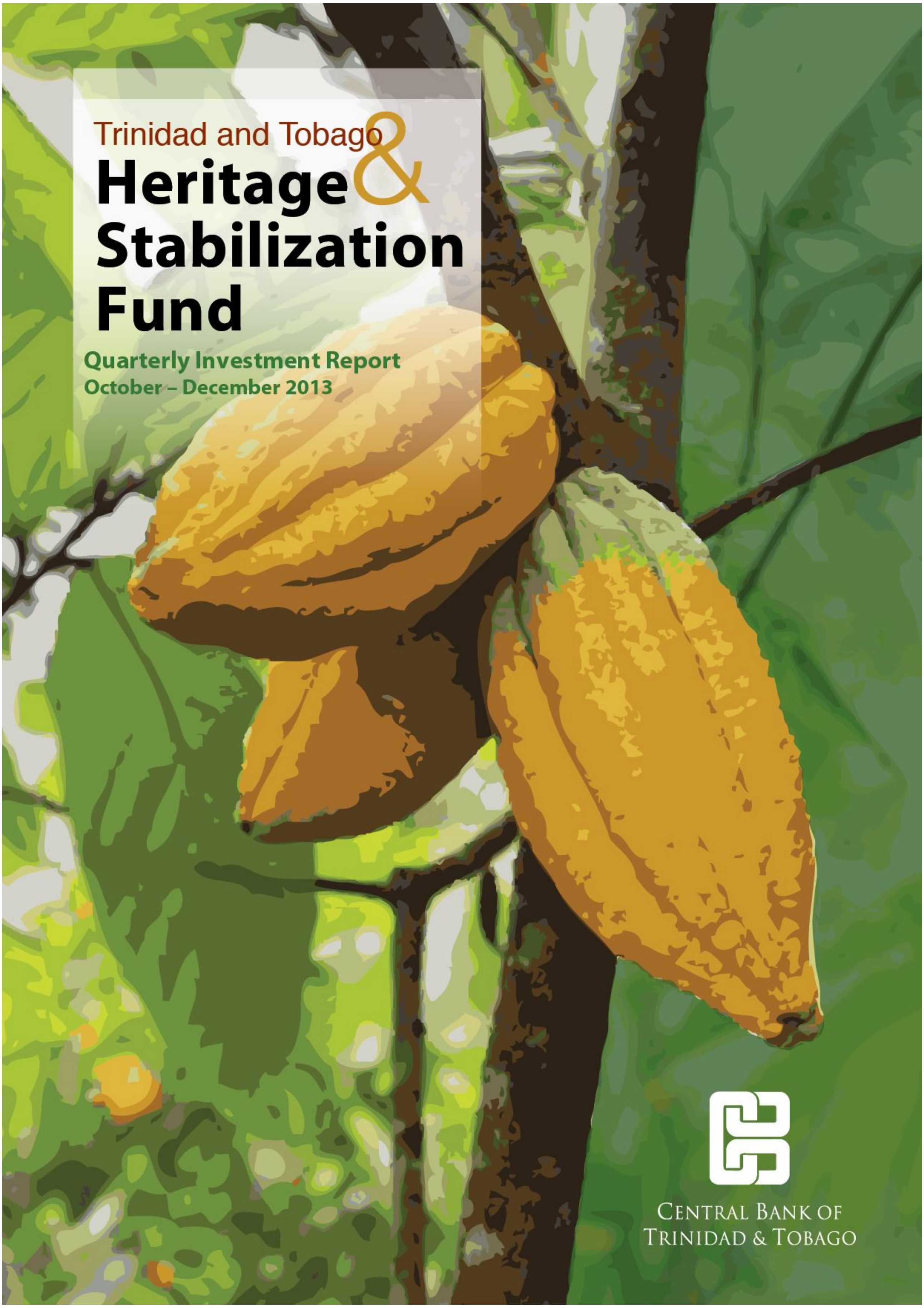
Trinidad and Tobago

Heritage & Stabilization Fund

Quarterly Investment Report
October – December 2013



Central Bank of Trinidad & Tobago

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EXECUTIVE SUMMARY

The **United States (US)** economy gained momentum in the third quarter of 2013 as the third estimate of GDP showed that the economy grew at an annualized rate of 4.1 per cent. Inventories accounted for a third of the gain in GDP, with consumer purchases and spending on services also showing an uptick from the previous estimate. During the third quarter US economic data was mostly positive and pointed to a continued expansion. In December the Fed announced it would start to reduce the pace of its asset purchases in January 2014, from $85 billion to $75 billion per month. Finally, the fiscal drag, which has weighed on growth, is showing signs of easing as U.S. lawmakers passed the first bipartisan federal budget produced by a divided Congress in 27 years, easing $63 billion in automatic spending cuts and averting another government shutdown.

Preliminary estimates showed that the **Euro zone** economic recovery advanced but remained fragile in the third quarter of 2013 as growth slowed during the period. The region's economy grew by 0.1 per cent quarter over quarter, after expanding 0.3 per cent in the previous three months. Unemployment in the Euro zone remained at a record high during the fourth quarter of 2013, with a reading of 12.1 per cent as at November 2013. Inflationary pressures eased further during the fourth quarter as the consumer price index slowed to 0.8 per cent growth in December from 1.1 per cent in September on an annualized basis. During the ECB's January meeting, ECB President, Mario Draghi, strengthened the bank's pledge to maintain an accommodative monetary policy stance for as long as necessary, while leaving its key rate at a record low of 0.25 per cent. In regulatory news, progress was made on the European Banking Union and a deal was reached that included a regional approach to risk and a commitment to burden sharing.

The **United Kingdom (UK)** economy grew by 0.8 per cent in the third quarter as consumer spending commanded a greater share of GDP growth. Inflationary pressures further eased in the fourth quarter of 2013, falling to the Bank of England's inflation target for the first time in four years. Labour market conditions continued to improve, exceeding expectations during the fourth quarter of 2013 as the unemployment rate fell to 7.1 per cent in November, compared to 7.6 per cent in September. In January, the Bank of England (BoE) Monetary Policy Committee decided to maintain the official rate at 0.5 per cent and the size of its asset purchase program at GBP 375 billion.

In **Japan**, GDP expanded by a slower rate than expected, with an annual rate of 1.1 per cent in the third quarter after an initial reading of 1.9 per cent. Japan's unemployment rate was recorded at 4.0 per cent in November and the labour force participation rate was unchanged from September to November and remains at 59.7 per cent. The Bank of Japan (BOJ) decided to maintain the current monetary policy during the most recent meeting with an increase in the monetary base at an annual pace of about 60-70 trillion yen. The general price level, measured by the Consumer Price Index (CPI,) rose over the fourth quarter as inflation touched 1.5 per cent in November.

In **equity markets**, political and policy risks temporarily dampened gains during the fourth quarter but stock prices ended the period higher, fuelled by encouraging global economic data. In the US, the Standard and Poor's (S&P) 500 index rose by 9.92 per cent for the quarter while other developed market equities, as measured by the MSCI EAFE index, increased by 5.36 per cent.

Overall, **bond markets** had modestly negative returns during the fourth quarter. The Fed's decision to start tapering its bond purchase program in January 2014 resulted in US Treasuries underperforming other G7 government bond markets. The broader US fixed income market was also lower, but positive performance in the U.S. Corporate, CMBS and ABS sectors helped to temper losses. Rates rose moderately throughout the

G-7 nations, except for in Italy, where a more stable political environment supported lower yields.

The HSF investment portfolio returned 3.95 per cent for the quarter ended December 2013, compared with a return of 2.66 per cent for the Strategic Asset Allocation (SAA) benchmark. The Fund's exposure to equity and fixed income contributed positively to absolute returns. At the end of December 2013, the net asset value of the HSF was US$5,354.7 million, an increase from the US$5,154.0 million reported at the end of September 2013.

Contribution to Quarterly Return,
For the period October 2013 – December 2013
/per cent/

	SAA Weights	Portfolio Weights as at 31-December-2013	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	3.95	2.66
US Core Domestic Fixed Income	40.00	34.80	0.02	-0.05
US Core Domestic Equity	17.50	22.49	2.29	1.76
Non US Core International Equity	17.50	20.95	1.61	0.98
US Short Duration Fixed Income	25.00	21.76	0.01	-0.03

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns
For the Quarters ended June 2013 – December 2013
/per cent/

	3 Months Weighted Return as at 31-Dec-2013		3 Months Weighted Return as at 30-Sep-2013		3 Months Weighted Return as at 30-Jun-2013	
	HSF	Bench-mark	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	3.95	2.66	3.95	3.47	-0.30	-0.69
US Core Domestic Fixed Income	0.02	-0.05	0.29	0.23	-0.90	-0.93
US Core Domestic Equity	2.29	1.76	1.36	1.12	0.71	0.54
Non US Core International Equity	1.61	0.98	2.21	2.01	0.07	-0.11
US Short Duration Fixed Income	0.01	-0.03	0.10	0.11	-0.15	-0.17

Comparative Financial Year to Date Returns
For the periods Dec 2012 & Dec 2013
/per cent/

	Financial Year to Date Return as at 31-Dec-2013		Financial Year to Date Return as at 31-Dec-2012	
	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	3.95	2.66	1.49	1.44

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The US economy expanded by 4.1 per cent on an annualised basis in the third quarter of 2013, with the pace of growth expected to pick up in the coming year as the impact of fiscal drag lessens. In this, the third and final estimate, inventories accounted for a third of the gain in GDP, with consumer purchases and spending on services also showing an uptick from the previous estimate. In addition, residential real estate helped to buoy the economy, as rising home prices boosted household net worth. The housing market recovery is expected to remain on track, but the rate of growth will likely slow as fundamental factors come into focus.

