDP Capital – Real Estate Advisory

René Tremblay
President and Chief Executive Officer
Ivanhoe Cambridge

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1 Member of the Human Resources, Ethics and Corporate Governance Committee
2 Member of the Audit Committee
3 Member of the Risk Management Committee
4 Jacques Lavallée, Vice-President, Internal Audit, since January 31, 2005

Glossary

ABSOLUTE RETURN
Return as measured by accounting records. Absolute return can be used to measure any set of investments, including a depositor's portfolio or the Caisse's overall portfolio.

ABSOLUTE RISK
Expression of a portfolio's market volatility. This risk is used to measure, on the basis of the securities in the portfolio, the magnitude of a potential return deficit in comparison with the portfolio's expected return.

ACCUMULATION INVESTMENTS
Investments in the form of shares of a publicly traded company in a traditional sector. The purpose of this activity is to take advantage of exceptional market opportunities in the sectors concerned which fulfill the long-term return objectives of the portfolio.

ACTIVE MANAGEMENT (EXTERNAL)
Portfolio management that differs from the benchmark index through selection of securities or sectors. External active management is undertaken by portfolio managers who are not employees of the Caisse but have been given a management mandate in consideration of fees.

ACTIVE RISK
Forecast volatility of the fund manager's value added, generally measured on the basis of the fund manager's current positions and the volatility and correlations of the return associated with these positions.

ACTUARIAL LIABILITIES
Total financial obligations that a pension or insurance plan must meet, given the nature of the plan and its commitments to participants.

AIMR®
Association for Investment Management and Research®. The association changed its name in 2004. See CFA Institute.

ARBITRAGE
Transactions carried out to profit from a real or apparent imbalance between two securities or two baskets of securities. Arbitrage involves the purchase of a security or a basket of securities that appears to be undervalued and the sale of another that appears overvalued. Depending on the products available, transactions may be conducted in cash or on the futures market.

ASSET ALLOCATION
Percentage of each asset category in a portfolio. It may refer to the portfolio's targeted or real asset allocation. The Caisse's total asset allocation results from the sum of the weighted asset allocation of each depositor.

ASSET-LIABILITY MATCHING
Development of a portfolio that takes into account the requirements of actuarial liabilities, such as current income, sensitivity to certain variables, etc. For example, if a plan must pay out a total of $10 million a month in benefits, the portfolio can be built with a suitable proportion of fixed income securities to provide the revenues necessary to pay for these benefits. This is an example of the matching of assets and liabilities on the basis of cash flows.

ASSETS UNDER ADMINISTRATION
Assets for which the Caisse's subsidiaries provide administrative services on behalf of the clients that own them. The Caisse and the subsidiaries that administer such assets are not involved in investment or disinvestment decisions and receive payment in the form of fees.

ASSETS UNDER MANAGEMENT
Assets that are owned by partner companies or clients of Caisse subsidiaries and managed by an affiliate or a subsidiary of the Caisse. The units that manage the assets are involved in investment and disinvestment decisions and receive fees as payment for services rendered.

AUTHORIZED INVESTMENT
Investment whose parameters (financial vehicle, financing terms, cost, expected returns, etc.) have been examined and accepted by the competent authority. Such an investment becomes a concluded investment when all the conditions set by the Caisse have been met.

BOTTOM-UP AND TOP-DOWN ANALYSIS
Bottom-up analysis examines the most specific elements before considering more general elements. For example, a company is analyzed before the impact of sector concentration, national concentration and foreign currency exposure are examined. Top-down analysis functions in the opposite direction.

BOTTOM-UP AND TOP-DOWN APPROACH
See Bottom-up and Top-down Analysis.

CAISSE'S BENCHMARK PORTFOLIO
Allocation of the Caisse's net assets resulting from the sum of the depositors' benchmark portfolios multiplied by their respective weights.

CAISSE'S OVERALL PORTFOLIO
Combination of the depositors' individual portfolios in proportion to their weighting at the Caisse. The performance of the Caisse's overall portfolio corresponds to the weighted average return on depositors' funds.

