FIXED INCOME

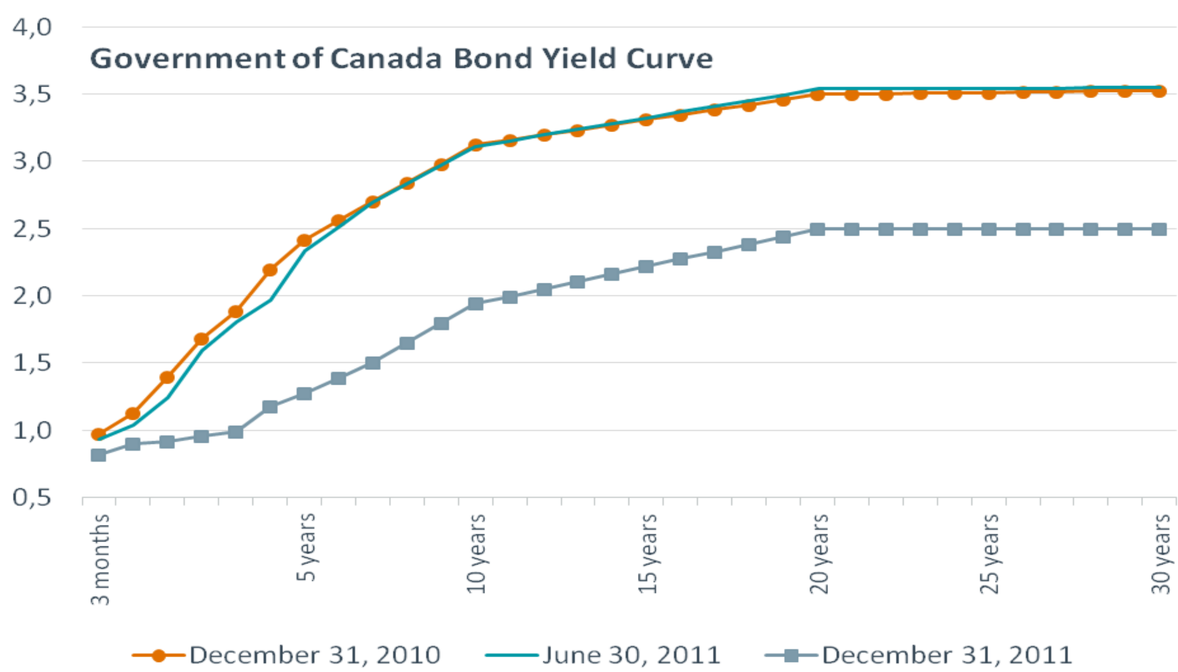
DESCRIPTION

The Fixed Income category consists of four portfolios: Short Term Investments, Bonds, Long Term Bonds and Real Estate Debt. It reduces the level of overall portfolio risk and matches the assets and liabilities of depositors.

The Bond and Real Estate Debt portfolios, with net assets totaling $48.3 billion, are actively managed, while the Short Term Investments and Long Term Bond portfolios, with net assets totaling $10.5 billion, are index-managed.

MARKET CONDITIONS

In 2011, the Canadian bond market had another year of good returns on government and corporate securities. This was largely due to the sharp decrease in the Government of Canada bond yield curve in 2011, primarily during the second half of the year (see graph). The decrease was driven by the precarious political and economic situation in the rest of the world, combined with Canada’s reputedly more favourable fiscal position, as reflected in the Government of Canada’s continued AAA credit rating. The Bank of Canada had to revise its economic scenario downwards and postpone monetary tightening.



The global bond markets also had a good year despite modest economic growth and the end of a wave of monetary easing in the United States. The solvency of mainly peripheral eurozone countries (Greece, Spain, Ireland, Italy and Portugal) was a focus of concern from August onwards. The market reacted adversely to a risk of contagion following a possible Greek default, and more specifically, its repercussions on the European banking system. Although stabilization measures (debt buybacks on the secondary markets and bank recapitalizations) were implemented, the expected economic slowdown depressed long-term rates on the major markets. Yields on 10-year government bonds in Canada and the U.S. ended the year at historical lows of less than 2%.

Changes in Government of Canada 10-Year Bond Yields

Source: Bank of Canada
Since 1982: Yield on Government of Canada 10-year benchmark bonds
Before 1982: Average yield on Government of Canada marketable bonds with maturities of over 10 years

The Canadian commercial real estate debt market also responded well to this environment with very positive performance in 2011. With mortgage credit spreads remaining fairly stable, the significant decrease in Canadian interest rates translated into higher returns over the year.

HIGHLIGHTS

Specialized Portfolio Performance

For the year ended December 31, 2011

	$ billions	Weight[1] %	Net Investment Results $ millions	Return %	Index %
Short Term Investments	6.8	4.3	47	1.1	1.0
Bonds	41.6	26.2	3,981	10.1	9.8
Long Term Bonds	3.8	2.4	628	18.6	18.6
Real Estate Debt	6.7	4.2	1,014	15.0	9.5
Total	**58.8**	**37.0**	**5,670**	**10.4**	**9.5**

[1] Compared to the Caisse's net assets

The overall return on the Fixed Income category was 10.4 %, 0.9% above the benchmark index. The portfolios in this category responded positively to a generalized decline in interest rates following on previous rate decreases in 2009 and 2010.

SHORT TERM INVESTMENTS

- The portfolio returned 1.1%, outperforming its benchmark index by 0.1%. This performance reflects an environment of very low short-term rates.

BONDS

- The largest share of assets held at the Caisse is invested in this portfolio: 26.2% or $41.6 billion as at December 31, 2011.
- The portfolio returned 10.1%, generating $4.0 billion in net investment results. The return was 0.3% above its benchmark index.
- The decline in medium- and long-term rates over the year drove up portfolio returns. Two thirds of the total return are value increases resulting from this decline.

LONG TERM BONDS

- The return on the portfolio was identical to the benchmark index at 18.6%.
- Almost 80% of the return was generated by value increases from lower long-term interest rates on government securities in the portfolio, which fell from 4% to 3%, a 1% decrease. This had an especially positive impact on the performance of this long-horizon portfolio.

REAL ESTATE DEBT

- This portfolio returned 15.0%, or $1.0 billion in net investment results, outperforming its benchmark index by 5.4%.
- Lower mortgage rates in Canada largely explain this strong performance in 2011.
- The last foreign assets were sold as part of the portfolio refocusing strategy. This took place in favourable conditions, which also helped deliver higher returns on these assets.