CENTRAL BANK OF
TRINIDAD & TOBAGO

TRINIDAD AND TOBAGO HERITAGE & STABILISATION FUND

QUARTERLY INVESTMENT REPORT
OCTOBER-DECEMBER, 2008

HERITAGE AND STABILISATION FUND

Quarterly Investment Report

October - December, 2008

INTRODUCTION

This Investment Report on the Heritage and Stabilisation Fund (HSF) covers the first quarter of the 2009 financial year, **October – December, 2008**. The report is organised in three sections. **Section I** deals with the international economic environment. **Section II** focuses on the performance of capital markets in which the HSF assets are invested, and **Section III** provides details of the portfolio.

SECTION 1 – ECONOMIC REVIEW

In November 2008, the National Bureau of Economic Research announced that the U.S. economy had slipped into recession in December 2007 making the current recession the longest period of economic contraction since the 1981-1982 recession. Economic conditions in the US continued to deteriorate in the first quarter of the financial year. The period was characterized by accelerating job losses, further declines in house prices, waning consumer confidence and significant weakness in manufacturing

The unemployment rate spiked further in December 2008, reaching 7.2%, the highest point in nearly 15 years. Nearly 2.6 million Americans lost their jobs in 2008, with 1.9 million occurring in the last four months of 2008. Consumer spending fell 3.8% and exports contracted as the global economy continued to slow. On the more positive side, depressed energy prices and declining economic activity led to a fall of 1.9% in the CPI in November, 2008. Consumer spending fell 3.8% and exports contracted as the global economy continued to slow. Most recent data indicate that GDP declined 3.8% in the fourth quarter of 2008 after declining 0.5% in the third quarter. For 2008, growth in the U.S was 1.3%, compared with 2% in 2007.

In response to the worsening economic conditions, the Federal Reserve (Fed) lowered the Fed Funds rate to a range of 0% - 0.25%, a historically low level, from 5.0% in September 2007. The Fed also indicated that it will be turning its attention to “quantitative easing,” effectively pumping more money into the economy by re-purchasing long-term Treasuries. This measure is intended to put more liquidity into the financial system while pushing long-term rates lower. In November 2008, the Fed also announced a US$ 500 billion programme to purchase government agencies and mortgage-backed securities in an attempt to stabilise the housing market.

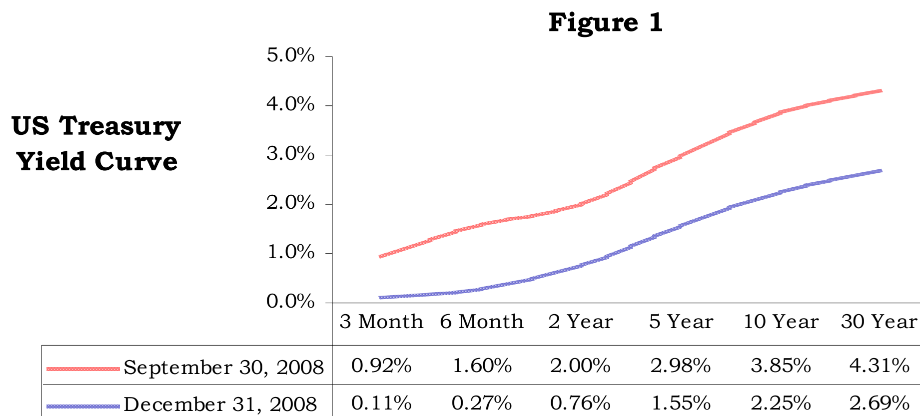
In the Euro-zone, the economic outlook also continued to weaken. The Euro-zone registered its second consecutive quarter of negative growth in the July – September, 2008 quarter with GDP contracting by 0.2%, confirming that the area was officially in a recession. The deterioration continued in the fourth quarter as industrial orders and industrial production declined and the unemployment rate climbed to 7.7%. Inflationary pressures eased over the period amidst weakening demand and declining energy and food prices. The European Central Bank (ECB) therefore cut its benchmark rate by 175 basis points to 2.5% during the quarter (by 50 basis points in both October and November and 75 basis points in December 2008). A further cut of 50 basis points was made in January 2009, taking the benchmark rate to 2%. Additionally, the Euro-area governments have been working on fiscal stimulus packages to help spur economic growth.

