

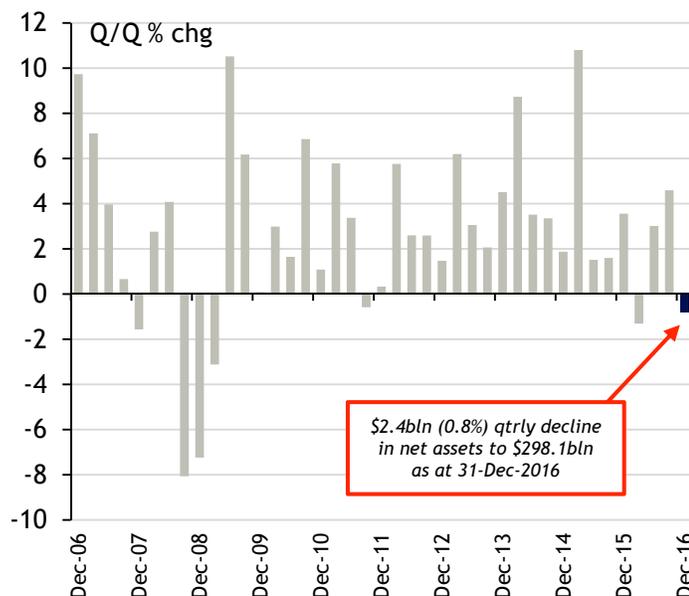
## Quick Hit – A Q3 wobble for CPP, but actuarially sound as ever

Given a flurry of bond deals, the perpetual stream of data/Fedspeak/earnings, White House press briefings (now required viewing), assorted other geopolitical developments and budgets/quarterlies from Canadian governments, you'd be forgiven if fiscal third quarter results for the CPP Fund (released earlier this month) escaped your attention. Here's what you might have missed: CPP net assets suffered a rare quarterly decline, falling \$2.4 billion to \$298 billion in the quarter ending December 31, 2016. That's just the third quarterly slip since markets recovered their footing after the global financial crisis (Chart 1). There's a seasonal element to this story, given that payments typically exceed contributions in the latter stages of the calendar year. But the October-December results also reflect the one-two punch to investment income from a sharp selloff in fixed income assets (blame Trump and the deflation trade if you'd like) and an appreciation in the Canadian dollar vs many non-US currencies (diluting foreign income when translated into loonies). You might want to get used to revenue volatility in the CPP Fund. With almost \$230 billion of net FX exposure in the CPP Fund as at 31-Dec-2016 (Chart 2), future fluctuations in the C\$ will surely leave their mark. As we saw last quarter, a diversified portfolio (Chart 3) can't fully insulate against big swings in a given asset class, and there's credit risk in fixed income portfolios (Chart 4). More generally, investment income is meant to account for a growing share of CPP revenue as more Canadians retire in the years and decades to come (Chart 5). Notwithstanding active/sophisticated management, investment income returns have proven inherently more volatile than the CPP's other main revenue stream—contributions (Chart 6)—so this evolving revenue mix hints at structurally higher volatility for quarterly returns ahead. But here's the thing, the CPP invests for the long-term. Despite last quarter's pressure, the Fund still returned 6.9% (net of costs) during the first nine months of fiscal 2017. The longer-term performance record is equally impressive: 6.5% nominal or 4.8% real over a ten year period encompassing the financial crisis. Look through quarterly gyrations and you'll find a public pension plan that is actuarially sound ([Link](#)). And for holders of CPPIB's 'AAA'-rated debt, safeguards remain as robust as ever, including CPP's vital public policy role, operational independence, stringent amending formula, strong governance framework, active risk management and timely/transparent reporting. There's ample liquidity, including positive net cash flows projected through 2020, and limited leverage. Then there's the vital statutory provision that only those CPPIB assets with a fair market value in excess of liabilities are available to satisfy CPP obligations. That fact that you can pick spread to lower-rated provinces make CPPIB bonds a compelling investment in our mind. And I'd be remiss if I didn't mention the tight markets we make in the bonds. Just try us.