For the quarter ending December 2013, US economic data was mostly positive and pointed to a continued expansion. The ISM Manufacturing index ended the fourth quarter at 56.5, which was a modest increase from 56.0 at the end of the third quarter. However, the ISM Non-Manufacturing gauge slowed somewhat, declining from 54.4 in September to 53.0 in December.

Labour market conditions continued to improve in October and November, with Nonfarm Payrolls coming in at 200,000 and 241,000 respectively. December Nonfarm payrolls disappointed, adding a mere 74,000. The lower than expected number was somewhat discounted by the market as a temporary slowdown due to colder weather conditions. The unemployment rate dropped over the fourth quarter to 6.7 per cent from 7.2 per cent at the end of the third quarter. Though improving job growth helped to lower the unemployment rate, a large part of the decline was attributed to lower participation rates, which have also trended down throughout the year. At the end of the fourth quarter, the participation rate was 62.8 per cent versus 63.2 per cent at the end of September.

Consumer prices rose throughout the fourth quarter after initially falling in October to -0.1 per cent from 0.2 per cent in September. In December, the Consumer Price Index (CPI) came in at 0.3 per cent as fuel and rent prices climbed higher. For the 2013 calendar year, the CPI and the CPI (ex Food and Energy) rose 1.5 per cent and 1.7 per cent respectively. Inflation levels remain below the Federal Reserve's 2.0 per cent target, and there is some speculation that this aspect of the Fed's dual mandate may play a larger role in shaping monetary policy in 2014.

In December the Fed announced it would start to reduce the pace of its asset purchases in January 2014, from $85 billion to $75 billion per month. The tapering announcement was broadly welcomed by investors and the markets. The Fed's decision was ultimately received as a positive signal about the strength of the US economy and a return to more normal conditions. The fiscal drag, which has weighed on growth, is showing signs of easing as U.S. lawmakers passed the first bipartisan federal budget produced by a divided Congress in 27 years, easing $63 billion in automatic spending cuts and averting another government shutdown. In an attempt to anchor short term rates, the Fed reinforced its forward guidance, stating that it "likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6.5 per cent".

Euro zone

The Euro zone economic recovery advanced but remained fragile in the third quarter of 2013 as growth slowed during the period. Preliminary estimates showed that the region's economy grew by 0.1 per cent quarter over quarter, after expanding 0.3 per cent in the previous three months. In the third quarter, activity in Germany slowed and France contracted 0.1 per cent after expanding 0.5 per cent in the second quarter. There were some bright spots in Spain and Italy; Spain emerged from a two-year recession and Italy's rate of contraction slowed from 0.3 per cent in the second quarter to 0.1 per cent in the third quarter. Export and import growth both pulled back to 0.2 per cent and 1 per cent in comparison to 2.1 per cent and 1.6 per cent in the previous quarter.

The Markit Eurozone PMI Composite Output Index declined early in the fourth quarter, coming in at 51.9 in October and 51.7 in November from 52.2 in September. However, output picked back up in December, with Eurozone PMI coming in at 52.1. Manufacturing strengthened over the fourth quarter but the Service sector slowed; the Eurozone Services PMI fell from 52.2 in September to 51.0 in December.

Unemployment in the Euro zone remained at a record high during the fourth quarter of 2013, with a reading of 12.1 per cent as at November 2013. Unemployment continued to vary across the Euro area from a low of 4.8 per cent in Austria and 5.2 per cent in Germany, to a high of 26.7 per cent in Spain. Furthermore, youth unemployment continued to be stubbornly high at 24.2 per cent for persons under the age of 25.

Inflationary pressures further eased during the fourth quarter. On an annualised basis, the consumer price index slowed to 0.8 per cent growth in December from 1.1 per cent in September. The annual core inflation rate, which excludes volatile costs such as energy, alcohol and tobacco, was 0.7 per cent in December, down from 1.0 per cent in September. The ECB anticipates that inflation will remain subdued over the medium term, and as a result, markets may place increasing pressure on the bank to ease further.

During the ECB's January meeting, the Governing Council kept its key rate at a record low of 0.25 per cent, while strengthening the bank's pledge to maintain an accommodative monetary policy stance for as long as necessary. Even as troubled periphery nations such as Portugal and Ireland returned to the debt markets and the Euro zone began its ascent out of a recessionary period, the ECB president continued to see weakness in the Euro economy. The President's use of stronger terms in his press release highlighted the risks inherent in the current fragile economic recovery despite improved confidence.

On the regulatory front, progress was made on the European Banking Union and a deal was reached that included a regional approach to risk and a commitment to burden sharing. However, details on the single resolution mechanism and fund were yet to be finalised.

United Kingdom

Economic conditions in the UK continued to improve in the third quarter of 2013. Data from the Office of National Statistics showed that the economy grew 0.8 per cent after expanding 0.8 per cent during the second quarter. Consumer spending commanded a greater share of GDP growth in the third quarter, when it contributed 0.5 percentage points versus 0.2 percentage points in the second quarter. Meanwhile, the savings ratio slipped during the third quarter from 6.2 per cent to 5.4 per cent.

Manufacturing activity picked up in the fourth quarter as the Markit PMI for manufacturing peaked in November at 58.1 before ending the quarter at 57.3 in December. This was an improvement from its end of third quarter reading of 56.3. The PMI survey showed growth in new orders and new export business over the quarter. The monthly PMI for services declined slightly to 58.8 in December, from a reading of 60.3 at the end of September.

Inflationary pressures further eased in the fourth quarter of 2013, falling to the Bank of England's inflation target for the first time in four years. The Consumer Price Index (CPI) increased by 2.7 per cent year on year to September 2013, but fell over the quarter to 2.0 per cent in December.

Labour market conditions continued to improve, exceeding expectations during the fourth quarter of 2013. The unemployment rate fell to 7.1 per cent in November, compared to 7.6 per cent in September. According to the Bank of England (BOE), the unemployment rate would likely reach its 7 per cent threshold "materially earlier than previously expected." Despite this, the Bank's Monetary Policy Committee saw no immediate need to alter its monetary policy stance, given its expectation that inflationary pressures would remain subdued and that downside risks to the economic recovery following the financial crisis continued to persist.

During the Bank of England's January Monetary Policy Committee (MPC) meeting, members voted to keep the bank rate as well as the asset-purchase program unchanged, stating that the interest rate will remain at 0.5 per cent, and the stock of asset purchases financed by the issuance of central bank reserves maintained at £375 billion.

Japan

Japan's economy grew at a slower rate than expected during the third quarter of 2013. After a preliminary reading of 1.9 per cent, the revised figure showed that the economy grew at an annual rate of 1.1 per cent, compared to 3.6 per cent in the second quarter. It is expected that the Japanese economy may rebound in the fourth quarter of 2013, supported by increased consumer spending ahead of the anticipated sales tax increase in April 2014. Macroeconomic indicators reported for the fourth quarter have generally been positive. The Markit/JMMA Japan Manufacturing Purchasing Managers Index (PMI) rose from 52.5 in September to 55.2 at the end of the quarter.

Business sentiment among Japanese large manufacturers improved in the fourth quarter, as the Tankan survey diffusion index of current business conditions rose to 16 from 12 in the previous three months. In contrast, sentiment among Japanese consumers fell during the quarter. Concerns about income growth and employment prospects helped to push consumer confidence lower for the quarter; the confidence index fell from 45.4 in September to 41.3 in December 2013. Labour market conditions remained constant in the quarter, as Japan's unemployment rate was recorded at 4.0 per cent in November. The labour force participation rate was unchanged from September to November and remains at 59.7 percent.

