INFLATION-SENSITIVE INVESTMENTS

DESCRIPTION

The Inflation-Sensitive Investments asset class consists of three portfolios: Real Estate, Infrastructure and Real Return Bonds. It consists of assets whose investment income is generally inflation-linked so as to partially hedge the inflation risk associated with the liabilities of many Caisse depositors.

The Real Estate and Infrastructure portfolios, which have $30.6 billion of net assets, are actively managed with an absolute-return approach. The Real Return Bonds portfolio, which has $1.2 billion of net assets, is indexed.

MARKET CONTEXT

In an environment of low interest rates, less-liquid assets, such as real estate and infrastructure, are becoming more popular because they offer a high, stable current return, while diversifying risk within an overall portfolio. Over the past four years, falling interest rates, combined with signs of an economic recovery in developed countries, have enabled this asset class to generate high returns.

As for real estate, the results depend on the region and sector. In Canada and the United States, shopping centres have offered solid returns for several years, notably because of strong rental income. These results are due to such factors as the economic upturn in the United States and a gradual decrease in uncertainty over macroeconomic conditions. Interest rates were in a downward trend until 2012, which caused discount rates for buildings to fall, also resulting in substantial increases in value. In Brazil, the performance of shopping centres has been sustained, partially because of the growing middle class and easier access to credit. Even so, the cyclical depreciation of the Brazilian real has affected the four-year return.

In 2013, the first increases in interest rates after a downward trend lasting several years did not have a significant impact on valuations because they were offset to a great extent by compressed risk premiums. In Canada, strong demand for real estate even lowered the discount rate for shopping centres.

In the infrastructure sector, global demand for new infrastructure, combined with the need to reduce government budget deficits, considerably increased the number of transactions involving private investors. Many large institutional investors expressed an interest in the sector. As a result, it is becoming more difficult to negotiate mutual agreements because many projects are auctioned, which pushes market prices up.

HIGHLIGHTS

	At Dec. 31, 2013	4 years			1 year		
Specialized portfolio	**Net assets ($ billions)**	**Return ($ millions)**	**Return (%)**	**Index (%)**	**Return ($ millions)**	**Return (%)**	**Index (%)**
Real Estate	22.6	8,660	13.0	14.0	2,896	15.1	15.6
Infrastructure	8.0	3,250	16.8	15.3	641	10.6	22.6
Real Return Bonds	1.2	148	4.1	4.1	(170)	(13.1)	(13.1)
Inflation-Sensitive Investments	**31.8**	**12,058**	**13.4**	**13.7**	**3,367**	**12.5**	**15.6**

Over four years, the Inflation-Sensitive Investments asset class generated $12.1 billion of net investment results. This is the asset class with the best absolute results for the period, with an annualized return of 13.4%. This return is 0.3% below the benchmark index. The return for 2013 is 12.5%.

REAL ESTATE

- Over four years, the Real Estate portfolio generated $8.7 billion of net investment results and a 13.0% annualized return, underperforming its benchmark index by 1.0%. The return for 2013 is 15.1%.

  - The absolute return over four years is due mainly to the increase in the value of shopping centres and office buildings in North America as well as the current return generated by the properties. The difference with the index is due primarily to the weak performance of the hotel sector, which is being reduced.

- Geographic and sector repositioning of the Real Estate portfolio resulted in a large volume of transactions over the past four years. Transactions since the end of 2009 totalled $23.1 billion, with $11.5 billion of acquisitions and $11.6 billion of sales.

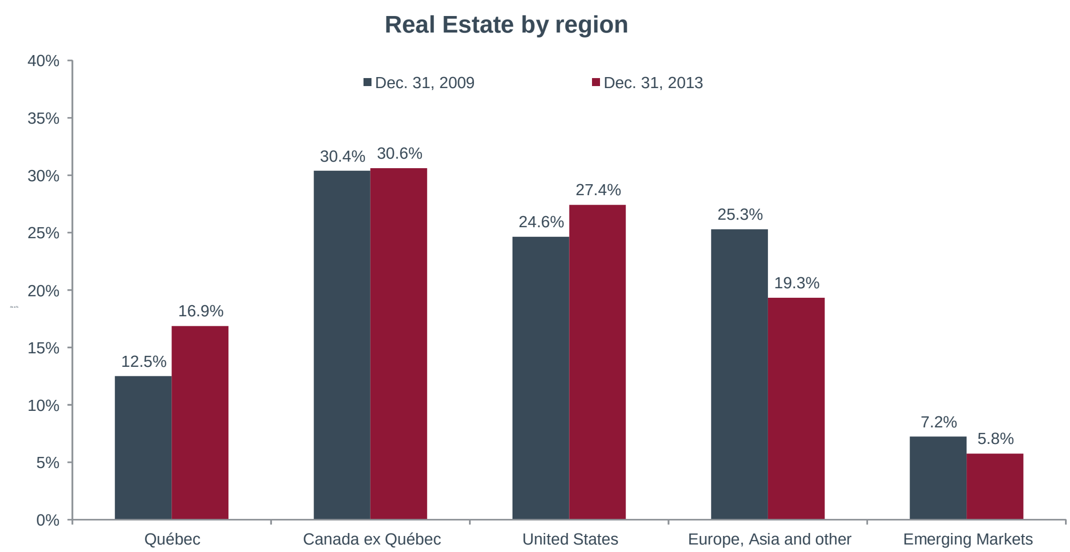
- Various transactions were also carried out in 2013, including acquisitions totalling $5.2 billion:

