«STRATEGY»

A NEW GAME PLAN

After playing defence for a couple of years, the Caisse is charging ahead with some offensive strategies

By Alexandre Daudelin / Photography by Luc Robitaille

Michael Sabia was appointed president and CEO of the Caisse de dépôt et placement du Québec in March 2009, at the peak of the financial crisis. In the two years since his appointment, Sabia has taken advantage of the upturn in the global economy to implement a new philosophy within the organization. Interesting results have already been reported: in 2010, the Caisse generated a total return of 13.6%, 4.1 points above its benchmark portfolio.

Through 2009 and 2010, the Caisse—which manages Quebec's public pension plans and is Canada's largest fund manager—implemented a number of changes, mostly defensive in nature. It significantly simplified its investment strategies, for instance, and focused on improving its risk management skills. It also put a lot of work into rebuilding depositor confidence—not an easy task. To achieve all of this, Sabia has insisted on transparency. "We built tools that would enable us to be more agile to face the turbulence of the markets—[that is, investing in more liquid assets]. We now invest only in things that we understand well. We sold everything that didn't fit into that category. Those changes have established our foundation."

Sabia built these tools around four principles, all grounded in common sense: prudence, thoroughness, client focus and simplicity. He says the Caisse will continue to implement its vision around these principles. But he emphasizes that while a good defence is important for success, it's not enough. "We need to supplement that with some offensive skills. Over the last two years, we've built a solid foundation. But now we need to begin Chapter 2: we must determine how and where we can generate the level of returns that our depositors will need on a long-term basis."

The Caisse has adapted its investment strategies bearing in mind the changes that have taken place in the economies of all of the Organisation for Economic Co-operation and Development countries. Institutional investors have also paid more attention to emerging economies and natural resources. In addition, the Caisse has decided to capitalize on its operational expertise in real estate.

The Governance Structure

To ensure that the four principles are applied, the Caisse has implemented a new governance structure consisting of three decision-making groups. First is the executive committee, which has become increasingly involved in major strategic issues and investment decisions. Next is the risk management committee, which evaluates upside and downside risks. Finally, the investment committee focuses on financial market outlooks.

"We are trying to create much more discussion between the groups. For the last year or so, we've broken down silos and made efforts to share more information across the organization. That level of collaboration will help us make better investment decisions in the long run," says Sabia.

In 2010, much of the Caisse's gains were in closed portfolios (assets that are not publicly traded), but Sabia doesn't see that as a major trend in the future. "It will vary from year to year, depending on what's going on in the broader markets," he explains. "We will always look for a relatively balanced approach between publicly traded securities and less-liquid securities. We do have a long history in illiquid assets: private equities, real estate and infrastructure. We will continue to exploit our strengths."

Major Changes Since the Crisis

In the last two years, the Caisse has significantly reduced its use of leverage. "If we compare [today] with the end of 2008, we have reduced our leverage ratio by 50% or so. The largest part to bring our leverage down has been completed, but we will continue to fine-tune it. Now we'd like to gradually lower our leverage level in real estate."

In 2008, the Caisse was harshly criticized for its exposure to asset-backed commercial paper. Since then, it has made a number of major changes with respect to derivative strategies. "The word *derivative* might scare some people, but it needs to be divided into two categories," Sabia explains. "First, there are publicly traded derivative products such as futures and options, which we will continue to use. They are easily understood, helpful and important."

However, the Caisse will be more cautious about investing in the other type of derivative going forward. "The second category is much more highly specialized, almost custom-designed and not publicly traded. We're going to be much more conservative in the future on those products," he assures. "What's bad is to use derivatives if you don't truly understand them. You have to really master what you are doing."

Winning Strategies and Team

Sabia believes that the Caisse, like any other institutional investor, needs to review its asset allocation regularly. In today's world economy, there are reasons for both optimism and pessimism. "The sovereign debt in Europe and oil prices, because of what's happening in the Middle East, are major issues influencing markets. On the other hand, the improving American economy, job growth and corporate profits in the U.S. give us hope. We have to look regularly at our asset allocation to determine how to protect our portfolio and how to get the full benefit of the global economy."

Sabia is insistent on the Caisse's goal of looking for long-term growth. "What matters to us is long-term performance. Therefore, we need to stay focused and be careful not to always be trying to adjust our portfolio to capture the latest trends or chase the short-term fashion."

He also reveals that the Caisse is contemplating more investments in emerging countries. Like everyone else, Sabia has observed the shift in the global economy toward high-growth markets. "More than 50% of world economic growth over the next few years will come from so-called high-growth markets, so getting access to that growth presents an interesting opportunity to generate returns. We need to determine how we're going to do it while remaining consistent with our four investing principles."

Over the coming year, Sabia will ensure that the Caisse builds a robust portfolio to face a volatile global economy. He will then launch a more offensive strategy. "This is key for us to profit from a very different world than the one that existed 10 years ago," he concludes. "This organizational transformation will position the Caisse as a winner in that new world."

He also says he's been very impressed by the quality of people he has seen within the organization throughout his first two years at the helm. "It sounds cliché, but I really mean it. I'm particularly proud of the leadership group we have and the commitment of all of our employees. That's very important for the long term. Our culture is changing in the right direction: we work more and more as a team. At the end of the day, it's about how work gets done and how decisions get made."

Sabia believes the Caisse has the ability to become a world-class leader in institutional investing. "We have the expertise, the assets and the scale. My goal is to realize that potential. We do have tremendous talents—both to meet the needs of depositors and to be a Quebec presence in the world markets. There is an exceptional contribution that the Caisse can make to the welfare of the province. That's why I'm here." BC

Alexandre Daudelin is editor of *Avantages*.
alexandre.daudelin@avantages.rogers.com

Q&A

MICHAEL SABIA TALKS ABOUT RESPONSIBLE INVESTING AND THE CAISSE'S IT BUSINESS AND OPERATIONAL MODELS.

A few years ago, the Caisse de dépôt et placement du Québec endorsed the UN Principles for Responsible Investment. Is this still part of your philosophy?
Very much so. We recently completed the review of our responsible investing philosophy. As a public investor, it's the right thing to do, and it's going to continue to be an important element of our approach. Up to now, our focus has been mainly on engaging companies in a dialogue regarding compensation policies, for instance. We're now ready to make some choices with regard to products that we are not going to invest in over the next few years.

We recently heard that the Caisse would be revising its information technology business model. What does this involve?
Our ability to share information inside our organization is crucial for us. Up to now, our information system was designed to meet [individual] needs in the organization. We needed to change our architecture to facilitate sharing within the organization. Also, the Caisse has traditionally relied on a lot of consultants. To build strong knowledge within the organization, we are moving away from that model by replacing consultants with actual employees.

The Caisse has reduced its expenses, thanks to the implementation of a new operational model. Have all of the efforts in this direction already been made?
It's an ongoing process, but the large part is done. We're always looking for opportunities to become more efficient and reduce costs. Since the early part of 2009, we've reduced our costs by 14%, or $43 million. We're among the best institutional investors around the world in that regard. At the end of 2010, we were at 19.4¢ per $1,000 of assets, which already represents world-class performance.