The Bank of Japan (BOJ) decided to maintain the current monetary policy during the most recent meeting. The board members agreed that the effects of easy monetary policy continued to take hold.   Meanwhile, the general price level, measured by the Consumer Price Index (CPI,) rose over the fourth quarter. Inflation was 1.5 per cent in November, up from 1.1 per cent in September. In an effort to reach 2.0 per cent inflation by March 2015, the BOJ will continue to increase the monetary base at an annual pace of about 60-70 trillion yen. The committee expects the economy to continue recovering moderately, but voiced various concerns, which ranged from the effect of an extended easy policy, to the weak momentum in Japanese exports, and the consequences of the scheduled sales tax increase in April 2014 on consumer sentiment.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

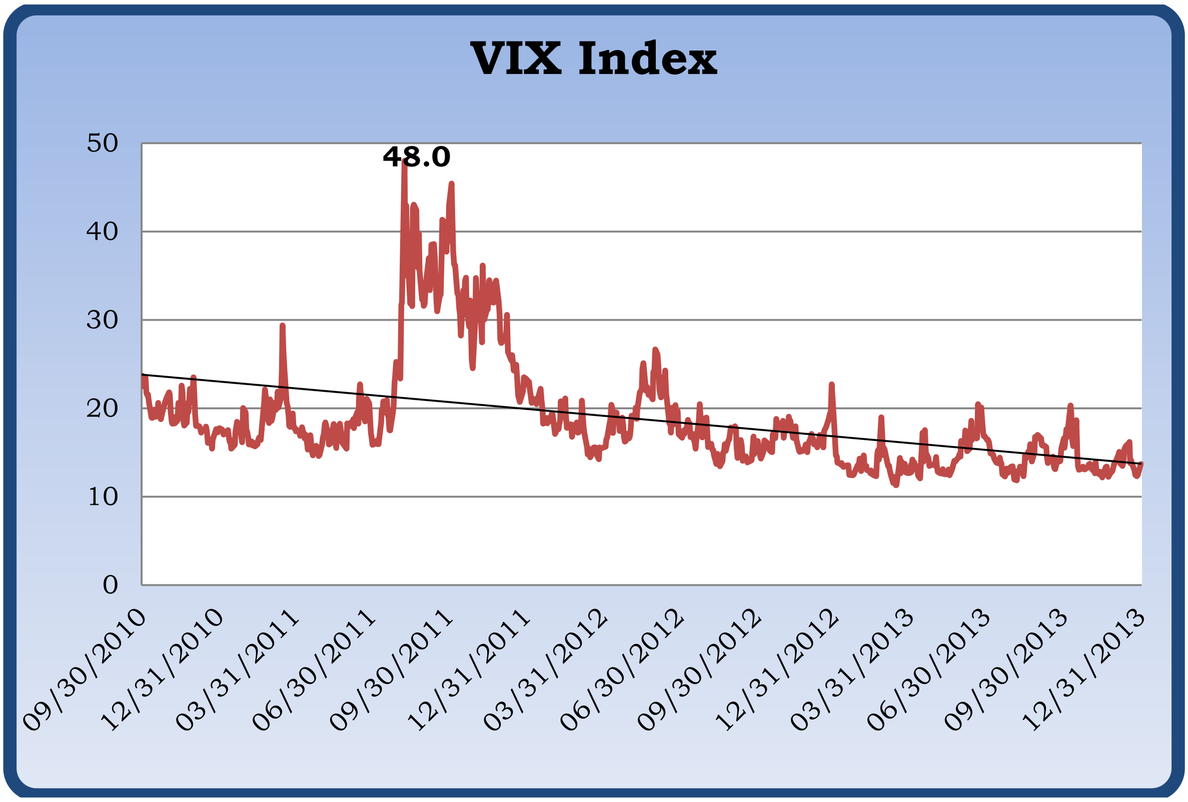
At the start of the fourth quarter of 2013, the 16-day partial U.S. government shutdown and debt ceiling impasse weighed on financial markets, as investors grew increasingly anxious about whether there would be a deal ahead of the debt ceiling deadline. On October 16th 2013, an agreement was reached to re-open the government and suspend the debt limit until early February 2014. The temporary resolution alleviated fears, and most equity markets quickly rebounded, to end both the month and the quarter higher. During the fourth quarter, investor sentiment was bolstered by increasingly positive news on the global economic front. The United Kingdom continued to surprise to the upside and a healthy U.S. economy prompted the U.S. Federal Reserve (Fed) to begin tapering its asset purchase program in January 2014 by $10 billion per month. Meanwhile, an accommodative European Central Bank (ECB) helped to stabilize the euro zone, with the region attaining sluggish but positive growth during the second and third quarter of 2013.

The Chicago Board Options Exchange Volatility (VIX), which is a proxy for investor anxiety and market risk, peaked early in the fourth quarter at 20.34, reflecting growing concerns about the length of U.S. government shutdown and the looming debt ceiling deadline. Once a resolution was reached, the VIX fell and remained at relatively low levels, except for a brief spike in December, when markets deliberated whether the US Fed would begin reducing its bond purchase program. On average, the VIX was flat for the fourth quarter, coming in at 14.23 versus 14.28 for the third quarter.

Risk assets continued to perform in the fourth quarter. In the equity markets, the US Standard and Poor's (S&P) 500 index hit record levels, rising 9.92 per cent versus 4.69 per cent over the prior 3 months. Japan and Germany were the best performing non-US developed markets, as the Nikkei 225 and DAX 30 index advanced 12.70 per cent and

11.14 per cent respectively. Across the G-7 nations, benchmark 10-year yields moved higher, except for in Italy, where yields fell 34.5 basis points. The yield on the 10-year US Treasury increased the most, ending the quarter up 41.8 basis points at 3.03 per cent.

Figure 1
Market Volatility in the US
/points /



Source: Bloomberg.

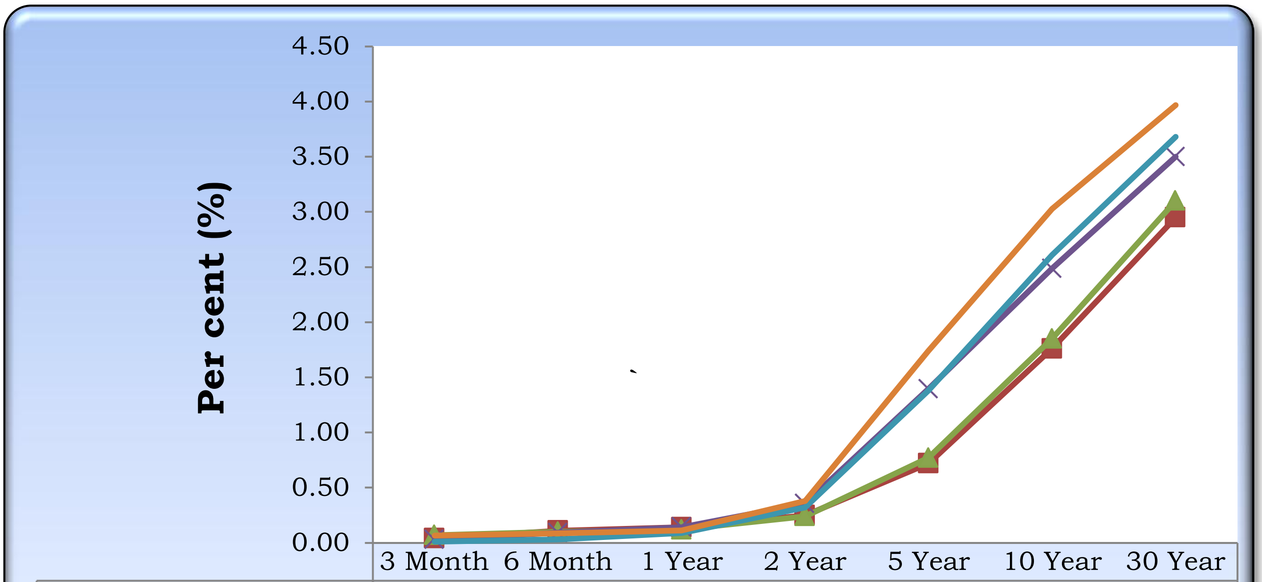
U.S. Fixed Income

US Treasury Fixed Income investors encountered uncertain markets at the start of the fourth quarter, due to the contentious political debates around the US federal budget and debt ceiling levels. As the debt ceiling deadline approached, the political divide in Washington created fears around the possibility of a U.S. debt default and pushed short-term yields significantly higher; 1-month yields peaked at 32 basis points from three basis points at the end of the third quarter. On October 16th, a last minute deal quelled market fears, sending yields lower across the curve.

As the fourth quarter progressed, improving U.S. economic data and the Federal Reserve's positive economic outlook helped to push medium to long-term yields higher. Markets began to price in a modest reduction in the Fed asset purchase program, and in contrast to the first round of taper talk, the rise in yields occurred in a more orderly manner. Over the period, 10-year and 30-year rates rose to 3.03 per cent and 3.97 per cent respectively and the long-end of the curve flattened, with spreads narrowing 13 basis points.

Medium-term yields ended the quarter higher and the 2-5 year part of the curve steepened, with spreads widening 30 basis points to 136 basis points at the end of the fourth quarter. Though rates increased across the yield curve, the Fed's forward guidance in December helped the shorter end of the curve to remain somewhat anchored, as investors expect rates to remain low well past the 6.5 per cent unemployment threshold. Front-end yields (less than one year) rose marginally with 3-month yields increasing six basis points to 0.07 per cent at the end of the fourth quarter.