In the United Kingdom, the Bank of England (BoE) cut its overnight lending rate by 300 basis points to 2% by the end of the fourth quarter of 2008. In January 2009, the BoE cut rates further by 50 basis points to 1.5%. Despite the declining interest rate environment, credit extended to businesses and individuals contracted at the fastest pace since the BoE began tracking lending (1994). The U.K economy contracted by 1.5% in the last quarter of 2008, following a 0.6% decline in the third quarter. This meant that the economy grew by 0.7% for the whole year, 2008. The number of unemployed rose to nearly 2 million and manufacturing orders fell to a 50-year low.

In Japan a similar deterioration was evident. The collapse in trade finance and the global slowdown had a profound impact on the Japanese economy. GDP contracted by 1.8% in the third quarter on an annualised basis, as business spending contracted and inventories were liquidated. It is estimated that GDP have declined further in the fourth quarter of 2008. Exports declined in November 2008 by a record 26.7% year-over-year as global demand for cars and electronics fell and the Japanese yen appreciated. Following the export collapse, industrial production plunged 16.2% year-over-year in November 2008. However, core CPI remained steady in November 2008 at 0% year-over-year. Given this economic picture, the Bank of Japan cut its overnight rate by 40 basis points to 0.1% and began to pay interest on the excess reserves commercial lenders hold at the Bank.

SECTION 2 – CAPITAL MARKET PERFORMANCE

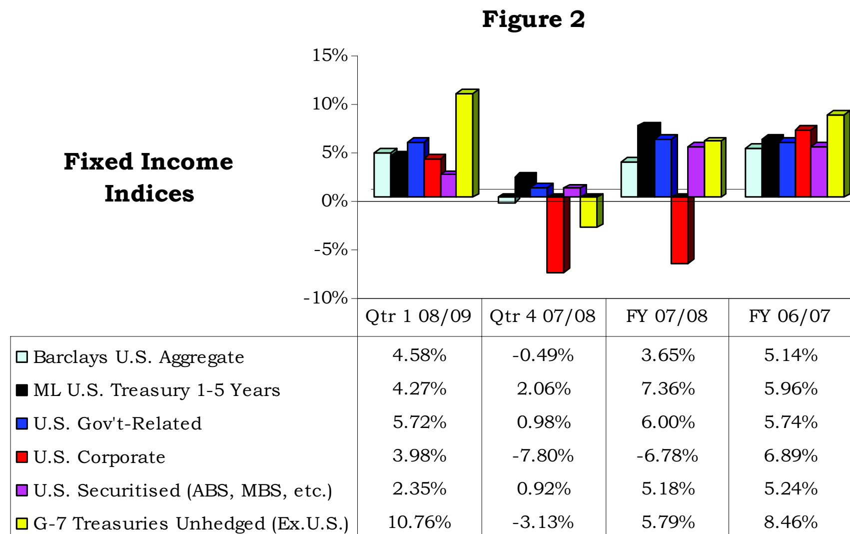
Fixed Income. The increasingly gloomy global economic outlook pushed global treasury yields lower during the quarter (see Figure 1). In December 2008, the ten-year U.S Treasury yield fell 68 basis points to end the month at 2.25%. At the short end, the three-month U.S Treasury yield remained near zero throughout the month as fearful investors continued to maintain a bias for treasury securities in order to preserve capital.



	3 Month	6 Month	2 Year	5 Year	10 Year	30 Year
September 30, 2008	0.92%	1.60%	2.00%	2.98%	3.85%	4.31%
December 31, 2008	0.11%	0.27%	0.76%	1.55%	2.25%	2.69%

The Merrill Lynch US Government Treasury 1-5 Years Index returned roughly 4.27% in the quarter ending December 2008. The boarder U.S. fixed income market, as represented by the Barclays U.S. Aggregate Index (formerly Lehman Brothers U.S. Aggregate Index), was up 4.58% in the quarter, with all sub-sectors posting positive returns. This outturn was largely as a result of U.S. government support of the corporate, agency and mortgage-backed sectors. U.S. corporate investment grade securities returned 3.98% as credit spread tightened during the quarter.

