Trinidad and Tobago

Heritage & Stabilisation Fund

Quarterly Investment Report

October – December 2014

CENTRAL BANK OF TRINIDAD & TOBAGO

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EXECUTIVE SUMMARY

The world economy continued to advance during the fourth quarter of 2014. Following a weaker than expected first half of the year, economic activity progressed in the second half with the United States (US) and United Kingdom (UK) economies leading the way amidst a weak Euro Area, faltering Japan and slowing China. Over the quarter, an array of downside risks emerged including low growth and the risk of deflation in the Euro Area, declining oil prices, geopolitical tensions between Ukraine and Russia, slowing growth of the Chinese economy and to a lesser extent, the Ebola virus. Of these, the plunging oil prices[1] and weak Euro Area dominated news headlines and contributed to a period of heightened volatility in a number of markets across the world.

Improving conditions in the labour market reinforced the view that the US economy continued to expand. Total nonfarm payroll employment increased on average by 289,000 per month in the fourth quarter of 2014, compared with 239,000 during the previous quarter. These employment gains were broad-based as various sectors including construction, services and manufacturing added to payrolls. As a result, the unemployment rate fell to 5.6 per cent in December from 5.9 per cent in September.

On the policy front, the Federal Reserve (Fed) concluded its asset purchase programme at its October meeting. Although the Fed expects GDP to expand faster than potential output, the Committee remains committed to maintaining the 0 to ¼ per cent target range for the federal funds rate for a "considerable time". Given the strength of the US economic recovery, there was growing concern that the Fed may raise rates before mid-2015. At its December policy meeting, the Committee re-iterated its view that the

[1] Global oil prices saw a rapid decline on account of a persistent glut in the market which was not met by global demand. The Organization of the Petroleum Countries failed to reduce its global supply against higher shale oil production in the US. Over the quarter, oil prices had fallen by over 50 per cent after peaking in July and August of 2014.

economy was on solid ground, but pledged to be "patient in beginning to normalize the stance of monetary policy".

In the third quarter, the Euro Area economy expanded 0.20 per cent quarter-on-quarter. However, economic conditions failed to progress during the fourth quarter. The Composite Purchasing Managers Index fell to 51.4 in December from 52.0 in September. Activity in both the manufacturing and services sectors showed little improvement. Factory output stagnated, with continued weakness in France and Italy, whereas Germany showed a modest increase and developments in Spain, the Netherlands and Ireland were encouraging.

The European Central Bank (ECB) kept key interest rates unchanged but hinted at potentially providing additional stimulus in early 2015. The size of December's Target Longer Term Refinancing Operation (TLTRO) allotment was disappointing, casting doubts over whether the existing mix of measures would be sufficient for the ECB to expand its balance sheet by 1 trillion euros. The Governing Council indicated that it would alter "the size, pace and composition" of its measures and announced that "technical preparations" were underway, should further action become necessary.

Though economic data for the fourth quarter has been mixed, the evidence suggests that the pace of economic growth in the United Kingdom (UK) has slowed further during the fourth quarter. Industrial production fell due to declines in oil and gas extraction and mining output. Construction activity unexpectedly dropped 2.0 per cent from October.

The Bank of England (BOE) kept its benchmark interest rate unchanged. Without growing support for an immediate increase, there is little evidence that the BOE is moving closer to raising rates. In addition, the BOE's concerns about the global slowdown and the economic stagnation in Europe, pushed markets to adjust their expectations regarding the first rate hike, with investors now anticipating an increase in the second half of 2015.

During the fourth quarter, economic data from Japan was mixed. Exports increased for a fourth consecutive month in December thanks in part to strong demand from the United States. However, core machinery orders were less than expected in November, increasing only 1.3 per cent compared with a forecast of 5.0 per cent. In addition, industrial production and retail sales fell in November, indicating that the economy may struggle to rebound from its recent downturn.

On the monetary policy front, the Bank of Japan (BOJ) surprised markets at its October meeting by increasing its bond buying program from 60-70 trillion yen a year to 80 trillion yen. The Board's decision was an attempt to safeguard the progress achieved thus far, and signaled to markets that policymakers are intent on ensuring that the economy does not return to deflation.

Diverging economic performance and central bank policies drove currency markets in the fourth quarter. The U.S. dollar continued to strengthen versus the other major currencies as the Fed ended the Quantitative Easing (QE) program and provided a positive assessment of the economy. The Fed's re-affirmation that the first interest rate increase could occur around mid-2015 helped support a stronger dollar. The British pound, the Euro and the Japanese yen depreciated during the fourth quarter of 2014. The yen was the weakest currency of the three; depreciating by 8.46 per cent vis-à-vis the US dollar mainly due to the Bank of Japan's October monetary expansion. The Euro also depreciated by 4.22 per cent relative to the US dollar while the pound sterling depreciated against the dollar by 3.92 per cent.

The US fixed income market added positive returns in the fourth quarter, as the demand for safe haven assets increased following heightened speculation about the Fed's interest rate hike, declining oil prices and a weak Euro Area. The broader fixed income market, as measured by the Barclays Capital US Aggregate Bond index, returned 1.79 per cent over the quarter compared with a return of 0.17 per cent in the third quarter of 2014. The 10-year US Treasury yield declined to 2.17 per cent by the end of the quarter from 2.49 per cent at the end of the previous quarter while the yields on the 0 to 2 year nodes of the curve increased. UK 10-year Gilts, German 10-year bunds and 10-year Japanese Government Bonds also fell over the period.

In equity markets, volatility returned globally as the persistent plunge in oil prices, a weak Euro Area and heightened speculation about the ECB's monetary easing and the US's rate hike loomed. In the US, equities reached record highs during the quarter sustained by improved economic data and strengthening of the US dollar. The Standard and Poor's (S&P) 500 index rose by 4.39 per cent for the quarter and crossed the 2,000 point milestone. In Europe, the markets were supported by the ECB's accommodative policies despite the risk of deflation which underwhelmed investors. Equities were also down on account of declining oil prices which spurred sizeable sell offs in energy stocks, particularly impacting the FTSE 100. Overall, international equity performance, as measured by the MSCI EAFE index, fell by 3.86 per cent over the quarter.

The HSF investment portfolio earned 2.25 per cent for the quarter ended December 2014, compared with an increase of 1.63 per cent for the Strategic Asset Allocation (SAA) benchmark. The Fund's exposures to both equity and fixed income added to absolute returns. At the end of December 2014, the net asset value of the HSF was US$5,653.9 million, an increase from the US$5,533.4 million reported at the end of September 2014.

