INFLATION-SENSITIVE INVESTMENTS

DESCRIPTION

The Inflation-Sensitive Investments category consists of three portfolios: Real Return Bonds, Infrastructure and Real Estate. These portfolios provide exposure to markets, including inflation-indexed, income-generating investments. This can partly hedge against the inflation risk associated with the liabilities of many Caisse depositors.

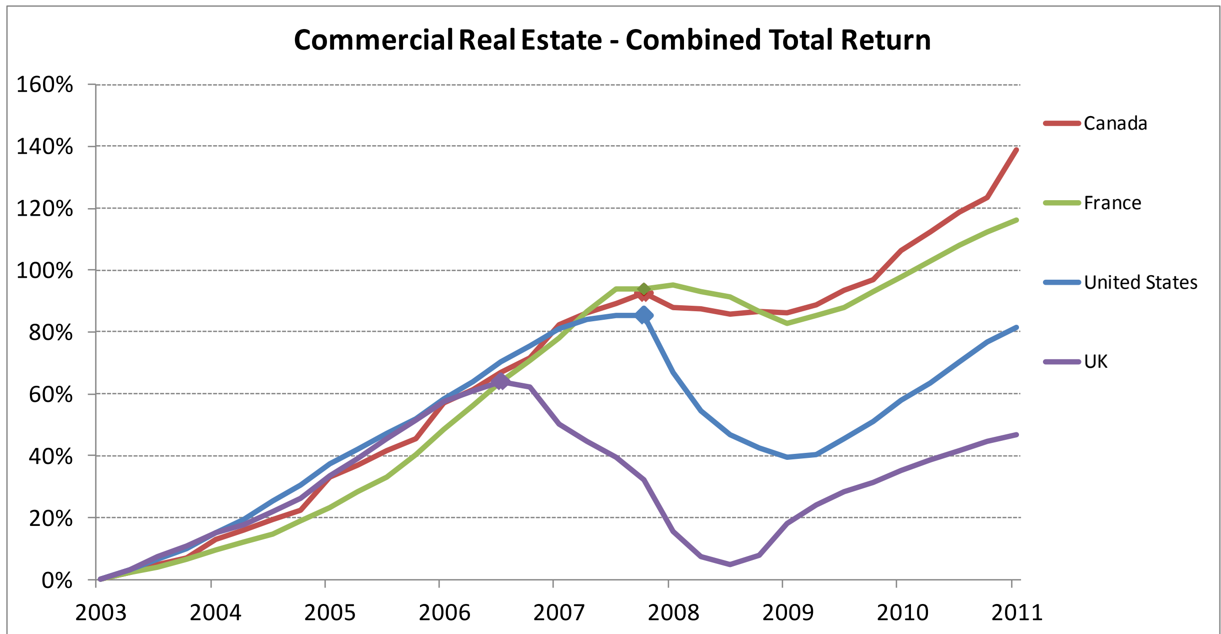
The Infrastructure and Real Estate portfolios, which have $24.0 billion in net assets, are actively managed. The Real Return Bonds portfolio, which has $1.3 billion in net assets, is index managed.

MARKET CONDITIONS

In an environment characterized by low interest rates and particularly volatile equity markets, less liquid assets, such as infrastructures and real estate, have become increasingly popular on account of the high, stable current income they provide and a generally low risk profile. Despite credit market volatility and the economic slowdown, projects and assets with excellent fundamentals maintained their ability to obtain financing at low rates, which has fared well for them and enabled them to post high returns.

In the infrastructure sector, the rebound in activity in 2010 continued into 2011, with a sharp rise in investments in this asset class. In the third quarter, 137 infrastructure funds, targeting an amount of $96 billion, were included on a global scale.

This phenomenon was also seen in real estate. On the one hand, in Canada, investment in commercial real estate assets maintained its solid performance as observed in 2010. On the other hand, for certain market sectors in the United States and Europe, commercial real estate investment fully offset the losses suffered during the 2008 financial crisis. In Europe, real estate asset sales by banks and governments resulted in an increased offer of assets on the market and, consequently, a certain price stabilization towards the end of the year.



Source : IPD (Investment Property Databank); NCREIF (National Council of Real Estate Investment Fiduciaries); in CAD hedged for currency risk

HIGHLIGHTS

Returns on Specialized Portfolios

For the year ended December 31, 2011

	$ billions	Weight[1] %	Net Investment Results $ millions	Return %	Index %
Real Return Bonds	1.3	0.8	203	18.4	18.3
Infrastructure	5.8	3.6	1,043	23.3	12.7
Real Estate	18.2	11.5	1,835	11.0	15.6
Total	**25.2**	**15.9**	**3,081**	**13.9**	**15.3**

[1] Compared to the Caisse's net assets

The overall return of the Inflation-Sensitive Investments category was 13.9%, 1.4% below the benchmark index, generating $3.1 billion in net investment results.

REAL RETURN BONDS

- The Real Return Bonds portfolio obtained an 18.4% return.
- Of this performance, 2.9% is the result of inflation over the period.
- The majority of the return is due to the decline in real interest rates over the year. They decreased from 1.1% to 0.26%, a 0.84% decline. The effect on the return of such decreases in rates is particularly positive for this portfolio given its long term.
- This year's excellent performance is in addition to the particularly high return of the last two years. In 2009 and 2010, the return was 17.1% and 11.1%, respectively.

INFRASTRUCTURE

- This specialized portfolio generated a return of 23.3%, $1.0 billion in net investment results. The return is 10.6% above its benchmark index.
- This return, which is higher than the expected long-term return, stems from the sound operational performance of portfolio companies and from the decline in long-term interest rates. In particular, the return substantially owes to the performance of energy and airport service assets, including Trencap and BAA (*British Airports Authority*).
- This year's excellent performance builds on the particularly high return from the last two years. In 2009 and 2010, the return on this type of asset was 33.6% and 25.4%, respectively.

REAL ESTATE

- The return on this portfolio stood at 11.0% in 2011, $1.8 billion in net investment results. The return was 4.7% below its benchmark index.
- This return is primarily attributable to increases in value of retail shopping centres and office buildings in Canada and the United States.
- The underperformance of the portfolio against its index is mainly due to the dilutive effect of cash and to the low return of funds and equity held by the portfolio relative to that of shopping centre, office, and industrial and residential building sectors that make up the benchmark index.
- This year's high return builds on the high return of 13.4% posted in 2010. In 2009, the portfolio had plummeted 12.7% in the aftermath of the 2008 financial crisis.