Trinidad and Tobago

Heritage & Stabilization Fund

Quarterly Investment Report

April – June 2015

Central Bank of Trinidad & Tobago

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EXECUTIVE SUMMARY

During the second quarter of 2015, downside risks to global growth resurfaced in the form of the Greek debt crisis and a slowing of the Chinese economy. This followed heightened concerns in the first quarter about the impact on global demand arising from the strengthening of the United States dollar. Despite these risks, global growth remained on a positive trajectory (albeit a revised downward projection) as estimated by the International Monetary Fund (IMF) in June. The IMF forecasted global growth for 2015 at 3.3 per cent, down from an estimated 3.5 per cent in April.

In the **United States (US)** economic data releases for the second quarter were somewhat mixed but broadly indicated that the US economy expanded albeit at a slower pace than previously anticipated. The non-farm payrolls increased in the second quarter relative to the first quarter and unemployment declined by 0.2 percentage points over the same period. Finally, the Fed kept monetary policy unchanged in the second quarter and continued to reiterate that the decision to raise rates will be data dependent and that subsequent increases would be determined on a meeting by meeting basis.

The **Euro zone** economic recovery gradually improved in the first quarter of 2015 as growth for the period was recorded at 0.4 per cent up from 0.3 per cent in the fourth quarter of 2014. The Composite Purchasing Managers' Index (PMI) pointed to continued growth in the Euro zone in the second quarter, as the index improved to a four month high of 54.2 in June. Furthermore, the IMF revised its Euro Area growth projection for 2016 upward to 1.7 per cent from the 1.6 per cent estimate recorded in April. Greece, however, continues to weigh on the Euro Area as the possibility of a Greek exit increased at the end of June and into the early days of July. Given the economic conditions in the Euro Area, the ECB continued to maintain its focus on supporting economic activity and maintaining price stability over the medium term, through its accommodative policy measures.

The economy of the **United Kingdom (UK)** continued to exhibit positive growth trends during the quarter, although first quarter growth was relatively slower than in the fourth quarter of 2014. Composite PMI data showed a relative slowdown in expansion in June, on account of slowed manufacturing growth. The Bank of England (BoE) kept its benchmark interest rate and its stock of asset purchases constant and also continues to set monetary policy to meet its 2 per cent inflation target in the medium term. By subtracting the transitory effects of oil prices, the BoE has concluded that there is still underutilized capacity in the UK economy.

In **Japan**, annualized growth measures gained momentum during the first quarter of 2015, expanding at 3.9 per cent compared to 1.2 per cent in the fourth quarter of 2014. Household spending and retail sales both reversed negative readings recorded in the first quarter and supported growth prospects going forward, with retail sales rising 3.0 per cent year-on-year in May and household spending increasing 4.8 per cent year-on-year in May. The Bank of Japan (BoJ) maintained the level of its bond buying program but lowered its growth projections to 1.7 per cent for the current fiscal year ending March 2016.

In **equity markets**, investor sentiment concerning Greek debt crisis was a driving force for returns during the second quarter. Both the S&P 500 and the MSCI EAFE posted quarterly declines in the second quarter, driven mainly by negative returns in the month of June, as Greece continued its debt negotiations. Japanese stocks however, appeared relatively unaffected by the developments in Greece, as aggressive quantitative easing by the BoJ helped to deliver strong gains over the second quarter.

Sovereign bond yields ended the quarter higher, as **bond markets** experienced a global market sell-off due to improving economic conditions in the US and UK. This sell-off was short lived, when the flight to quality trade returned to the market in June, pushing up the prices of US Treasuries and German bunds. Greek debt negotiations served to stem the outflow of funds and mitigate the rise in sovereign bond yields. The broader US fixed income market declined during the quarter, as credit spreads widened and greater bond supply entered the Municipal and US Investment grade corporate bond markets.

The HSF investment portfolio lost 0.02 per cent for the quarter ended June 2015, compared with a decrease of 0.51 per cent for the Strategic Asset Allocation (SAA) benchmark. The Fund's exposure to equity securities added to absolute returns, partially offsetting the losses generated by the fixed income portfolio. At the end of June 2015, the net asset value of the HSF was US$5,774.9 million, a decrease from the US$5,779.4 million reported at the end of March 2015.

Contribution to Quarterly Return

For the period Apr 2015 – Jun 2015

/per cent/

	SAA Weights	Portfolio Weights as at 30-Jun-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	-0.02	-0.51
US Core Domestic Fixed Income	40.00	36.53	-0.56	-0.67
US Core Domestic Equity	17.50	22.58	0.10	0.06
Non US Core International Equity	17.50	19.13	0.44	0.11
US Short Duration Fixed Income	25.00	21.75	0.00	0.00

NB: Differences in totals are due to rounding.

Comparative Quarterly Returns

For the Quarters ended Dec 2014 – June 2015

/per cent/

	3 Months Weighted Return as at 30-Jun-2015		**3 Months Weighted Return as at 31-Mar-2015**		**3 Months Weighted Return as at 31-Dec-2014**	
	HSF	**Bench-mark**	**HSF**	**Bench-mark**	**HSF**	**Bench-mark**
Composite Portfolio	-0.02	-0.51	2.29	2.25	2.25	1.63
US Core Domestic Fixed Income	-0.56	-0.67	0.65	0.65	0.57	0.71
US Core Domestic Equity	0.10	0.06	0.48	0.40	1.68	1.22
Non US Core International Equity	0.44	0.11	0.97	0.96	-0.08	-0.42
US Short Duration Fixed Income	0.00	0.00	0.17	0.23	0.08	0.12

Comparative Financial Year to Date Returns

For the periods June 2014 & June 2015

/per cent/

	Financial Year to Date Return as at 30-Jun-2015		Financial Year to Date Return as at 30-Jun-2014	
	HSF	Bench-mark	HSF	Bench-mark
Composite Portfolio	4.58	3.39	8.17	6.38
US Core Domestic Fixed Income	0.66	0.68	1.53	1.50
US Core Domestic Equity	2.28	1.68	3.60	2.86
Non US Core International Equity	1.33	0.65	2.66	1.74
US Short Duration Fixed Income	0.25	0.36	0.21	0.17

SECTION 1 – INTERNATIONAL ECONOMIC ENVIRONMENT

United States

The United States (US) economy contracted in the first quarter of 2015. Gross Domestic Product (GDP) fell at an annualized rate of 0.2 per cent compared to a 2.2 per cent increase in the fourth quarter of 2014. Severe winter weather and port delays on the west coast contributed to the slowdown, however, growth is expected to resume as these transitory factors abate. Economic data releases for the second quarter were somewhat mixed but broadly indicated that the US economy would expand, albeit at a slower pace than previously anticipated. The Markit US Composite PMI pointed to a slowdown in activity during the quarter, with a reading of 54.6 in June, down from 56.0 in May and 59.2 at the end of the previous quarter. The housing market however strengthened over the period, delivering robust growth in housing starts and new home permits. Increased activity in the housing market should help offset the negative effects of a stronger US dollar on exports and the manufacturing sector.

The labour market continued to make further progress and the pace of job gains picked up, with non-farm payrolls for the three months to June averaging 221,000 versus 195,000 in the first quarter. The unemployment rate fell from 5.5 per cent at the end of March to 5.3 per cent at the end of June. The improving jobs market coupled with savings from lower oil prices and higher equity and home prices should place US households in a better financial condition. Nonetheless, retail sales struggled to gain momentum in the second quarter, rebounding strongly in May only to retreat in June. While US consumers have been slow to increase purchases thus far, economists remain optimistic that the fundamentals supporting higher consumption levels will spur spending during the second half of the year.