The global treasury market was the best performing fixed income sector with G-7 Treasuries (excluding the U.S. treasury sector) returning 10.76%. The intensification of the flight to quality and deep interest rate cuts were main factors in performance. Within this sector, the Euro-area, U.K. and Japanese government bonds returned 6.10%, 10.61% and 2.67%, respectively, for the quarter. Figure 2 shows the historical performance in the fixed income market.

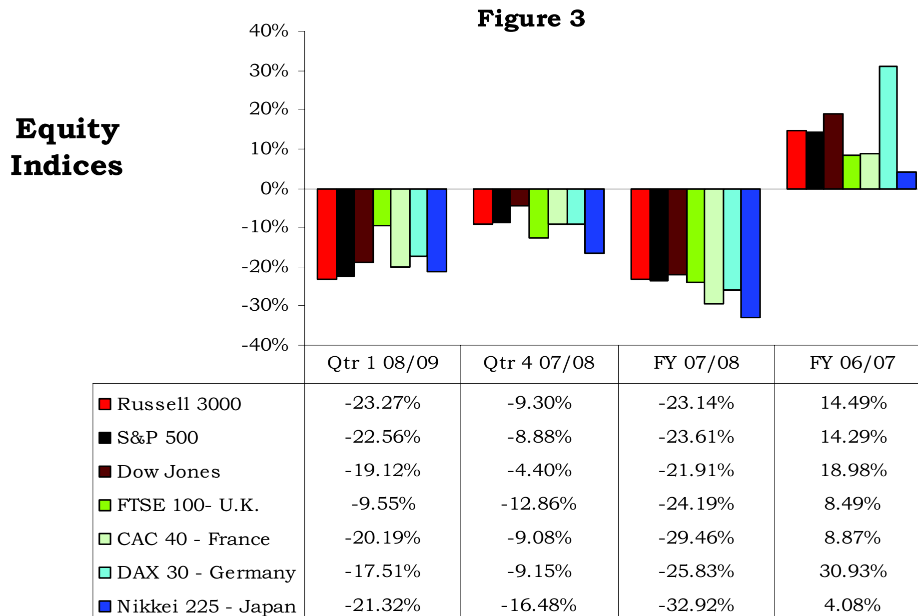


	Qtr 1 08/09	Qtr 4 07/08	FY 07/08	FY 06/07
Barclays U.S. Aggregate	4.58%	-0.49%	3.65%	5.14%
ML U.S. Treasury 1-5 Years	4.27%	2.06%	7.36%	5.96%
U.S. Gov't-Related	5.72%	0.98%	6.00%	5.74%
U.S. Corporate	3.98%	-7.80%	-6.78%	6.89%
U.S. Securitised (ABS, MBS, etc.)	2.35%	0.92%	5.18%	5.24%
G-7 Treasuries Unhedged (Ex.U.S.)	10.76%	-3.13%	5.79%	8.46%

Equity Markets. The decline in U.S. equities accelerated in the fourth quarter of 2008 as more companies announced lower earnings expectations. The losses in the equity market occurred despite continued efforts by the U.S. government to restore market confidence. Investors experienced high volatility in stock prices. The VIX Index (a proxy for the degree of

volatility) peaked on November 20th, 2008 at 80.86 but substantially fell in December 2008 as equity markets rallied, closing at 40. Despite the rally in equities in December 2008, all the U.S. main stock indices recorded sizeable declines in value for the entire quarter (see Figure 3). The Russell 3000 Index lost roughly 23.27% of its value, while the S&P 500 Index (22.56%) posted its worst quarterly performance since the fourth quarter of 1987 and worst annual decline in value since 1937.

