Caisse de dépôt et placement du Québec

Equities

HIGHLIGHTS

EQUITIES	5 years	2018
$151.2 B Net assets as at December 31, 2018	10.4% Annualized return	3.5% Return
	$59.1 B Net investment results	$4.8 B Net investment results

2 portfolios

Equity Markets

Benefits

The risk-adjusted return is higher than that of markets thanks to an absolute-return approach

Private Equity

Benefits

Expected long-term performance above that of equity markets

The **Equities** asset class represented 49% of la Caisse's overall portfolio as at December 31, 2018, and includes two specialized portfolios:

- **Equity Markets:** Actively managed, this portfolio invests in a variety of corporate stocks based on their fundamental value. It aims for sustained performance over the long term through its seven management mandates:

  > Global Quality
  > Canada
  > Growth Markets
  > Alternative Beta
  > Global Value
  > Relationship Investing
  > Strategic

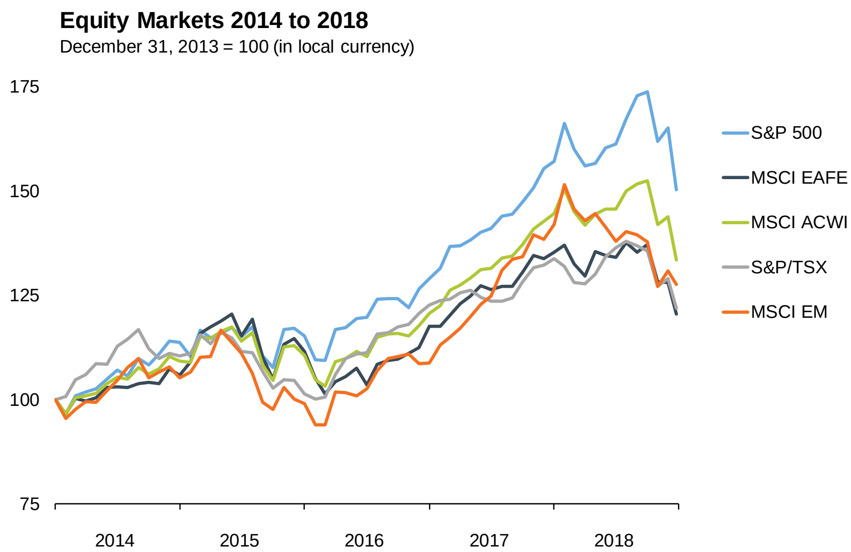
  Global management of the portfolio allows la Caisse to integrate, with some flexibility, its convictions into the decision-making process.

- **Private Equity:** This portfolio includes securities of public and private companies in which la Caisse takes privately negotiated stakes through which it aims to exercise increased influence. Focus is also placed on creating strategic partnerships with fund managers who oversee a portion of the portfolio's assets.

Market conditions

Equity Markets

Over the last five years, all the main global stock markets have had positive average gains. However, in 2018 they plummeted, posting one of the worst annual returns since the 2008–2009 financial crisis. In fact, despite strong growth in corporate earnings around the world, valuation multiples were down in an environment where U.S. monetary policy was normalizing, certain tariffs were increasing, the risk of trade wars was growing and geopolitical tensions were rising.



From 2014 to 2018, the S&P 500 index produced the best returns among the major stock markets, with an average annual gain of 8.5% (in local currency), thanks in large part to the technology and health care sectors. In 2018, however, its return was -4.4%, even though U.S. economic conditions were very positive, with the unemployment rate at a historical low, advantageous tax reform and relatively healthy earnings growth. This U.S. index started the year down in February, due to fears of inflation and rate hikes, which pushed the VIX volatility index to high levels. The amplification of the threat of a trade war with China and the tone the Federal Reserve adopted in its statements caused the index to fall sharply at the end of the year as well. The rate hikes announced at that time raised fear among investors of a severe slowdown in the U.S. economy.

The MSCI EAFE (Europe, Australasia and the Far East) earned the lowest return of the major indexes, with a five-year average gain of 3.8% and a return of -11.0% in 2018 (in local currencies). Lacklustre performance of the financial sector, especially in Europe where Brexit is directly impacting the major banks, drove down the index.

The Canadian S&P/TSX index posted an annual average return of 4.1% over the last five years and of -8.9% in 2018. The decline in the index was mainly caused by weakness in the finance, energy and materials sectors, with weakness in the latter two related to falling commodity prices, including oil.

The growth markets index, MSCI EM, recorded an annual average gain of 5.0% over five years and of -10.1% in 2018 (in local currencies). Trade and geopolitical tensions shook investor confidence and had a strongly negative impact on several countries, including China, Mexico and South Korea.

Private Equity

The private assets market continued to follow its upward trend of recent years with strong growth in 2018. Solid corporate results and the vitality of the main global economies, combined with the attractiveness of private equity, drove corporate valuations to high levels. Since the end of 2017, the capital available for investing rose 12%, reaching a new high. It remains concentrated in North America and Europe.