CAPITALIZATION RATE
Standardized and annualized net income of a property at a specific date, divided by the estimated value or selling price. This rate can be used to compare real estate property values.

CASH SECURITIES
Cash operations allowing for the immediate purchase or sale of assets at a defined price according to market conditions.

CFA INSTITUTE
Formally AIMR®. Association of investment professionals headquartered in Charlottesville, Virginia. Its mission is to serve investment professionals by providing training to its members and establishing high ethical standards for portfolio management.

CMBS
See Commercial Mortgage-backed Securities.

COMMERCIAL MORTGAGE-BACKED SECURITIES (CMBS)
Securities issued in tranches, for which credit ratings are provided by a recognized rating agency. Each tranche has a different credit rating depending on the guarantee associated with it. The guarantee is based on a group of mortgages granted to borrowers and on the guarantee provided by the issuer of the security.

COMMERCIAL PAPER
Debt security issued by a corporation with a maturity usually shorter than or equal to one year. Commercial paper is to corporations as Treasury bills are to governments.

COMPOSITE
Predetermined set of securities that have shared investment objectives or strategies. A composite may be based on one or more of the following criteria: currency, country, company size, type of product, etc.

CONCLUDED INVESTMENT
Investment that has been wholly or partially realized. For example, an investment in a fund is paid for gradually, as the fund makes investments in companies or ventures.

CONDUIT
Intermediary between an original lender and final investors. The intermediary borrows or buys loans through a third party with whom it maintains relations that respect business standards for underwriting and reporting. When the volume of loans is sufficiently large, they are resold in a securitized format with the individual securities sold to the final investors.

CORRELATION
Relation between two variables that vary as a function of each other, such as the return on one asset compared with the return on another. The correlation coefficient measures the degree of dependence between two variables.

CREDIT SPREAD
Difference in yields to maturity associated with issuers other than the government of the country concerned. In this sense, the spread between corporate bonds and Government of Canada bonds is a form of credit spread, as is the difference in yields to maturity between Ontario bonds and Government of Canada bonds, Québec bonds and Government of Canada bonds, etc.

CURRENCY RISK
See Foreign Exchange or Currency Risk Hedging.

DEPOSITOR
Organization or entity that makes deposits with the Caisse de dépôt et placement du Québec.

DEPOSITOR'S BENCHMARK PORTFOLIO
Net asset allocation among the specialized portfolios, established by the depositor with advice from the Caisse. This asset allocation must correspond to the depositor's needs and risk tolerance.

DEPOSITORS' NET ASSETS OR HOLDINGS
Total assets managed for depositors less liabilities (assets financed by borrowing) related to these assets.

DEPOSITORS' TOTAL ASSETS
Fair value of all assets held on behalf of depositors..

DERIVATIVES
See Derivative Products.

DERIVATIVE PRODUCTS, DERIVATIVE FINANCIAL PRODUCTS
Contracts, commitments or agreements for the sale or purchase of assets or the exchange of returns at a future date. These financial instruments are called derivatives because their value depends on an underlying asset. There are three types of derivative products: futures and forward contracts, options and swaps. A futures and forward contract is a commitment to take delivery of or to deliver an underlying value, while an option is a conditional commitment that enables the holder to buy or sell an underlying value at the price stipulated in the contract (strike price). These two types of derivative products involve many assets: shares, indexes, interest rates, currencies, etc. Swaps involve exchanging returns between assets.

Derivative products are included in a portfolio primarily to protect its value against a drop in prices or to diversify investment strategies, to manage risks effectively and achieve investment objectives.

DEVELOPMENT CAPITAL
A development capital style of investment takes the form of a purchase of stocks or bonds of an established, privately or publicly held company that is looking to expand through internal growth or through an acquisition. Also includes a partial or total buyback of shares from a shareholder allowing for the transfer of ownership.

DIRECTIONAL STRATEGY
Portfolio strategy based on the manager's ability to predict the direction of the price of a security or a group of securities.

DISCRETIONARY APPROACH
A portfolio manager who adopts a discretionary approach analyzes various parameters of the market and uses quantitative models to develop a measure of certainty regarding what appears to be a market imbalance. The decision is discretionary in that the transaction is carried out only if the manager believes the expected return compensates for the risk associated with the transaction.