Contribution to Quarterly Return, For the period Oct 2014 – Dec 2014 /per cent/

	SAA Weights	Portfolio Weights as at 31-Dec-2014	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	2.25	1.63
US Core Domestic Fixed Income	40.00	37.26	0.57	0.71
US Core Domestic Equity	17.50	22.50	1.68	1.22
Non US Core International Equity	17.50	18.17	-0.08	-0.42
US Short Duration Fixed Income	25.00	22.06	0.08	0.12

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns
For the Quarters ended June 2014 – December 2014
/per cent/

	3 Months Weighted Return as at 31-Dec-2014		3 Months Weighted Return as at 30-Sept-2014		3 Months Weighted Return as at 30-Jun-2014	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	2.25	1.63	-0.48	-0.73	2.56	2.30
US Core Domestic Fixed Income	0.57	0.71	0.06	0.07	0.78	0.81
US Core Domestic Equity	1.68	1.22	0.22	0.19	0.89	0.72
Non US Core International Equity	-0.08	-0.42	-0.74	-0.97	0.75	0.62
US Short Duration Fixed Income	0.08	0.12	0.00	-0.01	0.12	0.14

Comparative Financial Year to Date Returns
For the periods Dec 2013 & Dec 2014
/per cent/

	Financial Year to Date Return as at 31-Dec-2014		Financial Year to Date Return as at 31-Dec-2013	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	2.25	1.63	3.95	2.66
US Core Domestic Fixed Income	0.57	0.71	0.02	-0.05
US Core Domestic Equity	1.68	1.22	2.29	1.76
Non US Core International Equity	-0.08	-0.42	1.61	0.98
US Short Duration Fixed Income	0.08	0.12	0.01	-0.03

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The latest Gross Domestic Product (GDP) data revealed that the United States (US) economy expanded robustly during the third quarter of 2014 as real GDP increased at an annualized rate of 5.0 per cent, compared with growth of 4.6 per cent in the second quarter. This marked the strongest pace of expansion for the economy since the third quarter of 2003, reflecting both higher personal consumption expenditure as well as greater business investment spending. While the outlook for the economy remains positive, the rate of growth is expected to moderate over the medium term.

More recent data suggest that the manufacturing sector lost some momentum over the three months to December 2014 although it continued to expand. The Institute of Supply Management's Purchasing Managers Index[2] (PMI), which gauges the level of activity in the manufacturing sector, decreased to 55.5 in December 2014 from 56.6 in September. This slowdown was attributed in part to weaker overseas markets as well as the notion that companies may have delayed orders as they anticipated oil prices to fall to even more attractive levels.

Meanwhile, conditions in the labour market have been improving steadily. Total nonfarm payroll employment increased on average by 289,000 per month in fourth quarter of 2014 compared with 239,000 during the previous quarter. These employment gains were broad-based as various sectors including construction, services and manufacturing added to the number of persons employed. As a result, the unemployment rate fell to 5.6 per cent in December from 5.9 per cent in September.

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[2] An index value in excess of 50 per cent indicates an expansion in activities in the manufacturing sector, while a posting below 50 per cent represents a contraction.

On the price front, headline inflation continues to be well below the Fed's 2 per cent target as the rate measured 0.8 per cent year-on-year to December 2014, down from 1.7 per cent at the end of September 2014. This trend reflects the sharp decline in energy prices over the period. However, the core inflation rate, which removes the impact of food and energy costs, declined modestly to 1.6 per cent in December 2014 from 1.7 per cent three months earlier.

With regards to policy developments, the Federal Reserve (Fed) concluded its asset purchase programme at the end of October 2014. Although policymakers expect GDP to expand faster than potential output, the Committee remains committed to maintaining the 0 to ¼ per cent target range for the federal funds rate for a "considerable time". Given the strength of the US economic recovery, there was growing concern that the Fed may raise rates before mid-2015. At its December policy meeting, the Committee re-iterated its view that the economy was on solid ground, but pledged to be "patient in beginning to normalize the stance of monetary policy".

Euro zone

In the third quarter, the Euro Area economy expanded 0.2 per cent compared with growth of 0.1 per cent in the second quarter. Household and government spending helped to spur activity while gross fixed capital investments and external trade contributed negatively to the overall outturn. Greece and Spain were among the member states that recorded the highest growth rates, expanding by 0.7 per cent and 0.5 per cent, respectively. Meanwhile, the Italian economy remained in a recession during the quarter as it contracted a further 0.1 per cent. The German economy however, showed some improvement and avoided a recession by expanding 0.1 per cent over the period.

During the fourth quarter, economic conditions in the Euro Area remained subdued. The Composite Purchasing Managers Index fell in December to 51.4 from 52.0 in September. Activity in both the manufacturing and service sectors showed little improvement. Factory output stagnated, with continued weakness in France and Italy, whereas Germany showed a modest increase. Inflation in the region continued to deteriorate, falling from 0.3 per cent in September to -0.2 per cent in December, year on year. Food, alcohol and tobacco prices were unchanged but the sharp decline in energy prices pushed the inflation rate into negative territory.

The latest unemployment rate remained unchanged in November at 11.5 per cent from that recorded in September 2014. On a country level, there continued to be a wide disparity among member states, with the jobless rate in Spain at 23.9 per cent, whereas in Germany the rate was recorded at 5.0 per cent.

On the monetary policy front, the European Central Bank (ECB) kept key interest rates unchanged but hinted at potentially providing additional stimulus in early 2015. The size of December's Target Longer Term Refinancing Operation (TLTRO) allotment was disappointing, casting doubts over whether the existing mix of measures would be sufficient for the ECB to expand its balance sheet by 1 trillion Euros. Risks to the economy remain to the downside and the Governing Council is committed to ensuring that medium to long-term inflation expectations remain anchored below, but close to 2.0 per cent. The ECB indicated that it would alter "the size, pace and composition" of its measures and announced that "technical preparations" were underway should further action become necessary. As a result, investors widely expected the ECB to announce full quantitative easing at its January 2015 meeting.

United Kingdom

The United Kingdom (UK) economy lost momentum in the third quarter of 2014 as GDP growth slowed to 0.7 per cent, from 0.9 per cent in the second quarter. During the three months to September, lower energy prices and a subdued inflationary environment boosted household spending. However, exports and business investment slowed over the period, as businesses faced an uncertain environment due to the fragile economic conditions in Europe as well as the geopolitical issues in Ukraine and the Middle East.

Though economic data for the fourth quarter was mixed, the evidence suggested that the UK economy slowed further during the fourth quarter. Industrial production fell due to declines in oil and gas extraction and mining output. However, there were some bright spots, as manufacturing recovered from a decline in October to expand 0.7 per cent in November. While the pace of the recovery in the United Kingdom (UK) has moderated, the economic expansion is forecast to continue into 2015, fuelled by robust private consumption and corporate investment.

In the labour market, the unemployment rate fell more than expected in the fourth quarter. The jobless rate measured 5.8 per cent in November from 6.0 per cent at the end of September. Wages excluding bonuses increased 1.8 per cent from a year earlier, versus 1.2 per cent in September. The rise in earnings coupled with falling energy prices bode well for consumers. Lower oil prices as well as heightened competition among the major supermarkets have resulted in weaker inflationary pressures in the UK. The consumer price index dropped to 0.5 per cent in December from 1.2 per cent in September, year on year, and is expected to remain below the Bank of England's 2.0 per cent target for an extended period.