Equity Markets portfolio returns

La Caisse's strategy, based on building a portfolio that is robust in the long term and focused on absolute-return management, was beneficial. Over the last five years, the portfolio generated net investment results of $41.5 billion thanks to an annualized return of 9.5%. It outperformed its index by 1.9%, amounting to $7.8 billion of value added.

In 2018, the performance is a reflection of la Caisse's strategy. In conditions of highly volatile markets, the portfolio demonstrated its resilience with a return of -0.9%, compared to -2.5% for its index, generating value added of $1.8 billion.

The mandates inside the portfolio are based on the same basic principle: the selection of quality assets. This focus on quality explains the positive difference with the index, both over five years and for 2018.

GLOBAL QUALITY MANDATE

A pillar of la Caisse's absolute-return management strategy, this mandate invests in the securities of quality companies exposed to global growth that are traded on the major global stock exchanges. It targets companies with high and stable profits, solid economic foundations and cautious use of leverage. As a result, the investments tend to be less sensitive to market fluctuations and provide some protection during periods of market turbulence. Since its creation in 2013, the mandate has obtained a risk-adjusted return greater than the market. It captured almost all market highs, but only a fraction of market lows.

	5 years		2018	
$39.8 B Net assets as at December 31, 2018	11.8% Annualized return	8.3% Index	6.4% Return	-0.8% Index

$17.0 B
5-year net investment results

Five-year return

Since 2014, this mandate has generated net investment results of $17.0 billion and an annualized return of 11.8%. It outperformed its index by 3.4%, creating $4.8 billion of value added. This is by far the strongest contribution of all the mandates to the portfolio's total value added. While exposure to the U.S. market was very profitable for the overall portfolio, it was especially true for this mandate, which had 50% exposure to equities of companies established in the U.S. These securities provided their best return both over five years and in 2018, driven by the U.S. economy's strong expansion these last five years, particularly evidenced in the ongoing improvement of the labour market.

$2.5 B 2018 net investment results

2018 Return

The mandate posted a return of 6.4%, the highest of the portfolio. That translates into net investment results of $2.5 billion, and strong value added of $2.9 billion compared to the index. The 2018 performance is largely due to the selection of quality securities and sectoral positioning resulting from absolute-return management. These results demonstrate the resilience of the mandate, which plays a defensive role in the portfolio, demonstrating how valuable its behaviour is during the turbulent periods observed in the second half of the year.

CANADA MANDATE

This mandate invests in securities of publicly listed Canadian corporations, with an emphasis on constructing a quality, concentrated portfolio that reflects distinctive aspects of the Canadian assets universe. It targets companies that, in addition to having exposure to growth, possess fundamental qualities and competitive advantages that will persist in the long term. Shares in Québec companies represent around 40% of the mandate's composition, compared to 16% for the S&P/TSX index.

	5 years		2018	
$20.4 B Net assets as at December 31, 2018	6.0% Annualized return	4.5% Index	-7.2% Return	-8.9% Index

$7.0 B 5-year net investment results

Five-year return

The annualized return was 6.0% over five years, compared to 4.5% for its index. The selection of securities based on the absolute-return management approach has proven successful, as has the selection of Canadian companies well positioned to take advantage of the vitality in the U.S. economy. Accordingly, the mandate generated net investment results of $7.0 billion and value added of $1.7 billion. This essentially stems from Québec securities, which are responsible for nearly two thirds of the return for the period. It is worth noting the contribution of CN, CGI, Alimentation Couche-Tard and Gildan, companies that all have a quality management team and significant activities in the U.S.

-$1.6 B 2018 net investment results

2018 Return

Like the Canadian stock exchange, which had a negative return for 2018, the mandate earned -7.2% for the year. This downturn is attributable to the finance sector. It is worth highlighting that the mandate created significant value added in 2018, performing 1.7% better than its index. This is mainly explained by the strong performance of stocks such as CGI and Alimentation Couche-Tard, as well as by an advantageous selection of stocks related to natural resources.

GROWTH MARKETS MANDATE

This mandate invests in growth market securities. It draws on the strong potential of these economies to produce long-term returns greater than those of stocks in developed markets. It includes a significant absolute-return management component that is carried out alongside well-established local asset managers. In addition to sharing la Caisse's long-term investing philosophy, the partners have deep knowledge of these markets. The mandate also includes an alternative beta component, which is managed based on fundamental measures and not on traditional indexes based on market capitalization.

	5 years		2018	
$19.3 B Net assets as at December 31, 2018	7.7% Annualized return	6.3% Index	-7.9% Return	-8.9% Index

$5.3 B
5-year net investment results

-$1.7 B
2018 net investment results

Five-year return

Stock market performances of the major Asian markets, such as China, India and the stocks of IT companies in Taiwan and South Korea stimulated the mandate's return over the last five years. The careful selection process for expert partners with extensive knowledge of local markets also made a difference. At 7.7%, the return outpaces its index by 1.4%, representing value added of $1.0 billion, a good portion of which stems from external managers based in China. Since 2014, the mandate has generated net investment results of $5.3 billion.