Figure 2
US Treasury Yield Curve
/per cent/

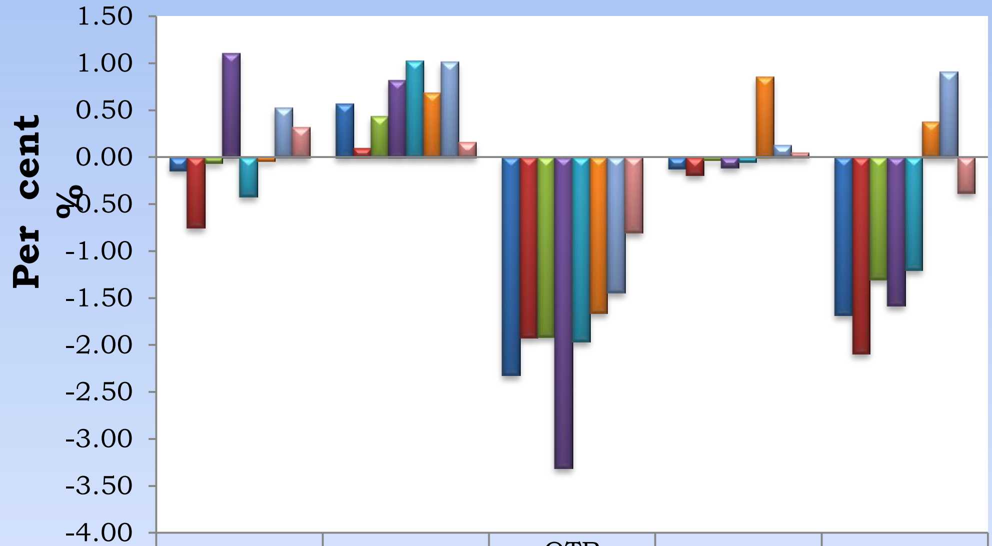


	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
December 31, 2012	0.04	0.11	0.14	0.25	0.72	1.76	2.95
March 31, 2013	0.07	0.10	0.12	0.24	0.77	1.85	3.10
June 30, 2013	0.03	0.09	0.14	0.36	1.39	2.49	3.50
September 30, 2013	0.01	0.03	0.09	0.32	1.38	2.61	3.68
December 31, 2013	0.07	0.09	0.11	0.38	1.74	3.03	3.97

Source: Bloomberg.

The broader US fixed income market as measured by the Barclays Capital US Aggregate Bond index, fell 0.14 per cent in the fourth quarter, compared with a gain of 0.57 per cent during the previous three months. Spread products generally outperformed similar-duration Treasuries, with US Corporates returning 1.11 per cent versus -0.75 per cent for US Treasuries. CMBS also performed well, supported in part by higher property valuations. In the US Investment Grade Corporate Bond market, spreads narrowed further and lower quality Baa rated bonds outperformed higher quality AAA and AA rated securities.

Figure 3
Returns on Fixed Income Indices
/per cent/



	QTR ended Dec-13	QTR ended Sep-13	QTR ended June-13	QTR ended Mar-13	FY 12/13
Barclays U.S. Aggregate	-0.14	0.57	-2.32	-0.12	-1.68
U.S. Treasuries	-0.75	0.10	-1.92	-0.19	-2.09
U.S. Agencies	-0.06	0.44	-1.91	-0.03	-1.30
U.S. Corporate	1.11	0.82	-3.31	-0.11	-1.58
U.S. MBS	-0.42	1.03	-1.96	-0.05	-1.20
G-7 Global Bonds (Hedged)	-0.04	0.69	-1.66	0.86	0.38
CMBS Index	0.53	1.02	-1.44	0.13	0.91
ABS Index	0.32	0.16	-0.80	0.05	-0.38

Source: Barclays Capital.

Overall, sovereign bond yields rose across the G-7 nations. Positive economic data coupled with the U.S. Fed announcement that tapering would begin in January 2014, generally pushed rates higher. However, rates fell in Italy, given that some of the political risks abated over the period with the coalition government surviving a confidence vote.

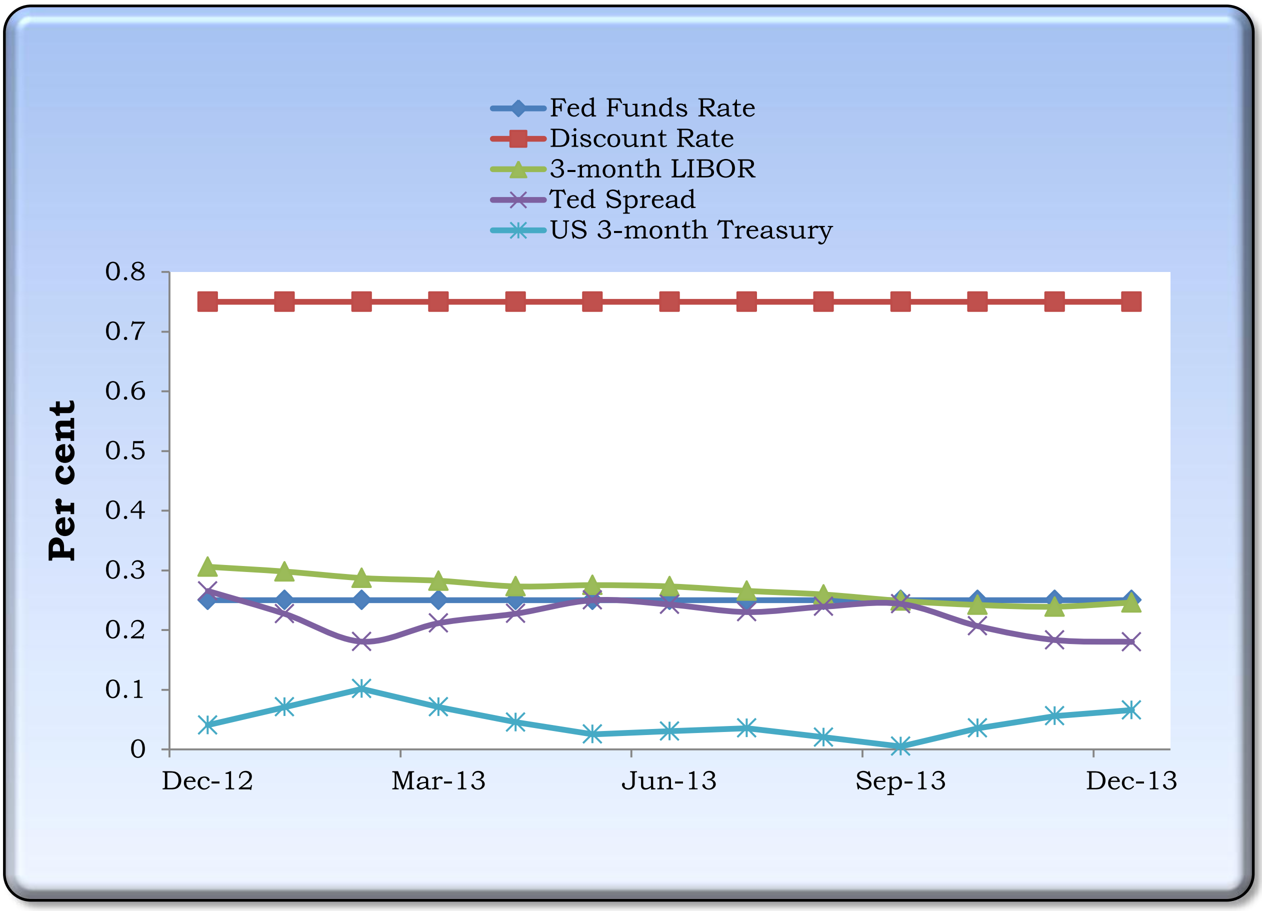
At the end of the third quarter, 10 year German bund yields were somewhat suppressed due to the dysfunction in Washington, as well as the political risk in Italy. Both threats subsided early in the fourth quarter and 10-year German bund rates rose 14.7 basis points to end the period at 1.93 per cent. In addition, demand for the perceived safe-haven German bunds fell during the fourth quarter, as better economic data in the region pushed investors into the potentially riskier peripheral countries.

The UK economy continued to surprise to the upside, driving benchmark UK Gilt yields higher by 30.2 basis points to 3.02 per cent at the end of the fourth quarter. Meanwhile, yields on 10-year Japanese bonds (JGBs) rose marginally by 5.4 basis points to end the period at 0.74 per cent. Though the Japanese government continues to provide support for JGB prices through their stimulus program, Japanese investors may be finding US Treasures more attractive, given the growing interest rate differential.

Money Market

Short-term interest rates moved modestly higher but remained at relatively low levels. Major central banks continued to stress their accommodative stance, with the US Fed utilizing stronger forward guidance. The 3-month US Treasury bill rate increased from 0.01 per cent at the end of the third quarter to 0.07 per cent at the end of the fourth quarter. Meanwhile, the 3-month London Inter-Bank Offered Rate (LIBOR) was unchanged for the quarter at 0.25 per cent.