Over the period, there was little development with respect to monetary policy. The Bank of England (BOE) kept its benchmark interest rate unchanged and the minutes from the December meeting revealed that the vote stayed at 7 to 2, in favor of maintaining the benchmark rates at current levels. Without growing support for an immediate rate increase, there is little evidence that the BOE is moving closer to raising rates. In addition, the BOE's concerns about the global slowdown and the economic stagnation in Europe, pushed markets to adjust their expectations regarding the first rate hike, with investors now anticipating an increase in the second half of 2015.

Japan

The Japanese economy contracted at an annualized rate of 1.9 per cent in the third quarter, technically entering a recession. Business and public spending were lower than anticipated and consumption has been slow to recover following the April sales tax increase.

The Japanese economy is expected to recover gradually and there are expectations that a weaker yen would help boost exports and aid the manufacturing sector. During the fourth quarter, economic data from Japan were mixed. Exports increased for a fourth consecutive month in December, due in part to stronger demand from the United States. However, core machinery orders were less than expected in November, increasing only 1.3 per cent compared with a forecast of 5 per cent. In addition, industrial production and retail sales fell in November, indicating that the economy may struggle to rebound from its recent downturn.

Overall, the labour market in Japan remains tight, with the jobs-to-applicant ratio at 1.12 in November from 1.09 in September. In November, the jobless rate was steady at 3.5 per cent. However, wage growth continued to disappoint, increasing 0.1 per cent year on year. The consumer has been affected particularly hard as wages have not kept pace with inflation. Household spending has been hurt by the higher consumption tax and the weaker Yen, which has made imports more expensive. Following his election victory in December 2014, Prime Minister Shinzo Abe conceded that the average worker had yet to benefit from his policies and promised to push for pay increases in 2015.

Inflation in Japan slowed for the fourth consecutive month in November, mainly due to lower oil prices. Excluding the effects from the April sales tax increase, inflation fell from 1.0 per cent in September to 0.7 per cent in November year on year.

On the monetary policy front, the Bank of Japan (BOJ) surprised markets at its October meeting by increasing its bond buying program from 60 – 70 trillion yen a year to 80 trillion yen. The additional stimulus was narrowly passed, with board members voting 5 to 4 in favor of expanding the BOJ's accommodative monetary policies. The board's decision was an attempt to safeguard the progress achieved thus far, and signaled to markets that policymakers are intent on ensuring that the economy does not return to deflation. Following the October meeting, the Bank of Japan maintained its monetary policy stance. The board acknowledged that the sharp decline in oil would diminish pricing pressure going forward, but expressed that "inflation expectations appear to be rising on the whole" and maintained that the Japanese economy was continuing "to recover moderately as a trend".

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

During the fourth quarter, against the backdrop of disappointing economic data in the Euro Area and China, falling commodity prices, persistent geopolitical risks and the uncertainty surrounding the timing of the Federal Reserve's (Fed) first rate hike, yields at the shorter end of the curve moved higher while yields of longer dated US Treasuries declined as investors sought safe haven assets. In addition, Central bank policy decisions drove developed sovereign bond yields lower during the quarter.

Yields in the euro zone moved lower, given the region's morose outlook and the mounting risk of deflation. Markets were somewhat disappointed that the European Central Bank (ECB) did not announce any additional stimulus measures during the fourth quarter. However, ECB President Mario Draghi indicated that there were plans to expand the bank's balance sheet and announced that technical preparations were underway, should the Governing Council decide to alter "the size, pace and composition" of their measures.

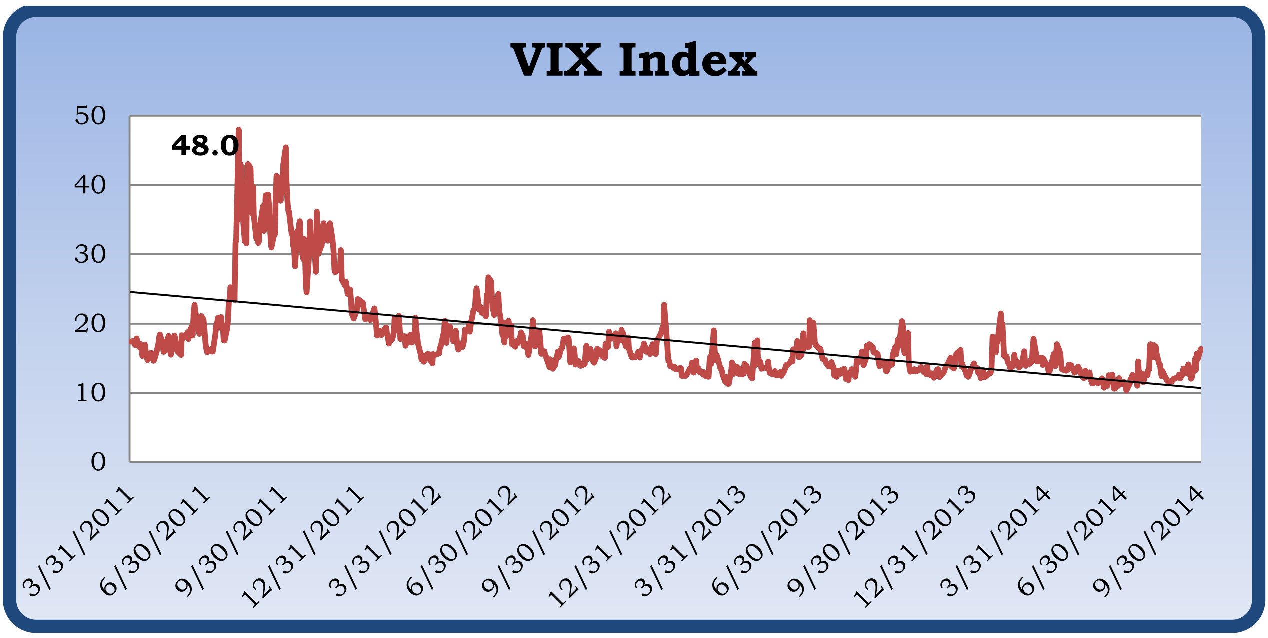
In the United Kingdom (UK), lower inflation, political uncertainty regarding the upcoming elections, economic stagnation in Europe and downward revisions to global growth dampened the Bank of England's (BOE) economic outlook. Markets shifted expectations regarding the timing of the first rate increase in the U.K., pricing in the possibility that the BOE may raise rates later than previously anticipated. Ten-year British Gilt yields fell 66.9 basis points to end the quarter at 1.76 per cent.

During the fourth quarter, 10-year JGBs declined 20.4 basis points to 0.32 per cent. The Bank of Japan surprised markets at its October 2014 meeting by expanding the annual target for its monetary base to 80 trillion yen from 60 to 70 trillion yen. The economy entered a recession following the April sales tax increase and waning inflationary pressures prompted the BOJ to provide additional easing in an effort to achieve its 2 per cent price target and end the country's deflationary mindset.

