FIRST CAPITAL FINANCIAL

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Sponsoring Mutual Fund Dealer

To read the latest annual report from the Canada Pension Plan Investment Board (CPPIB), you'd think everything was going great. For the fiscal year ending March 31st, crowed a press release accompanying the report, the CPP fund "returned 20.4% net of all costs, the highest return since inception". You'd had to read way, way down into the press release -and even further into the report itself- to find the bad news. The fund may have gained 20%, but markets generally were up more than 30%.

"Remember, son, it's never too early to start saving for retirement."

The real story then is that the fund underperformed the market averages by about 10 percentage points. In other words, its high-priced managers missed a third of all market gains. This underperformance was not a one-off, but rather a long-term structural problem where CPPIB has failed to beat markets over time. Any alpha (returns above baseline market returns) through its active management approach to stock selection has been wiped out buy the massive increase in costs it has incurred in the attempt. Costs have risen from a paltry $4 million in 2000, the first year the CPP started investing in the markets, to more than $4.4 billion last year.

At the outset, the fund had just five employees, while today it has close to two thousand. And all of them very well paid, where the average compensation for the top five CPP executives is over $3.5 million annually. All told the cost of running CPP has averaged $2 billion per year -an amount that directly subtracts from the payouts to Canadians in retirement.

In recent years the CPP has increased the ratio of equities to bond from a relatively safe 65:35 to a highly aggressive 85:15, without a commensurate increase in returns. What's more, is that is heavily invested in assets that aren't traded on public markets. Private equities and "real assets" such as shopping malls and infrastructure projects (two highly illiquid assets) now make up half of the fund's total investments.

Was any of this necessary? In part yes, because of today's low interest rates. The only way to buy more yield is with more risk after all. But CPP didn't have to invest in Bolivian water treatment plants to do that. By it's own admission, it could have done so at a fraction of the cost, just by adjusting the ratio of equities to bonds in a portfolio of index funds. So, will this massive and massively costly bet with our country's national pension pay off in the long run as claimed? Time will tell, but if it doesn't, the government will legislate higher contribution rates to cover up disappointing returns. First introduced in 1966, the CPP contribution rate stayed constant at 1.8% for two decades. But since 1987 this rate has increased to 5.45% -an increase of 300%. Click <here> for rates. CPP payouts have remained constant however, after adjusting for inflation. The Fraser Institute has calculated the real return for CPP to be a paltry 2.1%, so basically Canadians are just getting their own money back after decades of payroll contributions. A piggy bank would do almost just as well.

All the more reason to contribute regularly to your RRSP and TFSA plans, where over time, more money in generally means more money out! Our wealth management partners at Dimensional, EdgePoint, Guardian and Mackenzie have produced solid, risk-adjusted returns over the long term, and have contributed meaningfully to our client's financial security at retirement.

Be safe, be well!

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