DUE DILIGENCE
Complete review of a company, real estate asset, loan or equity, in order to certify accuracy and assure a level of confidence to the investor. This process includes business, financial, technical, legal and environmental audits.

DURATION
Average maturity of cash flows (coupon or face value). The maturity of each cash flow is weighted by its present value. This duration is also known as Macaulay Duration.

EFFECTIVE AVERAGE INTEREST RATE
Expression used in reference to the issuing of securities. This rate is calculated on the basis of the amount outstanding at the end of each securities issue and the interest rate authorized for each issue.

EXPECTED RETURN
Benchmark return to which is added the target value added, in accordance with the depositor's investment policy.

EXTERNAL MEMBER
Member of a committee or of the Board of Directors who is not an employee of the Caisse.

FAIR VALUE
Value of an investment that reflects all fluctuations resulting from market behaviour or from any event that makes it possible to consider appreciation or depreciation.

FOREIGN EXCHANGE OR CURRENCY RISK HEDGING
Financial operation whereby an investment is protected from fluctuations in the exchange rate between the currency in which the investment was made and the investor's original currency.

FUNDAMENTAL ANALYSIS
Analysis based on the intrinsic value of a company and its more or less long-term outlook. It evaluates the company's qualitative and quantitative elements to determine whether, at the current share price, it appears undervalued, overvalued or fully valued.

FUND OF FUNDS
Fund whose component securities are hedge funds. This approach generally ensures diversification of styles, philosophies, risks, etc.

GLOBAL MACRO
Investment operations based on an analysis of macroeconomic and political factors. The fund manager invests on the basis of the expected direction a market will take or the returns expected from one market compared with another. The manager can trade on interest rates, shares, currencies and commodities.

HEDGE FUND
Fund that primarily includes long and short positions on securities, markets, etc. that reflect the fund manager's opinion as to the probable trend in the value of such securities or markets.

INDEXED MANAGEMENT
Management that consists of obtaining the same return as the benchmark index by an identical matching of the portfolio.

INDIVIDUAL FUND
Fund attributed to a single depositor. An individual fund buys units from the Caisse's various specialized portfolios.

INFORMATION RATIO
Value added generated by a portfolio manager divided by active risk. By industry standards an information ratio greater than 0.5 for a given period is considered excellent.

INFRASTRUCTURE
Infrastructure investments take the form of the purchase of stocks or bonds of a company created to manage a specific project. The financing is characterized by less risk than other private equity investments owing to the stable and predictable nature of the long-term revenues.

INITIAL PUBLIC OFFERING
First offering of stock for sale to the public by a company. The shares are then listed on a stock exchange.

INTERNALLY GENERATED FUNDS
Cash flows generated by a company's operations. Internally generated funds are used to estimate the company's ability to grow.

INVESTMENT POLICY (DEPOSITOR)
All elements to be considered in the relationship between the Caisse and a depositor, with respect to the management of funds entrusted to the Caisse. The investment policy includes a description of the particular plan and its characteristics, the benchmark portfolio, the market indexes, the expectations for valued added and other technical aspects, such as the frequency of meetings and reporting requirements.

INVESTMENT POLICY (SPECIALIZED PORTFOLIO)
All elements that make up the rationale for a specialized portfolio or management mandate. These elements include management philosophy, portfolio structure, investment universe, market index, return and valued added objectives, as well as risk elements and their limits.

JOINT INVESTMENT
Investment made jointly with a fund. The management of the investment is done by the fund.

LEVERAGE
Situation where a portfolio is partly funded by the investor's equity and partly through borrowing. The classic example is the purchase of a property on which there is a mortgage.

LEVERAGED BUYOUT
High-yield investment in a company that wants to acquire a majority position in a third company that is usually well established and profitable. The acquisition is financed by an issue of high-yield bonds.

LIQUIDITY
Refers to cash equivalents and securities that can be easily turned into cash through a sale.

LONG POSITION
See Long/Short Position.