Figure 4
US Money Market Rates
/per cent/



Source: Bloomberg

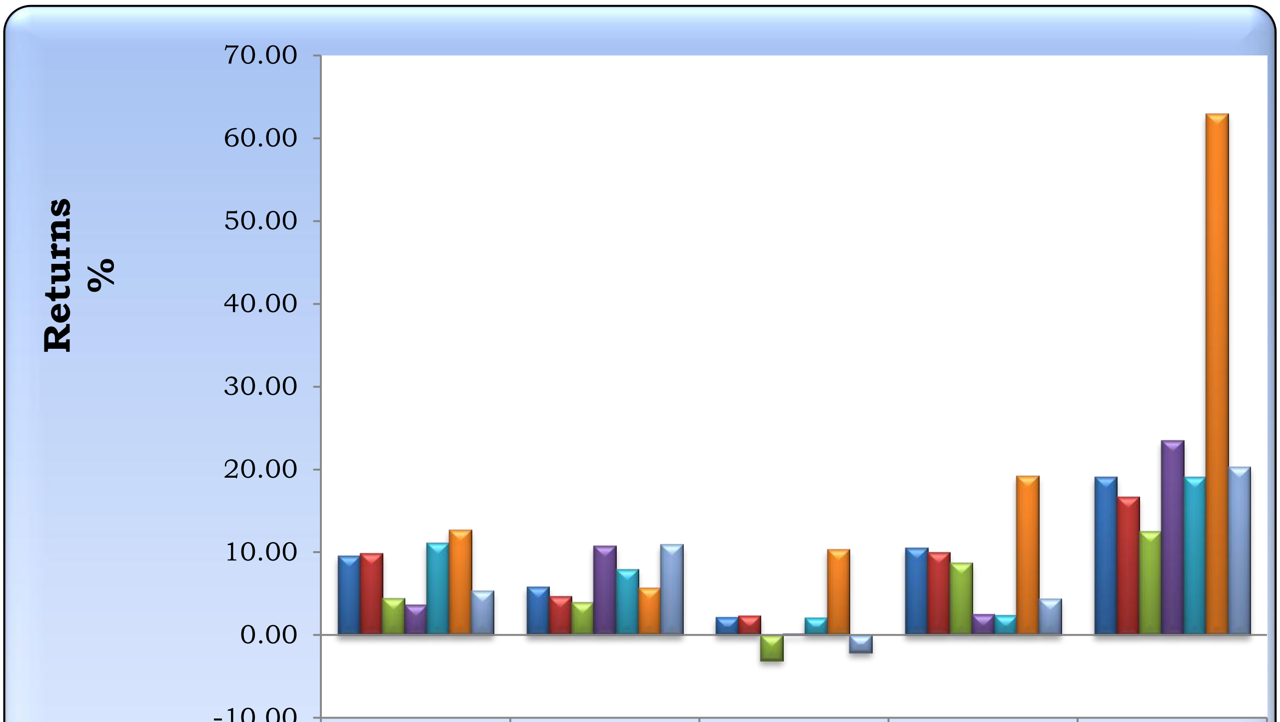
Equity Markets

In the fourth quarter of 2013, equity markets recovered from the partial US government shutdown and debt ceiling debates to end the period higher. In addition to the favourable economic developments throughout the developed world, the progress on the European Banking Union as well as the two-year bipartisan U.S. budget agreement all helped to lift markets.

In the US, the S&P 500 index gained 9.92 per cent, compared with a return of 4.69 per cent during the third quarter. All ten sectors in the index recorded gains in the fourth quarter. Industrials and Information Technology posted the highest returns, while bond equivalent sectors such as Telecoms and Utilities lagged the broader market. During the quarter, large cap outperformed small cap but for the 2013 calendar year, small cap outperformed large cap. This divergence may have been due to greater risk appetite by investors and a preference for companies with greater exposure to the US economy.

The MSCI EAFE returned 5.36 per cent over the fourth quarter as the Euro zone, United Kingdom and Japanese economies all added to the indices' performance. In the United Kingdom, the FTSE 100 rose 4.44 per cent over the period. Meanwhile in the Euro zone, Germany's DAX 30 index advanced 11.14 per cent, whilst the French CAC 40 index returned 3.68 per cent over the three months ending December 31, 2013. Though the Japanese Nikkei 225 index started the fourth quarter down a modest 0.88 per cent, a strong re-bound over the following two months left it in positive territory. Japan's Nikkei 225 rose 12.70 per cent in the fourth quarter, as equities continued to benefit from coordinated efforts by the Japanese government and the Bank of Japan to increase inflation and spur sustainable economic growth.

Figure 5
Price Returns on Equity Indices
/Per cent/



	QTR ended Dec-13	QTR ended Sept-13	QTR ended Jun-13	QTR ended Mar-13	FY 12/13
Russell 3000	9.56	5.83	2.17	10.53	19.11
S&P 500	9.92	4.69	2.36	10.03	16.72
FTSE 100 - UK	4.44	3.97	-3.06	8.71	12.54
CAC 40 - France	3.68	10.82	0.20	2.48	23.51
DAX 30 - Germany	11.14	7.98	2.10	2.40	19.10
Nikkei 225 - Japan	12.70	5.69	10.32	19.27	62.97
MSCI EAFE	5.36	10.94	-2.11	4.38	20.35

Source: Bloomberg

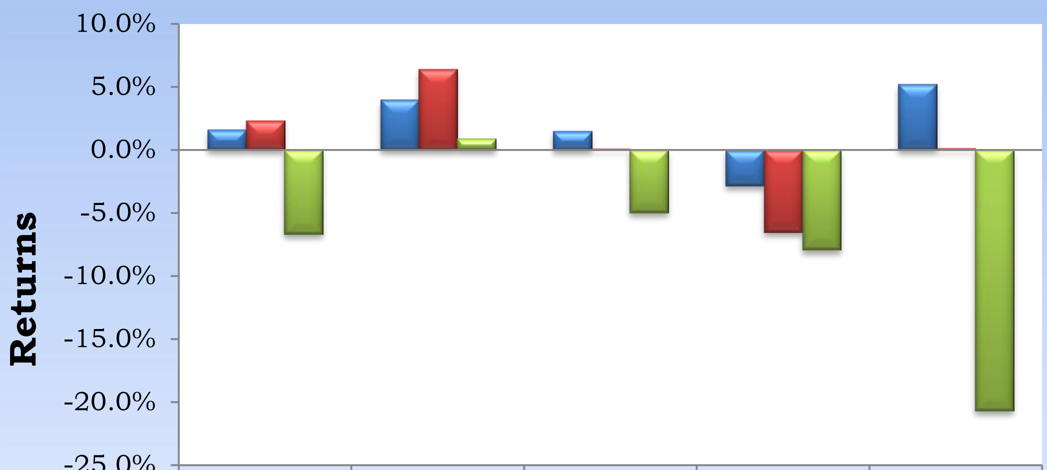
Currency Markets

The US dollar weakened early in the fourth quarter as the US Congress budget and debt-ceiling debates placed pressure on the US dollar index, pushing it to a low of 79.19 from 80.22 at the end of the third quarter. After several weeks of political posturing, a last minute agreement was reached to end the partial government shutdown and suspend the debt ceiling until early February 2014. The dysfunction in Washington temporarily hurt US dollar demand, but once the threat of a U.S. debt default abated, the US dollar recovered to end the fourth quarter modestly lower at 80.04.

The Euro strengthened over the quarter, rising 1.6 per cent over the past three months. Though the pace of the recovery in the Euro zone disappointed in the third quarter, its emergence from an 18-month long recession has created a renewed optimism for the region's prospects. The relatively better economic data coupled with investors winding down their bearish euro positions, have all helped to push the currency higher. The British Pound also appreciated in the fourth quarter, strengthening 2.29 per cent, with the UK economy continuing to surprise to the upside.

The Japanese Yen was the worst performing G10 currency, depreciating 6.71 per cent vis-à-vis the US dollar over the quarter. In addition to the 5.5 trillion yen stimulus package announced in December 2013, the Yen continued to weaken in the fourth quarter, as markets began to price in the expectation that Japan will need to remain relatively more accommodative versus the rest of the developed world.

