Caisse de dépôt et placement du Québec

FIXED INCOME

DESCRIPTION

The Fixed Income asset class constitutes a substantial source of liquidity in addition to helping reduce the level of overall portfolio risk and match clients' assets and liabilities.

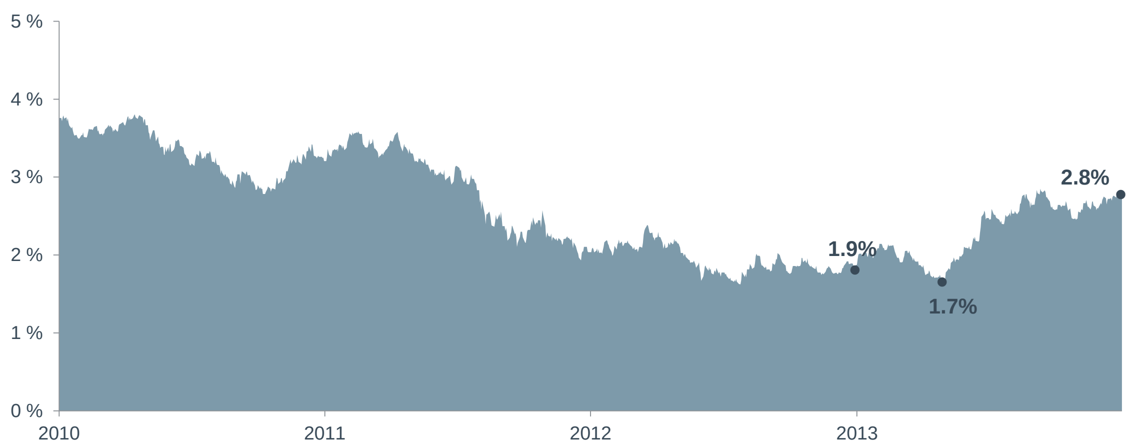
It consists of four portfolios. The Bond portfolio and the Real Estate Debt portfolio, with net assets totalling $63.8 billion, are managed actively, whereas the Short Term Investment portfolio and the Long Term Bond portfolio, with net assets totalling $5.4 billion, are indexed.

MARKET CONTEXT

Interest rates essentially fell from 2010 to 2012, but the trend reversed itself in 2013. This shift could mark the end of the historic decrease in interest rates that began early in the 1980s. The prospect of monetary tightening, which became more likely as of May 2013, caused medium- and long-term bond yields to rise. Many investors therefore turned to other asset classes, which had an impact on the bond markets in some of the developed countries, including Canada, the United States and Germany.

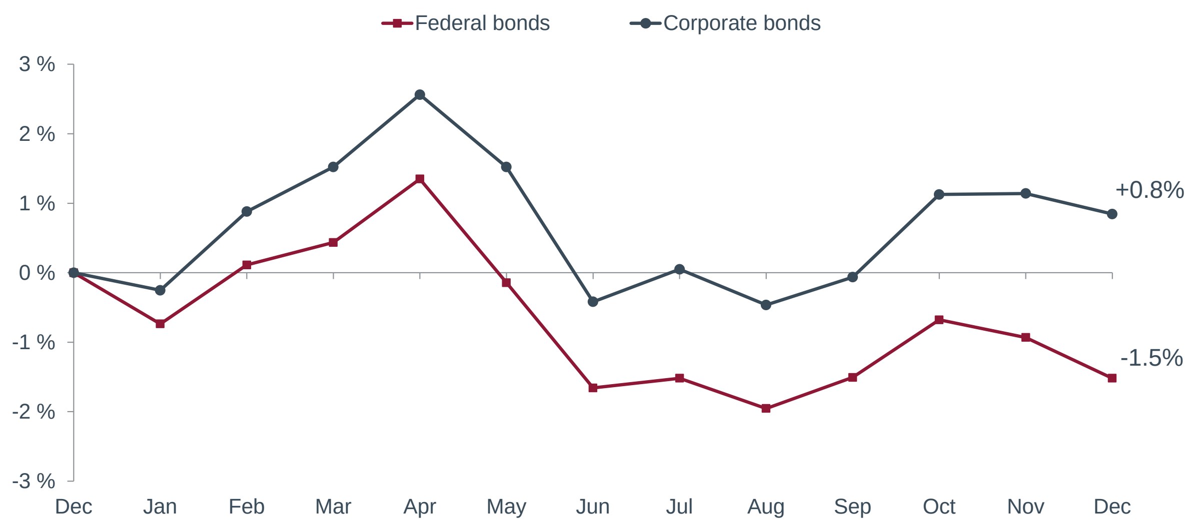
Government of Canada 10-year bond yields ended 2013 at 2.8%, an increase of almost 1.1% since May and 1.0% since the start of the year.