LONG/SHORT MANAGEMENT
Absolute return operation based on the opportunity for portfolio managers to buy or sell a security short on the basis of their opinion regarding the direction of its price. A long/short management mandate is not necessarily funded. In other words, the manager does not always benefit from start-up capital, but still has to generate profits while respecting the assigned risk limits.

LONG/SHORT POSITION
Long: The overweighting of a security, a sector or an asset class in comparison with the portfolio's benchmark index.
Short: The underweighting of a security, a sector or an asset class in comparison with the portfolio's benchmark index.

LONG/SHORT STYLE
See Long/Short Management.

MANAGEMENT MANDATE
Smallest measurable group of securities managed by a portfolio manager.

MARKET INDEX (BENCHMARK INDEX)
Index used to measure the effect of all investors' decisions. Accordingly, it allows comparison with the Caisse's portfolio management result for each specialized portfolio or management mandate.

The market index may vary depending on the investment horizon and mandate. It can be a stock market index for an entire portfolio or a subindex that corresponds to a chosen investment universe for a management mandate.

MEZZANINE DEBT (MEZZANINE LOAN)
Expression used in the private equity and real estate environments.

A hybrid financial vehicle whose return consists of a fixed portion of either cash or additional bonds and a variable portion consisting of warrants of a company. There is generally no repayment of capital during the term of the loan. Financing that bridges the gap between traditional financing and equity capital required for a real estate development.

There are many types of mezzanine loans based on the risks and barriers to investment. The two main types are called high-yield mezzanine and low-yield mezzanine. The former resembles bank equity while the latter is closer to traditional real estate financing.

NOMINAL RETURN
Return obtained by a portfolio (see Real Return).

NON-CAPITALIZED MANDATE
Management mandate given to a portfolio manager who must generate profits without any start-up capital. In this context, all cash investments must be made through borrowing.

OVERWEIGHTING
Percentage that is greater than the benchmark weighting.

POSITIONING ON THE YIELD CURVE
Allocation of a portfolio according to the final maturity date of all of its component securities. The curve is then generally divided into three segments: the short term with maturities in 1 to 5 years, the medium term from 5 to 10 years and the long term with a maturity of 10 years or more.

PLATFORM OR AFFILIATED COMPANY
Operations management company, specializing in one or more niche markets, that is part of the Real Estate group's network. Its mandate primarily involves asset management and real estate investment (investments in equity ownership or capital financing) on behalf of the Caisse, its main real estate subsidiaries and third-party investors. The Caisse or one of its real estate subsidiaries normally holds a minimum 50% interest, which entitles it to appoint representatives to the company's board of directors and to exercise control, under a unanimous shareholder agreement.

PRIVATE EQUITY
Investment made in a company on a private basis. Such transactions do not involve the usual mechanisms of the organized market.

PROMISSORY NOTE
Debt security whereby a borrower undertakes to pay a specific sum on demand at a fixed date. In the context of real estate financing, the loan can be structured so that more than one creditor shares the note with different rights and levels of priority according to different tranches. The holders of tranche A have priority rights to regular cash flows as well as to the underlying assets in the case of repossession.

PROPRIETARY RESEARCH
Research done by employees of the Caisse exclusively for the Caisse as opposed to research purchased from an external provider.

QUARTILE
The results of a sampling of fund managers are classified in descending order if the one at the end of the first quarter referred as the first quartile level and the one at the top of the last quarter called the third quartile. The second quartile is also known as the median.

REAL ESTATE INVESTMENT TRUST (REIT)
Corporation that manages a real estate portfolio whose units are traded on an organized market.

REAL RETURN
Return obtained by a portfolio over and above inflation. If an investment generates 6% per annum (nominal return) and inflation is 2%, then the real return is 4%. This return is used particularly in actuarial studies.

REBALANCING
Form of asset allocation with the goal of returning each asset category to its target percentage. These percentages can go off-target because of changes in the market, new expectations for returns, etc.

RELATIVE RETURN
Spread between a portfolio's absolute return and the reference index's market return. "Value added" is often used to describe this spread.