The Federal Reserve (Fed) kept monetary policy unchanged in the second quarter and continued to convey a somewhat consistent and balanced message. The committee re-iterated that the decision to raise rates will be data dependent and that subsequent increases would be determined on a meeting by meeting basis. Given the first quarter contraction and the weaker than expected rebound in economic activity in the second quarter, the Fed, as widely anticipated, did not raise rates at its June Federal Open Market Committee (FOMC) meeting. While the economy is moving towards full employment, inflationary pressures remain subdued with the Core Personal Consumption Expenditure (PCE) Index falling to 1.2 per cent in May from 1.4 per cent in

March. The Fed expects inflation to meet its 2.0 per cent target in the long run and several Fed members have mentioned that it would be appropriate to adjust monetary policy before the committee achieves its objectives. The FOMC reduced its growth expectations for 2015 from 2.3 to 2.7 per cent in March to 1.8 to 2.0 per cent in June but the majority of participants maintained that it would be appropriate for the first increase in the target federal funds rate to occur in 2015.

Euro Area

In the three months to March, the Euro Area expanded 0.4 per cent, up from 0.3 per cent in the final quarter of 2014. Growth was mainly supported by stronger domestic demand, particularly from an improvement in private consumption expenditure and an acceleration in gross fixed capital formation. The strength of the recovery remained uneven across member states of the Euro Area. Spain led the economic expansion, followed by France and Italy. Meanwhile, Germany's growth disappointed compared to the previous quarter, down to 0.3 per cent from 0.7 per cent in the first quarter of 2015.

Euro Area recovery continued on its modest growth trend in the second quarter of 2015, albeit uneven across member states as the combination of cheaper oil prices, a weak euro and the ECB's aggressive monetary policy stance continued to support progress over the period. In June, the Composite Purchasing Manager's Index (PMI) printed 54.2, a four-month high, up from 53.6 in May and 54.0 in March. This upturn in overall expansion suggested the currency bloc gained traction over the second quarter and was driven by accelerated rates of growth in both the Services and Manufacturing sectors, particularly in Germany, France and Italy. Meanwhile, the Greek debt situation remained a significant downside risk to the Euro Area

Over the quarter, Greece continued to weigh on growth prospects in the Euro Area as the possibility of a Greek exit underpinned by the uncertainty surrounding Greece's debt crisis intensified nearing the end of June. On June 26th, Greece imposed capital controls and declared a bank holiday that would continue indefinitely. This, after the ECB announced it would not increase the already expansive €89 billion Emergency Lending Assistance (ELA) Facility to the Greek financial system. At the same time, the Greek Government called for a July 5th Referendum for voters to decide if they accepted the austerity measures in exchange for a bailout deal by its creditors. Adding to this, on June 30th, Greece defaulted on its €1.6 billion payment to the IMF and faced expiry of its then existing bailout package from the ECB. By the end of June, the Greek government was in €2 billion arrears to the IMF and had yet to seal a new deal with its creditors. On July, 6th, the results of the snap referendum revealed the Greeks rejected further austerity measures which put the Euro Area at greater risk of a Greek exit. On July 9th, however, the Greek government submitted proposals to its creditors in order to unlock needed bailout funds. Following intense talks between the Greek government and Eurozone, leaders approved third bailout in the amount of €7 billion, which would be facilitated through the European Stabilization Mechanism (ESM), and the ECB restored the conditions for a raise in the ELA, previously capped just under €89 billion.

The Euro Area labour market continued to improve during the second quarter of 2015. Unemployment edged down to 11.1 per cent in May, from 11.2 per cent in March and 11.6 per cent for the same period of 2014. Notwithstanding this, unemployment across some member states remain elevated, particularly in Greece, Spain and Italy, which showed little improvement over the quarter. Euro Area inflation improved to 0.2 per cent in June, after bottoming out in April at 0 per cent. Inflation excluding energy and food also edged up to 0.8 per cent in June, from 0.6 per cent in March. The main contributors to Euro Area inflation were food, alcohol and tobacco prices, which continued to edge up marginally but low energy prices continued to suppress the inflation rate.

Against this backdrop, the ECB remained focused on maintaining price stability over the medium term, citing that its accommodative stance has contributed to supporting economic activity. The ECB maintained its key interest rates over the quarter. Disinflationary pressures are expected to dissipate over 2015 due to the expected stabilization in oil prices and firmer growth prospects in the Euro Area.

United Kingdom

In the UK, GDP rose 0.4 per cent in the first quarter, faster than the 0.3 per cent first estimate but down from 0.8 per cent growth in the three months to December 2014. The first quarter growth was driven by consumer spending, corporate investment and strength in the construction sector. Consumer spending rose 0.9 per cent in the three months to March and business investment grew 0.2 per cent over the same period. The slowdown in the growth for the quarter was partly attributable to the unfavourable net trade balance which subtracted an estimated 0.6 per cent.

Despite the slowdown in the first quarter due to a drag on the external balance, the UK economy continued to strengthen in the second quarter, albeit at a moderate pace. In June, the Markit/CIPS UK Composite fell to 57.4 from 58.9 in March, on account of slowed manufacturing growth but was supported by robust expansions in Construction and Services. Growth across sectors was driven by slightly higher employment levels over the quarter, despite a decline in employment in the manufacturing sector. On the political front, following its victory in May, the Conservative party called for a post-legislative referendum for the country's continued membership in the European Union (EU). To that end, Standard and Poor's downgraded the country's credit outlook from stable to negative, placing the UK's AAA rating at risk. The credit rating agency cited that the economy would face challenges if it were to separate from the EU.

In June, the Consumer Price Index (CPI) stood at 0 per cent after it increased to 0.1 per cent in May, in line with expectations. The 0 per cent reading showed that higher prices for alcohol and tobacco offset lower prices for food and non-alcoholic beverages. Meanwhile, CPI ex-energy and food continued to trend downward in the three months to June. By the end of June, CPI ex-energy and food was 0.8 per cent, down from 1.0 per cent in March. Over the quarter, the benign inflation prints for the UK economy, triggered a second letter[1] in May from Governor Mark Carney to Chancellor Osbourne as the inflation print fell by more than 1 per cent below the 2 per cent target. As was the case with the first letter written in February, the persistent decline in inflation was mostly attributable to the drop in energy prices, food and other goods, together with some downward pressure on import prices on account of the sterling's appreciation. The decline in both the core and headline inflation rates to more than one percentage point below the 2 per cent target has raised concerns about the first potential rate hike. However, the Bank of England (BoE) maintains that the factors constraining price growth are "likely to dissipate fairly shortly" and could strengthen "notably" by year end. Meanwhile, inflation expectations remain broadly in line with the Bank's inflation target.

In the broader labour market, May's unemployment rate stayed at its lowest rate since 2008 at 5.6 per cent, alongside growth in wages. Average weekly earnings accelerated to

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If the target is missed by more than 1 percentage point on either side – i.e. if the annual rate of CPI inflation is more than 3% or less than 1% – the Governor of the Bank must write an open letter to the Chancellor explaining the reasons why inflation has increased or fallen to such an extent and what the Bank proposes to do to ensure inflation comes back to the target. [1]Source: The Bank of England

3.2 per cent in May from 2.3 per cent in March and 2.7 per cent in April. Growth in Average Weekly Earnings ex-bonus also edged up in May to 2.8 per cent from 2.7 per cent in April and 2.3 per cent in March.