Warren Lovely

### Chart 1: Rare quarterly decline

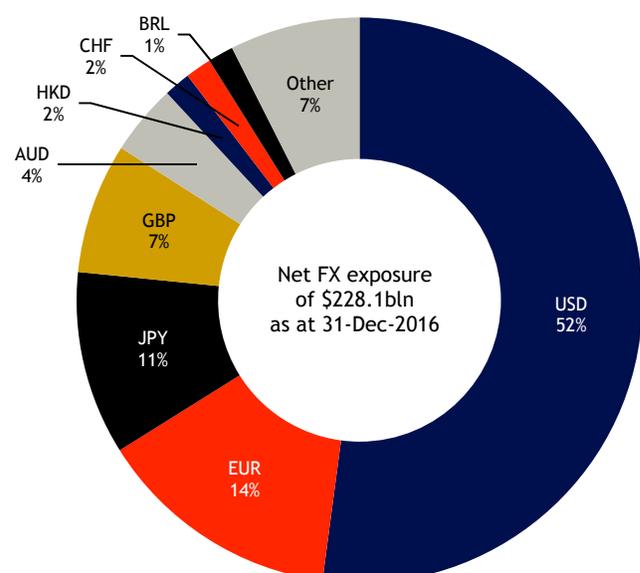
Quarterly change in CPP Fund net assets



Source: NBF, CPPIB

### Chart 2: Currency a key factor

Net currency exposures in CPP investment portfolio (31-Dec-2016)

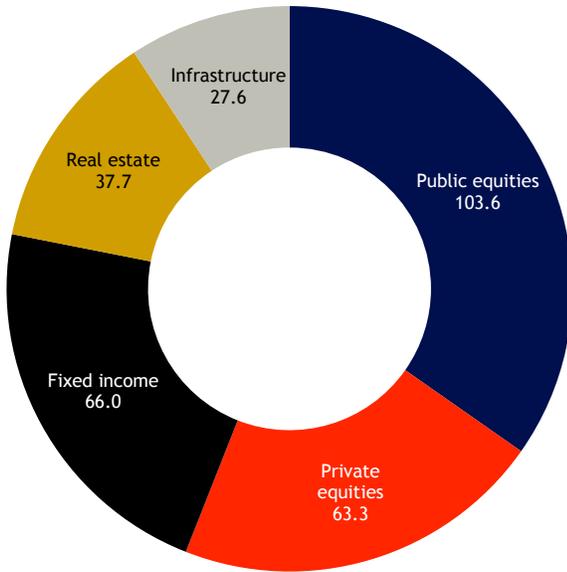


Source: NBF, CPPIB

# Government Credit

## Chart 3: A diversified portfolio

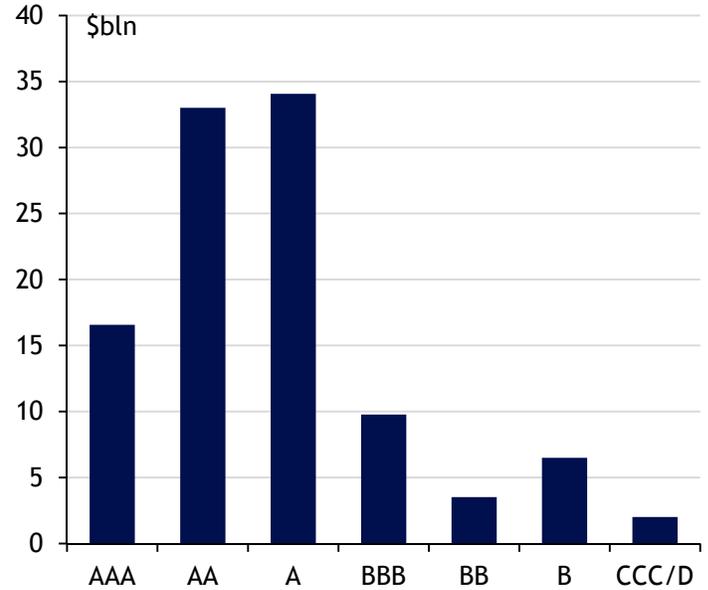
CPP asset mix (31-Dec-2016)