Developed equity markets posted gains at the end of a volatile fourth quarter of 2014 with the exception of the some European markets which posted negative returns on account of a deteriorating economic landscape. In the US, equity markets rallied, particularly in December with the S&P was reaching a milestone after crossing the 2000 mark.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, spiked during the fourth quarter of 2014 ending the period at 19.2 points, up from 16.71 points at the beginning of the fourth quarter of 2014. The VIX reached a high of 26.25 mid-October 2014 on account of speculation about U.S. economic data and the Fed's statements at that time, but quickly retreated to levels below 20 the following week. Despite these pockets of market volatility during the fourth quarter, the VIX averaged just 16 over the quarter, which was 2.5 points above the average of the prior three quarters, but still well below crisis levels.

Figure 1
Market Volatility in the U.S.
/points /

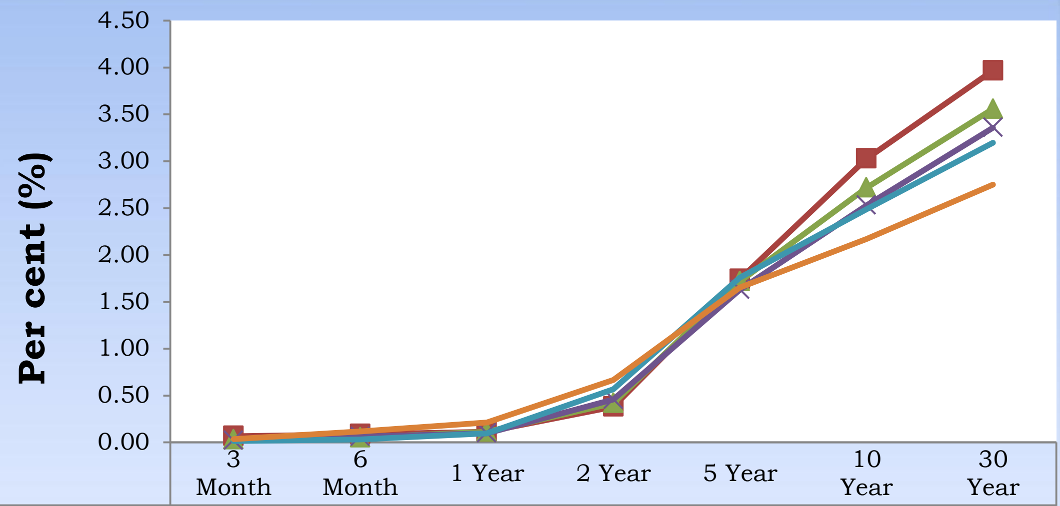


Source: Bloomberg

U.S. Fixed Income

During the quarter ended December 2014, yields ~~at the shorter end~~at the 0-2 year portion of the curve moved higher as the U.S. economic recovery gained traction. The 2-year U.S. Treasury rate rose 9.7 basis points to end the quarter at 0.67 per cent, while the yield on the 10-year Treasury fell 31.8 basis points to 2.17 per cent. Over the quarter, demand for safe haven assets was driven by falling oil prices and global macroeconomic concerns. In addition, demand for longer dated U.S. treasuries was supported by the relative value of the U.S. Treasury market in relation to other developed market bonds. The U.S. Treasury curve flattened further and the spread between the 2-10 year portion of the curve narrowed 41.5 basis points to 1.51 percentage points.

Figure 2
U.S. Treasury Yield Curve
/per cent/

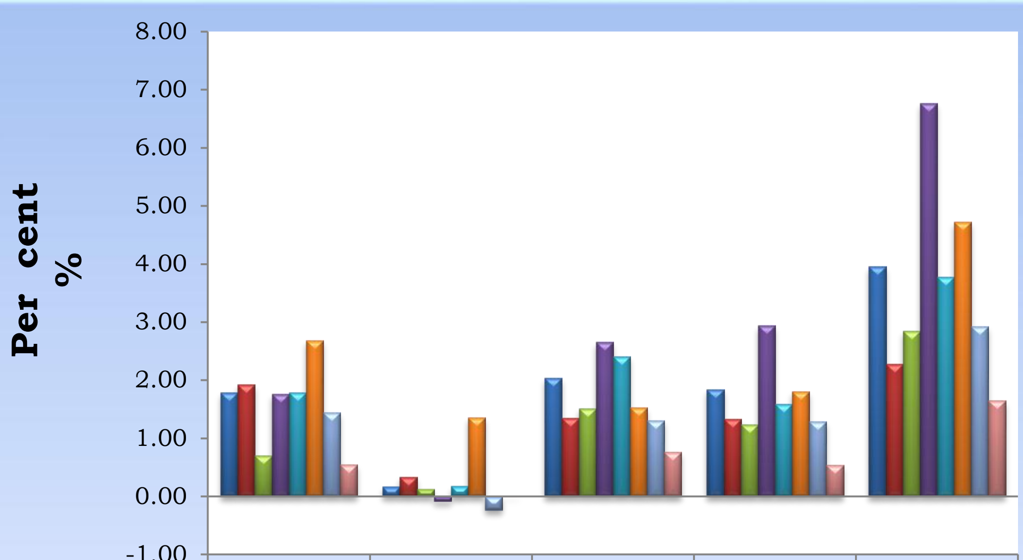


	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
December 31, 2013	0.07	0.09	0.11	0.38	1.74	3.03	3.97
March 31, 2014	0.03	0.05	0.11	0.42	1.72	2.72	3.56
June 30, 2014	0.02	0.06	0.10	0.46	1.63	2.53	3.36
September 30, 2014	0.02	0.03	0.10	0.57	1.76	2.49	3.20
December 31, 2014	0.04	0.12	0.21	0.66	1.65	2.17	2.75

Source: Bloomberg

The broader U.S. fixed income, as measured by the Barclays Capital U.S. Aggregate Bond index returned 1.79 per cent over the final quarter of 2014. The risk-off environment during the quarter pushed U.S. Treasuries higher, which returned 1.93 per cent. Spread sectors also performed well, although underperforming similar-duration treasuries amid heightened volatility, slowing global growth and geopolitical risks overseas. In the U.S. Corporate Investment grade sector, lower-quality Baa corporates generally underperformed higher quality A-rated issues. U.S. Corporates added 1.77 per cent versus 1.93 per cent increase for U.S. Treasuries. CMBS securities gained 1.45 per cent, while ABS securities added 0.55 per cent for the quarter. G-7 Global Sovereign bonds returned 2.69 per cent as global developed bond yields continued its decline over the quarter. In the MBS market, limited supply helped to support MBS prices during the quarter, even as the Fed concluded its asset purchase program.