Against this backdrop, the minutes of its June 3rd meeting revealed the BoE's Monetary Policy Committee set its monetary policy to meet the 2 per cent inflation target in the medium term, "in a way that helped to sustain growth and employment." The Committee subtracted the transitory impacts of the oil price decline, and concluded that was there was still underutilized capacity the UK economy, but maintained a positive outlook for inflation. Consequently, the Bank kept its benchmark interest rate unchanged and maintained the positions for the stock of purchased assets at £375 billion. To this extent, the Monetary Policy Committee expressed that "the strength of the headwinds to growth had begun to ease" and "as they ease further over time, the interest rate required to keep the economy operating at normal levels of capacity and inflation at the target was likely to continue to rise." The BoE also revealed that the pace of tightening would be gradual.

Japan

The Japanese economy gained momentum in the first quarter of 2015, expanding at an annualized pace of 3.9 per cent compared to 1.2 per cent in the fourth quarter of 2014. The better than expected growth was largely driven by a build-up in inventories which is unlikely to persist going forward. After emerging from its technical recession in the fourth quarter, Japan's economic recovery remains fragile. The Nikkei Japan Manufacturing Purchasing Managers' Index hovered around the 50.0 level during the second quarter and export growth slowed, highlighting potential challenges for Japan, given China's move to re-balance its economy and its lower growth outlook.

After falling 10.6 per cent year over year in March, overall household spending grew 4.8 per cent in May, the first positive reading since the April 2014 sales tax hike. In addition, retail sales reversed its negative growth trend from the first quarter, rising 3.0 per cent year-on-year in May versus -9.7 per cent in March. While there are signs that the Japanese consumer is beginning to spend, some of the gains in retail purchases may have been fuelled by a weaker Yen, which is attracting an increasing number of tourists to Japan.

There was continued progress in the labour market, which should bode well for Japanese households. The unemployment rate trended lower to 3.3 per cent in May from 3.4 per cent in March, and the Jobs-to-applicants Ratio rose to 1.19 in May from 1.15 in March.

Inflationary pressures rose modestly as oil prices stabilized but remained well below the Bank of Japan's 2.0 per cent inflation target. The consumer price index rose 0.5 per cent in May versus 0.2 per cent in March (excluding the effects of the sales tax increase). However, the inflation index ex-fresh food was flat at 0.1 per cent.

At its July meeting, the Bank of Japan (BOJ) decided to maintain its bond buying program at 80 trillion yen a year but lowered its economic growth forecast. The BOJ reduced its growth projection for the current fiscal year to March 2016 by 0.3 percentage points to 1.7 per cent. Inflation is expected to reach the bank's target of 2.0 per cent in the fiscal year beginning April 2016. Governor Kuroda tried to talk down expectations for further stimulus but market participants anticipate that the BOJ will announce additional easing later this year in order to achieve its inflation target.

SECTION 2 – CAPITAL AND MONEY MARKET REVIEW

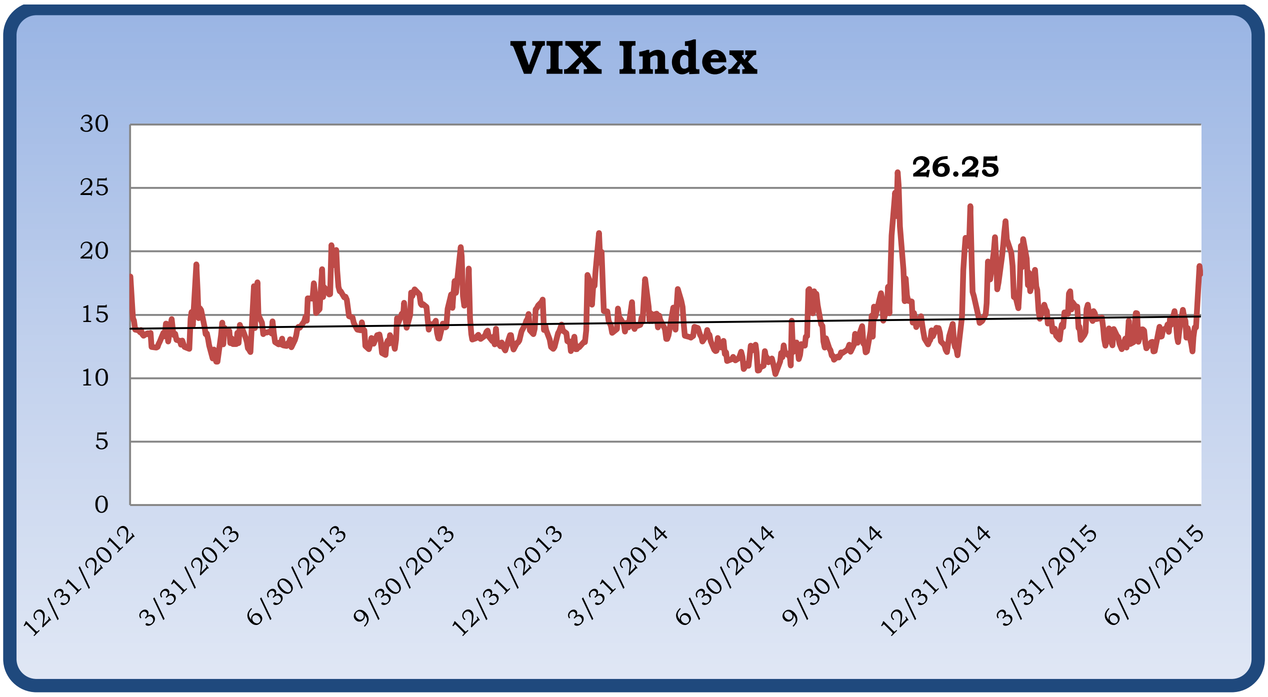
Over the quarter, global equity and bond markets were significantly affected by global headwinds as signs of an improving global economy were outweighed by the Greek debt crisis and to a lesser extent, the Chinese equity market slowdown and the expected first interest rate rise of the Federal Reserve. In equity markets, performance was adversely impacted by the heightened uncertainty surrounding the negotiations between Greece and its creditors to secure bailout funds, particularly as the June 30th IMF debt repayment neared, and contributed to relatively higher volatility levels. In European markets, the ECB's Quantitative Easing (QE) Program continued to provide support to the European equities over the second quarter but a widely anticipated correction in Germany's DAX 30, lead to lower returns. In Asian equity markets, Chinese equities also slid despite monetary easing measures by the People's Bank of China while the BoJ's continued efforts supported equity market returns.

The Chicago Board Options Exchange Volatility Index (VIX), which is a proxy for investor anxiety and market risk, averaged 13.76 points over the period, and stayed within a comfortable range, for the most part, between 12 and 16 points. On June 29th, however, the VIX reached its highest level over second quarter, at 18.85 points, which represented a 23 per cent surge from the beginning of the quarter and a 34 per cent spike from the previous day. This, as Greece's June 30th €1.6 billion repayment to the IMF was likely to result in default by the Greek government. To this end, the markets braced for a potential sell-off and by end of day June 30th, the VIX had reached 18.23 points.

Figure 1

Market Volatility in the U.S.