Figure 6
Foreign Exchange Returns for Major Currencies vis-à-vis the US Dollar
/per cent/



	QTR ended Dec-13	QTR ended Sept-13	QTR ended Jun-13	QTR ended Mar-13	FY 12/13
EUR	1.60%	3.97%	1.49%	-2.83%	5.19%
GBP	2.29%	6.40%	0.10%	-6.50%	0.12%
JPY	-6.69%	0.89%	-4.96%	-7.93%	-20.67%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

Over the period October to December 2013, the asset classes of the Fund deviated from their Strategic Asset Allocation (SAA) and the US Core Fixed Income mandate fell out of the permitted (+/- 5 per cent) range. As at December 31, 2013, the US Core Fixed Income mandate had an allocation of 34.80 per cent, which was 5.20 per cent below the Strategic Asset Allocation of 40 per cent. The approved SAA for the HSF investment portfolio is as follows:

i.	***US Short Duration Fixed Income Mandate***	*25.0%*
ii.	***US Core Domestic Fixed Income Mandate***	*40.0%*
iii.	***US Core Domestic Equity Mandate***	*17.5%*
iv.	***Non US Core International Equity Mandate***	*17.5%*

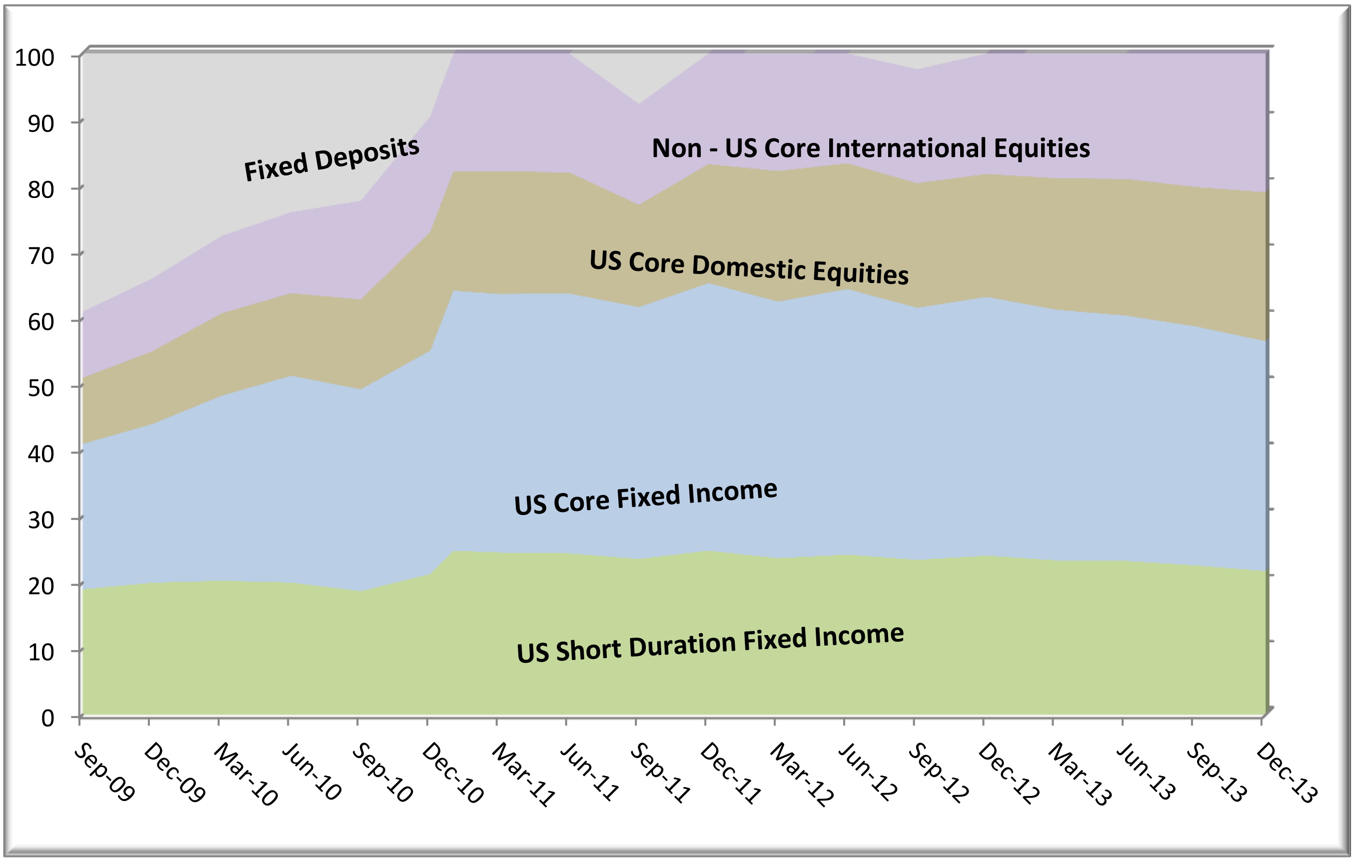
Throughout the quarter, the two equity mandates carried overweight allocations relative to their SAA weights and these resulted from their stronger performance when compared with their fixed income counterparts. By the end of the quarter, the asset class with the largest overweight was the US Core Domestic Equity mandate while the US Core Fixed Income mandate had the largest underweight position.

The total net asset value of the Fund as at the end of December 2013 totaled US$5,354.7 million, compared with US$5,154.0 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,353.4 million, while the remaining portion (US$1.3 million) was held in cash to meet the day-to-day expenses that arise from the management of the Fund. The Fund's target asset allocation and the portfolio weighting for the period December 31 2012 to December 31 2013 are shown in Table 1, overleaf.

Table 1
Portfolio Composition relative to the Approved SAA
/per cent/

	Asset Class		***Dec-12***	***Mar-13***	***Jun-13***	***Sep-13***	***Dec-13***
		Target Weight SAA	***Actual % of Fund***	***Actual % of Fund***	***Actual % of Fund***	***Actual % of Fund***	***Actual % of Fund***
Portfolio Weights	Cash	0.00	0.00	0.00	0.00	0.00	0.00
	US Short Duration Fixed Income	25.00	24.09	23.38	23.30	22.61	21.76
	US Core Domestic Fixed Income	40.00	39.14	37.92	37.11	36.15	34.80
	US Core Domestic Equity	17.50	18.57	19.86	20.64	21.07	22.49
	Non-US Core International Equity	17.50	18.20	18.84	18.95	20.17	20.95

Figure 7
Asset Composition of the HSF Portfolio
/per cent/



Performance of the Investment Portfolio

For the fourth quarter of 2013, the HSF investment portfolio gained 3.95 per cent, compared with a return of 2.66 per cent for the SAA benchmark[1]. This outperformance of 129 basis points was attributed to favourable security selection as well as the deviation between the portfolio and SAA weightings. The majority of the HSF portfolio's returns were generated by the equity portion of the Fund, which contributed 3.90 per cent to the overall performance, while the fixed income mandates added 0.05 per cent to the overall return. On an asset class level, all four mandates outperformed their respective benchmarks during the quarter ended December 31, 2013.

The **US Short Duration Fixed Income** portfolio posted an absolute return of 0.04 per cent during the fourth quarter of 2013, outperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 16 basis points. This outperformance was attributed to the portfolio's exposure to spread products (Agency RMBS and CMBS) as spreads tightened during the quarter and US Treasury yields spiked. The net asset value of this mandate as at December 31, 2013 was **US$1,165.1 million,** compared with US$1,164.8 million at the end of the previous quarter.

The longer duration fixed income mandate which consists of **US Core Fixed Income** securities, posted a return of 0.04 per cent during the fourth quarter of 2013, outperforming its benchmark, the Barclays Capital US Aggregate Bond index, which declined 0.14 per cent. The outperformance of this portfolio relative to the benchmark resulted from its underweight allocation to US Treasuries and overweight allocations to

[1] The SAA benchmark is a blended benchmark which comprises, Bank of America/Merrill Lynch US Treasury 1-5 Years Index (25%), Barclays US Aggregate Bond Index (40%), Russell 3000 ex Energy Index (17.5%), and MSCI EAFE ex Energy Index (17.5%).

the corporate credit sector and to Commercial Mortgage Backed Securities. Security selection detracted from overall returns over the period especially in the corporate credit sector. The net asset value of this mandate as at December 31, 2013 increased in comparison to the previous quarter, totaling **US$1,863.0 million** compared with US$1,862.6 million as at September 30, 2013.

The **Non-US International Equities** mandate generated a gain of 8.05 per cent for the fourth quarter of 2013, compared with a return of 5.67 per cent for its benchmark, the MSCI EAFE ex Energy index. This outperformance was mainly on the account of added value from stock selection with hedged country allocations also adding to returns. The largest impact from stock selection was recorded from holdings in France, UK, Germany, Switzerland and Hong Kong. Additionally, sector allocations to Information Technology and Telecommunication services also benefited the portfolio. The net asset value of the Non-US Core International Equity mandate as at December 31, 2013 grew to **US$1,121.5 million**, from US$1,039.0 million at the end of September 2013.