Source: NBF, CPPIB | Note: Figures in C\$billions

## Chart 4: A look at credit risk

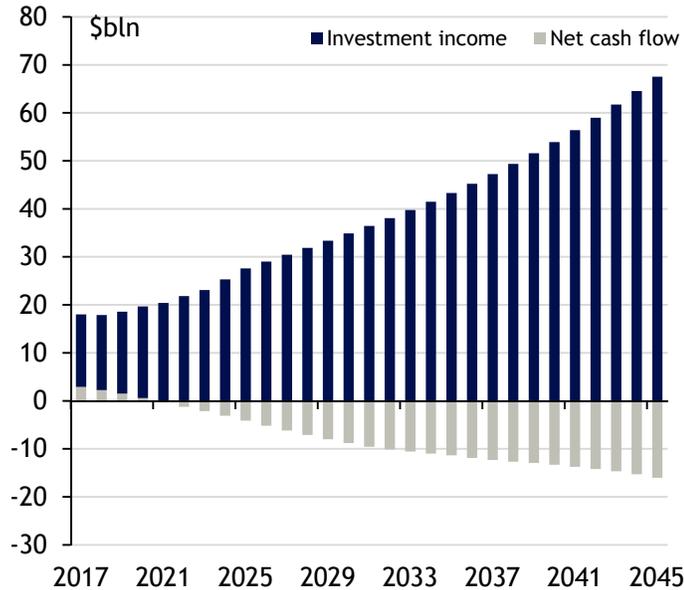
Credit risk exposures in CPP investment portfolio (31-Dec-2016)



Source: NBF, CPPIB

## Chart 5: Investment income to grow

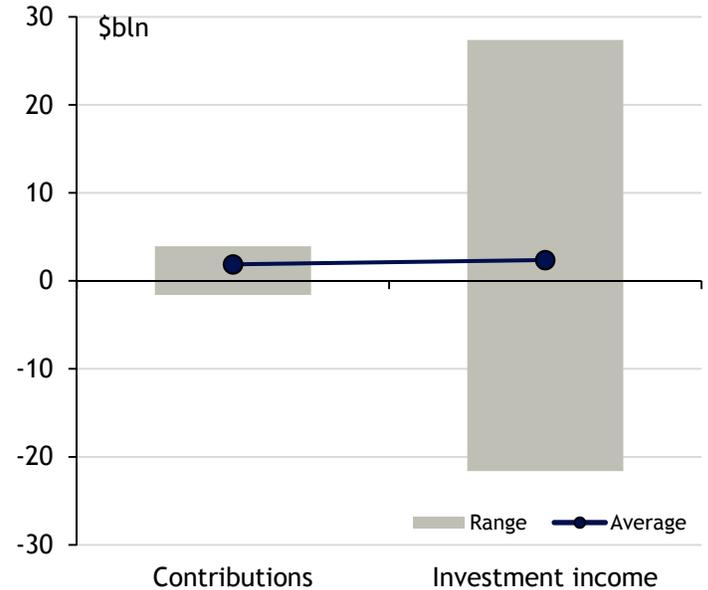
Projected net cash flow & investment income (as per actuarial report)



Source: NBF, OSFI

## Chart 6: Investment income fluctuates

Range of annual changes in CPP revenue streams (2000 to 2015)



Source: NBF, OSFI

## Economics and Strategy

### Montreal Office

514-879-2529

#### Stéfane Marion

*Chief Economist and Strategist*  
stefane.marion@nbc.ca

#### Paul-André Pinsonnault

*Senior Fixed Income Economist*  
paulandre.pinsonnault@nbc.ca

#### Krishen Rangasamy

*Senior Economist*  
krishen.rangasamy@nbc.ca

#### Marc Pinsonneault

*Senior Economist*  
marc.pinsonneault@nbc.ca

#### Matthieu Arseneau

*Senior Economist*  
matthieu.arseneau@nbc.ca

#### Angelo Katsoras

*Geopolitical Analyst*  
angelo.katsoras@nbc.ca

#### Kyle Dahms

*Economist*  
kyle.dahms@nbc.ca

### Toronto Office

416-869-8598

#### Warren Lovely

*MD, Public Sector Research and Strategy*  
warren.lovely@nbc.ca

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