RELATIVE VALUE STRATEGY
Strategy that consists of evaluating the price of a security by comparing its past price behaviour with recent changes or by comparing its price with other comparable securities. For example, if the price of security "A" increased X% during the past week whereas the prices of comparable securities remained unchanged, the portfolio manager may have an opportunity to sell security A. Relative value strategies seek to benefit from the price anomalies of financial instruments. These strategies use quantitative and qualitative analyses to identify securities and margins on securities which deviate from their intrinsic and/or historical value.

REPO
Short for repurchase agreement. Refers to borrowing money against the temporary transfer of a guaranteed bond. If demand for the bond is high, the lending rate is low; if the demand for the bond is low, the lending rate is higher. In either case, the lending rate is lower than that for an overnight loan because of the bond guarantee.

RISK PREMIUM
Additional return required in comparison with the return obtained on an investment considered risk-free, such as Government of Canada Treasury bills or bonds.

S&P/TSX CAPPED INDEX
Index consisting of the same securities as the S&P/TSX Composite Index, with one additional restriction: no security can represent more than 10% of the market capitalization of the index.

SECURITIES BORROWING AND LENDING
For the lending of bonds, see REPO. Securities can be lent or borrowed in exchange for a fee. The lending of securities is generally backed by government bonds or by money. This type of loan is done under an agreement.

SECURITIZATION
Operation whereby a company converts assets or debt securities (mortgage loans, credit card debt, etc.) by combining and structuring them in the form of a new security, which it then offers to investors. In this way it can increase its return, increase its liquid assets, revenues, etc.

SHORT POSITION
See Long/Short Position.

SOFT-DOLLAR COMMISSION
Fee paid to a full-service broker on top of brokerage fees, in exchange for which the client usually receives research services and financial information.

SPECIALIZED PORTFOLIO
Group of securities with a common set of characteristics (currency, product type, market behaviour, etc.). Specialized portfolios are similar to mutual funds.

STRUCTURED FINANCING (REAL ESTATE)
Process associated with real estate financing which involves grouping debt assets, dividing them into tranches according to the associated risk level and then reselling the tranches to investors.

SUBORDINATED DEBT
Debt that ranks below another debt claim. Security that entitles the holder to be reimbursed after other debt holders.

SYNDICATION
Entrusting a group of financial institutions to carry out an investment or a financing operation.

SYSTEMATIC APPROACH
Approach based on mathematical models incorporating several variables which a portfolio manager defines according to their degree of reliability and relevance. By adopting a systematic approach, the manager follows a set of decision-making rules and tries not to be influenced by his or her opinion at the time.

TIME-WEIGHTED RATE OF RETURN
Return based on the initial fair value for the period, the contributions weighted by the time of contribution and the final fair value. The return alone is considered without regard to the decision as to when to call sums of money or to entrust sums to be managed.

TOTAL ASSET
See Depositors' Total Assets.

TOTAL ASSET ALLOCATION
See Asset Allocation

TOTAL ASSETS UNDER MANAGEMENT
All assets managed by the Caisse, namely all depositors' assets, as well as assets under management and assets under administration on behalf of clients.

TRADITIONAL MANAGEMENT
Portfolio management based solely on the buying and selling of securities with the purpose of outperforming a benchmark index.

UNDERLYING ASSET
Real asset on which a derivative is based.

UNDERWEIGHTING
Percentage that is lower than the benchmark weighting.

UNDERWRITING (DEBT AND EQUITY)
Process whereby a lender evaluates a file according to cash flows and the value of the property, the quality of the borrower, the local market, the available security interest and any other relevant factors relating to the file's risk.

VALUE ADDED
See Relative Return.

VALUE AT RISK (VaR)
See Active Risk.

VENTURE CAPITAL
Investment in the form of a stock purchase, generally of an unlisted company, either a start-up or an early-stage firm. The expected high return makes this type of investment, usually done in stages, attractive.

VOLATILITY
A market or security is said to be volatile when it is subject to rapid price changes. Volatility is said to be high when prices or rates vary widely over a short period.

