FIXED INCOME

DESCRIPTION

The Fixed Income category consists of four portfolios: Short Term Investments, Bonds, Long Term Bonds and Real Estate. These portfolios reduce the level of overall portfolio risk and match the assets and liabilities of depositors.

The Bonds and Real Estate Debt portfolios, whose net assets total $48.6 billion, are actively managed. The Short Term Investments and Long Term Bonds portfolios, whose net assets total $7.0 billion, are index managed.

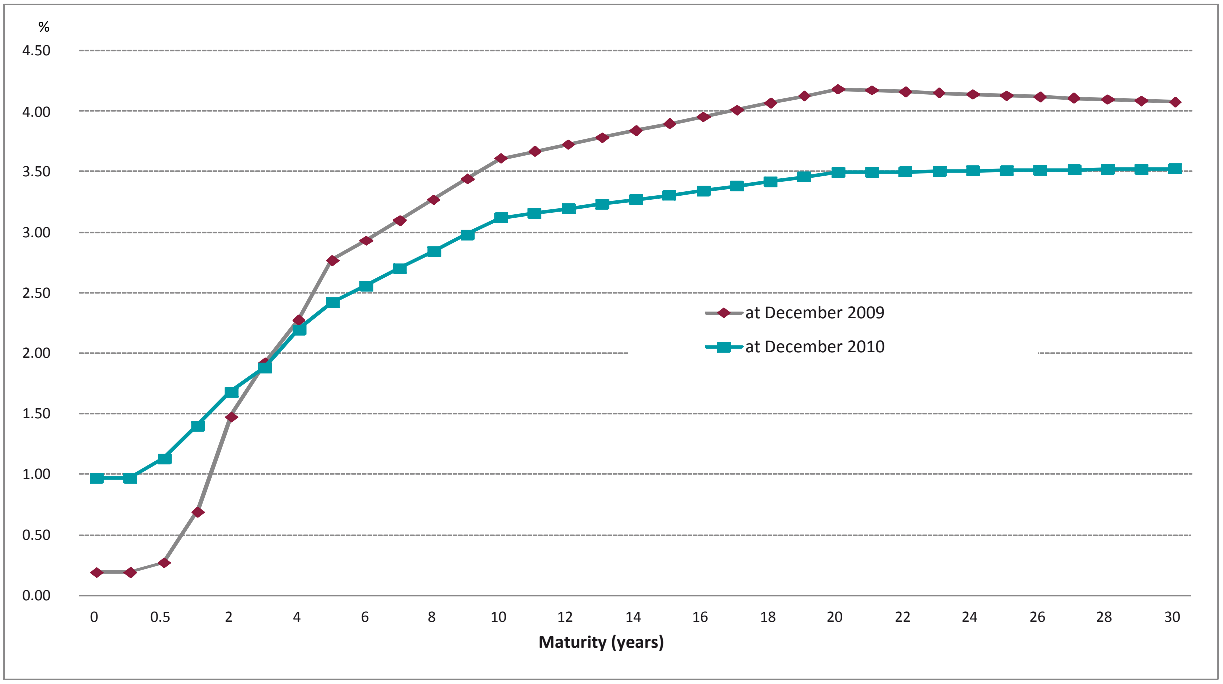
MARKET CONDITIONS

In 2010, global bond markets were initially affected by concerns about the creditworthiness of certain eurozone countries and fears of an economic slowdown in the United States. Support measures by the authorities (IMF, EU and ECB) finally calmed markets in Europe, leading to a gradual narrowing of credit spreads in the fourth quarter. In the U.S., a second wave of monetary easing in the fall was not enough to maintain the downward trend in rates that began in the second quarter. A U.S. economic recovery, coupled with continued tax cuts, was behind a large part of the rate hike in the fourth quarter.

Although the Bank of Canada raised its rates by 25 basis points three times, medium- and long-term Government of Canada bond rates declined before rising again in the fourth quarter. Very popular with foreign investors, the Canadian bond market performed well in 2010, supported particularly by a favourable fiscal situation and strong dollar.

Given an environment of low interest rates, a rebound in quality commercial property market valuations and a return of risk appetite, the real estate debt market saw a substantial improvement in liquidity. In addition, mortgage credit spreads contracted significantly, enabling the market to end the year on a good note.

Changes in Canadian federal bond rates in 2010



HIGHLIGHTS

- The Fixed Income category's overall return was 9.7%, 2.7% above the benchmark index.

SHORT TERM INVESTMENTS

- The portfolio's return was 0.7%. This performance is due to an environment of very low short-term rates.

BONDS

- This portfolio returned 8.4%, 1.6% above its index, generating $583 million in added value.
- Lower medium- and long-term rates (see chart) during the year positively contributed to portfolio returns.
- About three quarters of the added value is due to prudent corporate bond selection. The other quarter comes primarily from provincial and sovereign bond selection.

LONG TERM BONDS

- This portfolio saw a 12.3% return. It is identical to its index.
- This performance can be explained mainly by increases in value related to the decline in long-term rates.

REAL ESTATE DEBT

- This portfolio posted a 17.1% return, 10.0% above its benchmark index, delivering $777 million in added value.
- The decline in Canadian mortgage rates, the U.S. housing market recovery and U.S. asset sales, conducted as part of the portfolio refocusing announced in 2009, were behind this result.

Specialized portfolio performance

For the year ended December 31, 2010

	$BILLIONS	Weight[1] %	Return %	Index %	Variance %
Short Term Investments	3.4	2	0.7	0.5	0.1
Bonds	40.0	26	8.4	6.8	1.6
Long Term Bonds	3.6	2	12.3	12.3	0.0
Real Estate Debt	8.6	6	17.1	7.1	10.0
Total	**55.6**	**37**	**9.7**	**7.0**	**2.7**

[1] Compared to the Caisse's net assets