/points /



Source: Bloomberg

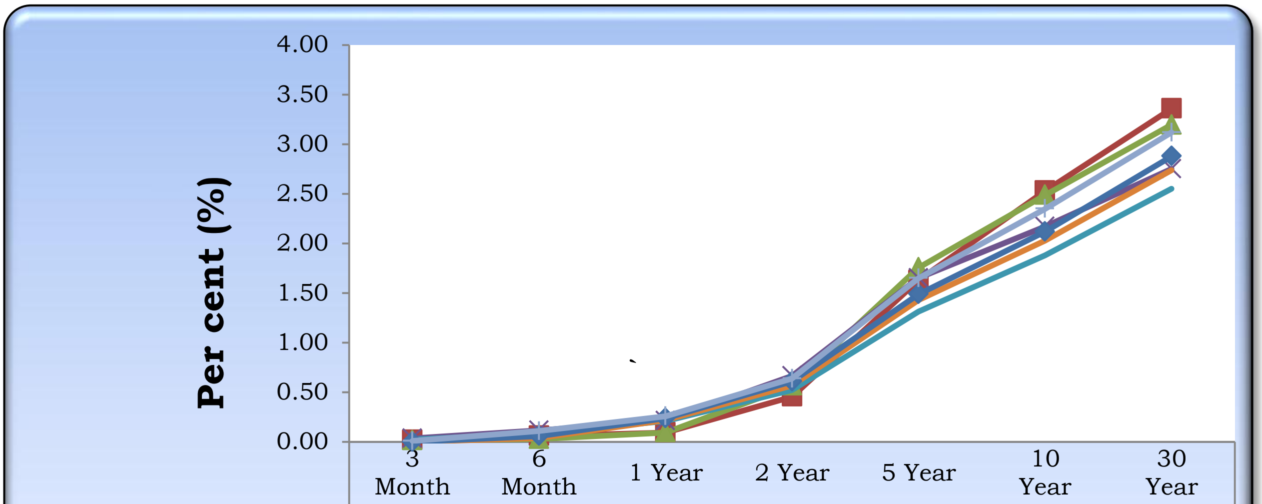
U.S. Fixed Income

During the second quarter, rates moved higher amid increased volatility and the US yield curve steepened with the spread between the 2-10 year portions of the curve rising 34.2 basis points to 1.71 per cent. US Treasury yields rose over the period due to a mixture of technical and fundamental factors. In early May and June, US Treasuries sold-off in tandem with German bunds. In addition, improving economic conditions in the United States increased the likelihood that the Federal Reserve would raise rates at least once this year. The 10-year reached a high of 2.50 per cent before retreating modestly towards quarter end, as safe haven flows resulting from the uncertainty surrounding Greece's membership in the Eurozone and the sharp downturn in the Chinese equity markets pushed treasury prices higher.

Figure 2

U.S. Treasury Yield Curve

/per cent/



	3 Month	6 Month	1 Year	2 Year	5 Year	10 Year	30 Year
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
March 31, 2015	0.02	0.09	0.21	0.52	1.31	1.88	2.55
April 30, 2015	0	0.04	0.22	0.57	1.43	2.03	2.74
May 29, 2015	0	0.06	0.24	0.61	1.49	2.12	2.88
June 30, 2015	0.01	0.11	0.26	0.64	1.65	2.35	3.12

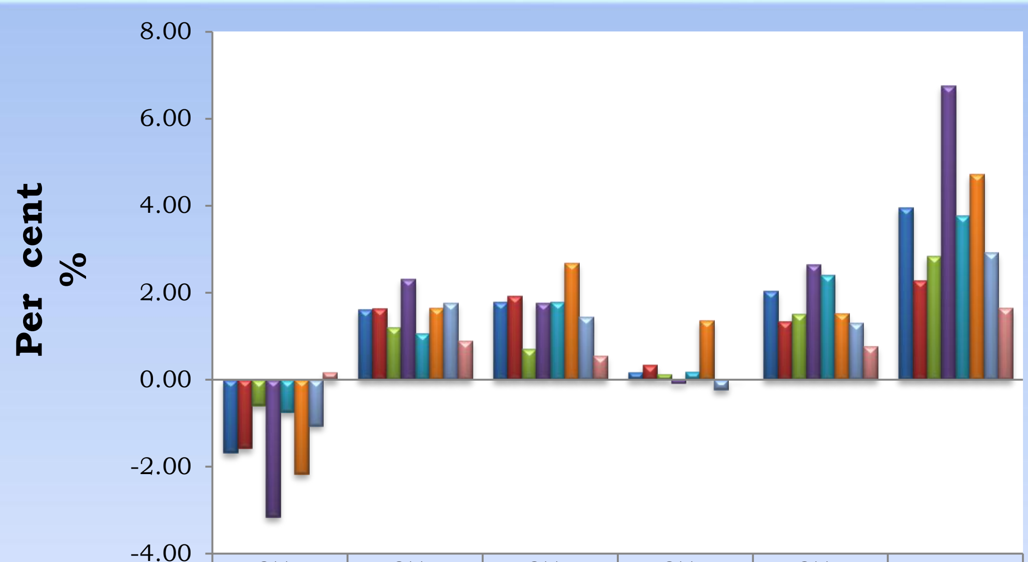
Source: Bloomberg

The broader US fixed income, as measured by the Barclays Capital US Aggregate Bond index declined 1.68 per cent over the second quarter. Spread sector performance was mixed; Municipals and U.S. Investment Grade corporates underperformed like-duration US Treasuries, while asset-backed securities and agencies posted a modest outperformance. Credit spreads widened over the period and greater supply negatively affected both the Municipal as well as the U.S. Investment Grade corporate sectors. In addition, the Municipal bond market was hurt by Puerto Rico's struggle to raise cash and the island's need for a comprehensive debt restructuring plan.

Figure 3

Returns on Fixed Income Indices

/per cent/



	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	FY 13/14
Barclays U.S. Aggregate	-1.68	1.61	1.79	0.17	2.04	3.96
U.S. Treasuries	-1.58	1.64	1.93	0.34	1.35	2.28
U.S. Agencies	-0.59	1.21	0.71	0.13	1.52	2.85
U.S. Corporate	-3.16	2.32	1.77	-0.08	2.66	6.77
U.S. MBS	-0.74	1.06	1.79	0.18	2.41	3.78
G-7 Global Bonds (Hedged)	-2.17	1.66	2.69	1.36	1.53	4.73
CMBS Index	-1.06	1.77	1.45	-0.23	1.31	2.93
ABS Index	0.17	0.90	0.55	0.01	0.77	1.65

Source: Barclays Capital

Global Fixed Income Markets

Global developed sovereign bond yields broadly rose over the second quarter. While economic data in the United States and the Eurozone reflected improving fundamentals, concerns regarding China's equity market correction and its slower growth outlook, as well as the potential contagion effects from the Greek debt crisis moderated higher yield movements over the quarter.

German bunds rallied earlier in the year as the European Central Bank (ECB) engaged in a full-scale bond buying program. The 10-year German bund reached a low of 0.05 per cent before reversing sharply, hitting an intraday high of 1.06 per cent. The collapse in German bund prices precipitated a broader global developed sovereign bond rout, and while improving fundamentals in the Eurozone supported higher yields, the size and pace of the increase indicated that there were also technical factors involved. The lower liquidity in the market coupled with traders simultaneously seeking to exit similar positions, may have exacerbated the magnitude of the move. Rising tensions between Greece and its creditors drove German bund demand near quarter end. Peripheral bond spreads widened, however, the increase was somewhat contained as contagion in the region was expected to be limited.