Government of Canada 10-year bond yields



The corporate credit market benefited greatly from the economic conditions. Support from the Federal Reserve in the United States, as well as various measures put in place in Europe, including bank stability and oversight mechanisms, helped calm the markets. Yield spreads tightened significantly, enabling corporate bonds to outperform federal bonds.

Returns on bond indexes - 2013



HIGHLIGHTS

Specialized portfolio	At Dec. 31, 2013 Net assets ($ billions)	4 years Return ($ millions)	4 years Return (%)	4 years Index (%)	1 year Return ($ millions)	1 year Return (%)	1 year Index (%)
Bonds	55.0	8,920	5.7	4.7	33	0.2	(1.2)
Real Estate Debt	8.8	2,741	9.1	4.7	8	0.1	(1.2)
Short Term Investments	3.5	218	1.0	0.9	61	1.1	1.0
Long Term Bonds	1.9	986	6.5	6.6	(143)	(6.5)	(6.4)
Fixed Income	**69.2**	**12,865**	**5.9**	**4.5**	**(41)**	**0.0**	**(1.2)**

After taking advantage of the substantial decreases in interest rates over the past few years, the Fixed Income portfolios generated a lower return in 2013. Over four years, this asset class generated $12.9 billion of net investment results. The annualized return for that period is 5.9%, or 1.4% more than the benchmark index. For 2013, the Fixed Income asset class returned 0% but preserved capital.

BONDS

- This actively managed portfolio is the largest in terms of assets, with \$55.0 billion, or 27.6% of clients' net assets as at December 31, 2013.

- Over four years, it has generated \$8.9 billion of net investment results and a 5.7% annualized return, outperforming its benchmark index by 1.0%. Even though bond yields were up in 2013, active management made it possible to preserve capital and generate a return of 0.2% on the year.

- Consistent with the last four years, in 2013 La Caisse capitalized on improving economic conditions and, more recently, the normalization of interest rates.

- Each type of strategy used by the Bond portfolio contributed positively to the variance in relation to the benchmark index over the past four years:

  - Positions that mitigated the impact of rising rates in developed countries;

  - Overweighting provincial securities, especially Québec bonds, in the expectation of narrower rate spreads; and

  - Overweighting the bonds of public and private companies, combined with a higher return on the portfolio's holdings.

REAL ESTATE DEBT

- This actively managed portfolio consists of first-ranking Canadian commercial mortgage loans on quality assets. Mortgage underwriting operations are carried out mainly in Québec but increased in Ontario and Western Canada in 2013.

- Over four years, the net investment results of the Real Estate Debt portfolio reached \$2.7 billion. The annualized return is 9.1%, or 4.4% more than the benchmark index. The 2013 return is 0.1%.

- The portfolio outperformed its benchmark index over four years partially because of attractive credit premiums that made it possible to generate a higher current return. The value added is also due to the tightening of mortgage rate spreads and the realization of gains on the sale of foreign assets in order to refocus the portfolio on quality Canadian assets.

SHORT TERM INVESTMENTS

- This indexed portfolio had an annualized return of 1.0% over four years and 1.1% in 2013. These results reflect the extremely low levels of short-term interest rates.

LONG TERM BONDS

- This indexed portfolio generated an annualized return of 6.5% over the past four years. In 2013, it returned -6.5%.

  - The falling interest rates of recent years contributed significantly to the relatively high return on long-term bonds over four years.

  - The 2013 result is due essentially to the increase in interest rates, which lowered the price of the long-term bonds in the portfolio.