Figure 3
Returns on Fixed Income Indices
/per cent/



	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	QTR ended Mar-14	FY 13/14
Barclays U.S. Aggregate	1.79	0.17	2.04	1.84	3.96
U.S. Treasuries	1.93	0.34	1.35	1.34	2.28
U.S. Agencies	0.71	0.13	1.52	1.24	2.85
U.S. Corporate	1.77	-0.08	2.66	2.94	6.77
U.S. MBS	1.79	0.18	2.41	1.59	3.78
G-7 Global Bonds (Hedged)	2.69	1.36	1.53	1.81	4.73
CMBS Index	1.45	-0.23	1.31	1.29	2.93
ABS Index	0.55	0.01	0.77	0.54	1.65

Source: Barclays Capital

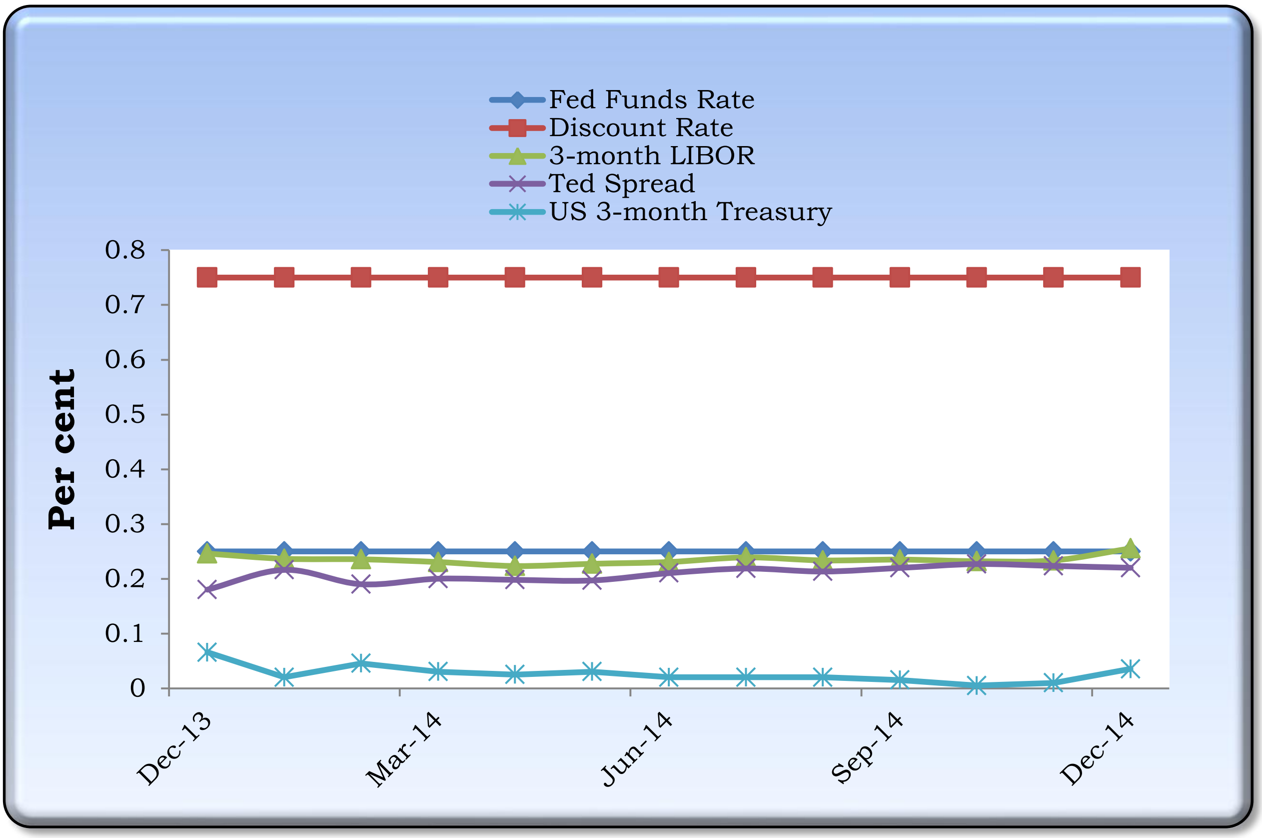
Global Fixed Income Markets

Developed sovereign bond yields continued to trend lower over the fourth quarter. In the Eurozone, the ECB pursued more aggressive measures during the quarter targeted at amplifying sluggish consumer demand, growth and deflationary pressures in the region. In this regard, the ECB maintained its policy rates, continued its Asset Backed Securities Purchasing Program, and began the third round Covered Bond Purchase Programs and another round of its Target Long Term Refinancing Operations. Against these measures, euro-area bond rates were lower. During the quarter, the Euro Area continued to be afflicted by the conflict between Russia and Ukraine which further dampened member countries' export driven growth, albeit less heightened compared to third quarter. German 10-year bunds continued its decent, ending the quarter at 0.54, 40.8 basis points lower than end of third quarter. Italian 10-year bonds fell 45.50 bps over the period to end the quarter at 1.88 per cent. In the UK, while political risk arising from the Scottish Referendum has abated in the fourth quarter, the deteriorating global environment and the moderating pace of domestic growth weighed on yields in the three months to December 2014. The UK 10-year gilt declined 66.9 basis points over the period, ending the quarter at 1.76 per cent.

Money Market

Short-term interest rates increased slightly during the fourth quarter of 2014 as major central banks' monetary policies diverged in the fourth quarter of 2014. The 3-month U.S. Treasury bill rate incremented over the fourth quarter 2014 while the 3-month London Inter-Bank Offered Rate (LIBOR) was also relatively unchanged at 0.25 per cent from 0.23 at end third quarter 2014.

Figure 4
U.S. Money Market Rates
/per cent/



Source: Bloomberg

Equity Markets

In the U.S., even though the S&P 500 returned 4.39 per cent in the fourth quarter; there were periods of volatility in mid-October and again in mid-December, given concerns surrounding the outlook for global growth as well as the precipitous fall in energy prices which pushed risk assets lower. Equity prices trended higher in October and November, as markets focused on a strong third quarter earnings season, solid U.S. economic growth and the net positive effects of lower oil prices on consumer spending. In December, the sharp drop in oil prices contributed to a general risk-off environment, with the index ending the month marginally lower, declining 0.16 per cent. For the quarter, utilities, consumer discretionary and healthcare were the top performing sectors, while materials and energy detracted from returns.

The MSCI EAFE (USD) fell 3.86 per cent over the quarter as the Euro and Japanese yen currencies continued to depreciate against the U.S. dollar. Equity markets in the euro zone were down in October and December as weak macroeconomic data and the lack of any significant commitments by the ECB to ease monetary policy weighed on sentiment. The German DAX rose 3.5 per cent over the quarter, supported by German export companies, which received a boost from the weaker euro. In the UK, the FTSE 100 lost 0.86 per cent in the fourth quarter, mostly due to the energy sector, which suffered significant losses.

In Japan, the Nikkei rose 7.9 per cent over the quarter. Despite the economy entering a recession in the third quarter, the weaker Yen, the Bank of Japan's expansion of its monetary base target and the Japanese Government Pension Investment Fund decision to increase its allocation to equities was generally supportive of risk assets.