In the United Kingdom, gilts moved higher with the 10-year bond rising 44.8 basis points to end the period at 2.02 per cent. In addition to the global developed sovereign bond sell-off, yields increased due to improving economic fundamentals, which brought forward market expectations regarding the timing of the Bank of England's first rate rise.

Table 1

G-7 Generic Government 10 Year Yields

/per cent/

Country	Generic Government 10 Year Yields		Change (basis points)
	June 2015	March 2015	
US	2.353	1.923	43.00
UK	2.024	1.576	44.80
France	1.192	0.474	71.80
Germany	0.763	0.180	58.30
Italy	2.331	1.239	109.20
Canada	1.681	1.354	32.70
Japan	0.459	0.395	6.40

Source: Bloomberg

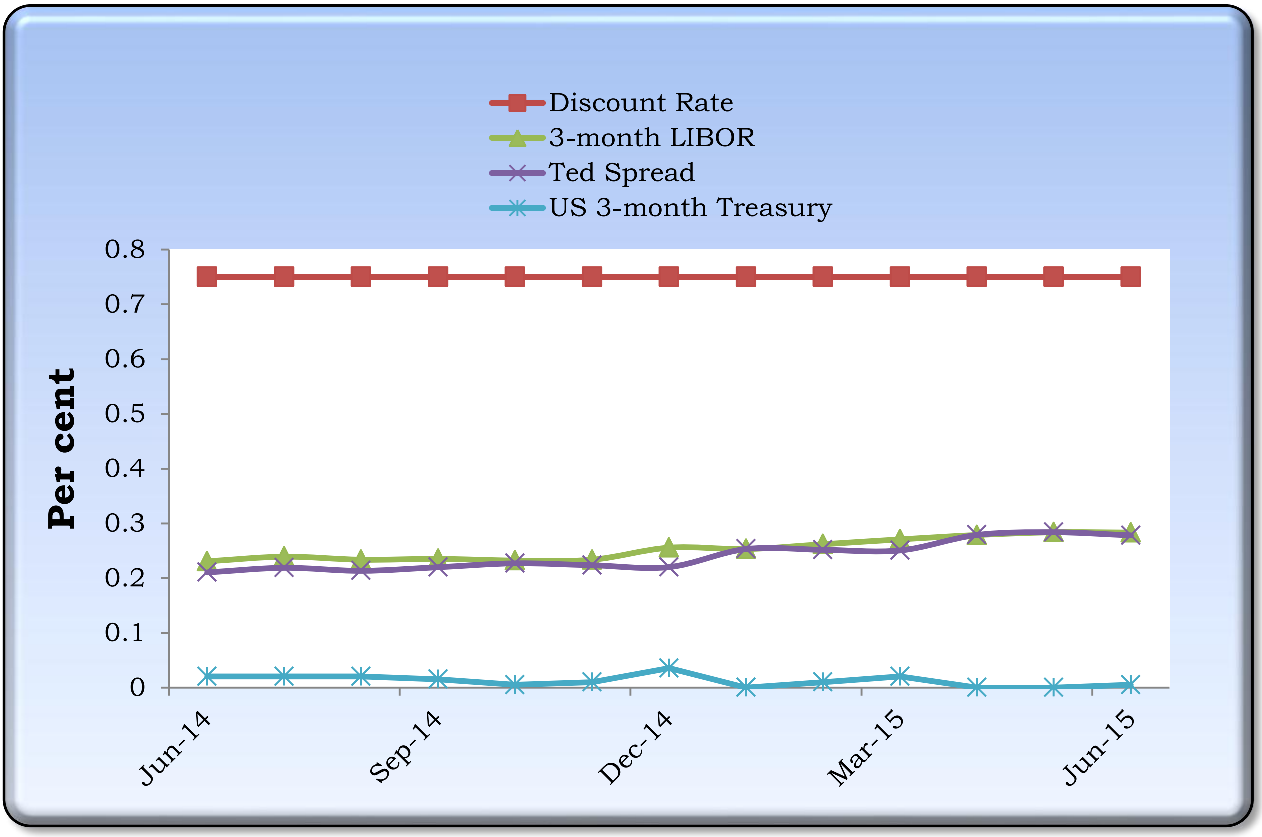
Money Markets

In the second quarter of 2015, the Fed funds rate and Discount rate remained unchanged at 0.25 per cent and 0.75 per cent as the timing of the Fed's first rate hike was pushed out until September or December of 2015. The 3-month US Treasury bill rate posted an overall decline by quarter-end June, to 0.0051 per cent from 0.0203 per cent in March and after hitting 0 per cent in April and May. The 1-month and 3-month London Inter-Bank Offered Rate (LIBOR) continued its upward trend, increasing to 0.1865 and 0.2832 in June from 0.176 and 0.27 in March respectively. Spreads between the 3-month futures contracts for US Treasuries and Eurodollars (Ted Spread) continued to widen over the second quarter. By quarter-end, the Ted Spread had increased by 0.11 per cent, to 0.2781 per cent from 0.2505 per cent.

Figure 4

U.S. Money Market Rates

/per cent/



Source: Bloomberg

Equity Markets

In the three months to June, US equity markets were relatively flat and were dragged lower by June's negative performance and the impact of the strong US dollar on export competitiveness. Concerns over the Greek debt crisis outweighed the strong first quarter corporate earnings and positive US economic data. Meanwhile robust merger and acquisition (M&A) activity helped prevent a larger decline in equity markets. Over the quarter, the S&P 500 returned -0.23 per cent and traded within a tight range, albeit above its 200 day moving average.

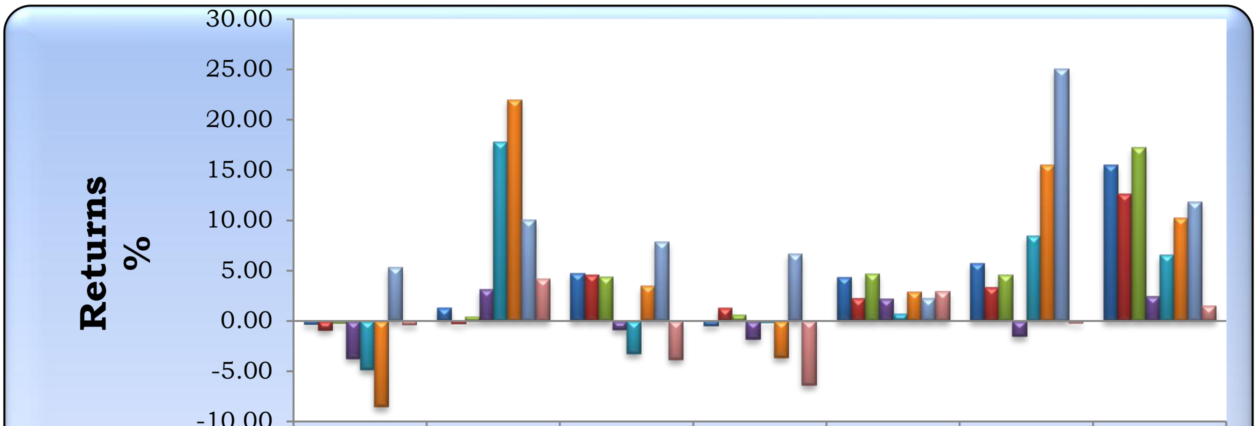
Non-US developed equity markets performance, as measured by the MSCI EAFE returned -0.37 per cent, largely on account of underperformance of European and UK equities as the escalation of the Greek debt crisis precipitated a shift in investor sentiment in European markets. Over the quarter, Germany's DAX 30 and France's CAC 40 lost its footing and declined before recouping some losses by the end of June. By quarter-end, the DAX had shed 8.53 per cent, although up 15.52 per cent year-to-date while the CAC 30 returned -4.84 per cent. Meanwhile, in the UK, the clear result from its May elections helped the FTSE 100 to partially offset the negative sentiment from the breakdown in bailout negotiations between Greece and its creditors over the quarter.