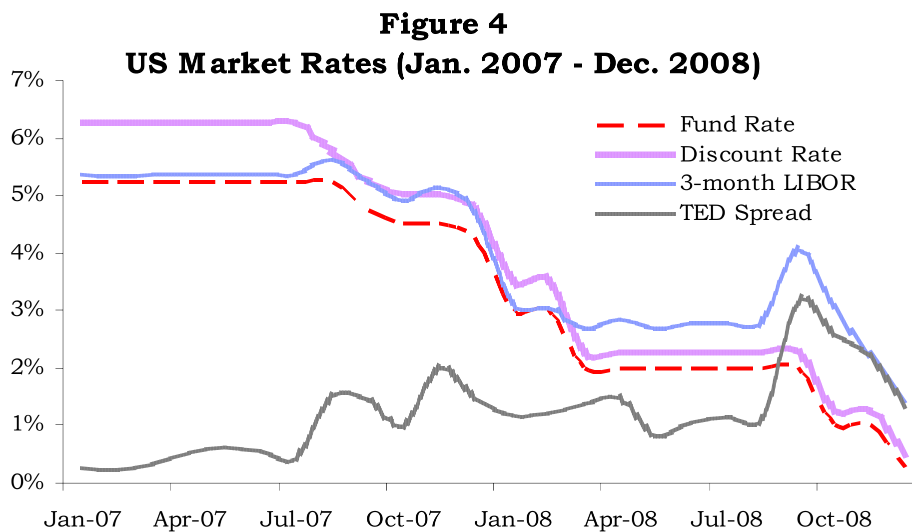
As the financial crisis that began in U.S. spread to the rest of the world, other equity markets also suffered. The main indices in the United Kingdom, Germany, France and Japan all recorded losses during the period (see Figure 3).



	Qtr 1 08/09	Qtr 4 07/08	FY 07/08	FY 06/07
Russell 3000	-23.27%	-9.30%	-23.14%	14.49%
S&P 500	-22.56%	-8.88%	-23.61%	14.29%
Dow Jones	-19.12%	-4.40%	-21.91%	18.98%
FTSE 100- U.K.	-9.55%	-12.86%	-24.19%	8.49%
CAC 40 - France	-20.19%	-9.08%	-29.46%	8.87%
DAX 30 - Germany	-17.51%	-9.15%	-25.83%	30.93%
Nikkei 225 - Japan	-21.32%	-16.48%	-32.92%	4.08%

Money Market. The concerted efforts by some central banks to bolster credit markets by aggressively cutting interest rates and injecting liquidity into banks appeared to have reaped some benefits during the quarter. The U.S. 3-month LIBOR fell from its October 10th peak of 4.28% to a December year-end level of 1.43%. The U.S. 1-month LIBOR also ended the period lower at 0.44%.

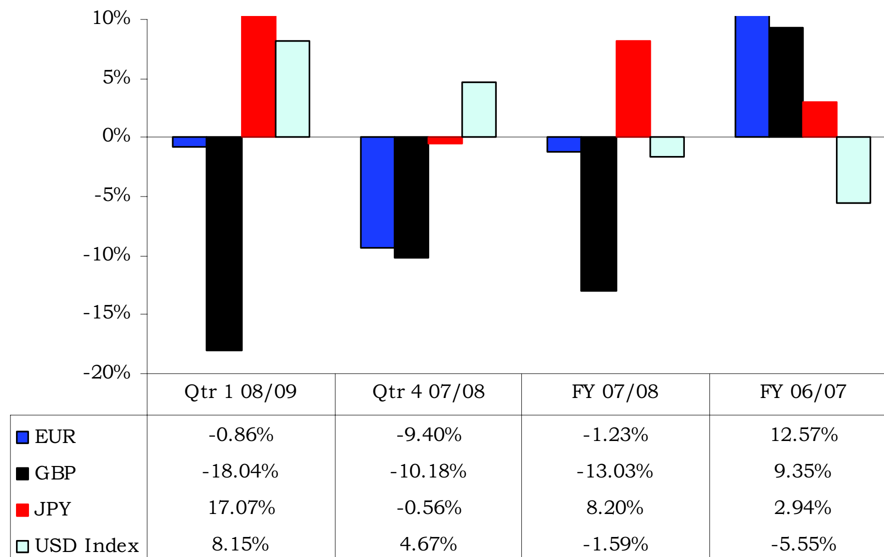
The TED spread, the difference between the interest rates that commercial banks and the U.S. Treasury pay to borrow money for three months, tightened drastically, another indication that the credit markets were showing signs of thawing. The TED spread closed December 2008 at 1.35% down from the record level of 3.15% in September 2008. However, it still remains well above historical levels, which suggests that credit conditions have still not returned to normal.[1] Figure 4 below shows the key short-term money market rates for the U.S. between the period from January 2007 and December 2008.