Figure 5
Price Returns on Equity Indices
/Per cent/

	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	QTR ended Mar-14	FY 13/14
Russell 3000	4.74	-0.46	4.37	1.50	15.54
S&P 500	4.39	0.62	4.69	1.30	17.29
FTSE 100 - UK	-0.86	-1.80	2.21	-2.23	2.48
CAC 40 - France	-3.25	-0.15	0.71	2.22	6.58
DAX 30 - Germany	3.50	-3.65	2.90	0.04	10.24
Nikkei 225 - Japan	7.90	6.67	2.25	-8.98	11.88
MSCI EAFE	-3.86	-6.39	2.95	0.00	1.53

Source: Bloomberg

Currency Markets

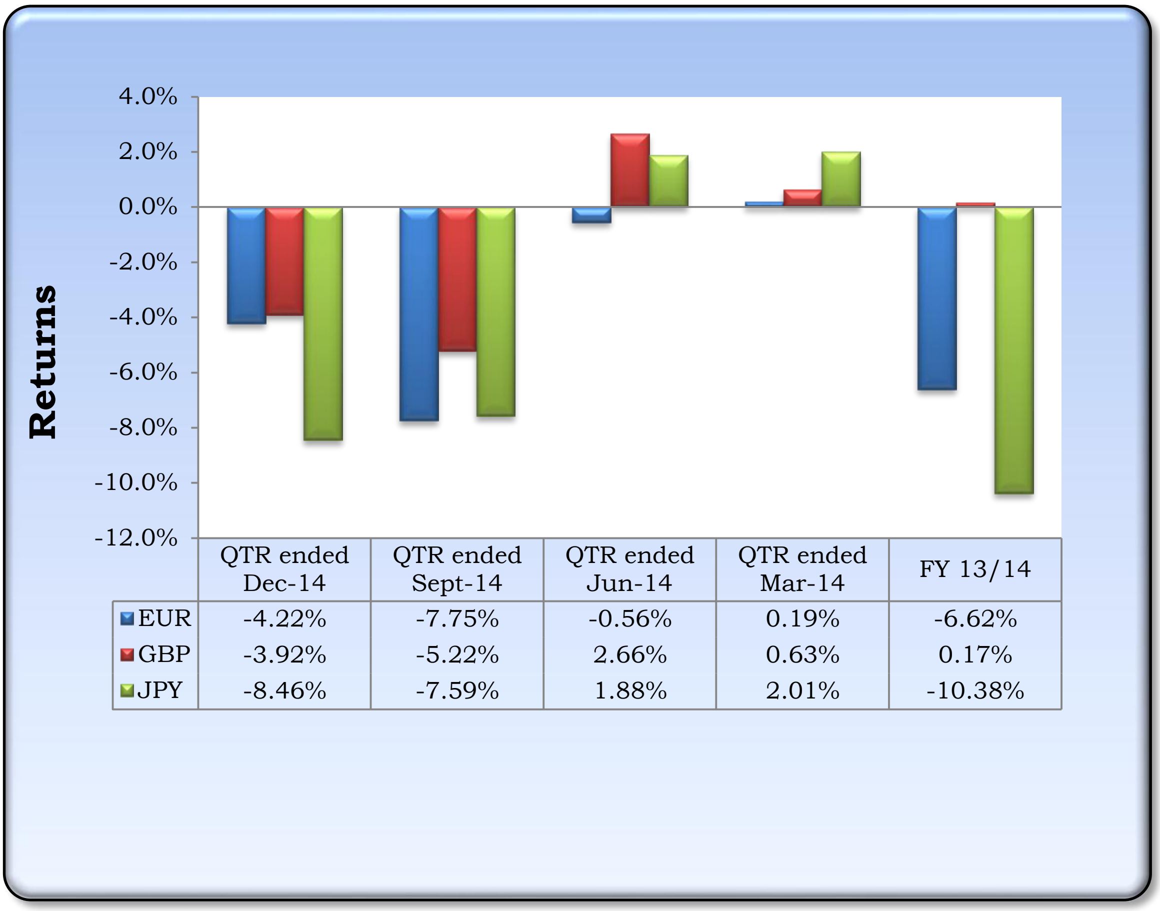
Diverging economic performance and central bank policies drove currency markets during the fourth quarter. The U.S. dollar continued to rally versus other major currencies. The Fed's conclusion of its bond buying program and its positive assessment of the economy, suggested that there was little change in the committee's outlook. The Fed's re-affirmation that the first interest rate increase could occur around mid-2015 helped support a stronger dollar.

The Euro currency continued its downward trend over the fourth quarter. The currency weakened further as it appeared increasingly likely that the ECB would announce some form of quantitative easing at its January 2015 meeting.

The pound depreciated over the quarter as policy makers lowered their growth and inflation forecasts due to the global slowdown and lower energy prices. The Bank of England Governor, Mark Carney highlighted the downside risks to the U.K. given the stalling recovery in Europe and the benign inflationary environment. Given the change in the BOE's outlook, market participants began to adjust their expectations for the first rate increase, pushing the timing to the second half of 2015.

The Yen lost 8.46 per cent over the three-month period. The currency came under increasing pressure in November, following the Bank of Japan's surprise announcement to expand the annual target for its monetary base to 80 trillion yen from 60 to 70 trillion yen.

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



	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	QTR ended Mar-14	FY 13/14
EUR	-4.22%	-7.75%	-0.56%	0.19%	-6.62%
GBP	-3.92%	-5.22%	2.66%	0.63%	0.17%
JPY	-8.46%	-7.59%	1.88%	2.01%	-10.38%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

During the period October 2014 to December 2014, the asset classes of the Fund deviated from the Strategic Asset Allocation (SAA) benchmark weights but remained within the permitted (+/- 5 per cent) range. 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%*

