

# Intelligence MEMOS



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From: Miville Tremblay

To: Canadian Pension Watchers

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Re: REFLECTIONS ON A CANADIAN TILT TO PUBLIC PENSION FUND INVESTMENTS

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Should Canada's large pension funds follow the path of Quebec's Caisse de dépôt et placement and demonstrate a greater home bias, or national preference, in their investments?

This burning question is at the heart of a debate in the cozy world of investment. The Caisse is the model that inspires and frightens with its dual mandate of simultaneously optimizing depositor returns as well as promoting Quebec's economic development.

In theory, a perfectly diversified investor would have a small stake in every asset in the world. In practice, this is neither possible nor desirable, but wise investors spread their eggs across a large number of baskets.

A home bias is an over-representation of investments in an investor's country. Here, that would mean anything above 3 percent, which is the weight of Canadian assets in the world.

An open [letter](#) last March from business leaders deplored that Canadian stocks have fallen from 28 percent of total pension fund assets in 2000 to less than 4 percent in 2023, claiming it increases the cost of capital for companies and reduces their value and inhibits their growth.

A national preference is financially justified by the information advantage an investor has on their home turf – the Caisse knows Quebec companies better than Chinese ones – and by reducing risks like currency fluctuations or expropriation.

On the other hand, Canadian equity markets are hardly diversified: Financials, energy (oil and gas) and materials represent 63 percent of the flagship index.

Finance Minister Chrystia Freeland has commissioned former Bank of Canada governor Stephen Poloz, to survey the major pension funds for measures that could encourage them to invest more in Canada. His report is expected in the fall.

Meanwhile, Keith Ambachtsheer, a leading authority on pension funds, Sebastien Betermier, a professor of finance at McGill, and Chris Flynn, of CEM Benchmarking, the richest database on pension funds, provide [useful insight](#) by comparing the investments of 157 funds from Canada, the UK and the US, from 2013 to 2022.

In 2022, Canadian companies made up 18 percent of the equity portfolio of Canadian pension funds, down from 33 percent in 2013. Canadian bonds had fallen from 96 percent to 88 percent over the same period. A similar push to international diversification is seen in both other nations.

At the same time, the overall weight of equities has also declined as real estate and infrastructure rise as pension managers seek a middle risk and return course between equities and bonds.

Large Canadian funds have invested heavily in infrastructure abroad, such as ports in Australia or airports in Europe, but in Canada these prized assets belong to the government. The authors recommend that Ottawa sell off some holdings and recycle the money into new infrastructure.

Home bias as a percentage of assets is an imperfect indicator. The larger a fund, the more imprudent it becomes to have a high proportion of its investments in Canada and become a big fish in the pond. The Caisse wants to increase its Quebec assets to \$100 billion in 2026, but says nothing about the percentage, which could remain around the current 20 percent.

Reverting to the pre-2005 Canadian content mandate for retirement funds (and RRSPs) would be a mistake.

A golden rule is to respect the autonomy of managers making investment decisions. Politicians can propose projects and create incentives, but they must not become investment managers.

Fortunately, the Caisse can refuse to invest in a public transit project in east-end Montreal, but do so in Quebec City if it deems the conditions favourable.

Canada's large public pension funds, the Maple 8, do not want a Caisse-like dual mandate, and they let the phone ring when a minister calls.

The 1965 creation of the Caisse was an expression of Premier Jean Lesage's Maitre chez nous aspirations. But times have changed.

It would now be more appropriate to reframe national preference as a manifestation of sustainable finance, which takes into account the investment impacts on the economy, the environment and society. After all, retirees and future retirees worry about the world left to their children.

While respecting their fiduciary duty, actively managed pension funds can play a key – and profitable – role in financing the transition to a low-carbon economy, by investing in green infrastructure and companies with credible decarbonization plans.

It is more complicated, but necessary, to reconcile risk management, the search for returns and a favourable impact on the environment and society. Not in every investment, not to solve every problem, but this equilibrium is the North Star of sustainable investments.

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