The Japanese equity market was the top performing developed stock market over the quarter. Stocks were supported by the Bank of Japan's ongoing monetary policies, positive economic data and a depreciating yen. By the end of the second quarter, the Nikkei 225 had added 5.36 per cent.

Figure 5

Price Returns on Equity Indices

/Per cent/



	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	FYTD 14/15	FY 13/14
Russell 3000	-0.34	1.32	4.74	-0.46	4.37	5.77	15.54
Dow Jones	-0.88	-0.26	4.58	1.29	2.24	3.38	12.65
S&P 500	-0.23	0.44	4.39	0.62	4.69	4.60	17.29
FTSE 100 - UK	-3.72	3.15	-0.86	-1.80	2.21	-1.54	2.48
CAC 40 - France	-4.84	17.81	-3.25	-0.15	0.71	8.47	6.58
DAX 30 - Germany	-8.53	22.03	3.50	-3.65	2.90	15.52	10.24
Nikkei 225 - Japan	5.36	10.06	7.90	6.67	2.25	25.12	11.88
MSCI EAFE	-0.37	4.19	-3.86	-6.39	2.95	-0.20	1.53

Source: Bloomberg

Currency Markets

The U.S. dollar paused from its upward trend in the second quarter, retreating 2.92 per cent, as measured by the US Dollar (DXY) Index. However, growing divergence in monetary policy across the globe is expected to drive currency movements and support a stronger U.S. dollar going forward.

After falling 11.3 per cent in the first quarter, the euro currency recovered modestly in the second quarter, gaining 3.88 per cent as technical and fundamental factors pushed the currency higher. The euro appreciated over the period as inflation entered positive territory for the first time in four months and there was growing optimism that the European Central Bank's quantitative easing program was providing some relief in the region. The Euro currency reached a high of 1.145 in mid-May but retreated modestly toward the quarter end, as the Greek debt negotiations deteriorated and the country was unable to make its June 30th payment to the International Monetary Fund (IMF).

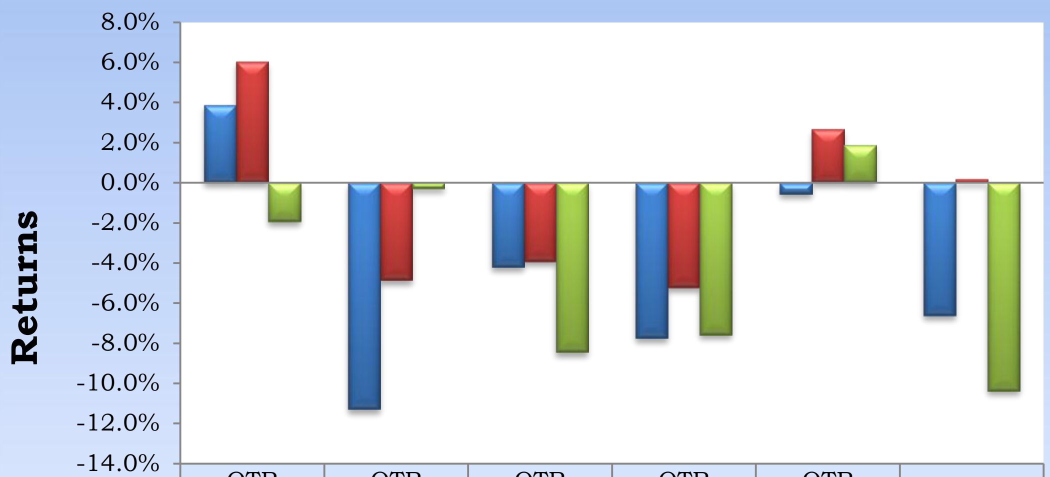
In the United Kingdom, the British pound climbed higher over the second quarter as the May 8th general elections resulted in a definite majority for the Conservative party. In addition, low but positive inflation as well as stronger than expected wage growth supported the view that the BoE may raise rates earlier than previously anticipated.

The Japanese Yen weakened over the period, falling 1.93 per cent versus the U.S. Dollar. The Japanese Yen moved in a tight trading range at the start of the second quarter but depreciated significantly starting mid-May, as stronger economic data in the U.S. and comments from the Fed Chair Janet Yellen indicated that a rate hike was likely this year.

Figure 6

Foreign Exchange Returns for Major Currencies vis-à-vis the U.S. Dollar

/per cent/



	QTR ended Jun-15	QTR ended Mar-15	QTR ended Dec-14	QTR ended Sept-14	QTR ended Jun-14	FY 13/14
EUR	3.88%	-11.30%	-4.22%	-7.75%	-0.56%	-6.62%
GBP	6.03%	-4.87%	-3.92%	-5.22%	2.66%	0.17%
JPY	-1.93%	-0.29%	-8.46%	-7.59%	1.88%	-10.38%

Source: Bloomberg

SECTION 3 – PORTFOLIO PERFORMANCE

Strategic Asset Allocation

During the period April 2015 to June 2015, the asset classes of the Fund deviated from the Strategic Asset Allocation (SAA) benchmark weights and the US Core Domestic Equity mandate exceeded the permitted (+/- 5 per cent) range. As at May 31, 2015, the US Core Domestic Equity Mandate had an allocation of 22.63 per cent, or 5.13 per cent above the SAA of 17.50 per cent. As at June 30, 2015, the US Core Domestic Equity mandate had an allocation of 22.58 per cent, which was 5.08 per cent above the SAA of 17.50 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 historically when compared with their fixed income counterparts. At the beginning of July, the portfolio was re-balanced to within the permitted SAA range for each of the mandates. A total of US$407.56 million was withdrawn from the two equity mandates and deposited to the two fixed income mandates.

The total net asset value of the Fund as at the end of June 2015 was US$5,774.9 million, compared with US$5,779.4 million at the end of the previous quarter. Of this total, the investment portfolio was valued at US$5,774.7 million, while the remaining portion (US$0.2 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 September 30, 2014 to June 30, 2015 are shown in Table 2, overleaf.