2018 Return

After turning in the best performance in the portfolio in 2017, the mandate recorded the strongest decline in 2018. This is primarily explained by the risk-averse sentiment stemming from the uncertainty around trade and geopolitical tensions. These conditions drove investors out of growth markets and into countries considered safer, like the U.S. The majority of the return's decline stems from securities in China and South Korea. Note that the mandate produced positive value added attributable to the external management and alternative beta active management activities.

ALTERNATIVE BETA MANDATE

This mandate invests in securities in developed markets, excluding Canada. The strategy employed involves weighting securities based on various fundamental measures, such as sales, cash flows and dividends, rather than on their market capitalization.

	5 years	2018	
$16.3 B Net assets as at December 31, 2018	This portfolio was created in 2016.	-0.7% Return	-0.1% Index

$3.5 B
Net investment results since its creation in 2016

Returns

Since its creation in 2016, the mandate has delivered net investment results of $3.5 billion. However, it posted a neutral return for 2018. The geographic allocation resulting from the securities weighting, particularly high in Europe, had a negative impact on the mandate.

Private Equity portfolio returns

This portfolio primarily includes direct investments and stakes in investment funds. Investments are made across many sectors and various regions, in Canada, the U.S. and Europe, with an increased presence in growth markets. Approximately one quarter of assets were invested in Québec as at December 31, 2018. The investment approach focuses on quality partnership and long-term value creation, mainly through operational efficiency gains.

Over the past several years, the composition of the Private Equity portfolio has changed considerably, as the share of funds has decreased while direct interests in companies have increased. The portfolio's net assets were generally renewed, notably in 2018 with over $9 billion invested. This significant change in the portfolio explains the quality of the performance over five years and in 2018.

	5 years		2018	
$42.9 B Net assets as at December 31, 2018	12.8% Annualized return	8.9% Index	16.6% Return	8.7% Index

$17.7 B
5-year net investment results

Five-year return

The strategy of increasing the weight of less-liquid assets, including those in private equity, was beneficial for la Caisse. Over five years, the portfolio generated net investment results of $17.7 billion and an annualized return of 12.8%. It outperformed its index by 3.9%, equivalent to $5.4 billion of value added. In recent years, la Caisse has pursued its direct investing strategy, with numerous transactions in world-class companies in Québec and around the world. Direct investments, which represent three quarters of the portfolio's activities, delivered a return greater than that of investment funds over the period. However, investments funds have still contributed significantly to the portfolio's results with a high return. They have allowed la Caisse to seize attractive direct co-investment opportunities through its partners.

$5.9 B

2018
net investment
results

2018 Return

The portfolio particularly distinguished itself in 2018, with a 16.6% return, which is nearly twice that of its index. It created $2.8 billion of value added on net investment results of $5.9 billion. This is the result of the excellent performance of two portfolio activities. Direct investments benefitted from a high return on assets, both for large Québec companies and international companies. The materialization of certain investments also contributed to the return.

In 2018, the Private Equity teams deployed over $9.0 billion in international markets, with major investments in renowned companies, including:

- Techem: Acquisition of this German global leader in sub-metering valued at around €4.6 billion.
- Alvest: A significant capital stake of this French company specialized in electric airport ground support equipment, in partnership with Ardian.
- FNZ: Acquisition of this global fintech firm with a business value of £1.65 billion, as part of a long-term partnership with Generation Investment Management, which plans to invest US$3 billion in the coming years.
- Power Solutions: In partnership with Brookfield, a US$13.2-billion commitment to acquire 100% of this Johnson Controls entity that produces vehicle batteries.
- Avison Young: $250-million investment to back the global expansion strategy of this Canadian commercial real estate company.

Investment results table for Equity Markets portfolios

As at December 31, 2018		5 years			2018		
Specialized portfolio and mandate	Net assets $M	Net investment results $M	Return %	Index %	Net investment results $M	Return %	Index %
Equity Markets	**108,301**	**41,459**	**9.5**	**7.6**	**(1,028)**	**(0.9)**	**(2.5)**
Global Quality mandate	39,759	17,030	11.8	8.3	2,453	6.4	(0.8)
Canada mandate	20,426	6,954	6.0	4.5	(1,644)	(7.2)	(8.9)
Growth Markets mandate	19,315	5,258	7.7	6.3	(1,734)	(7.9)	(8.9)
Alternative Beta mandate	16,337	3,460	N/A	N/A	(23)	(0.7)	(0.1)
Others	12,464	8,757	N/A	N/A	(80)	N/A	N/A
Private Equity	**42,927**	**17,664**	**12.8**	**8.9**	**5,868**	**16.6**	**8.7**
Equities	**151,228**	**59,123**	**10.4**	**8.1**	**4,840**	**3.5**	**0.3**