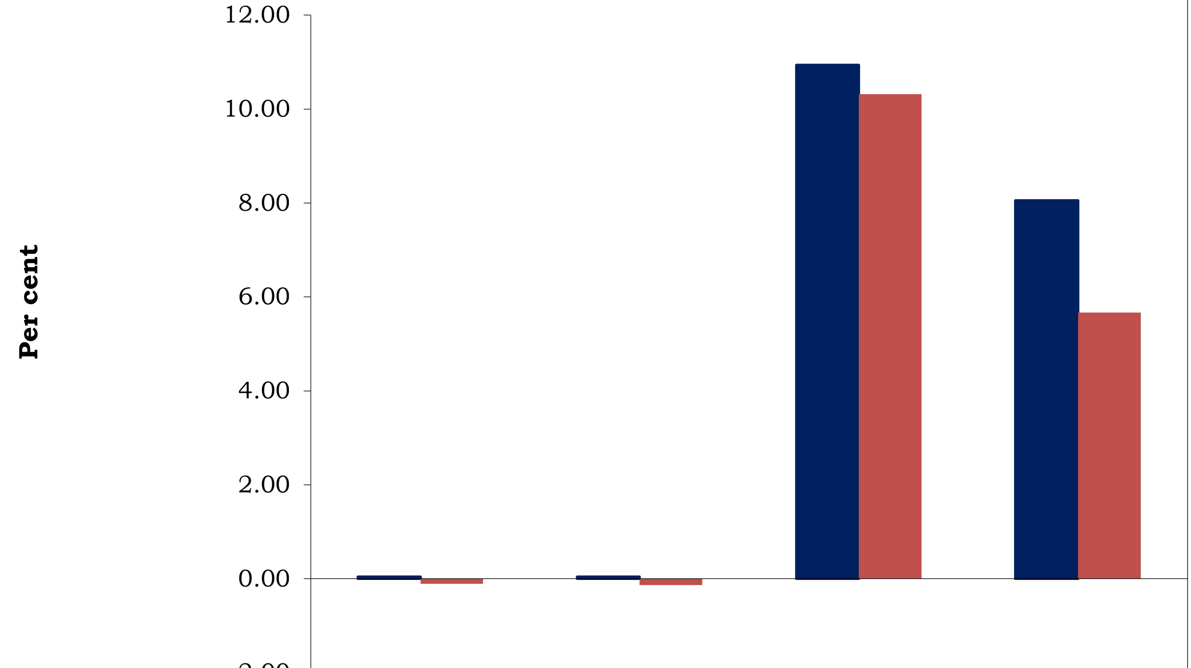
The **US Core Domestic Equities** mandate returned 10.94 per cent, compared with a benchmark return of 10.32 per cent. This outperformance was due to the managers' favourable stock selection and sector allocation decisions. On a sectoral level, the Consumer Discretionary, Financial Services and Materials sectors added the most to excess returns. The net asset value of this mandate, as at December 31 2013, was **US$1,203.8 million**, compared with US$1,085.7 million at the end of September 2013.

Table 2
Contribution to Quarterly Return,
For the period October 2013 – December 2013
/per cent/

	SAA Weights	Portfolio Weights as at 31-Dec-2013	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	3.95	2.66
US Core Domestic Fixed Income	40.00	34.80	0.02	-0.05
US Core Domestic Equity	17.50	22.49	2.29	1.76
Non US Core International Equity	17.50	20.95	1.61	0.98
US Short Duration Fixed Income	25.00	21.76	0.01	-0.03

NB: Differences in totals are due to rounding.

Figure 8
Absolute Returns by Asset Class
For the period October 2013 – December 2013
/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core International Equities
Composite Portfolio Return	0.04	0.04	10.94	8.05
SAA Benchmark Return	-0.11	-0.14	10.32	5.67

Mandate

SECTION 4 –COMPLIANCE AND PORTFOLIO RISKS

Compliance

During the quarter ended December 31 2013, one of the Fund's fixed income managers breached a compliance limit, which relates to the ownership of a certain class of private placement fixed income securities. According to the manager, the breach occurred due to the acceptance of a voluntary corporate action, which exchanged bonds of one entity for the bonds of another corporate entity. As a result, of the compliance breach, the manager reduced the holdings of the private placement bonds and this transaction was completed at a gain to the portfolio.

In the month of December 2013, the US Core Fixed Income mandate exceeded the maximum 5.0 per cent variation from the Strategic Asset Allocation as highlighted previously. As a result of this breach, the Fund has undertaken to review the maximum allowable variation from the SAA in light of current market conditions and the outlook for the various asset classes.

Portfolio Risks

The main risks for the HSF portfolio are Credit, Concentration, Interest Rate, and Currency risks. The following paragraphs give a description of how these risks are mitigated.

Credit Risk

For the **money market portion** of the Fund, Credit Risk is minimized by the strict adherence to the following standards: (i) all counterparties must have a minimum credit rating of either A-1 from the Standard and Poor's rating agency or P-1 from Moody's; and

(ii) a maximum exposure limit for counterparties of no more than 5.0 per cent of the market value of the portfolio.

For **fixed income instruments**, Credit Risk is mitigated by the use of credit concentration limits as well as minimum credit quality ratings. Bonds must have an implied investment grade rating as defined by Standard and Poor's, Moody's or Fitch. Should the required ratings on an existing fixed income security fall below the minimum standards, the security must be sold within an agreed upon timeframe. Table 3 below shows the Average Credit Quality of the US Short Duration and US Core Fixed Income Portfolios as at September 30, 2013.

Table 3
Average Credit Rating

Mandate	Portfolio	Benchmark
US Short Duration	**AA+**	**AA+**
US Core Fixed Income	**AA**	**AA+**

Concentration Risk

Concentration or Diversification Risk is minimised by investing across various asset types. The portfolio is currently invested across four asset groupings as follows - US Short Duration Fixed Income, US Core Domestic Fixed Income, US Core Domestic Equity and Non-US Core International Equity. The Asset classes in which the Fund invests react differently under a given market condition. As such, it is likely that when one asset class has strong returns, another may have lower returns. The Fund's investments are also diversified across a number of assets with the aim of securing a positive return under a range of market conditions and to lower the total risk of the portfolio. In addition, Concentration Risk is minimized within asset groups. For the **equity**

portfolios, this Risk is managed by imposing a maximum percentage holding of 3.0 per cent of any security's outstanding shares, as well as a maximum sector deviation relative to the benchmark of 5.0 per cent.

Interest Rate Risk

Interest Rate Risk is managed using a weighted average effective duration limit on the respective portfolios, with an allowable range of one (1) year longer or shorter than the weighted average duration of the respective benchmark. Table 4 shows the weighted average duration for the US Short Duration and US Core Domestic Fixed Income portfolios as at December 31, 2013.

Table 4
Weighted Average Duration
/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.68**	**2.64**
US Core Domestic Fixed Income	**4.92**	**5.31**

Currency Risk

Currency Risk is managed by containing and managing the exposure to non-US dollar instruments. For the Fixed Income and US Core Domestic Equity mandates, no more than 10 per cent of the market value of the portfolio can be invested in securities which are denominated in currencies other than the US Dollar. The Non-US Core International Equity Portfolio is comprised primarily of non-US dollar denominated securities, and the Fund accepts the currency risk inherent in the relevant benchmark. For this mandate, currency hedging is permitted up to 15 per cent of the market value of the portfolio using the US dollar as the base currency. At the end of September 2013, the currency exposure for this portfolio was 99 per cent of its market value. During the quarter, all the portfolios were within their respective limits.

Appendix I
HSF Portfolio
Historical Performance since Inception

Quarter End	Current Returns			Financial YTD			Annualised Return Since Inception		
	Portfolio	Benchmark	Excess	Portfolio	Benchmark	Excess	Portfolio	Benchmark	Excess
	%	%	bps	%	%	bps	%	%	bps
FY 2010									
December	0.96	0.89	6.65	0.96	0.89	6.65	3.72	3.78	-6.16
March	1.61	1.68	-6.20	2.59	2.58	0.49	3.95	4.03	-7.76
June	-1.83	-1.89	6.05	0.71	0.64	6.69	3.07	3.12	-5.18
September	5.33	5.08	24.73	6.07	5.75	31.93	4.37	4.35	2.06
FY 2011									
December	2.29	2.21	8.15	2.29	2.21	8.15	4.70	4.65	4.13
March	1.62	1.54	7.24	3.94	3.79	15.68	4.81	4.76	5.72
June	1.88	1.81	6.68	5.89	5.67	22.91	4.98	4.91	7.00
September	-4.82	-4.28	-53.66	0.79	1.14	-34.89	3.57	3.63	-6.29
FY 2012									
December	2.74	3.03	-28.52	2.74	3.03	-28.52	3.97	4.08	-12.00
March	5.04	4.46	57.50	7.92	7.63	29.29	4.78	4.78	-0.08
June	-0.90	-0.60	-30.42	6.95	6.98	-3.72	4.37	4.43	-6.13
September	3.53	2.98	55.03	10.73	10.18	55.02	4.68	4.65	2.07
FY 2013									
December	1.49	1.45	4.11	1.49	1.45	4.11	4.88	4.83	4.76
March	3.29	2.90	39.19	4.82	4.38	44.01	5.23	5.12	11.20
June	-0.30	-0.69	39.05	4.51	3.66	84.64	4.97	4.80	17.26
September	3.95	3.47	47.35	8.63	7.26	137.06	5.40	5.16	24.01
FY 2014									
December	3.95	2.66	129.38	3.95	2.66	129.38	5.80	5.37	42.67

Notes:

(1) Differences in totals are due to rounding.