Table 2

Portfolio Composition relative to the Approved SAA

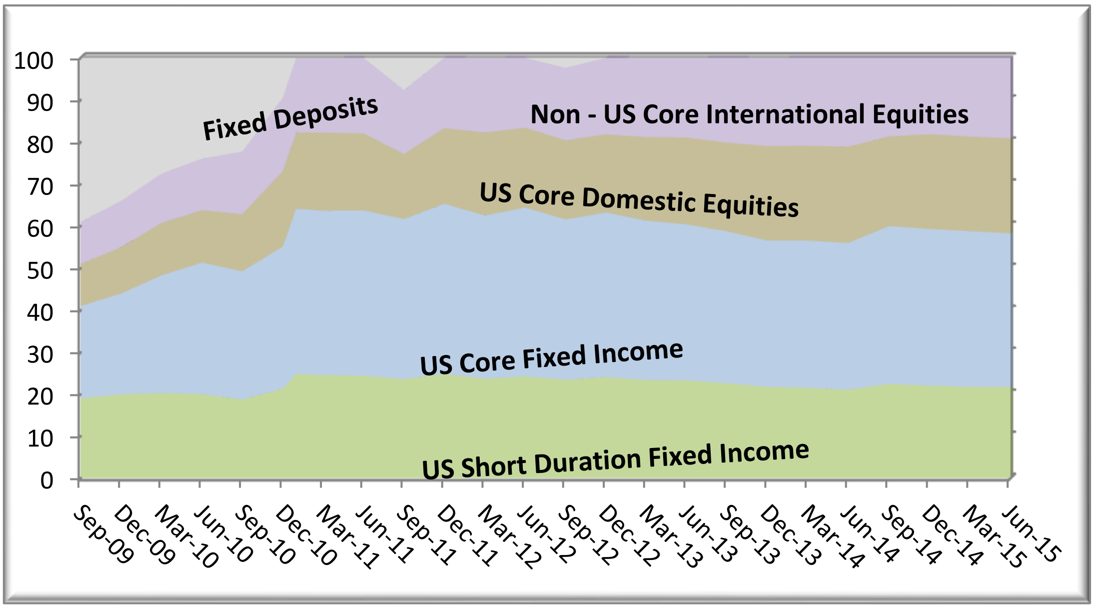
/per cent/

	Asset Class	Target Weight SAA	Sep-14 Actual % of Fund	Dec-14 Actual % of Fund	Mar-15 Actual % of Fund	Jun-15 Actual % of Fund
Portfolio Weights	Cash	0.00	0.00	0.00	0.00	0.00
	US Short Duration Fixed Income	25.00	22.47	22.06	21.74	21.75
	US Core Domestic Fixed Income	40.00	37.52	37.26	37.08	36.53
	US Core Domestic Equity	17.50	21.33	22.50	22.48	22.58
	Non-US Core International Equity	17.50	18.68	18.17	18.70	19.13

Figure 7

Asset Composition of the HSF Portfolio

/per cent/



Performance of the Investment Portfolio

For the second quarter of 2015, the HSF investment portfolio decreased 0.02 per cent, compared with a decrease of 0.51 per cent for the SAA benchmark [1]. This outperformance of 49 basis points can be attributed to favourable 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 approximately 0.54 per cent, while the fixed income portion of the Fund detracted approximately 0.55 per cent.

The **US Short Duration Fixed Income** portfolio increased 0.01 per cent during the second quarter of 2015, underperforming its benchmark, the Bank of America Merrill Lynch US Treasury 1-5 year index, by 1 basis point. This underperformance was attributed to interest rate decisions and yield curve positioning during the quarter. The portfolio was negatively impacted by being underweight the three year portion of the US Treasury curve, even as interest rates increased. The net asset value of this mandate as at June 30, 2015 was **US$1,255.8 million,** compared with US$1,256.6 million at the end of the previous quarter.

The longer duration fixed income mandate which consists of **US Core Fixed Income** securities, declined by 1.51 per cent for the second quarter of 2015, outperforming its benchmark, the Barclays Capital US Aggregate Bond index, by 17 basis points. This relatively better performance was due to interest rate and security selection decisions. Security selection, with respect to spread products including US Treasury Inflation Protected securities and agency mortgage securities, was particularly positive. The net asset value of this mandate as at June 30, 2015 stood at **US$2,109.7 million** compared with US$2,142.8 million as at March 31, 2015.

The **Non-US International Equities** mandate rallied 2.34 per cent for the second quarter of 2015, compared with an increase of 0.53 per cent for its benchmark, the MSCI EAFE ex Energy index. This outperformance was due to positive stock selection and country allocations in the portfolio. Stock selection provided the largest impact from holdings in the Consumer Discretionary and Financials sectors. Additionally, country allocation in Japan and Ireland also added to performance. The net asset value of the Non-US Core International Equity mandate as at June 30, 2015 rose to **US$1,105.0 million**, from US$1,080.8 million at the end of March 2015.

The **US Core Domestic Equities** mandate returned 0.47 per cent, compared with a benchmark return of 0.30 per cent. During the quarter sector allocation helped to drive outperformance. Allocations to the Technology and Financial Services sectors provided the largest impact to positive excess returns. The net asset value of this mandate, as at June 30, 2015, was **US$1,304.2 million**, compared with US$1,299.0 million at the end of March 2015.

Table 3

Contribution to Quarterly Return

For the period Apr 2015 – Jun 2015

/per cent/

	SAA Weights	Portfolio Weights as at 30-Jun-2015	Weighted Return HSF	Weighted Return Benchmark
Composite Portfolio	100.00	100.00	-0.02	-0.51
US Core Domestic Fixed Income	40.00	36.53	-0.56	-0.67
US Core Domestic Equity	17.50	22.58	0.10	0.06
Non US Core International Equity	17.50	19.13	0.44	0.11
US Short Duration Fixed Income	25.00	21.75	0.00	0.00

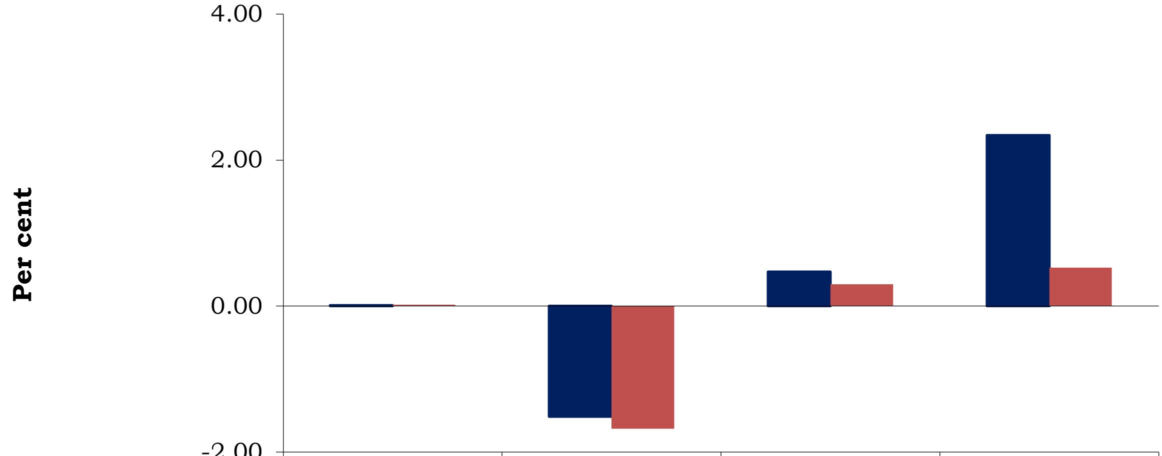
NB: Differences in totals are due to rounding.

Figure 8

Absolute Returns by Asset Class

For the period Apr 2015 – Jun 2015

/per cent/



	US Short Duration	US Core Fixed Income	US Core Domestic Equities	Non US Core Internationa l Equities
Composite Portfolio Return	0.01	-1.51	0.47	2.34
SAA Benchmark Return	0.02	-1.68	0.30	0.53

Mandate

SECTION 4 – COMPLIANCE AND PORTFOLIO RISKS

Compliance

As at May 31, 2015, and June 30, 2015 the US Core Domestic Equity mandate deviated from the Strategic Asset Allocation (SAA) benchmark weight, exceeding the permitted (+/- 5 per cent) range. The US Core Domestic Equity mandate had an allocation of 22.63 per cent, or 5.13 per cent above the SAA of 17.50 per cent as at May 31, 2015. At the end of June 2015, the US Core Domestic Equity mandate had an allocation of 22.58 per cent, or 5.08 per cent above the SAA of 17.50 per cent. By July 31, 2015, all of the asset classes of the fund were within their permitted ranges.