Currency Markets. The U.S. dollar strengthened against the currencies of most of its trading partners over the quarter. It gained 0.86% and 18.04% over the Euro and Pound Sterling, respectively. The Japanese yen was the best performing currency in the quarter gaining 17.07% against the U.S. dollar as investors continued to unwind Yen carry trades. The yen rose to a 13-year high versus the U.S. dollar in December 2008 and a six-year high versus the Euro in October 2008. The Yen stood at ¥ 90.64 per dollar, while the GBP and Euro were valued at US$ 1.3971 and US$ 1.4593, respectively, at the end of the quarter. (see Figure 5).

[1] The TED Spread is usually 50 basis points and the pervious record was set during Black Monday on October 19, 2007.

Figure 5
FX Return for Major Currency Versus the USD

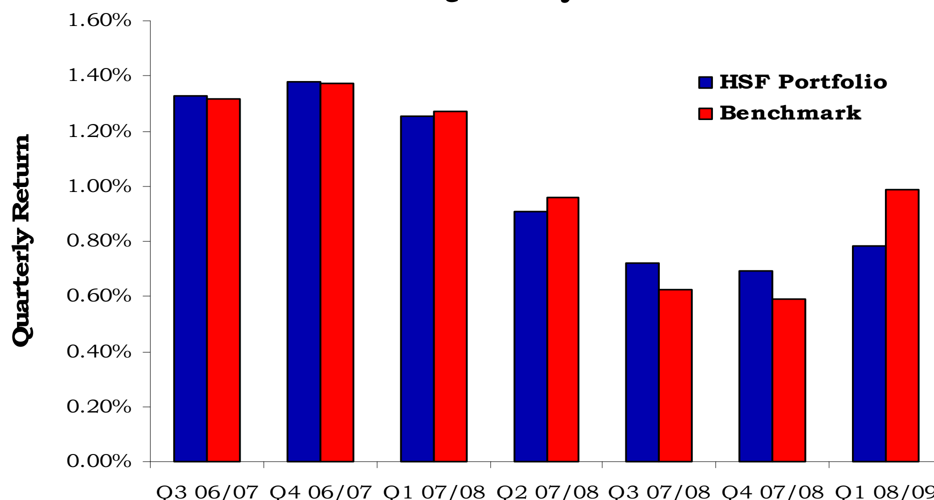


	Qtr 1 08/09	Qtr 4 07/08	FY 07/08	FY 06/07
EUR	-0.86%	-9.40%	-1.23%	12.57%
GBP	-18.04%	-10.18%	-13.03%	9.35%
JPY	17.07%	-0.56%	8.20%	2.94%
USD Index	8.15%	4.67%	-1.59%	-5.55%

SECTION III – PORTFOLIO PERFORMANCE

The **HSF Composite Portfolio** underperformed its benchmark, 5% Merrill Lynch U.S. Government Treasury 1-5 Years Index and 95% U.S. 1-month LIBID Index, by 21 basis points, returning 78 basis points (2.34% annualised) for the three months to December 2008. The benchmark returned 99 basis points (2.97% annualised) for the period (see Figure 6 and Appendix I for historical Performance). The tactical decisions taken to preserve the asset value of the HSF during the quarter detracted from performance.

The **HSF U.S. Treasury Portfolio** returned 4.22% for the period, slightly underperforming its benchmark (Merrill Lynch U.S. Government Treasury 1-5 Years Index) by 5 basis points. In light of increased uncertainty in September 2008, the following month Central Bank chose not to rebalance the portfolio to match the duration of the benchmark. Rebalancing at that time would have meant selling and buying treasuries in a very volatile market. The resultant portfolio had a shorter duration compared to the benchmark. This meant that as the prices of treasuries increased, the portfolio did not benefit as much as the benchmark. In November and December, the Bank resumed the monthly rebalancing of its portfolio.



During the period, US$ 79.5 million of 3-month U.S. treasury bills were purchased bringing the HSF US Treasury Portfolio to approximately US$ 241.3 million by the end of the period.

The **HSF US Fixed Deposit Portfolio** underperformed its benchmark, the U.S. 1-month LIBID Index, by 28 basis points during the period. The portfolio returned 54 basis points, compared to the benchmark return of 82 basis points. This was due to the placement of shorter term fixed deposits over the period that attracted lower interest rates. The Bank reduced the terms of the deposits over this period to make the portfolio more liquid in the uncertain financial times. The portfolio closed the period with a market value of US$ 2,669.2 million.