(2) In August 2009, International Equities and Fixed Income Securities were added to the HSF portfolio. The performance benchmark for the HSF portfolio became a blended benchmark which comprise, Bank of America/Merrill Lynch US Treasury 1-5 Years Index, US One-month LIBID Index, Barclays US Aggregate, Russell 3000 ex Energy, and MSCI EAFE ex Energy.

(3) In January 2011, the HSF Portfolio achieved its Strategic Asset Allocation where the portfolio was invested in four assets classes. US Short Duration Fixed Income (25), US Core Fixed Income (40), US Equity (17.5) and Non-US International Equity (17.5).

(4) With effect from the quarter ended December 2012, the Annualised Returns Since Inception were computed using a geometric average and not the previously used arithmetic average. For comparative purposes, prior period annualized returns since inception shown above were computing using a geometric average.

Appendix II
Heritage and Stabilisation Fund
Portfolio Valuation (USD)

Valuation Date	Net Asset Value	Net Profit	Accumulated Surplus & Unrealized Capital Gains/Losses	Contributions

Annual Portfolio Valuation

September 30, 2007	1,766,200,701	41,966,361	41,966,361	321,706,043
September 30, 2008	2,888,421,556	67,177,392	110,379,131	1,054,174,457
September 30, 2009	2,964,686,478	34,782,418	186,755,766	-
September 30, 2010	3,621,984,041	87,931,196	364,361,226	477,344,263
September 30, 2011	4,084,016,158	179,748,798	374,074,067	451,400,519
September 30, 2012	4,712,376,278	125,221,977	794,770,772	207,550,846
September 30, 2013	5,154,027,747	312,776,304	1,193,778,722	42,414,251

Quarterly Portfolio Valuation

December 31, 2011	4,191,162,904	10,474,106	481,361,876	-
March 31, 2012	4,397,263,070	42,045,281	687,290,865	-
June 30, 2012	4,378,930,036	34,014,167	642,769,982	26,241,964
September 30, 2012	4,712,376,278	38,688,423	794,770,772	181,308,882
December 31, 2012	4,780,065,524	42,243,928	861,557,777	-
March 31, 2013	4,933,344,741	70,726,991	1,015,212,703	-
June 30, 2013	4,914,375,234	56,685,027	996,411,094	-
September 30, 2013	5,154,027,747	143,120,358	1,193,778,722	42,414,251
December 31, 2013	5,354,721,875	77,853,526	1,393,727,735	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	8,695	141
Coupon (%)	3.40	1.85
Duration (Years)	5.31	2.64
Average Life (Years)	7.04	2.72
Yield to Maturity (%)	2.39	0.74
Option Adjusted Spread (bps)	40	0
Average Rating (S&P)	AA+	AA+
Minimum Rating (S&P)	BBB-	AA

Equity Benchmarks

Key Characteristics	Russell 3000 (ex energy)	MSCI EAFE (ex energy)
Total Holdings	2,828	847
Earnings Per Share (EPS Growth 3-5y fwd)	10.40	10.29
Price Earnings (P/E fwd)	15.4	14.95
Price / Book (P/B)	3.76	1.75
Weighted Average Market Capitalization* (Bn)	$87.6	$62.2

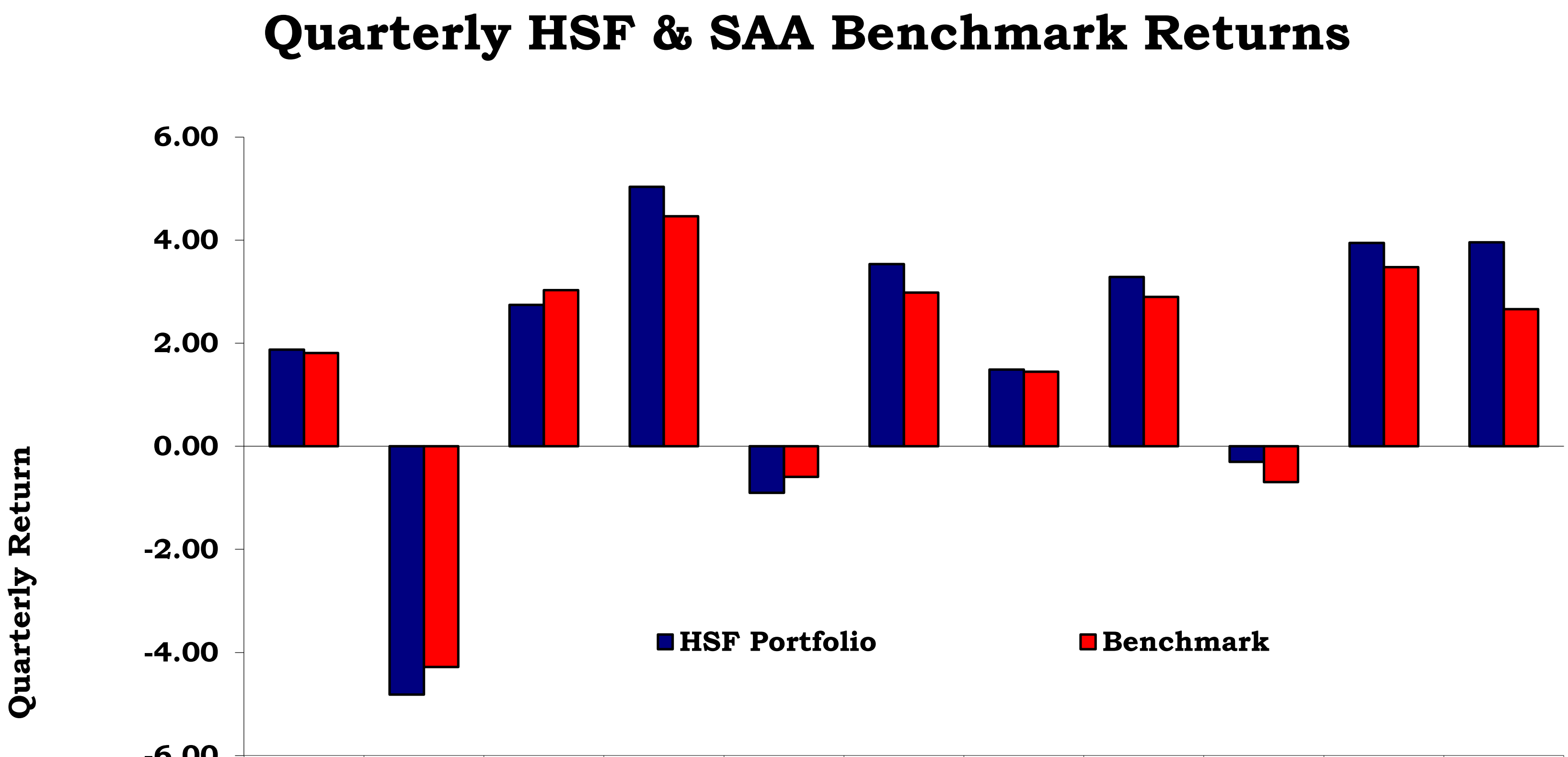
*Market capitalization is a measurement of the size of a company (share price x the number of outstanding shares). The weighted average market capitalization of a stock market index represents the average size of the firms comprising the index where each is weighted according to its market capitalization.

Appendix IV
Summary of the Fund’s Net Asset Value by Mandate
/US$ Million/

	December 2012	March 2013	June 2013	September 2013	December 2013
Total Fund Value	**4,780**	**4,933**	**4,914**	**5,154**	**5,355**
Total Value of Equity	**1,757**	**1,909**	**1,945**	**2,125**	**2,325**
US Core Domestic Equity	887	980	1,013	1,086	1,204
Non-US Core International Equity	869	929	931	1,039	1,122
Total Value of Fixed Income	**3,021**	**3,023**	**2,969**	**3,027**	**3,028**
US Short Duration Fixed Income	1,151	1,153	1,145	1,165	1,165
US Core Domestic Fixed Income	1,870	1,870	1,823	1,863	1,863
Total Value of Cash or Cash Equivalents	**2**	**1**	**1**	**2**	**1**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/



	FY2011 Q3	FY2011 Q4	FY2012 Q1	FY2012 Q2	FY2012 Q3	FY2012 Q4	FY2013 Q1	FY2013 Q2	FY2013 Q3	FY2013 Q4	FY2014 Q1
HSF Portfolio	1.88	-4.82	2.74	5.04	-0.90	3.53	1.49	3.29	-0.30	3.95	3.95
Benchmark	1.81	-4.28	3.03	4.46	-0.60	2.98	1.44	2.90	-0.69	3.47	2.66