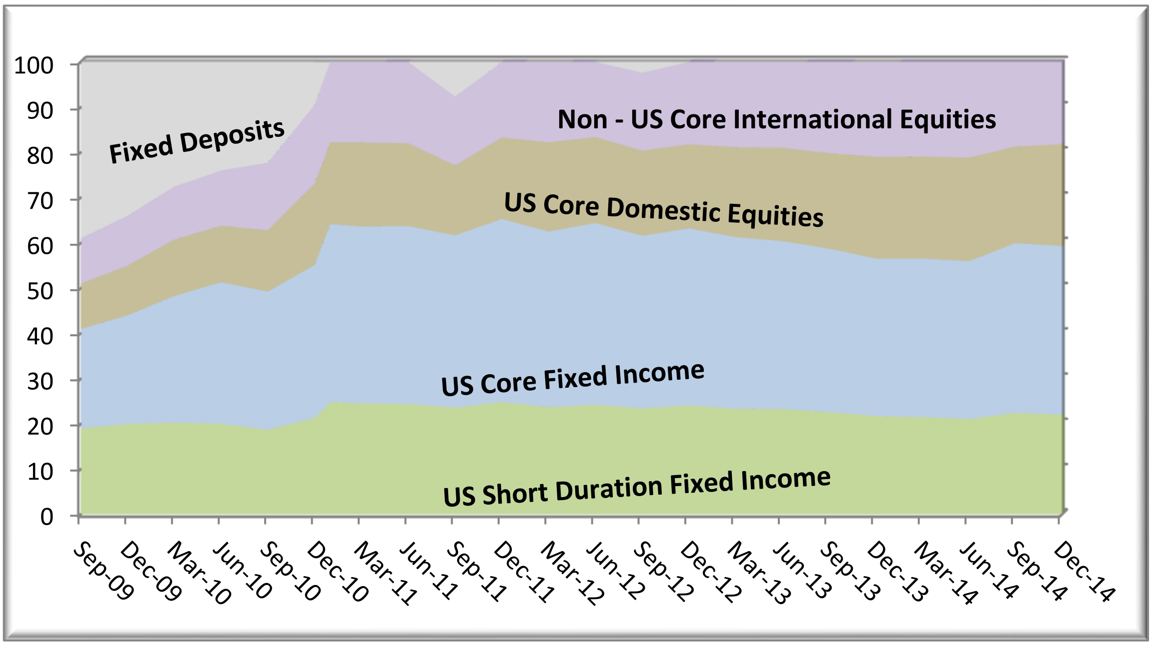
By the end of the quarter, the asset class with the largest overweight was the US Core Domestic Equity mandate while the US Short Duration Fixed Income mandate had the largest underweight position.

The total net asset value of the Fund as at the end of December 2014 was US$5,653.9 million, compared with US$5,533.4 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,653.1 million, while the remaining portion (US$0.8 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 weightings for the period March 31, 2014 to December 31, 2014 are shown in Table 1, overleaf.

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

Portfolio Weights	Asset Class	Target Weight SAA	Mar-14 Actual % of Fund	Jun-14 Actual % of Fund	Sep-14 Actual % of Fund	Dec-14 Actual % of Fund
	Cash	0.00	0.00	0.00	0.00	0.00
	US Short Duration Fixed Income	25.00	21.53	21.09	22.47	22.06
	US Core Domestic Fixed Income	40.00	35.01	34.93	37.52	37.26
	US Core Domestic Equity	17.50	22.56	22.87	21.33	22.50
	Non-US Core International Equity	17.50	20.90	21.12	18.68	18.17

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



Performance of the Investment Portfolio

For the fourth quarter of 2014, the HSF investment portfolio increased 2.25 per cent, compared with an increase of 1.63 per cent for the SAA benchmark[1]. This outperformance of 62 basis points can be attributed to favorable security selection and the deviation between the portfolio and SAA weightings. The HSF portfolio's quarterly return was primarily impacted by the equity mandates which added 1.61 per cent, while the fixed income portion of the Fund contributed 0.65 per cent.

The **US Short Duration Fixed Income** portfolio posted an increase of 0.35 per cent during the fourth quarter of 2014, underperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 14 basis points. This underperformance was attributed to interest rate decisions made during the quarter

[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%).

(i.e. the portfolio having a duration less than that of the benchmark) and the portfolio's exposure to Agency and breakeven inflation securites. The net asset value of this mandate as at December 31, 2014 was **US$1,247.1 million,** compared with US$1,243.1 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 1.52 per cent during the fourth quarter of 2014, underperforming its benchmark, the Barclays Capital US Aggregate Bond index, by 27 basis points. The underperformance of this portfolio relative to the benchmark was due to interest rate decisions by the manager and allocations to spread products over the quarter as yields fell. The net asset value of this mandate as at December 31, 2014 increased in comparison to the previous quarter, totaling **US$2,106.5 million** compared with US$2,075.7 million as at September 30, 2014.

The **Non-US International Equities** mandate declined 0.44 per cent for the fourth quarter of 2014, compared with a decline of 2.43 per cent for its benchmark, the MSCI EAFE ex Energy index. This outperformance was due to positive stock selection and to a lesser extent from favourable currency hedging against the euro and yen. The largest impact from stock selection stemmed from holdings in the Health Care and Financials sectors. Additionally, stock selection in developed Europe and the United Kingdom also benefited the portfolio. The net asset value of the Non-US Core International Equity mandate as at December 31, 2014 shrank to **US$1,027.3 million**, from US$1,033.4 million at the end of September 2014.

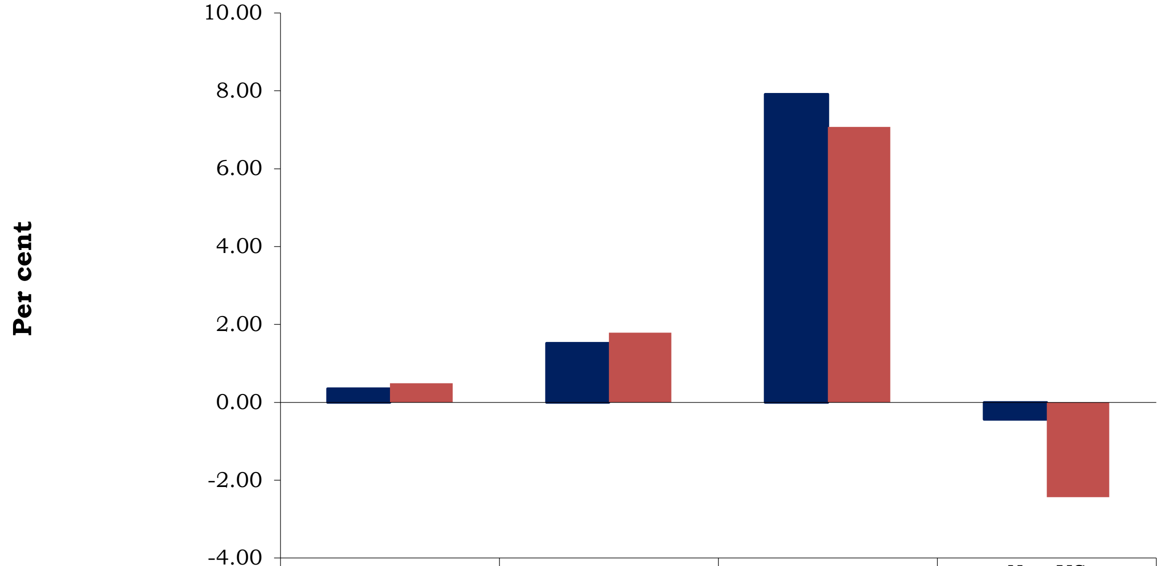
The **US Core Domestic Equities** mandate returned 7.91 per cent, compared with a benchmark return of 7.07 per cent. Stock selection was the major contributor to outperformance in this mandate, with the largest impact from Consumer Discretionary stocks. The net asset value of this mandate, as at December 31, 2014, was **US$1,272.1 million**, compared with US$1,179.8 million at the end of September 2014.