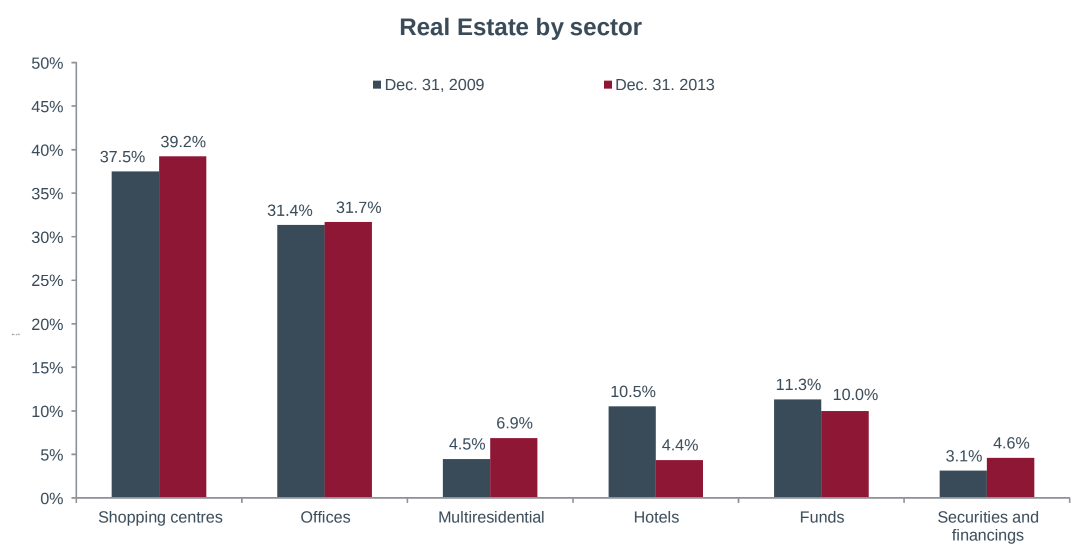
  - Investments in the United States, including an interest in 1211 Avenue of the Americas in New York City, the acquisition of the office towers at 10 and 120 South Riverside Plaza in Chicago, the purchase of 999 Third Avenue (Wells Fargo Center) in Seattle and additions to the multiresidential portfolio.

  - The repositioning of the European portfolio continued. The acquisitions include interests in London’s Woolgate Exchange and PointPark Properties, a logistics and warehouse company.

- In Québec, Ivanhoé Cambridge became, once again, the sole owner of Place Ville Marie, after acquiring its partner's share of the landmark property in downtown Montréal. The acquisition of a 50% interest in Carrefour de l'Estrie and the completion of renovations at Galeries d'Anjou are also among the achievements in 2013.

- The figures below show the increase in the weighting of the United States and the decrease in that of Europe, as well as the increase in the multiresidential portfolio and the impact of the sale of hotels since the end of 2009.





Note: Other investments, particularly in land and the industrial sector, represent approximately 3% of the portfolio (not shown).

INFRASTRUCTURE

- Over four years, the Infrastructure portfolio has a 16.8% annualized return, outperforming its benchmark index by 1.5% and generating $3.3 billion of net investment results. For 2013, the absolute return is 10.6%.

- The four-year return is due mainly to the solid operating results of the companies in the portfolio as well as falling interest rates.

    - Regulated assets and economic infrastructure generated most of the portfolio's increase in value in 2013. More than half of the results come from the current return generated by these assets.

    - In 2013, the difference between the portfolio's 10.6% return and the 22.6% return on its benchmark index is due to the strength of the equity markets. The index consists of publicly traded companies subject to considerable volatility, whereas the portfolio comprises privately held assets and aims for more stable and predictable long-term returns.

- A repositioning of the portfolio began in 2013. Several major transactions were concluded, including the sale of the stake in Enbridge Energy Partners and the acquisition of interests in Invenergy's wind power projects and in the Port of Brisbane in Australia. The transactions improved the geographic and sector diversification of the portfolio, among other things.

REAL RETURN BONDS

- This indexed portfolio generated an annualized return of 4.1% over four years. In 2013, the increase in real rates had a very negative impact on the prices of long-dated bonds. As a result, the return for the year is -13.1%.