The HSF ended the quarter with a **Net Asset Value of US$ 2,909.7 million**, an increase of roughly US$ 21.3 million from the end of financial year 2007/08. This position was due to increases in the market values of financial assets and interest earned as there were no contributions to the HSF during the quarter.

Portfolio Risk

The *interest rate risk* of the portfolio is managed by strict adherence to the overall duration of the HSF portfolio, which is two (2) years. Also, the HSF US Treasury Short Duration Portfolio is passively managed with zero tracking error and as such, the risk of underperforming its benchmark (benchmark risk) or exposing the portfolio to greater market risk than the benchmark is minimised.

The portfolio's *credit risk* is minimised by strict adherence to (1) credit quality and (2) concentration limit. All counterparties must have a minimum credit rating of either A1 from the Standard and Poor's rating agency or P1 from Moody's. Credit risk is further minimised by a maximum 5 percent exposure limit for counterparties. All standards were complied with during the period under review.

All assets held in the HSF portfolio are invested in U.S. dollars, the reporting or base currency. As a consequence, the portfolio is protected from fluctuations in value due to adverse foreign currency rate movements against the U.S. dollar.

Central Bank of Trinidad and Tobago
January 27, 2009

Appendix I

HSF Portfolio
Historical Performance since Inception

Quarter End	Current Returns			Fiscal YTD			Annualised Return Since Inception		
	Portfolio %	Benchmark %	Excess bps	Portfolio %	Benchmark %	Excess bps	Portfolio %	Benchmark %	Excess bps
2006/07									
March	0.233	0.230	0.30						
June	1.327	1.316	1.04						
September	1.381	1.376	0.52	**2.966**	**2.947**	**1.89**	**5.475**	**5.440**	**3.50**
2007/08									
December	1.252	1.269	-1.80						
March	0.907	0.960	-5.28						
June	0.730	0.626	10.36						
September	0.685	0.592	9.27	**3.614**	**3.491**	**12.30**	**4.337**	**4.242**	**9.48**
2008/09									
December	0.782%	0.987%	-20.54	**0.782%**	**0.987%**	**-20.50**	**4.203%**	**4.244%**	**-4.10**

Note: (1) In May 2008, US Treasury instruments were added to the HSF portfolio. As a result, the performance benchmark for the HSF portfolio became a blended benchmark, which comprised of 2.5% Merrill Lynch US Treasury 1-5 Years Index and 97.5% US One-month LIBID Index.

Appendix II

Heritage and Stabilisation Fund
Portfolio Valuation and Cash flows (USD)

Valuation Date	Net Asset Value	Income	Contributions
March 15th, 2007	1,402,178,155.01	0	
March 31st, 2007	1,405,448,567.24	3,270,412.33	
April 30th, 2007	1,411,478,932.10	6,030,364.86	
May 31st, 2007	1,417,875,123.07	6,396,190.98	
June 30th, 2007	1,424,094,965.45	6,219,841.89	
July 31st, 2007	1,510,286,135.41	6,477,228.26	79,713,942.22
August 31st, 2007	1,517,179,218.56	6,893,083.09	
September 30th, 2007	1,766,200,701.73	6,928,748.59	241,992,101.13[1]
October 31st, 2007	1,773,862,028.73	7,759,113.00	
November 30th, 2007	1,780,847,020.73	6,987,839.67	
December 31st, 2007	1,788,304,749.27	7,457,728.54	–
January 31st , 2008	1,795,307,089.20	7,003,928.24	
February 29th, 2008	1,799,941,409.88	5,019,474.67	
March 31st, 2008	1,804,531,743.56	4,590,333.68	
April 30th, 2008	1,988,785,132.77	4,042,772.01	180,210,617.20
May 31st, 2008	1,993,347,377.77	4,562,245.00	
June 30th, 2008	1,997,251,772.00	5,476,329.00	
July 31st, 2008	2,460,269,502.00	4,599,453.00	458,130,174.00
August 31st, 2008	2,466,193,072.00	5,461,046.00	
September 30th, 2008	2,888,421,556.00	5,699,080.57	415,833,666.53
October 31st, 2008	2,896,852,886.00	7,192,244.00	
November 30th, 2008	2,906,013,589.59	5,576,434.00	
December 31st, 2008	2,909,717,167.00	3,529.009.00	

[1] The last quarter contribution for the fiscal year 2006/07 was paid on September 28, 2007.