Tables and figures

1 Organization chart of the Caisse as at December 31, 2004 – figure 1

3 Composition of total assets under management – figure 2

3 Results and changes in total assets under management – table 3

4 Returns for the Caisse and its depositors – table 4

4 Performance of the investment groups in relation to market or recognized indexes – table 5

5 Breakdown of depositors' net assets by investment type – figure 6

5 Detailed breakdown of depositors' net assets by investment type – table 7

29 Relationship between the Caisse and its depositors – figure 8

30 Depositors' holdings management process – figure 9

31 Composition of a fictitious depositor's benchmark portfolio – table 10

32 Active management and active risk – figure 11

34 Characteristics of the specialized portfolios and their correlation – table 12

35 Industrial production: United States, Japan, Euro Zone, Canada – figure 13

36 Exchange rate of the U.S. and Canadian dollars – figure 14

38 Weighted average returns on depositors' funds – table 15

38 Breakdown of contribution in dollars by investment group – table 16

38 Depositors' net assets 2000 – 2004 – figure 17

38 Total contribution of investment activities 2000 – 2004 – figure 18

39 Returns earned by the investment groups – long term – table 19

41 Returns earned by the investment groups – short term – table 20

42 Change in active risk per asset class for 2004 – figure 21

43 Composition of the benchmark portfolio and changes in the Caisse's overall portfolio – table 22

44 Specialized portfolios by investment group – table 23

46 Depositors' net assets by specialized portfolio – figure 24

46 Return on Canadian Equity – table 25

47 Return on U.S. Equity (hedged) – table 26

48 Return on Foreign Equity (hedged) – table 27

48 Return Emerging Markets Equity – table 28

49 Return on Québec International – table 29

50 Depositors' net assets by specialized portfolio in the Fixed Income group – figure 30

51 Return on Short-term Investments – table 31

51 Return on Real Return Bonds – table 32

52 Return on Bonds – table 33

55 Depositors' net assets by specialized portfolios – figure 34

55 Hedge fund management teams – figure 35

56 Return on Hedge Funds – table 36

57 Return on Commodities – table 37

58 Organizational chart of Real Estate Group – figure 38

61 Regional distribution within the global commercial real estate cycle – figure 39

62 Breakdown of total asset under management – Real Estate group – table 40

63 Sector breakdown of the specialized Real Estate portfolio – figure 41

63 Geographic breakdown of the specialized Real Estate portfolio – figure 42

64 Return on the specialized Real Estate portfolio – table 43

65 Return on the specialized Mortgages portfolio – table 44

65 Sector breakdown of the specialized mortgages portfolio – figure 45

65 Geographic breakdown of the specialized mortgages portfolio – figure 46

67 Expertise of the Private Equity Group – table 47

68 Authorized investments – table 48

69 Total assets under management by the Private Equity group – table 49

69 Changes in the fair value of the investments of the Private Equity group – figure 50

70 Breakdown of the specialized Private Equity portfolio by investment category – figure 51

70 Geographic breakdown of the specialized Private Equity portfolio – figure 52

71 Sector breakdown of the specalized Private Equity portfolio – figure 53

71 Return on Private Equity – table 54

72 Sector breakdown of the specialized Investments and Infrastructures portfolio – figure 55

72 Geographic breakdown of the specialized Investment and Infrastructures portfolio – figure 56

72 Return on the specialized Investments and Infrastructures portfolio – table 57

72 Breakdown of the specialized Investments and Infrastructures portfolio by investment category – figure 58

77 Recurring operating expenses expressed in cents per $100 of Depositors' average net assets – figure 59

77 Recurring operating expenses expressed in cents per $100 of Depositors' average total assets under management – figure 60

78 Geographical allocation of the fixed-rate notes maturing in 3, 4 and 5 years – figure 61

78 CDP Financial's credit ratings – table 62

107 Risk management – figure 63

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Information:
(514) 842-3261
info@lacaisse.com

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www.lacaisse.com

Business Office

Centre CDP Capital
1000, place Jean-Paul-Riopelle
Montréal (Québec) H2Z 2B3
Tel.: (514) 842-3261
Fax: (514) 847-2498

Head Office

Édifice Price
65, rue Sainte-Anne, 14e étage
Québec (Québec)
Canada G1R 3X5
Tel.: (418) 684-2334
Fax: (418) 684-2335

Caisse de dépôt et placement du Québec