Table 2
Contribution to Quarterly Return,
For the period Oct 2014 – Dec 2014
/per cent/

	SAA Weights	Portfolio Weights as at 31-Dec-2014	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	2.25	1.63
US Core Domestic Fixed Income	40.00	37.26	0.57	0.71
US Core Domestic Equity	17.50	22.50	1.68	1.22
Non US Core International Equity	17.50	18.17	-0.08	-0.42
US Short Duration Fixed Income	25.00	22.06	0.08	0.12

NB: Differences in totals are due to rounding.

Figure 8
Absolute Returns by Asset Class
For the period Oct 2014 – Dec 2014
/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core Internationa l Equities
Composite Portfolio Return	0.35	1.52	7.91	-0.44
SAA Benchmark Return	0.49	1.79	7.07	-2.43

SECTION 4 –COMPLIANCE AND PORTFOLIO RISKS

Compliance

During the quarter ended December 31 2014, there were no breaches of the Investment Guidelines.

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

Within 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 December 31, 2014.

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 over a range of market conditions and lowering 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, 2014.

Table 4
Weighted Average Duration
/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.29**	**2.64**
US Core Domestic Fixed Income	**5.04**	**5.24**

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 December 2014, the currency exposure for this portfolio was 97 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
March	1.46	1.30	16.28	5.47	4.00	147.73	5.80	5.37	43.52
June	2.56	2.30	25.90	8.17	6.38	178.44	5.96	5.51	45.76
September	-0.48	-0.73	25.31	7.65	5.60	204.51	5.69	5.22	47.69
FY 2015									
December	2.25	1.63	62.27	2.25	1.63	62.27	5.81	5.26	54.46

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	Quarterly Income	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
September 30, 2014	5,533,425,248	392,680,521	1,572,945,746	-
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	-
March 31, 2014	5,429,643,570	86,362,097	1,467,996,676	-
June 30, 2014	5,563,339,006	90,809,342	1,602,500,838	-
September 30, 2014	5,533,425,248	137,655,556	1,572,945,746	-
December 31, 2014	5,653,895,156	53,339,276	1,693,454,823	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	9,079	152
Coupon (%)	3.34	1.86
Duration (Years)	5.24	2.64
Average Life (Years)	7.24	2.72
Yield to Maturity (%)	2.13	0.96
Option Adjusted Spread (bps)	39	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	2,854	863
Earnings Per Share (EPS Growth 3-5y fwd)	10.3	9.08
Price Earnings (P/E fwd)	16.7	14.7
Price / Book (P/B)	2.7	1.70
Weighted Average Market Capitalization* (Bn)	$100.87	$56.2

*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.

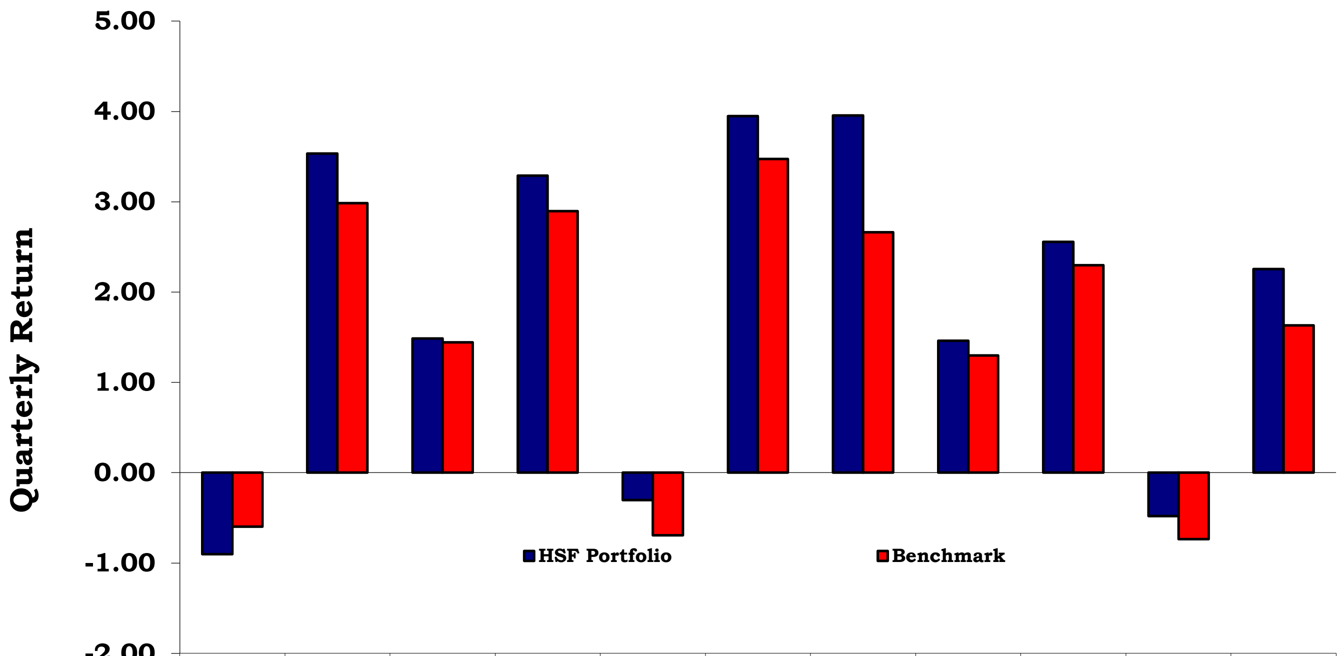
Appendix IV
Summary of the Fund's Net Asset Value by Mandate
/US$ Million/

	December 2013	March 2014	June 2014	September 2014	December 2014
Total Fund Value	**5,355**	**5,429**	**5,563**	**5,533**	**5,654**
Total Value of Equity	**2,325**	**2,359**	**2,446**	**2,213**	**2,299**
US Core Domestic Equity	1,204	1,225	1,272	1,180	1,272
Non-US Core International Equity	1,122	1,135	1,174	1,033	1,027
Total Value of Fixed Income	**3,028**	**3,070**	**3,115**	**3,319**	**3,354**
US Short Duration Fixed Income	1,165	1,169	1,173	1,243	1,247
US Core Domestic Fixed Income	1,863	1,901	1,942	2,076	2,106
Total Value of Cash or Cash Equivalents	**1**	**1**	**3**	**1**	**1**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/

Quarterly HSF & SAA Benchmark Returns



	FY2012 Q3	FY2012 Q4	FY2013 Q1	FY2013 Q2	FY2013 Q3	FY2013 Q4	FY2014 Q1	FY2014 Q2	FY2014 Q3	FY2014 Q4	FY2015 Q1
HSF Portfolio	-0.90	3.53	1.49	3.29	-0.30	3.95	3.95	1.46	2.56	-0.48	2.25
Benchmark	-0.60	2.98	1.44	2.90	-0.69	3.47	2.66	1.30	2.30	-0.73	1.63