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THE *CPP INVESTMENT FUND*

SOURCE OF PRIDE OR SHAME FOR CANADIANS?

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The *CPP Investment Fund* has been producing good performance numbers for many years. For example, in a recent widely-publicized ranking of 10yr. investment returns in an international sample of large pension and sovereign wealth funds, *CPP*'s performance ranked near the very top. Yet, in the May 24 edition of the Globe&Mail, columnist Andrew Coyne told us that the *CPP Fund* "could have earned more by buying index funds" rather than spending $billions on internal and external management expenses. What are we to make of these two seemingly contradictory findings?

CPP's 10yr. return ranking relative to its peers is straight-forward: near the top is good…near the bottom is bad. The calculations that led Coyne to his 'waste of money' conclusion are more complicated. It requires creating an alternative investible benchmark portfolio that (a) fits the mandate for *CPP* assets, and (b) could be passively implemented at very low cost. To that end, *CPP* has been using an 85%/15% blend of a publicly-traded global equities index fund and Govt. of Canada bond portfolio. Due to the outsized positive impact of a small number of US-based growth stocks (often referred to as 'The Magnificent Seven'), this 85/15 reference portfolio has had an exceptionally strong performance in recent years, making it a tough benchmark to beat. For example, it had an annualized return of 9.5% over the last 10yrs, versus 9.2% for the *CPP Fund*.

So should *CPP* throw in the towel on active management and move to the passive 85/15 reference portfolio mix? Or should it re-examine the appropriateness of the more concentrated 85/15 mix as a reasonable benchmark investment policy for *CPP* assets? The dot.com experience of the late 1990s/early 2000s suggests it is worth taking another look at this question (remember what happened to Nortel?). Some simple math supports the 'taking another look' approach. Return volatility (i.e., tendency for returns to bounce around over time) is a reasonable proxy for how risky a portfolio is. Notably, the more diversified *CPP Fund* has had materially lower return volatility over the course of the last 10yrs than the more concentrated 85/15 reference portfolio. As a result, the *CPP Fund* materially outperformed the 85/15 reference fund over the course of the last decade on a risk-adjusted basis.[i]

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There is a final important point to make here. Who do we want the ultimate owners of the globe's productive capital to be? Do we want them to be some mix of uninterested passive owners and active short-term 'beauty contest' traders as Mr. Coyne apparently visualizes? Or do we want them to be engaged long-term owners like *CPP Investments*, who focus on their investments creating sustainable value for *CPP* members in the challenging decades that lie ahead? By choosing the 'engaged owner' option, *CPP Investments* itself must invest in the necessary human resources to make this a credible reality. As Mr. Coyne observed in his column, those necessary human resource investments do not come cheap. However, they are essential to *CPP Investments* achieving its mission to maximize the long-term return of *CPP* assets without subjecting them to undue risks.

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i. *Specifically, the return volatility of the CPP Fund over the last 10yrs. was 6.3% vs. 10.6% for the 85-15 reference portfolio. The CPP Fund produced an Excess Return of 1.13% per unit of volatility, versus 0.79% per unit of volatility for the 85-15 reference portfolio.*

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