

BOB'S REMARKS:

Investment Performance

Diversification and risk management continue to be the hallmarks of our investment philosophy. They allow us to survive market ebbs and flows. Our current asset mix policy is 45% equities, 33% inflation-sensitive assets and 22% fixed income. Let me give you an overview on the performance of those assets classes.

We finished 2007 with \$50 billion in equities, compared to \$48.8 billion at year-end 2006. Although we beat the one-year benchmark, that benchmark was negative, at -1.6%. Our return was -0.1%. This truly was a currency story, with U.S. markets returning 10% in U.S. dollars, but being reduced to -6% when measured in Canadian dollars. On a four-year basis, equities generated 12.8%, compared to a 10.7% benchmark.

Our non-Canadian equities were doubly impacted both by the strong Canadian dollar, and the downward pressure exerted by the credit crisis on the public equity markets. We did well in the first half of the year, until the credit markets tightened and forced many investors to sell their high quality equity investments to generate the liquidity they needed to meet their other obligations. This forced public equity prices down. In the long term, this has opened a buying opportunity for us.

Our private equity investments totaled \$9 billion at year-end, returning 9.8% compared to a benchmark of -0.9%. As credit markets tightened, this market also slowed in the second half of the year.

Our inflation-sensitive portfolio is our second largest asset class. It includes such assets as real estate, infrastructure, timberland, real-return bonds and commodities. It was our most successful asset class in 2007, adding \$1.5 billion, with a 7% rate of return, compared to a benchmark of 2.9%. At year-end, the total value of this class was \$39.3 billion, compared to \$35.4 billion at the end of 2006. These investments tend to correlate

closely with changes in inflation, hence they act as a hedge against increases in the cost of future pension benefits.

Real estate assets comprise the largest portion of this asset class. They totaled \$16.4 billion at year-end, almost \$2 billion more than the previous year. Our real estate subsidiary, Cadillac Fairview, manages all of these assets on our behalf.

Although our infrastructure team is facing growing competition from other investors for assets, they made several valuable additions to the portfolio last year. They partnered with Australia's Victorian Funds Management to acquire nearly 50% of Birmingham International Airport in the U.K. And as I noted earlier, they closed the \$2.4 billion purchase of the New York and Vancouver marine container terminals, and completed the purchase of significant interests in three Chilean water utilities, in which we are partners with the Chilean government. I'd like to spend a moment on our Chilean water acquisition at this point, because I want to address a misperception that has been brought to our attention.

First, it's important for everyone to understand that Chile's water and waste water services and rates are regulated by the Chilean government. This ensures fairness in price and service for customers, and appropriate revenue for water suppliers. In order to fast track the modernization of their water distribution and wastewater treatment system – and safeguard the health of the population – the government of Chile needed investment assistance from the private sector.

Since privatization began in 1998, access to potable water and wastewater services in Chile has increased dramatically – to 99% and 78% respectively – and 87% in the areas served by the investments in which we're partnered with the government. That sounds pretty progressive, given that Environment Canada has predicted that Canadian cities and communities will need \$10 to \$20 billion over the next 20 years to clean up waste water treatment facilities here at home – just to meet the current national standards.

Commodity investments also fall into our inflation-sensitive asset class. Our 2007 commodities returns are a good example of the benefits of investment diversification and how one year's loser can become the next year's winner. In 2007 our commodity investments returned 12.4%, compared to a 15% loss in 2006. This is largely due to the portfolio's strong weighting towards the energy sector and relative to a four-year return of 6%.

Our third asset class is Fixed Income and Absolute Return Strategies. Its 2007 performance lagged the benchmark, returning 5.6%, compared to the 9.6% benchmark. With capital shifted out of the asset class in the latter half of the year in response to the credit market conditions, assets at year-end totaled \$18.7 billion, compared to \$21.5 billion in 2006.

Fixed Income comprises such traditional investments as government and corporate bonds and money-market securities, as well as derivatives and securitized pools of assets. We also include Absolute Return Strategies here, which include hedge funds and currency hedges, because they also provide steady income, but with an additional risk allocation for adding value above the benchmark.

I'll address securitized assets first. We did not invest directly in the types of investments that gave rise to what is now known as the subprime crisis. We did, however, have some indirect exposure to subprime assets through other debt securities. These debt securities had subprime mortgage-backed securities as collateral, as well as limited exposure to non-bank asset-backed commercial paper. In addition, we invested in bank-sponsored asset-backed commercial paper and commercial mortgage-backed securities, which trading values were materially impacted by the global credit crisis. In short, like so many other institutional investors, we were not immune to the subprime mortgage crisis.