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 4 below shows the Average Credit Quality of the US Short Duration and US Core Fixed Income Portfolios as at June 30, 2015.

Table 4

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 5 shows the weighted average duration for the US Short Duration and US Core Domestic Fixed Income portfolios as at June 30, 2015.

Table 5

Weighted Average Duration

/Years/

Mandate	Portfolio	Benchmark
US Short Duration	**2.57**	**2.64**
US Core Domestic Fixed Income	**5.53**	**5.63**

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 June 2015, the currency exposure for this portfolio was 92 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
March	2.29	2.25	3.95	4.60	3.92	67.71	5.92	5.39	53.34
June	-0.02	-0.51	49.43	4.58	3.39	119.07	5.74	5.16	57.93

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				
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	-
March 31, 2015	5,779,420,631	77,654,405	1,818,925,956	-
June 30, 2015	5,774,951,169	131,202,349	1,814,160,678	-

Appendix III
Summary Characteristics of Composite Benchmarks
Fixed Income Benchmarks

Key Characteristics	Barclays US Aggregate Index	Merrill Lynch 1-5 Index
Total Holdings	9,496	155
Coupon (%)	3.22	1.87
Duration (Years)	5.63	2.64
Average Life (Years)	7.87	2.72
Yield to Maturity (%)	2.39	0.91
Option Adjusted Spread (bps)	51	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	2,833	860
Earnings Per Share (EPS Growth 3-5y fwd)	12.6	8.76
Price Earnings (P/E fwd)	17.5	15.2
Price / Book (P/B)	2.1	1.8
Weighted Average Market Capitalization* (Bn)	$108.7	$58.1

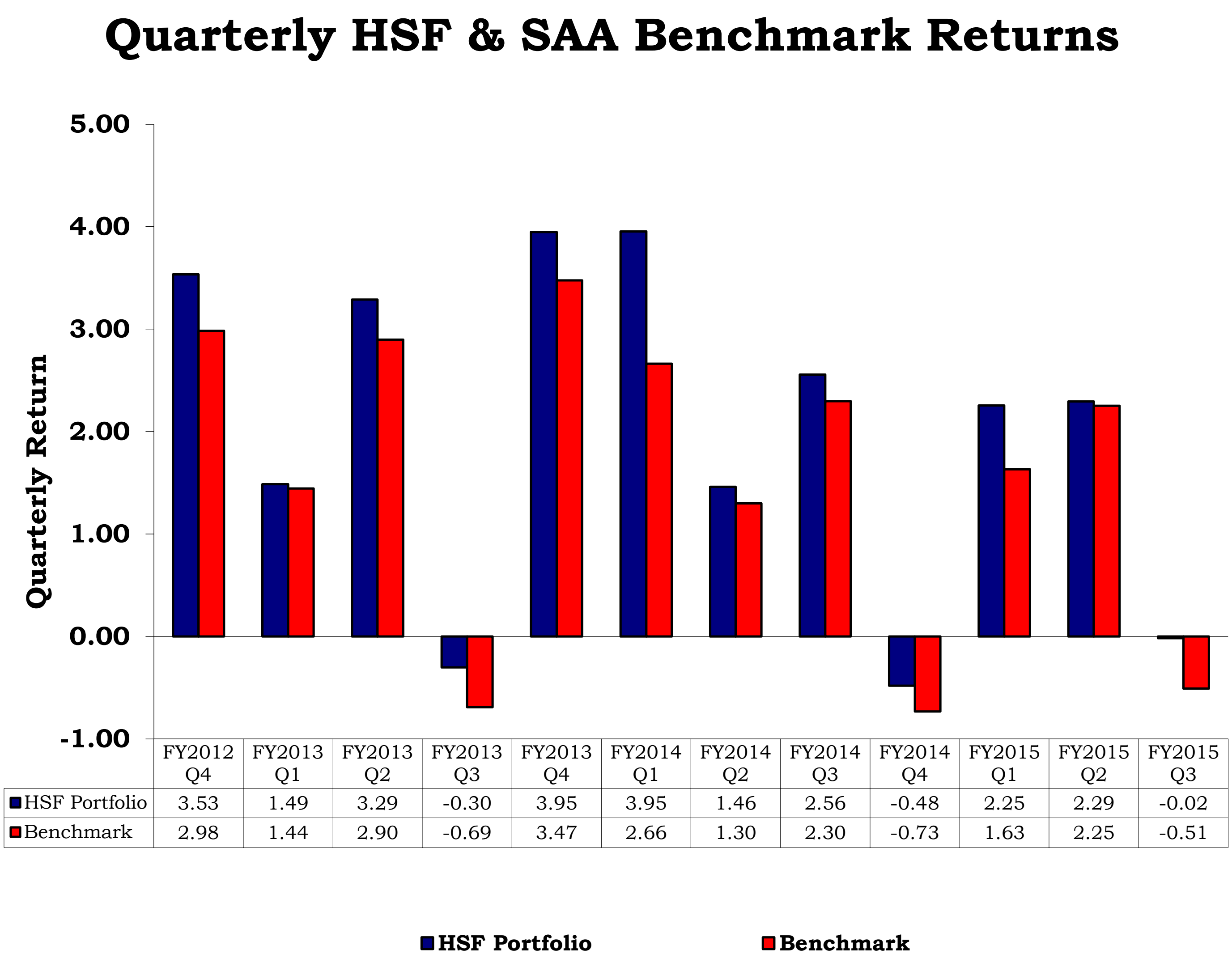
*Market capitalization is a measurement of the size of a company (share price x the number of outstanding shares). The weighted average market capitalization of a stock market index represents the average size of the firms comprising the index where each is weighted according to its market capitalization.

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

	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Total Fund Value	**5,563**	**5,533**	**5,654**	**5,779**	**5,775**
Total Value of Equity	**2,446**	**2,213**	**2,299**	**2,380**	**2,409**
US Core Domestic Equity	1,272	1,180	1,272	1,299	1,304
Non-US Core International Equity	1,174	1,033	1,027	1,081	1,105
Total Value of Fixed Income	**3,115**	**3,319**	**3,354**	**3,399**	**3,366**
US Short Duration Fixed Income	1,173	1,243	1,247	1,257	1,256
US Core Domestic Fixed Income	1,942	2,076	2,106	2,143	2,110
Total Value of Cash or Cash Equivalents	**3**	**1**	**1**	**0**	**0**

NB: Differences in totals are due to rounding.

Appendix V
HSF Portfolio Quarterly Returns
/per cent/



	FY2012 Q4	FY2013 Q1	FY2013 Q2	FY2013 Q3	FY2013 Q4	FY2014 Q1	FY2014 Q2	FY2014 Q3	FY2014 Q4	FY2015 Q1	FY2015 Q2	FY2015 Q3
HSF Portfolio	3.53	1.49	3.29	-0.30	3.95	3.95	1.46	2.56	-0.48	2.25	2.29	-0.02
Benchmark	2.98	1.44	2.90	-0.69	3.47	2.66	1.30	2.30	-0.73	1.63	2.25	-0.51